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# HOUSING FINANCE INTERNATIONAL

*The Quarterly Journal of the  
International Union for Housing Finance*



Pakistan, Algeria, Chile, Germany,  
the Anglo-Saxon model, Foreclosure  
and access to mortgage funding,  
UK lessons for emerging markets



# HOUSING FINANCE INTERNATIONAL

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## 2 Editor's Introduction

## 3 The House Building Finance Corporation (HBFC) - Pakistan. An institutional turnaround spanning 2005-2007

ZAIGHAM MAHMOOD RIZVI

## 13 Housing and Housing Finance in Algeria: Opportunities and Challenges

BY ABDELKADER BELTAS PH.D

## 21 Market-Liberal Homeowner Societies: Questions of Convergence in & around an Anglo-Saxon Model?

RICHARD RONALD

## 35 Better Foreclosures make for Better Access to Mortgage Lending

BRUNO DE GASPERIS

## 41 Chile's Housing Finance: A Story of Success?

INDER J. RUPRAH AND LUIS T. MARCANO

## 49 From Renters to Owners: The Case of Germany

DR. MICHAEL VOIGTLÄNDER

## 53 Housing Development and Housing Finance in Britain – some lessons for emerging markets

MARK BOLEAT

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# Editor's Introduction

by Friedemann Roy

In a recent Comment by John Authers from the Financial Times,<sup>1</sup> the subprime crisis was linked to Harry Potter's search of all parts of Lord Voldemort's soul that is split in many different parts and scattered across the world. The evil Lord can only be killed once Harry Potter finds and destroys all these individual parts (known as horcruxes). Harry Potter soon realises that this task is fiendishly difficult.

Harry Potter's fight appears to be dreadfully similar to the current subprime crisis. Subprime loans were split into many complicated financial instruments, and distributed, or hidden, worldwide. Since the eruption of the crisis, the battle for investors and regulators (= Harry Potter) has been to identify where these subprimes are (= horcruxes) and to neutralise them. Until they are all found, Lord Voldemort will rule the earth.

This issue of *Housing Finance International* will, however, not only deal with Harry Potter and the magic which might be needed to sort out the present credit squeeze. It is also aimed at providing information about countries where government and lenders co-operated and have achieved promising results in shaping their housing markets.

Our first article, which describes the turnaround of the House Building Finance Co-operation (HBFC) in Pakistan is an example of this co-operation. Zaigham Mahmood Rizvi, the author, points out that professional management coupled with commitment of the stakeholders and the Board (that includes representatives from the Pakistani Government) managed to transform HBFC so that it is now able to fulfil its mission ie to provide affordable housing solutions to low and middle income groups of the population.

The second article by Abdelkader Beltas looks at the Algerian Mortgage Refinance Corporation (SRH) which has been established to facilitate the supply of long-term funds to foster mortgage market development in Algeria. After a short description of the macro economic conditions and the housing market, he

analyses the mortgage market. The last part of his article deals with secondary market development and the role of SRH.

Our third article provides an in-depth assessment on market-liberal homeowner societies. In this context, the author, Richard Ronald, refers to the British, US and Australian housing markets. In these countries, the model of market orientated housing provision and consumption has been strongly aligned with a particular type of policy regime which emphasizes economically liberal approaches to governance and welfare. Although this model is under comprehensive scrutiny given the current market failures, it is unlikely to diminish since the restructuring of welfare and pension systems has been bound up with the past expansion of homeownership and house prices. Richard Ronald claims that governance, the maintenance of power and political legitimacy, as well as economic stability, now necessitates the support of homeowners and housing market conditions.

The fourth article is presented by Bruno de Gasperis. Lending to individuals can be limited and rendered more costly by the excessive length of foreclosures: reposessions and judicial auctions in many countries involve a slow and expensive process, causing unsatisfactory credit recovering ratios. This in turn has a negative impact on the cost of lending. One possibility to improve the foreclosure process is to ensure accessible and transparent auction sales of the property in question. As an example he refers to Italy where this objective has been achieved through the introduction of internet portals. Since its inception, foreclosures have become shorter and achieved a higher amount. Bruno de Gasperis concludes with recommendations for emerging markets which often face a similar situation as Italy.

Our fifth article, which is written by Inder Ruprah and Luis Marcano, assesses the housing policy efforts in Chile to improve the access to housing for lower income groups. In view of higher home ownership

rates, an increasingly deep and sophisticated mortgage market as well as a complementary role between the public and private sector, the Chilean housing model is considered successful. However, the positive developments in the mortgage market have not resulted in better housing accessibility for lower income groups. In particular, the collaboration of public and private institutions has rather lead to a system that produces excessively dense housing solutions in an undesirable equilibrium.

The sixth article by Dr. Michael Voigtländer analysis the effects of housing privatisation in Germany. Cash-strained cities like Berlin or Dresden offered residential property in their possession to private equity funds to maintain communal services. Most German cities are important landlords. Tenants often benefit from cheap rents. After the privatisation, tenants were given the opportunity to buy their rented apartments. The funds bought these stocks because they believed that the German real estate market will surge in the near future since market prices have remained flat during the last 10 years while all other major OECD countries, except Japan, experienced a housing price boom. This assumption was wrong. In his article, he concentrates on an assessment among the existing tenants for interest in buying.

The last article, by Mark Boleat, is a succinct description of the British housing model. It may be an interesting model for other countries since it is implemented by removing obstacles rather than creating new institutions and it requires minimal public funding. In addition, he refers to implications of the credit crunch, in particular on Northern Rock.

I hope you will enjoy reading these articles. Maybe the articles will inspire you to come up with comments and recommendations. They are more than welcome!

<sup>1</sup> See J. Authers, "Harry Potter and the subprime crisis", Financial Times, 15/16 December 2007.

# The House Building Finance Corporation (HBFC) – Pakistan

## An institutional turnaround spanning 2005 to 2007

By Zaigham Mahmood Rizvi, Chairman/CEO, HBFC

### BACKGROUND

The House Building Finance Corporation (HBFC) was set up under the Government Act (titled “HBFC Act-1952”) as a public sector enterprise soon after Pakistan’s independence in 1947. Thus HBFC (the Corporation), established in 1952, became the country’s first specialized housing finance institution and is currently ranked amongst the oldest housing finance institutions in Asia-Pacific region.

During the partition between India and Pakistan, there was a large influx of refugees crossing the border into Pakistan to settle mainly in the larger cities of Karachi and Lahore. Rehabilitation of these refugees, encompassing the provisioning of housing and employment, became the foremost issue facing the leadership of the new born state. In order to economically empower the people for housing and gainful employment, two institutions were created by the founding fathers of the country:

- (i) The Refugees Rehabilitation Corporation, and
- (ii) The House Building Finance Corporation.

With this purview, HBFC was created as a State Enterprise and by default, being in public sector became victim of the:

- Pros and cons inherent to a Public Sector Enterprise within a developing country.
- Over the years it became an administrative arm of government’s

Social Service program and got plagued with inefficiency, corruption, political influences, and poor market perceptions.

- Nearly its entire loan portfolio was declared as either Non-Performing Loans (NPLs) or potential NPLs raising the fundamental question of its commercial viability and sustainability.

### WORLD BANK ASSESSMENT

A World Bank Report in June, 7 2002 “A Housing Finance System for Pakistan – Issues & Options” carried out a detailed review of HBFC and commented:

*“Given the low rate of provisioning, HBFC may be in a situation economically equivalent to bankruptcy.” (P-2)”*

Furthermore, it also observed that:

*“Given its legacy as a Development Finance Institution (DFI), attempts to restructure HBFC as a commercially operating housing finance institution are not provisioning. Rather HBFC might focus on becoming an efficient manager of Government programs of social housing products, which would still require a major upgrading of its internal corporate environment....*

*.... “flawed charter, poor governance with administrative and political interferences... (P-14)”*

*.... “A vast majority (98%) of credits due for more than 3 years (a very substantial share over 12 years). Recovery prospects are slim or nil [for these credits].” (P-14)”*

*“HBFC has a long-standing reputation problem domestically and even abroad among donors. These reputational problems must be factored in and addressed by any restructuring plan for HBFC.” (P-27)”*

In addition to the aforementioned analysis by the World Bank, an inspection report of the State Bank of Pakistan (SBP) on HBFC, prepared for period ending 2004 reiterated similar remarks on the status of NPLs in HBFC’s loan portfolio.

### APPOINTMENT OF NEW MANAGEMENT

Around that period, the then Prime Minister of Pakistan, Mr. Shaukat Aziz (previously serving as the Finance Minister of Pakistan) began emphasizing the importance of the issues of housing and housing finance in the country, leading to the creation of the following three main initiatives:

- (i) Announcement of a National Housing Policy - 2002 (the first ever such document prepared on housing within Pakistan).
- (ii) The State Bank of Pakistan (the country’s central bank) started encouraging commercial banks to enter the business of mortgage finance.
- (iii) The Government of Pakistan (GOP) also decided to try and revive HBFC to play its due role as the pioneer specialized housing finance institution in the country.

Building on this momentum, in January 2005, the GOP appointed a professional banker from the private sector as the new Chairman and Managing Director at HBFC. To start, the new management was tasked to come up with candid answers to the following fundamental questions:

- Was HBFC still needed as a specialized housing finance institution given that approximately 20 commercial banks had now entered and are competing with one another within the housing finance business? If the answer is YES, then
- Can HBFC be transformed into a commercially viable and sustainable housing finance institution?

The new management at HBFC first conducted a comprehensive review of the situation and noted its response as follows:

- The business focus of HBFC is **Small & Medium Housing (SMH) for Low and Middle Income Groups (LIG)** of the population. There is no financial institution except HBFC currently catering to this substantially large, un-served and/or underserved market segment. The Management argued in view of the Government's policies on SME banking that even though it is promoting specialized SME banking, no commercial bank has focused on SMEs finance despite the fact there are more than 40 commercial banks are operating in the country. The fact remains that SME represents a very sizeable business segment and thus needs to be accurately served with a business focus. The same holds true for justifying HBFC having a business focus for SMH financing.

- The following plan was imperative in succeeding to remake HBFC into a commercially sustainable entity:

- (a) A comprehensive **"reforms and restructuring"** program to develop an efficient mortgage delivery platform.
- (b) Drawing upon international expertise (possibly with the technical and advisory support of the IFC/World Bank Group) to develop a **"business plan"** and a **"capacity building plan"**.

- (c) Complete support and dedicated commitment of the Ministry of Finance (MOF), the SBP and the Board of Directors to achieve (a) and (b) above.

A presentation on management's view point was given to the GOP and finally the Management was given the go ahead to proceed as per plan.

### GROUND REALITIES FACING NEW MANAGEMENT

In order to present a better comprehension of the ground realities faced by the new management in its endeavors, it is necessary to provide a review of some critical functions and activities at HBFC:

- (i) HBFC prior to January 2005 (where they were).
- (ii) HBFC subsequent to the reforms program & turnaround of 2005-2007 (where they are).
- (iii) Future of HBFC (the way forward).

### HBFC PRIOR TO JANUARY 2005 (WHERE THEY WERE)

A brief overview of state of affairs, as prevailing prior to January 2005, would facilitate a better understanding of **"where it was"** and **"where it is today"**. To assess the state of affairs needed time and lot of active involvement from the new management. The new management was convinced that any **"effective treatment"** would depend upon the quality of **"diagnostics"**, so a comprehensive review of the state of affairs was immediately initiated.

#### 1. Non-Performing Loans (NPLs)

As mentioned earlier, a very sizeable portion of the corporation's loan portfolio was non-performing. The actual size of NPLs and the provisioning needed accordingly was hiding behind the definition of **"loan classification"**. The State Bank of Pakistan's (SBP) Inspection Report for period ending December 2004 had remarked that out of a total asset size of approximately Rs.20 Bn, nearly Rs.12 Bn were classified as NPLs which did not include other potential NPLs of around Rs.6 Bn.

The World Bank report for the year 2002 accorded the entire portfolio of HBFC as literally delinquent in contrast to the 90% estimate awarded by the SBP. In the absence of precise data, the management classified the portfolio, partly using Ageing Analysis, to be as follows:

NPL's = 54%	Defaults age of 3 months and above. A sizeable outstanding portfolio has finished its 20 year tenor.
Potential NPL's = 15%	Same as above, but not classified.
Partly Performing = 31%	This comprised of the portfolio which was irregular, and/or performing.

On the liability side, HBFC had an outstanding credit line of approximately Rs.13.5 Bn payable to the SBP. As such, if the situation would have continued, the much needed provisioning/write-offs would have wiped out the entire assets along with any chance of repaying the SBP credit line. Therefore, in the eyes of the new management, the first and foremost challenge was **"default management"**.

### 2. Financial health of the Corporation

- (a) HBFC as an **"on-going"** entity:

The two main issues severely eroding the health of the organization were:

- (i) Need for more provisioning and write offs: In the absence of any attention focused on loan recovery from NPL's and Potential NPL's, and defaults getting deeper in ageing, the eroding assets would have eroded any chance of HBFC honoring its financial commitments.
- (ii) Negative Cash Flows: As concluded in the World Bank report, the organization was gradually approaching bankruptcy. The SBP was refusing to roll over its credit lines since 2002, and instead demanded repayment of existing credit lines under a very tight repayment plan. This, coupled with very hefty establishment expenses created doubts on HBFC as an **"on-going"** entity.



(iii) No efforts were made to obtain market based funding, nor was it possible to do so in view of the unhealthy accounts of the Corporation. During 2004, the corporation had sizeable negative cash flows, and if that situation would have continued, by middle of year 2007 HBFC would have had no money to pay even for staff salaries.

(b) Cost of funding: The return to SBP on its credit line was not on normal credit terms having an agreed cost of capital. The return was based on HBFC paying a percentage of its profits to the SBP and the remainder to its shareholders in the form of dividends. As such, the operational staff at HBFC never learned the concept of external funding costs, and had no mechanism of intermediation cost and spread based lending.

(c) Very high loan processing cost: The average total yearly establishment expenses during 2000 to 2004 were around 40% of average value of annual new loan productions. The following factors were responsible for the abnormally high loan processing costs:

- Overstaffing coupled with poor human asset value (4 - 5 loans per staff).
- Since there was no concept of branch profitability, approximately half of the branches (out of a total branch network of 55) were not meeting their own establishment costs.
- Very low business volume, both in number and value of new loans.

(d) Misleading financial results: Since the corporation's accounts were not being maintained per "**Generally Accepted Accounting Principles**", the operational results reflected in financial statements were also not indicative of the true state of the Corporation's affairs. In certain instances, due to

inadequate training and the absence of adequate systems, a single-entry accounting practice was being followed. Although more than half of the loan accounts (213,000 out of 430,000) had been closed in the branches, settlements in these closed accounts were still appearing in the Head Office control accounts, thus incorrectly reflecting the income due to unrealized/unearned income.<sup>1</sup> Furthermore, to compound the magnitude of this error, taxes and dividends were continuously paid on these inflated profits. Such practices, in addition to erroneous low provisioning, were resulting in financial results contrary to factual position.

### 3. Poor Accounting Practices

Since 1982 (a period of 23 years), the Corporation's accounts were being "**qualified**" for "**non-reconciliation of accounts**". While the issue had originally surfaced in 1972 as in the World Bank Report, the previous managements failed to resolve this issue, which subsequently became the root cause of corruption and many more accounting malpractices. The new management decided to address this and many other accounting issues and initiated a comprehensive review and reforms of its accounting system. The Annual Accounts for year ending Dec 31, 2007 are now "**qualification free**", for the first time since 1982.

### 4. Absence of Systems & Manuals

Since its establishment in 1952, the corporation never initiated any efforts to develop and/or design systems, processes or manuals. In one of its initial Board Meetings in 1952 the Board decided to follow the Government practices and policies till such time. Rather than developing Policy and Operational Manuals of their own, the operational matters were

being delegated by management to be managed through policy circulars and directives. As evident in the review of majority cases by the new management, even though these circulars and directives lead to many conflicts and contradictions, they had not even been compiled in one place for ease of review in managing the affairs of the Corporation.

### 5. Poor personnel policies and Human Resource Planning

- **Excess staff:** The Corporation had more than 1,450 staff which was too high in relation to the size of its portfolio.
- **Lack of professional staff:** The majority of the staff was not professionally qualified (e.g., CA's, CPA's, Risk Managers, MBA's etc.) nor was any effort made to improve their quality/performance through training and continuing education.
- **Performance measurement:** As the corporation followed government policies and procedures on personnel matters, it never developed a performance measurement system. One out of every third employee within the Corporation was involved in some sort of litigation/contestation against the Corporation on issues like promotions, increments, transfers etc. Due to bureaucratic red-tape, any efforts by management to punish someone on corruption charges would take 4 to 5 years, which was the biggest deterrent for any management action against culprits.

### 6. Low level of computerization and use of technology

The corporation was operating on an abysmally low level of computerization which was limited to accounts and personnel functions at the Head Office. The use of other technological aids was literally non existent. The Corporation's

<sup>1</sup> Since the accounts are physically settled/ closed in the field and files were then sent to the head office accounts for making entries in the system Head Office (HO) Control Account. The people at head office would take time either due to negligence or due to lengthy procedure for closing an account. The system involved re-submission, by a client, of the proof of payments made in say 20 years, which again may take months. During all these gaps between settlement of an account in the field and actual closing entries at HO control account, the account will remain operative in the system and charge interest. Sometimes HFBC would claim this additional interest from the client and closure would get further delayed.

new management realized that a massive initiative was drastically needed in the areas of software development, provision of hardware, IT Training, and networking for the Corporation to even contemplate surviving in the future.

### HBFC: SUBSEQUENT TO THE REFORMS PROGRAM & TURNAROUND OF 2005-2007 (WHERE THEY ARE)

In accordance with the Companies Ordinance, 1984 (corporate law in Pakistan), a company's Chief Executive Officer (CEO) is appointed for a three year term. The new CEO was appointed by the Prime Minister of Pakistan to head the Corporation from January 2005 to December 2007, and has completed his three years tenure.

Following the diagnostic analysis of the corporation, a comprehensive Reforms and Restructuring program ensued. This program was divided into the following three segments:

- Establishing the direction for the Corporation – **Vision & Mission.**
- Setting the house in order – a comprehensive **Reforms Program.**
- Instituting a Roadmap for the future – **Business Plan**

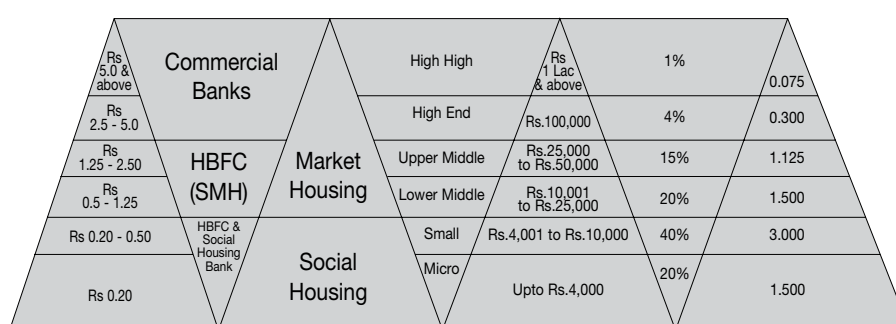
#### 1. Establishing the direction for the Corporation:

HBFC did not have a defined business focus, although it had been drawing its main clientele from low and middle income segments (LIG) of the population, with an average (since inception) loan size of less than Rs.100,000. Today the average loan size is Rs.350,000\* Furthermore:

- its operational policies did not have a business focus for the LIG market segment;
- it had an upper loaning limit of Rs.7.5 mn., and
- it was considering to enhance that upper limit with a view to capturing the high end market, the business focuses for commercial banks.

Since its inception in 1952 till 2000, HBFC literally enjoyed a monopoly status in the housing finance market. It was only after the SBP directive in 2000 that other commercial banks were allowed to enter the housing finance market, and market competition surfaced for HBFC.

Since then, nearly twenty five commercial banks (out of more than 40) have entered the housing finance market. The new situation demanded that HBFC should position itself for a market niche. An analytical view of the “housing market continuum” is presented in Fig 1.



#### Housing Continuum:

A brief look at the above Housing Continuum, developed by HBFC, as a best estimate based on whatever statistics were available, highlights the main issues of mortgage affordability, housing finance players, housing market, market segments, income distribution, and housing shortage in Pakistan.

(a) Social Housing (Micro & Small): Social Housing deals with low (*small*) and low-low (*micro*) income segments of the population. The market players are currently not interested in this segment resulting in a “*social crisis situation*”. This is mainly due to:

- The small and micro housing segment is the most oppressed and immensely neglected segment of the market.
- For “*small*” the monthly income ranges between Rs.4,001 to Rs.10,000 (representing 40% of the total population of Pakistan) whereas for “*micro*” it is a mere Rs.4,000 and below (representing 20% of the total population of Pakistan).
- The huge existing disparity between real estate prices and mortgage affordability within the Social Housing segment which is widening further with time.

- Nearly 60 % of the population falls within this category resulting in a massive housing demand/supply gap and practically no “*organized*” supply.
- Housing affordability of this segment ranges from Rs.0.20 to Rs.0.50 Million.

As can be gathered from the above analysis, without any government intervention/support in the past, this situation has lead to the creation of illegal habitats and squatter settlements (commonly referred to as “Katchi Abadis” in Pakistan) to epidemic proportions within major cities.

(b) Market Housing:

- Market housing mainly caters to the High-High, High, Upper Middle and a portion of the Middle income segments of the market.
- Monthly income levels are between:
  - High-High – Rs.1 lac & above (representing 1% of the total population of Pakistan) <sup>2</sup>
  - High – Rs.100, 000 (4% of population)
  - Upper Middle – Rs.25,001 to Rs.50,000 (15 % of population), and
  - Lower Middle income groups – Rs.10,001 to 25,000 (20% of

\* Exchange Rate Rs.60=1 US\$

population).

- Commercial banks are focusing on only the High-High and High end market segments with mortgage affordability of Rs.2.5 million and above, whereas HBFC is solely taking care of the housing needs of the Upper Middle, Lower Middle, Small and Marginal to Micro Level income groups.
- Housing Continuum reveals that Market Housing deals with that segment of the population where the market mechanism takes care of housing issues since:
  - affordability and property prices have a match, and
  - against a relatively smaller demand there is a matching supply.

The market scenario led the management to the following conclusions:

- Currently all commercial banks are targeting their efforts towards the High End of the housing market which comprises approximately 10% to 15% of the total housing market and as such HBFC has no role to play in that segment.
- 10% of the market comprising of the Upper-Middle segment represented a grey area where HBFC and commercial banks could compete if necessary. However, the commercial banks would still maintain an obvious differential competitive advantage.
- 55% to 60% of the market segment comprising of Low and Lower-Middle income segments is an area which commercial banks currently are not interested in pursuing. This is the segment where HBFC has traditionally been an active operator, and over the years has developed itself as the sole brand servicing this segment.
- The Low and Middle income market segments would not be an attractive and commercially viable market segment for commercial banks in view of comparative higher risks and higher processing costs vis-à-vis the size of earning assets being booked.
- Due to risks involved in titles, property valuation and income assessment, commercial banks were focusing only within a few large cities and a few posh

localities ("safe-heavens"). Nearly 90% of the urban areas were undeclared as "no-go-areas" for commercial banks housing finance activities.

In comparison, HBFC enjoyed operations within nearly 50 cities of the country and had a very good understanding of the Low and Middle income housing market.

(c) **Vision and Mission statements:**

In light of the aforementioned analysis, the new management, in consultation with the Board of Directors and the shareholders of the Corporation, envisioned the following Vision and Mission statements for HBFC:

**Vision: "To be the prime housing finance institution of the country, providing affordable housing solutions to low and middle income groups of population by encouraging new constructions in Small & Medium Housing (SMH) sector."**

**Mission: "To be a socially responsible and commercially sustainable housing finance institution."**

To reflect the new Vision and Mission of the Corporation, a new slogan was coined:

**"HBFC, the Housing Bank for Small & Medium Housing (SMH) finance."**

The SMH market-niche provided a justification to the Government and to the SBP that focusing on SMH finance is as important for the housing sector as Small and Medium Enterprises (SME) are for the manufacturing and trade sector.

The corporation's logo was accordingly changed to reflect the new business focus:



1952-96



1996-2000



2001-2004



2005

... and in 2007:



**Housing Building Finance Corporation Limited**

The new logo was designed keeping in mind the following nuances:

- Low income segments do not dream of owning a fancy home. Their dream is for a roof, a shelter over their head.
- The logo font was changed from capital to small alphabets to reflect a shift in the Corporation's business focus ie from large to small.
- The alphabet "b" for "building" was highlighted, showing that the new business focus was to promote new construction ie building finance. HBFC's mission is to operate in the primary market and increase housing stock through new housing construction. That is not the case for commercial banks, which mainly operate in the secondary market where nearly 3/4th of their mortgage finance is focused on. In contrast, more than 3/4th of HBFC's financing is for new constructions.

**2. Setting the house in order**

In order to prepare the organization to play a much bigger role, in a more prudent and efficient manner, a comprehensive Reforms & Restructuring Program was designed in 2005 and immediately put into action. It was consciously decided that for the next two years (2005 to 2006), before trying to accelerate the new housing loans portfolio, management will focus all their concentration in setting the house in order, developing an efficient delivery platform, and envisioning a well thought out Business Plan covering both the assets and liabilities sides of the Corporation's balance sheet.

In this arduous journey of transforming this ailing institution into a vibrant, proactive

<sup>2</sup> 1 lac is Rs 1000,000



and forward looking institution, the new management decided to take all those who matter “on board”, without whose support and commitment the mission would become a mission impossible. Through a carefully worked out plan of presentations and briefing sessions, the management took the following crucial parties on board:

- The Board of Directors
- The Shareholders of the Corporation (GOP and the SBP)
- The HBFC staff

Through these presentations the management created awareness that if the present state of affairs were to continue, the Corporation would no longer be considered an “on-going” entity. A reformed and restructured HBFC will not only be commercially viable and sustainable, but will play a much bigger role in the housing finance market in the country. It needed a major operation overhaul to ensure its viability and sustainability. In short, in order to survive, it was time to change. The salient features of the Reforms Program covered:

#### (a) Loan Recovery and Default Management

The first and the foremost mission was two pronged:

- to improve the financial health of the corporation by making loan recoveries from NPLs and potential NPLs, and
- to make the remaining irregular portfolio into a truly performing portfolio.

Due to persistent defaults, the outstanding loan amount against borrowers was multiples of the original loan amount (3 to 5 times in certain cases). To help the borrowers, a partial relief in the amount of interest payable to the Corporation was allowed under three different Relief Packages:

#### Relief Package 2005

**Time Expired** – where the loan tenor (20 years) had expired and the loan still remained outstanding. The borrower was asked to pay back the loan as determined on a simple formula of Principal Plus, giving more relief based to smaller loans.

#### Relief Packages 2006 and 2007

**Time Remaining** – Outstanding loan was rescheduled and rephrased after giving a concession on the interest rate.

Previously, the task of loan recovery was the additional responsibility of the credit staff without any insights either from the field staff or by management. To counter this, two new functions were established, “**Default Management**” and “**Potential NPLs and Partly Performing Portfolio**”. Country-wide recovery conferences were held to educate the field staff on the new Recovery Plan, which also highlighted the newly introduced incentive scheme for staff involved in recovery efforts. The success of this endeavor is evident from the results itself, as during the last three years the Corporation has made cash recoveries of more than Rs.10 Bn. The table below gives the movement of NPL's from 2004 to 2007, and a projection till year 2012:

Year	NPL's	Potential Performing NPL's	Total	
2004	54*	15*	31	100
2007	38	5	57	100
2008	24	0	76	100
2012	9	0	91	100

(Figs. are in %)

\* For year 2004 the actual figures might be even higher, since NPLs classification at that time was not in accordance with State Banks' Prudential Regulations on Provisioning.

Since the NPLs are getting under control and are targeted to fall within single digits by the year 2012, the two separate

departments for recovery (ie loan servicing and default management) have now been merged into one. The main emphasis now is on strictly monitoring the process of granting of new loans, so as to ensure that fresh loans do not add to the size of the non-performing portfolio.

#### (b) Business Growth Plan

Technical assistance from the International Finance Corporation (IFC) was sought in development of a long term business plan. The business plan was developed by CMHC of Canada and funded under the IFC's technical assistance program. The Plan projects home financing targets for the next 10 years (2007-2016), both in terms of value and number of mortgage assignment. The Business Plan projects that 194,000 new mortgages aggregating Rs.218 Bn would be produced during the next 10 years, gradually rising from 8,000 new mortgages/year in 2007 (valued at Rs.4 Bn) to 32,000 mortgages per year by the end of 2016 (value Rs.40 Bn). In order to fund fresh loans of Rs.218 Bn during the period, the Corporation would need fresh funding of Rs.164 Bn to be raised from the market, while the balance would be funded through loan recoveries from the existing loan portfolio. Thus, the business plan posed two new challenges to the management:

- A wider product range, outreach and market penetration to ensure that enough business will be available to meet targets.
- Since the funding to support business will have to be market based, it was essential to design, develop and launch new instruments of finance and simultaneously develop HBFC's image as a credit worthy institution.

#### (c) Product Range

The HBFC is targeting to expand its product range from two to ten and more products in the coming years. The range would cover retail as well as wholesale (or project) housing finance products.

#### (d) Market based Financing Instruments

The corporation has started necessary preparations to raise market based/cost efficient medium to long term funding through instruments like Mortgage Backed Securitization, Sukuk (Bonds), REITs, and Certificates of Investments (COI's). Since the corporation had never initiated/raised market based funding in the past, it was by itself a challenge to improve its perception as a bankable entity within the financial market. By the end of 2007, HBFC has already managed to float its first ever Sukuk of Rs.1.5 Bn, which has been very well received by the financial market. This successful launch has set up a good benchmark for raising further funding. During 2008 HBFC intends to raise an additional Rs.6.0 Bn through issuance of Sukuk in two tranches of Rs.3.0 Bn each. These funds are needed to finance new mortgages of Rs.7 to 8 Bn planned for the year 2008, which are more than double the 2007 level.

#### (e) Computerization

Since the corporation was computerized at a very basic level and only for the functions of accounts and pay-roll, a comprehensive computerization was a massive need and challenge. Management was cognizant of the fact that unless the functions of loan origination, processing, servicing and other related accounting functions were not fully computerized and integrated, the Corporation would not be able to handle the planned business growth. The comprehensive computerization of HBFC had 3 pronged challenges for the management.

(i) Changing the mind set: Getting the staff motivated and committed for a fully computerized environment was a major challenge. The staff, which for many years was used to doing things manually, was opposed to moving towards a comprehensive computerization environment. In the end, management was able to convince and motivate the staff on job enrichment, job security and

the concept that without computerization and technology, HBFC would never move into the future.

- (ii) Development of Comprehensive Software: By engaging a local software company, an eight Module Loan Management Program and a Three Module Financial Management Program was developed. The software is under implementation at the Head Office and also in the field.
- (iii) Hardware: As mentioned earlier, in the past basic networking of workstations and a general level of computerization was confined only to the accounts and personnel functions. As such, a comprehensive plan of computerization and development of workstations was prepared for all levels followed by provisioning of hardware and networking. Local Area Networking (LAN) has since been completed and now Wide Area Networking (WAN) is nearing the completion stage.

#### (f) Use of Technological Aids for Efficient Management

The Corporation had a wider geographical spread in the country, a large branch network, and a sizeable head office in addition to a large field staff. For effective and cost efficient operations, the management decided to maximize use of technological aids as follows:

- A Biometric Attendance System linked to payroll.
- Video and Audio Conferencing to facilitate interaction and wisdom sharing with Head Office and field staff.
- Introduction of a Tele-Monitoring System: Through SMS Messaging, generated through the new introduced software system, existing clients are now being reminded about due installments, payments received etc, as well as providing an inexpensive additional medium to the Corporation to market itself to existing and potential clients.
- Establishment of a Client ID Verification System: On-line ID Verification System (VeriSys) of the National Database &

Registration Authority of Pakistan (NADRA) has been installed at HBFC premises through which identification details of the applicant and his "family tree" can be pulled and fed to the database. HBFC is now working on to link its clients identification database, with the national database through biometric identification system.

- HBFC is also now running a fully operational Call Centre to facilitate its existing and potential clients.

#### (g) A dynamic website

In keeping with the rebirth of HBFC's image, the Corporation's existing website has been redesigned, technically upgraded and comprehensively updated to include additional contents. It now provides:

- On-line loan application facilities (e-home)
- On-line customer account statements
- An on-line mortgage tracker to facilitate new buyers of property
- A mortgage calculator
- An information portal on relevant real estate related matters

#### (h) Improving the work environment & culture

As can be imagined, the work environment and culture at HBFC was of a typical public sector enterprise in a developing country. This not only created a demotivating environment for the existing staff, it also proved to be an inherent inhibiting factor for management in trying to induct professionally competent fresh blood from the market. As evident from the pictorial images, extensive renovation work is now being done in all the offices of the Corporation to improve the work environment, remake the organization to meet modern day operational challenges, and to create a workplace conducive for enhancing productivity of the work force.

## We were:



## We are:



## i) Expansion of Outreach

Since HBFC's business focus under its new Vision and Mission statements is Small & Medium Housing (SMH), it essentially needed to expand its outreach from big cities to small cities/towns in addition to low income habitats on the outskirts of big cities. Management realized that, in light of the Corporation's existing heavy establishment expenses, opening new physical branches would be a cost-prohibitive option and would adversely affect its financial viability. Therefore, HBFC designed and implemented a novel "**expansion of its outreach**" program, under which the "**HBFC on Wheels**" (Mobile Service Vans) program was launched, and Stationary Service Agents were also appointed in different cities:

- Stationary Service Agents: These are essentially pseudo franchise arrangements (or Service Centers), under which Service Representatives are appointed to originate, process mortgage applications and submit completed applications on-line to nearest HBFC branches. These Representative Offices are equipped with the necessary computer hardware/software and are linked to nearby HBFC branches through networking. These Service Reps. are rewarded through service fees/commissions on successful deal closures and subsequent servicing of these loans. Under the program, HBFC's outreach has already expanded from 50 to 85 cities, and is likely to expand to 150 cities by the year 2010.

- HBFC on Wheels (Mobile Service Vans): Vans bearing the HBFC logo and operating as mini-mobile offices have been launched to further expand HBFC's reach to suburban areas of many big cities and to smaller towns which are not or can not be covered through Service Representative Offices. These mobile offices are equipped with all the necessary "on-line" services as any other representative's office, enabling HBFC to serve potential borrowers for on-line submissions of loan applications, getting

information on loan balances or HBFC products.

## Representative Office



## Mobile Van



## j) Human Resource Planning

Even though many existing officers had gained an invaluable and vast experience working for the Corporation, there was still a dearth for well qualified and educated professionals. The new management was cognizant of the importance of human capital and immediately launched a comprehensive HR Program aiming at short, medium and long term objectives. The program covered:

- Inducting graduates (eg MBAs, CPAs, M Com etc.) directly from universities at an **entry level** position as “**Management Trainees**”.
- After one year as a Management Trainee, good performers were then inducted into regular service and mostly positioned in field offices.
- Initiated a **career planning program** to develop future leadership.
- Conducted selected inductions of experienced hires at **middle and senior level** management.
- Actively participated in the IFC sponsored “**Capacity Building Program**” of SBP to develop **training modules in Housing Finance**.
- Realizing these changes might create a conflicting culture of values between existing and newly hired staff, management initiated efforts to identify, manage and effectively mitigate any obstacles to the development of a more harmonious work environment.

## (k) Co-Branded Credit Card

Due to high inflation and costs of living, low and middle income borrowers occasionally face adverse cash constraints which ultimately impact on their ability for timely repayments, leading them to become unwilling defaulters. The management realized that these borrowers may not default if they were provided with some short term cash support. For this purpose, HBFC made arrangements with a local commercial bank to issue a Co-Branded Credit Card to its clients. At this point it is crucial to highlight the fact that most of HBFC’s low and middle income clientele did not have any type of banking

relations, nor a credit card facility, and are thus being gradually brought into the banking net.

These arrangements allow HBFC to facilitate its borrowers for payment of (up to) three monthly installments through a “blocked Credit Card facility”. This facility provides 45 days interest free funding to the borrowers and is secured by the “loan security” available to HBFC. However, the credit card company would still follow a default client under its normal process.

## (l) Digital Archiving, Disaster Recovery & Continuity of Operations

The above program was commenced in January 2006 with the important task of archiving of critical records. Being a 54 years old institution, HBFC has a large collection of critical documents including title documents of mortgaged property, accounting records, minutes of Board of Director meetings, personnel files, loan documentations, etc. The new management realized that the current manner in which these documents were being stored/maintained carried a lot of risk, more so in case of a natural disasters like fire, earthquake etc. The program has an ultimate objective of gradually moving towards a ‘Continuity of Operations’ plan. Currently, the electronic storage of such documents with offsite back-up is in progress.

## FUTURE OF HBFC (THE WAY FORWARD)

### 1. Financial Restructuring

A financial restructuring plan has been submitted to the GOP/SBP with the following main components:

- **Voluntary Separation Scheme (VSS):** A grant has been sought from the Government whereby the Corporation would be downsized to replace ineffective and excess staff. Approximately half of the staff has been offered a voluntary separation under this scheme and the payback period of the

scheme is expected to be 5 to 6 years. The Government, as part of a revival plan, had in the past provided similar financial support to other state enterprises and financial institutions.

- **Conversion of Debt to Equity:** Per SBP regulations, HBFC is required to raise its Capital from the existing Rs.3.5 Bn to Rs.6.0 Bn. A higher Capital base is nonetheless essential for the Corporation to support its projected business growth in addition to maintaining its capital adequacy. In view of this, the GOP and SBP have been approached to convert part of their outstanding credit lines to equity (Rs.3.2 Bn.).

### 2. Privatization

Following the financial restructuring stage, the capital of the Corporation would have been raised to approximately Rs.6.5 Bn and the Corporation would be wholly owned by the GOP (MOF&SBP). Under the envisioned privatization plan, a majority of the shareholding (51% plus) will be divested as follows:

- Pre-IPO offer to IFC: About 15-20% of the shareholding would be divested to IFC under an Initial Public Offering (IPO). The IFC has (in principle) shown an interest in the HBFC pre-IPO offer, subject to successful financial restructuring and a firm committed privatization program.
- In the next phase, 15% of the shareholding will be divested at premium by the GOP to the general public through a stock market listing. The terms determined so far are an offer price at premium of Rs.25 per share (par value of Rs.10 per share).
- In the third and final privatization phase, 26% of the shareholding, along with management rights, would be offered to strategic investor(s) having a proven standing in the mortgage finance business.

Management envisions that under the above privatization program, which is likely to be completed by end of 2009, the GOP



is expected to receive about Rs.8.0 Bn as privatization proceeds by divesting a part of its shareholding, and would still continue to maintain a 45-49% shareholding in HBFC. Valued at offer price, the value of GOP's remaining shareholding in HBFC will be around Rs.8.0 Bn, and is expected to go much higher, if HBFC achieves its business targets.

### 3. Micro Housing & Housing Finance

Since about 20% of Pakistan's population can afford only micro housing and housing finance, the Board of HBFC has decided to promote a separate platform for the purposes of "micro housing finance". Under the program, the following four institutions are in the process of being established:

- (a) **Social Housing Company:** To promote and develop micro-housing schemes, a separate company in collaboration with NGOs and the corporate sector is being set up.
- (b) **Social Housing Bank:** A micro-housing finance bank is also being established, with possible equity participation from multi-lateral agencies and the corporate sector. The bank will provide micro-finance to purchasers of micro-housing being developed by the aforementioned Social Housing Company and similar programs. The bank will be regulated under the State Bank's regulatory regime for micro-finance banks.
- (c) **Centre for Low Cost Technology and Low Cost Construction Materials:** With technical support from a local engineering university, the "Centre of Excellence & Research for Low Cost Construction Technologies" is being established to provide technical support to builders of low cost housing schemes.
- (d) **Sponsor a Shelter Foundation:** Since HBFC has been the oldest government financial institution providing housing finance to the low and middle income groups it has always been facing social and political pressures to waive off loans. The new management categorically reiterated the business

perspective of the Corporation that HBFC is an "opportunity organization" and not a "charity organization". As such, any charity platform wishing to waive off existing loans to the needy and poor had to be an absolutely separate entity from HBFC. For this purpose HBFC has proposed to GOP to set up a "Sponsor a Shelter Foundation". This foundation will be funded by religious charities and through tax deductible donations from the general public and the corporate sector.

### CONCLUSION

The housing and housing finance sector, more so for low and middle income segments of populations, is crucial for developing countries both socially and economically. The institutions like HBFC have a critical role to perform, and thus their owners and stakeholders have a responsibility to ensure that management of such organizations are given an enabling environment to deliver on their objective. Many of such institutions in the developing world, being in the public sector, are faced with the challenges of very poor performance, inefficiencies, corruption etc, leading to a major challenge of commercial viability and sustainability. The case of HBFC is a candid example wherein by inducting professional management, and with commitment of the Board and the stakeholders, such institutions could be prepared to effectively serve their mission. While the Reforms and Restructuring achieved at HBFC during a short period of three years are commendable, the institution still faces the challenge of continuity and sustainability of the Reforms Program. Unless HBFC is privatized, and continues to remain in the public sector, the potential threat of its going back to its past will remain. In State Enterprises, the Government has the privilege to appoint leadership of the enterprise, and this privilege is generally mis-used.



# Housing and Housing Finance in Algeria: Opportunities and Challenges

By Abdelkader Beltas, Ph.D, President & CEO  
The Algerian Mortgage Refinance Corporation (SRH)

## INTRODUCTION

Like many other former socialist countries, Algeria has been pursuing, for many years, policies and strategies emphasizing public sector responsibility for meeting the basic needs of low and moderate income households. On the financial side, the government had to provide the necessary finance through sponsoring and subsidizing the state saving & contingency agency "CNEP". The agency had a total monopoly up to 1999; its main mission was to implement state social housing policies in terms of financing and savings collection.

The underdeveloped mortgage market and the difficulties in obtaining long term mortgage loans made it difficult to resolve the housing shortage problem. The percentage of outstanding mortgage loans with respect to GDP is less than 1% which is considered to be very low by any standard.

However, a number of obstacles had hindered the development of mortgage lending activity in Algeria such as: weak legislation, especially a lack of clear and effective foreclosure and eviction procedures; difficulties in getting long term funds and the handling of unreported incomes in the underwriting process. The banks (mainly public) were anxious, in the mid-1990s, to see some measures taken to tackle these problems before considering mortgage lending. These measures include the creation of specialized institutions, cleaning up outdated legislation and

regulations and adding new ones; liberalizing the housing and financial sectors and bringing other financial institutions to the mortgage market.

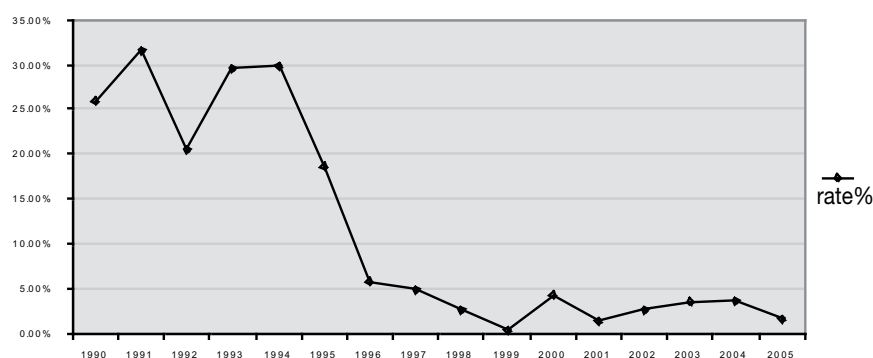
Furthermore, in order to set up a real mortgage market, the Government has provided the technical assistance needed. One type of technical assistance was provided by Fannie Mae in order to create a secondary mortgage market; the second one was provided by the World Bank for the development of a primary mortgage market. These efforts have led to an increase in mortgage lending activities in the last five years and have changed the prospect of considering housing as a social good "provided mainly by the State" to housing as an economic unit which can be bought and sold in the market.

## BACKGROUND

Situated in the Northern part of Africa, Algeria is the second largest country in the continent, covering an area of 2.4 million square kilometers. The population stands, as of last general census conducted in 1998, at 29 million; the figure is estimated at 33 million in 2006 and it will be 34.4 million at the end of 2007. The average annual growth rate of the population is about 1.78%. The percentage of urban population is about 66%. The annual rate of growth of the urban population was 3.6% between 1987 and 1998; This trend has continued in recent years; the average annual growth rate of urban households was for the same period 4.6%.

On the other hand, the average annual GDP growth rate was 2.2% (2000), 5.3% (2005) and 3% in 2006; GDP per capita is

## RATE OF INFLATION

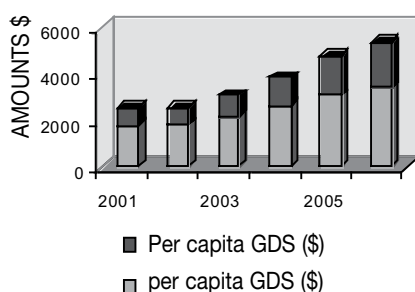


Source: National Office for Statistics (ONS)

evaluated at US\$3,431.1 (2006) ; the unemployment rate is at 12.3% and the inflation rate at 2.5% (2006).

However, Algeria's economy was characterized during the 1980s by stagnant or declining per capita income, increasing unemployment, and high inflation. Faced with this situation, the Government began implementing economic reform in 1989 but the efforts made in order to correct past economic deficiencies were either insufficient or could not be sustained.

#### PER CAPITA (GDP & GDS) US\$



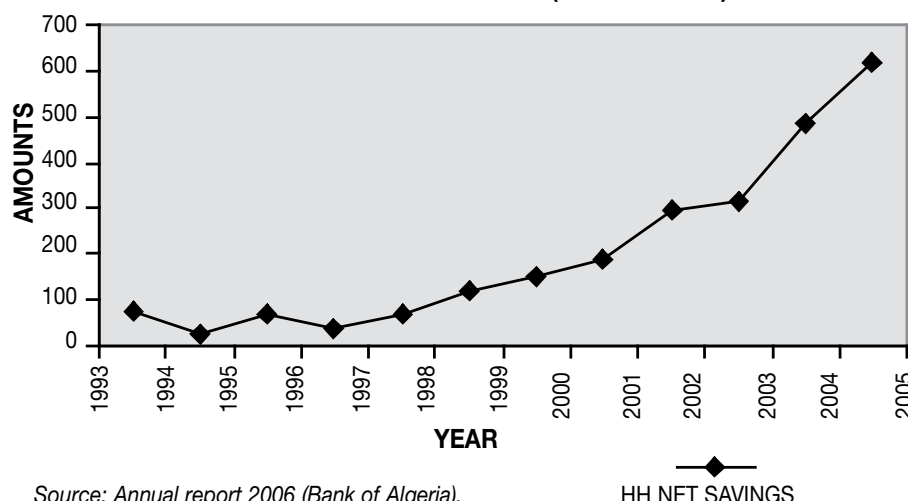
Source: Annual report 2006  
(Bank of Algeria)

A program initiated in mid-1990s, supported by the IMF, was the first step in an economic liberalization and reform process that sought to establish a solid macroeconomic and institutional basis for an improvement in the growth performance and a reduction in unemployment.

Structural measures were taken under the program which aimed at liberalizing the economy and establishing market mechanisms. Among these measures were those related to the banking sector and public enterprise restructuring, particularly those operating in the housing sector.

These reforms have had a positive impact on macro-economic variables and development of financial sector which constitute a precondition for establishing an acceptable mortgage market.

#### HOUSEHOLDS NET SAVINGS (BILLION of AD)



Source: Annual report 2006 (Bank of Algeria).

HH NET SAVINGS

#### CURRENT FINANCIAL SYSTEM

The Algerian financial system is organized in three sectors: banking, insurance and the capital markets.

**The Banking Sector** consists of 17 commercial banks; seven are public and the remaining 10 are private. In addition, there are seven financial institutions for leasing and credit; one specialized bank, the Algerian Development Bank; and seven representative offices of foreign banks. The sector is regulated by the Bank of Algeria.

Private banks have been present in Algeria since the late 1990s, but public banks still dominate the sector, accounting for more than 94 % of deposits and about 93 percent of credits in 2005.

The Algerian banking system was officially liberalized in the 1990s, with the promulgation of laws on money and credit. There has been an urgent need to modernize the sector for some time. Recent efforts have focused mainly on updating the inter bank payments system and bank surveillance.

With the new liquidity from the rapidly developing economy, Algerian banks have increased their financing activities. Market potential has also attracted a number of large foreign players.

However, Algerian banks still face some challenges. Banking activity remains quite small, with low deposit rates and just 1,278 bank branches or one per 26,200 people. Credit represented only 22.7 % of GDP in 2006, compared to more than 60% in neighboring countries (such as Tunisia and Morocco).

**The Insurance Sector** is organized and regulated by the Ministry of Finance (or more specifically by Le Conseil National des Assurances). It covers three types of insurance activity: direct insurance, international reinsurance and specialized insurance. There are currently 16 players operating in the sector. Twelve companies, four of which are state owned, specialize in direct insurance. Three companies provide specialized insurance services, one of which provides coverage for mortgage loans risk. All specialized insurance companies are relatively new to the market. There is only one company providing reinsurance services in Algeria and one company providing mortgage insurance.

The insurance sector is dominated by the three old state owned companies (CAAR, CAAT and SAA), which accounted for 66 % of premium revenues in 2003. The market share of new companies has been growing steadily in recent years. At the end of 2003, the direct insurance companies collectively ran 691 branches, 64 % of which belonged to the four state owned insurance companies.

The new insurance law opens the doors for insurance companies to distribute their products by way of other outlet, mainly through commercialization via the banks.

**The Capital Markets** in Algeria are still underdeveloped and dominated by the bond market with 30 debt securities issued since 2003 totaling about 2.1 billion US\$. The bond market has been more successful in recent years than the stock market. Perhaps the most interesting development of 2006 was the first issue of a private corporate bond by Cevital and Arab Leasing Company(ALC). Cevital is one of the largest private firms in Algeria as well as a leader in the private sector. Cevital raised 5 bn AD (\$705 million) in capital, with a 2.93 bn AD(400 million) retractable bond (a bond with a put option) maturing in 2011 and 2.07bn AD (\$290 million) retractable bond due to reach maturity in 2012.

The six year bond has a 3.75% coupon with an average yield of 3.67%, and 100.34% average price on bidding. Similarly, the seven-year bond has a 4% coupon with an average yield of 3.8%, and 101.05% average price on bidding. Both of the bonds are backed by mortgages.

## THE CURRENT STATE OF THE HOUSING MARKET

During the first twenty five years after independence in 1962, Algeria's main policy was directed to investment in the industrial sector, and little attention was paid to the housing sector. Because of tight government regulations on private ownership there was little, if any, private housing construction. The state confined itself to improving public utility services and putting aside housing sector development.

As a result, housing shortages began to show towards the end of the 1970s. During this period the overall investment was made outside the housing sector. The only initiative in this area was to build new villages in rural areas to encourage agriculture. Out of 1,000 units planned only 300 units were accomplished.

In the 1980s, housing shortages became important mainly due to the increase in the population growth rate (it was nearly 3.2% a year) and the pressing demand for housing. This situation had led the authorities to review previous policies and make housing a top priority. It was then decided to initiate a program of 100,000 units to be supplied on a yearly basis in urban and rural areas for a period of at least 10 years ahead. This program was to be financed from public funds in order to house low income households and employees in the public sector. But the economic crisis and social unrest that followed particularly, the drop in oil revenues in 1986, had resulted in stopping the program.

During the 1990s, the occupancy rate jumped to an alarming level that is 8.8 persons per housing unit. This level was considered to be one of the highest in the world. The housing shortage jumped to about 1.5 million housing units and it had become a major issue for the government and therefore a new policy had to be worked out.

The total housing stock in the country was 5.9 million units in 2005 as compared with 5.02 million units in 1998 and 3.6 million units in 1987. The useable housing stock was only 4.7 million units in 2005, 4.1 million units in 1998 and only 3.0 million units in 1987.

In comparison, the total number of households was 5.7 million in 2005 (estimation), as compared with 4.4 million in 1998 and 3.2 million in 1987. The number of households increased by 38% during the period 1987-98, an average annual increase of 2.9%. The average size of household by occupied unit is still very high; it was 7.09 in 1987 as compared to 6.58 in 1998. It is expected, however, that this number will be reduced to 6 persons per occupied housing unit by 2009.

The housing crisis that emerged in the 1990s, however, had led to the conviction that previous policies were shortsighted because they did not involve the natural actors and the final users in the preparation,

implementation and management of the housing processes.

As a result, the market economy replaced the planned system and therefore government policy was shifted from a housing landlord, producer, and financier to a role of regulator. The private economic agents become more interested in housing business, promoting therefore a market based system for owner occupied dwellings, supported by the up-front subsidy program proposed by the Government with the objective of achieving more transparency and ease the implementation of the new housing program.

Although the housing sector has been under scrutiny since the year 1990, it did not respond as it was expected in terms of meeting either economic growth or social shelter objectives, producing only - on average - 50% of the housing units demanded in urban areas.

The unsatisfactory situation of housing market in Algeria is mainly due to a combination of a number of constraints impacting on housing supply and demand.

**On the supply side**, there are constraints which impede the production of sufficient affordable housing units, especially with respect to the availability of land with legal title; the availability of infrastructure, the shortage of which is partly due to lack of financing; in addition a recent government policy limits the production program of social rental housing to a minimum level per year, recognizing the high cost and the unsustainability of the program. The restriction imposed upon access to subsidized rental housing, coupled with an increase in rents and provision of home-ownership grants, has increased the relative attractiveness of private ownership. The overall strategy was to shift from the public provision of subsidized social rented houses to the encouragement of privately owned housing, financed through affordable long term mortgage loans.

The housing reform undertaken in the 1990s with respect to the supply of housing units has included the privatization of the construction industry, which as a result had led to a reduction in the cost of construction and delay of production, besides some improvement in the availability of land. Before the reform, housing construction, mainly performed by the State Owned Enterprises, could last between five and ten years, a situation which added extra costs. The housing costs were inflated and were mainly supported by the state budget.

After the reform, the average time of construction was reduced to 18 months and at most 24 months. Today, the prices of houses can be considered a fairly good approximation of costs.

The average house price ranges between 19,000 AD (259.56 USD) and 23,000 AD (314.21 USD) per sq metre for social housing (totally paid for by the government), and between 25,000 AD and 28,000AD for apartments on hire purchases. Private market prices are estimated to range from around 35,000AD (614.75 USD) to 45,000 AD (614.75 USD) per square metre for an apartment and more for a villa.

#### Average housing market prices

Type of flats*	Surface m <sup>2</sup>	Average price/ m <sup>2</sup>	Total price Algerian Dinars
1 bed room	30	40,854	1,225,620
2 bed room	50	40,854	2,042,700
3 bed room	65	40,854	2,655,510
4 bed room	80	40,854	3,268,320
5 bed room	100	40,854	4,085,400

1 USD = 72 Algerian Dinars.

(\*): the apartment flats offered by the private and the public sector range from 1 to 5 bedrooms.

Although some concrete results have been achieved since the implementation of the reform program, such as: a) reduction in the number of years to complete the housing project, and b) the reduction in costs, thanks to competition between the private and public sectors, there is much more to

be done particularly in view of the availability of serviced land and registration of property titles.

On the demand side, access to mortgage financing was hindered by the underdeveloped mortgage market particularly up to late 1990s and the difficulty in obtaining the long term affordable mortgage loans from the banking system. As a result, most owner occupied housing was self financed, which implies less affordability and delayed access to home ownership. The situation was, until 1999, aggravated by the inefficient housing finance monopoly of the national saving & contingency agency (CNEP), which has still the lion's share of the mortgage market.

#### Tenure Distribution

	1987	1998
Owner occupied	64.1%	67.2%
Rented	22.1%	13.8%
Free housed	12.9%	15.8%

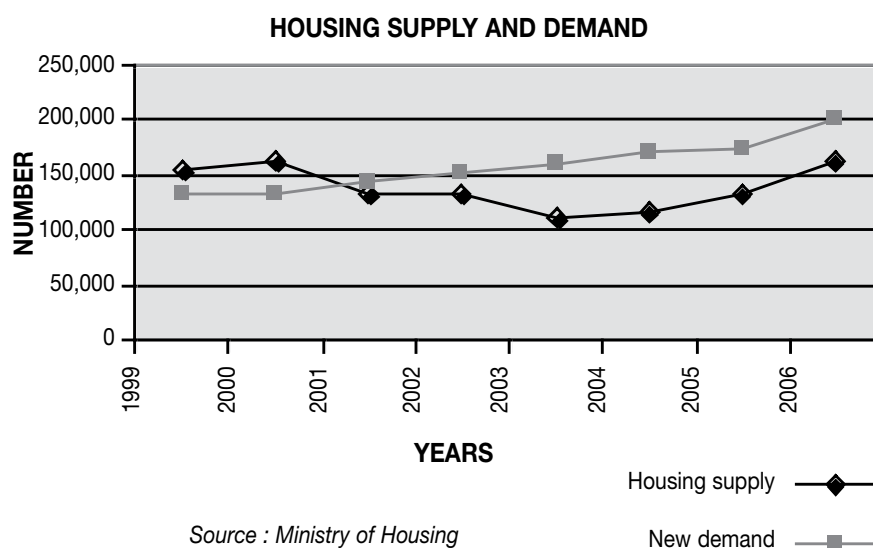
Source: ONS (General census, 1998, 1987).

The main obstacles to satisfy the increased demand for owner occupied housing have been: the legal and regulatory environment which does not ease access to titled land and comprises therefore effective

mortgage collateral and makes foreclosure on unpaid mortgage uncertain particularly if we compare the level of housing prices to the level of household income. In order to overcome these problems, the housing affordability issue needs to be alleviated; the land and ownership titling must be facilitated and the mortgage market should be more efficient. The supply curve of housing is inelastic, even in the medium term, which means that the increase in demand for housing leads to an increase in prices. This situation can be reversed by making housing supply market more competitive; any increase in demand will be offset by proportionate increase in the quantity supplied.

#### Housing shortages

It is clear that Algeria suffers from a severe housing shortage, especially in urban areas. The housing shortage has been estimated on the basis of the number of households including those without shelter, available housing stock, aspects of congestion and overcrowding. The general census of 1998 provides background information on households including homeless people, and acceptable housing stock. Overcrowding and congestion is assessed on the basis of the number of living rooms in the dwelling unit, number of members and number of married couples in the households.



The estimated new demand for housing exceeds 150,000 units/year for the next ten years, which has to be added to the accumulated deficit of more than 1.2 million housing units. In addition, the quality and age of the existing stock requires huge investment in renovation and restoration.

This situation highlights the underdeveloped housing market in Algeria and the difficulties in obtaining affordable houses. The low level of mortgage loans is not necessarily due to unaffordable lending conditions alone but also the lack of experience of banks in mortgage lending.

It is difficult for the time being to be more precise or accurate in estimating the future demand for residential mortgages in Algeria. What is certain, however, is that the core strategy of the current government is to facilitate home ownership and to help launch the production of 1 million new units of housing to be delivered by 2009 in order to make up the accumulated deficit. This includes some 344,000 units that were started before 2005, but not completed, as well as 690,000 new units. Among the latter, 120 000 units are for social housing<sup>1</sup>. Another 490,000 units are part of government-sponsored housing projects designed to help middle-class citizens become home owners, with 275,000 of these in rural areas. The remaining 80,000 units will be up-market flats.

## CURRENT STATE OF DEVELOPMENT OF MORTGAGE MARKET

### Infrastructure of Mortgage Lending

One of the major reforms undertaken by the government in the mid- 1990s was to clean up the legal environment in order to boost the mortgage market. Precise measures were taken towards greater transparency in the pricing and availability of land, mostly trying to reform its disposal of domainial land (State Owned land), clarifying the legal status of a large part of urban land, reducing

titling issuance delay and providing a coherent and updated database.

In 2003, the Government concluded a contract with the World Bank for four years (2003- 2007) in order to provide technical assistance for reforming the legal infrastructure,( in particular modernizing the civil Code in respect to the law of Money and Credit) for mortgage and foreclosure procedures, deed and titles (transfers, lien, certificate of conformation, subrogation). Further measures provided technical assistance to the Agence Nationale du Cadastre and the Conservation Fonciere in order to speed up the titling of land and properties, especially in urban areas.

Mortgages in Algeria are regulated by civil law, land registry law, securities law and a special law on securitization promulgated in 2006.

The granting of mortgage loans is subjected to registration of mortgages in the land registry office. There are two types of mortgage registrations which could take place: the conventional one organized by land registry Code and the legal registration formula which is organized by the 2003 budgetary law. In the former case, the foreclosure must be dealt with through the judicial process, whereas the latter could be arranged outside the court process (the latter is used only by the banks).

In the case of conventional registration the costs may vary between 1% and 2.5% depending on the value of the property. But in the case of legal registration with the land registry, a lump sum of about 30 US\$ is required per mortgage loan. In addition, there are no extra registration charges in the case of a transfer of assets from a bank to a securitization vehicle.

### Relevant Prudential Regulations

Mortgage lending in Algeria is offered mainly by universal commercial banks. There are no specialized lenders either in or

outside the banking system. All the banks are supervised by the Bank of Algeria and have to observe prudential rules, such as a minimum capital requirement; the maximum loan amount which can be allocated to one client, that is 20% of the overall activity. .

The Bank of Algeria has lately allowed the classification of mortgage collateral value as being less risky than before and it has been attributed a risk weight of 50%. At the same time, it has regulated the maturity mismatching of asset/liability management. The transformation rate is set at 40% and was made effective in January, 2007. However, the classification of the risk of mortgage securities by the Bank of Algeria is still to come.

Up to the end of the 1990s, there was not any indication of a serious mortgage market in Algeria. The CNEP (a national saving & contingency agency) was the only institution which could offer mortgage loans. Obtaining a loan was subject to certain criteria eg opening of a saving account and accumulation of a certain amount of savings. The system was bureaucratically run and very inefficient as the CNEP did not ask for a guarantee in the form of collateral. That is why the level of non performing loans was found to be very high at the end of 1990s.

However, faced with this situation, it was decided in the mid 1990s to open the mortgage market to all banks and therefore a number of measures were taken in order to boost housing finance activity and create a mortgage market, namely :

- creating a secondary mortgage facility (the Algerian mortgage refinance corporation (SRH)<sup>2</sup> specialized in refinancing mortgages
- promoting competitive access to banking loans by households and private building firms,
- restructuring the state agency CNEP by transforming it into CNEP-Bank and
- creating the Caisse Nationale du Logement (CNL) in order to help improve

<sup>1</sup> Social housing is also called rented social housing. It is built and financed by the state and offered to households who cannot afford to pay a market price either for buying or renting a house or flat, but a monthly rent equivalent to 30% of market price is paid to the State. .

<sup>2</sup> SRH was established and chartered by the Algerian authorities in 1997 as part of national effort to increase the availability of housing to the low and moderate income segment of the population .



- access to ownership,
- e) establishing the Société de Garantie du Crédit Immobilier (SGCI), to guarantee mortgage loans made by the financial institutions for home purchase ,
- f) creating the Fonds de Garantie et de Caution Mutuelle (FCGMP) to guarantee advance payments made by housing unit purchasers to developers,
- h) modifying the banking act to authorize all banks to grant mortgage loans for housing purposes and
- i) introducing adjustments to the existing legislation on mortgages.

### Primary mortgage market

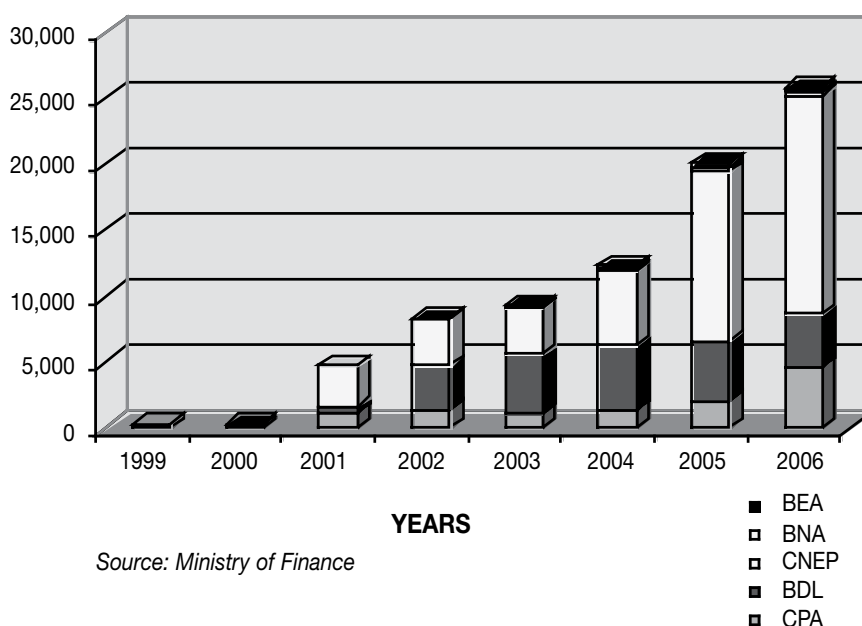
Although the number of private banks has increased since the end of 1990s, their contribution to mortgage lending is still limited. The public banks dominate the mortgage lending market.

No public banks (except CNEP) did mortgage finance before 1999. Therefore, they did not have the experience needed to raise the level of mortgage activities; they were merely in need of some technical assistance to develop strategies and initiate mortgage finance products.

A technical assistance program was provided by the Government in cooperation with the World Bank between 2003 and 2007 which was aimed at increasing the capacity of the public financial institutions to handle and evaluate mortgage financing, and therefore a training program was worked out for bank staff.

The training program included marketing, origination of loans, credit risk evaluation, and scoring. The aim was to develop the adequate expertise needed to develop the mortgage market. More than 1,600 bank staff have received the required training. Additionally, the private banks (all foreign) have been more interested in the mortgage housing finance business after the promulgation of a new law on titling, the creation of the new profession of real estate appraisers, the evaluation of mortgage risks

**MORTGAGE LENDING BY PUBLIC BANKS (1999 – 2005)**  
**AMOUNTS IN MILLION OF ALGERIAN DINARS<sup>3</sup>**



Source: Ministry of Finance

and also the promulgation of a new law on securitization.

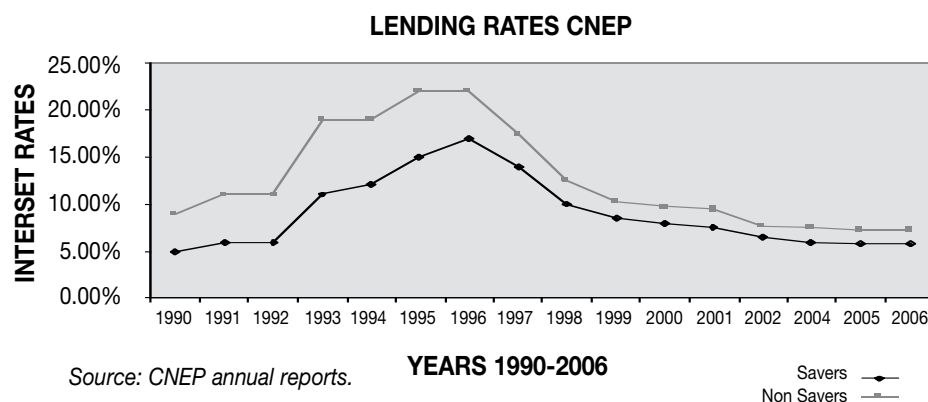
The mortgage lending market is developing rapidly in Algeria, though it remains small. CNEP has been the traditional mortgage lender since the 1980s and still dominates the market with more than 60% of total outstanding loans. Although the mortgage market was opened for other banks only in the late 1990s, some banks have made significant gains in market share (as it is shown in the figure above).

The other public banks offering mortgage credit include BDL, CPA, BNA, and BEA. The private banks which have just started housing finance include: Societe Generale, BNP Paribas, Jordan based Housing Bank, and Gulf Bank.

Mortgage loans are offered only by commercial banks. There are mainly conventional mortgages with a maturity up to 30 years, interest rates fixed or adjustable

and the loan to value ratio is 80% except the CNEP which is set at 90%. All mortgage loans should be supported by collateral evaluated at current prices. The level of monthly mortgage payment (PTI) is generally set between 30 and 40% depending on the level of income and the price of the house. There are no Islamic institutions offering mortgage finance in Algeria, and no institutions offering micro-credits for housing finance purposes.

<sup>3</sup>BEA : Banque Extérieure d'Algérie ; BNA : Banque Nationale d'Algérie ; CNEP : Caisse Nationale d'Epargne et de Prévoyance ; BDL : Banque du Développement Local ; CPA : Caisse Populaire d'Algérie (these are major public banks offering mortgage loans).



The banking sector currently relies on deposits (mainly short term) for funding; the absence of term liquidity weakens the attractiveness to the banking sector. The primary and secondary markets in bonds and other term securities are emerging but still underdeveloped, limiting prudent opportunities for the banking sector to raise long-term finance to fund long-term lending. It is clear that more efficient financial market mechanisms must be established both to mobilise greater financial flows for mortgage lending and to help improve the terms of mortgage generally available in the banking sector.

This in turn, will improve the affordability of housing. In addition, it is desirable to develop a medium term debt market, particularly with respect to the liquidity of debt instruments.

Because of a new emerging mortgage market in Algeria, there is not sufficient information to evaluate non performing mortgage loans compared to commercial loans. Only CNEP's portfolio contains a considerable number of non-performing loans which has been due to questionable lending practices during the socialist rule. However, the mortgage interest rates have gone down very sharply in recent years and the banks can further mitigate mortgage interest rate risks through the mortgage refinance company (SRH).

### Secondary mortgage market

The secondary mortgage market created in the late 1990s, was aimed at improving

the terms and conditions of market-based mortgage financing for the banking sector, which relies heavily on deposits (mainly short term) for funding; creating a sustainable market source of liquidity for mortgage lending to commercial banks; building investor confidence in Algeria's emerging bond market, and making the housing lending activity more attractive to potential investors.

The secondary mortgage market is has been recently reinforced by the promulgation of a new law on securitization and the review of the Civil Code in order to clean up all past obstacles.

However, the secondary mortgage facility (SMF) is intended to add a significant element to the evolving Algerian financial market, by serving as an intermediary between long term lenders for housing and long term investors.

The importance of the SRH to long term lenders should be reflected over time in the terms and conditions under which commercial banks in Algeria would be willing to offer housing loans, thereby passing the benefits on to households. However, quantitative estimates of selected, perceived economic and social benefits of the SRH may be derived from the utility function of lenders and households alike who will be permitted access to the form of financial intermediation provided by the SRH.

It is clear, however, that the main benefits for lenders could arise from reducing both

the interest rate risk and liquidity risk associated with their mortgage lending for housing. Benefits could also arise for borrowers from competition among lenders causing them to pass through the benefits from improved risk management.

For the Secondary Mortgage Facility, the benefits to the home buyers are multiple. It can help ensure the availability of mortgage funds, which will in turn alleviate potential upward pressure on the mortgage interest rate. Over time, a lowering of the mortgage rate may be possible because the improvement in the liquidity of residential mortgage loan will allow for a reduction in the risk premium on such loans.

Two types of mortgage securitization are offered by the Algerian Mortgage Refinance Company (SRH):

- Securitization without transfer of assets, on-balance sheet, which means that the bank or a financial institution keeps the mortgages on its balance sheet; and
- Securitization with transfer of assets "true sale" or "off- balance sheet", in this case there is a transfer of risks from the originator to SRH, but the originator keeps the servicing against a negotiated margin.

The company has refinanced up to now 'with recourse' a total of 100 million USD of mortgage loans, and it is now negotiating with two major banks (CPA and CNEP) for securitizing mortgage portfolios on a 'true sale' basis.

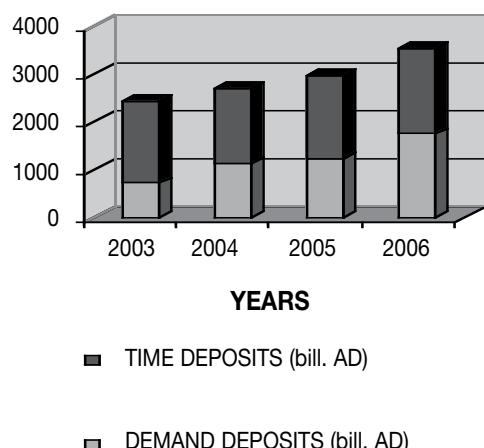
### Mortgage Funding

Mortgage funding has traditionally been based on retail deposits. But the use of deposits for financing mortgage loans creates issues in terms of asset and liability management as deposits typically have short to medium periods of notice, whereas the mortgage loans are medium to long-term products.

In recent years, with the demand for mortgage credit increasingly outstripping the supply of deposits, mortgage lenders have looked more and more towards capital markets to finance the funding gap.

In Algeria, there is a good and stable deposit base, especially in recent years. The annual average increase for the past four years was about 15%. However, the cost of demand deposits declined at an increasing rate; it decreased from 6.125% in 2001 to 1.875% in 2005. The annual average cost of banking deposits was 4.2% for the period 2001- 2005 whereas the average lending rate was on average 8% for the same period.

**DEPOSIT BASE (ALL BANKS)**



Source :

*Annual report 2006 (The Bank of Algeria)*

On the other hand, the rate on the annual average housing saving accounts provided by CNEP was 5.3% for the period 2001-2005, against the annual average lending rate of 7.1% for the same period.

The average cost of the Treasury securities with maturities of five and ten years was 3.78% and 5.25% respectively over the period 2001-2005. The average cost of commercial bonds, including mortgage bonds with maturities varying from three to six years, was about 4.5% for the same period. Moreover, the securitization process is just starting in Algeria after the promulgation of the new law in 2006. The funding for securities comes essentially from institutional investors like insurance companies and pension funds.

According to the regulation of the Bank of Algeria, the banks are allowed to transform

no more than 40% of demand deposits for medium and long term financing and only 20% of accumulated saving accounts can be used for medium & long term funding.

However, the commercial banks in Algeria are not sufficiently capitalized. If they need to increase their lending activities to an optimum level, they should either to sell some of their mortgage assets to refinancing corporation (SRH) or to ask their shareholders for recapitalization. The latter may prove to be difficult to obtain.

## CONCLUSION

Algeria has managed, in a short time period, to stabilize the economy at a macroeconomic level (low inflation, low interest rates, low unemployment) in order to boost the development of the mortgage market; it has also improved the judicial processes, providing the basis for adequate laws and titling systems which should allow households to establish ownership and pledge collateral.

Although a number of objectives have been achieved, there is still more to do: more efficient instruments are needed to meet the challenges of providing an adequate supply of housing units, both in terms of volume and price ranges.

However, the current system requires a more adequate infrastructure that provides better information for assessing collateral and credit risk; the long term savings stimulated by insurance and pension funds reform is an important source of funding in Algeria for the time being, but the issue which is still to be addressed in the future is how to diversify this source. Should the level of household domestic savings be raised to an adequate level in order to create a pool of resources capable of supporting households' needs in home financing or should the development of a sustainable capital market through the issuance of mortgage securities become a priority? These are the main issues to be tackled in the near future.

# Market-Liberal Homeowner Societies: Questions of Convergence in & around an Anglo-Saxon Model?

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## INTRODUCTION

The orientation towards homeownership in state policies and household practices, and the increasing influence of housing markets have become characteristic of housing systems across advanced societies. Some countries have been more strongly orientated towards owner-occupier housing than others, and there has been a particular association of Anglo-Saxon societies with a normative market-liberal, homeownership model of housing provision, consumption and finance (see Forrest et al., 1990; Kemeny, 1981, 1992; Ronald, 2008; Saunders, 1990). The experiences of these 'homeowner societies' have dominated the literature and have promoted the assumption that, firstly, there is a consistent state approach to the promulgation of homeownership across these countries, and secondly, that there is a similar shared cultural ideal of a homeownership 'dream'. Nevertheless, there is substantial diversity in the organization of housing that has led to the domination of homeownership in housing policy and residential preferences. What is more unifying among this group of societies is a market-liberal model of owner-occupation that has emerged in recent years, characterized by asset-based welfare approaches which support increasing dependency on markets and neo-liberal state practices. The features of this model are becoming increasingly resonant in processes of global neo-liberalization in terms of social and economic policies,

international financial deregulation and integration, and patterns of individualized consumption (Doling, 2006; Forrest, 2007). Also significant is evidence that market-liberal influences, in context of increasing pressures of globalization on welfare states, are undermining the base of social-rental policy systems in social democratic European societies (Clapham, 2006; Kemeny, 2005) and driving a singular market-liberal mode of housing policy across the developing world.

The aim of this paper is to examine consistencies and differences in the development of housing systems, policies and practices in Anglo-Saxon societies. This will illustrate how homeownership systems and preferences have been actively developed, rather than naturally evolved, and how, a 'model' of homeownership has emerged that supports a neo-liberal framework of welfare restructuring and housing financialization. Essentially, the approaches of both governments and populations to housing and individual security have realigned across English speaking, homeowner societies in recent years towards more commodified and privatized, consumption and welfare practices. This has effectively driven a polarization of tenure preferences individually and institutionally, and supported a characteristic shift of risks from the state to individual households. Also evident are similar outcomes in Anglo-Saxon homeowner societies following the

growing in-affordability of housing which has begun to generate gaps between social groups based on ownership of, and access to, housing property. The paper begins by briefly setting out a framework for understanding housing systems as well of 'models' of homeowner societies. It then considers three key illustrative empirical cases – Britain, the USA and Australia – in order to demonstrate the diversity of pathways among Anglo-Saxon homeowner societies, as well as patterns of convergence around a market-liberal model of homeowner society. In the last section, the more social and global impacts of this model are considered as well as emerging features of these housing systems.

## HOUSING SYSTEMS AND WELFARE REGIMES

Housing systems, made up of the myriad of institutions and practices surrounding the organization of housing, constitute an important dimension of social systems, having a significant impact on the organization of other social goods and relations. For example, more or less government provision and regulation of housing can enhance or reduce the relative dependency of households on the state, the family or the market for the satisfaction of, not only housing, but also various types of other needs. The idea of housing system models is not particularly developed as it has proved difficult to categorize housing systems in terms that can be related to

other social dimensions. The theories of tenure and the typology of housing systems put forward by Kemeny (1992, 1995) have been useful, but have proved difficult to integrate with welfare regime typologies of social divergence (Esping-Andersen, 1990), that have been dominant.

In Kemeny's work he identifies dualist and unitary types of rental systems. Unitary systems are usually characterized by substantial direct state provision of non-profit rental housing which competes directly with private market housing, giving the state significant influence on overall housing prices and standards (eg Sweden and the Netherlands). Dualist societies are dominated by homeownership and the private rental market, with a small residual of public housing maintained for categories of worthy poor, which does not compete with the private mainstream sector (eg UK). Kemeny identifies other features of societies orientated towards private homeownership related to ideological aspects of individualism and the organization of urban space and welfare spending. Individuals in such societies are more likely to seek to build up a reserve of housing wealth through participation in the housing market that eventually reduces housing costs and offsets pension shortfalls in old age. Consequently, people may be more inclined to support privatistic approaches to social welfare and resistant to high-tax, high-spend policies. Kemeny's model of homeownership strongly reflects the features of Anglo-Saxon societies and the particular organization of a market-liberal model of homeownership.

Although many other groups of societies also demonstrate high rates of homeownership that reflect different intersections of housing systems and social organization (for example, East Asia (see Ronald, 2006, 2008)), this paper focuses on patterns of development across three Anglo-Saxon homeowner societies to illustrate a process of convergence on a market-liberal housing system model and its influence on welfare regime trajectories and in promoting market ideologies. What is now characteristic of these societies is the

significance of housing markets and individual participation within them, which 'commodifies' dwellings themselves and relations between households to their homes. Commodification decouples individuals from government provision and undermines the 'de-commodifying' affects of welfare states (the social provision of goods that make individuals independent from markets). Convergence around a market-liberal homeownership model can be related to the growing influence of neo-liberal approaches to governance, and the greater orientation of welfare systems around individual self-provision facilitated by owner-occupied housing assets (or asset-based welfare) in these societies. The growth of homeownership has been a significant factor in polarizing perceptions of tenure and eroding the status of public rental housing. This has constituted the market rather than the state as the best provider of such goods, undermining social policies. A further argument is that growing homeownership rates globally reflect the increasing influence of this model. Market based consumption and circulation of housing properties has been particularly attractive across a growing number of societies where global economic pressures have squeezed the welfare capabilities of the state and enhanced the economic precariousness of individuals who increasingly see housing as an investment asset and a hedge against economic insecurity in the future.

### THREE ANGLO-SAXON HOMEOWNER SOCIETIES *Homeownership in Britain*

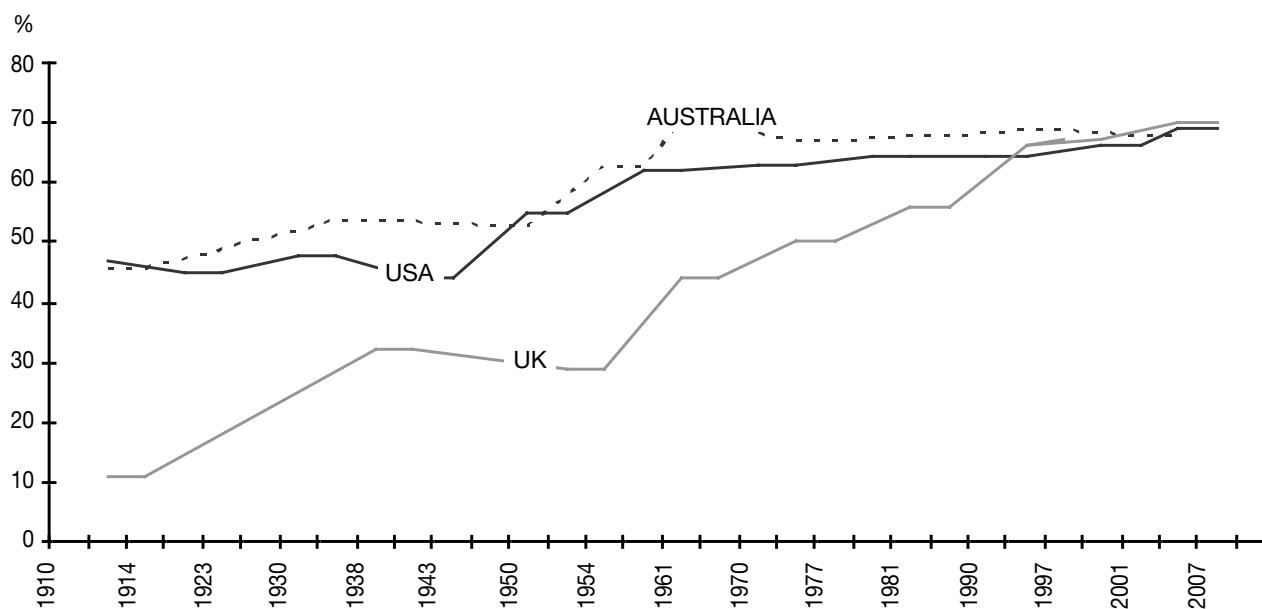
At the beginning of the 20th century most British households rented their homes from private landlords and as few as one in ten were owner-occupiers (figure 1). For the Edwardian middle-classes there was a plentiful supply of quality rental housing and thus little need to take on the level of indebtedness associated with individual house purchase. For lower income groups renting was also the norm although slum dwellings were abundant. Options open to lower-income groups were further constrained by a limited borrowing

infrastructure and a lack of low cost housing. However, in the early 20th century, the housing situation became more socially and politically salient, while private renting also became decreasingly economically viable.

Largely as a response to working class demands for better housing, the introduction of the Housing and Town Planning Act (1919) promised Local Authorities state support in providing new housing for rent. In the early 1920s however, subsidies available for municipal rental housing were eroded and funds were increasingly shifted by Local Authorities into the provision of owner-occupied homes, which was the institutional preference (Merrett, 1982). The main obstacle to expanding homeownership was the inability of the working-classes to obtain credit. Consequently, into the 1920s and 30s private mortgage finance institutions, along with a municipal housing loan system, were developed (see Boddy, 1980; Boleat and Coles, 1987). With the expansion of housing built by speculative builders (private housing production almost doubled in the 1930s (HMSO, 1939) and finance packages provided for lower-income households, increasing numbers of affluent working-class households were able to buy. By 1938 the private rental sector had declined to 58 percent, with owner occupied housing increasing to 32 percent. The marginal stock of municipal social-rental housing had also increased to around ten percent.



FIGURE 1: HOMEOWNERSHIP RATE INCREASES



Sources: *Housing Finance Review*, (UK) 1999-2000; DCLG, 2006; US Census Bureau; Australian Bureau of Statistics, 2001; Atterhög, 2005; Baxter and McDonald, 2005

The immediate post-war period was characterized by massive housing shortages and a growth in support for public housing along with a resurgent working-class. The new welfare state established by Attlee's Labour government called for radical changes in housing policy which involved the mass building of rental housing. However, social-rental housing provision fitted awkwardly with other welfare institutions (Malpass, 2005), and while there were ambitions to provide housing as a 'merit good' available across social classes, public housing did not become embedded in the welfare state. Nonetheless, a mass expansion of Local Authority housing construction was initiated as a solution to the nation's housing needs. In the 1950s the Conservatives returned to government and, arguably in response to the expansion of the welfare state, committed themselves to the ideal of the 'property owning democracy'. Although the Tories envisaged various kinds of property ownership, homeownership was a more malleable target. They first sought to reverse rental housing policy by increasing

the share of housing built for sale to 50 percent. Homeownership continued to expand into the 1960s further supported by economic growth and Mortgage Interest Tax Relief (MITR).

In the 1970s, homeownership established itself as the majority tenure (55 percent in 1975), with private-renting making up only 16 percent of housing. The 1970s property price-boom established a more imminent perception of gains made through homeownership which had previously been closely allied to the point of entry and length of time in the market. Inflation also helped to create particular perceptions about potential capital gains (Bootle, 1996). Significantly, the housing boom established of an 'enduring belief that homeownership is one of the best, if not the best, investment accessible to ordinary people' (Doling et al., 1991, p 110). Labour governments also became more partisan to homeownership policy and by the late 1970s sought to reduce the financial burden of public housing programmes. However, municipal and housing association rental-

housing already accounted for around a third of stock and, at this point, public-rental and owner-occupation stood together as pillars of the British housing system.

1979 is considered a watershed year in housing policy as, under Thatcher's Conservative government, housing privatisation became a focus of policy. The emphasis was more homeownership through tax cuts, lower mortgage rates and special schemes to make purchase easier. Most important was the sale of council houses backed by discounts to reduce purchase price and mortgage costs. The 1980s' 'right-to-buy' legislation made sitting-tenant purchases increasingly attractive, resulting in the eventual sale of more than two-million council homes (see Forrest et al., 1990; Murie, 1998). Concomitantly, the scope of Local Authority housing was reduced with restrictions put on capital made from property sales for replacement building as well as a substantial transfer of stock into the hands of housing associations. Another significant measure was the deregulation of the credit

market (1985 Financial Services Act, 1986 Building Societies Act), which increased lender market competitiveness and made mortgages more available. Over the 1980s home-buyers experienced an upward trend in the amount they were borrowing in relation to the price of the property. The number of mortgages increased by more than 75 percent between 1980 and 1999 (Wilcox, 2000). However, following economic downturn and interest rate increases (to more than 15 percent) the housing market crashed at the end of the decade and losses were consolidated into the early 1990s. Nonetheless, by this time the homeownership rate was above 64 percent and preferences for the tenure had become entrenched in consumer and policy discourses.

The Blair Labour government approach to homeownership after 1997 was initially cautious. One of the first major steps taken in housing policy, finally abolishing MTR in 2000, eroded the advantages for homeowners. However, New Labour soon began to warm-up to owner-occupation. Policy approaches increasingly associated homeownership with the ideal of the 'opportunity society'. This position was reinforced by the apparent affluence generated by the resurgence of the housing market. Between 2000 and 2006 housing policy initiatives focused on expanding the construction of private housing, broadening access to homeownership and further disengagement of the state from the provision of subsidized rental-housing (table 2). Consultation papers further recommended liberalisation of the private housing sector as well as the creation of stake-hold opportunities for social-renters and shared-equity programmes for first time buyers (see Barker, 2004, 2006; ODPM 2000, 2005a.b; Miles, 2004). Shared ownership and equity schemes like HomeBuy have aimed to expand homeownership to households who would have otherwise rented or have been priced-out by market increases. Further deregulation of housing finance also made borrowing cheaper, stimulating housing demand and market prices. With the declining affordability of housing in the

2000s and growing pressure on housing supply, in 2005 plans were set out to intensify housing production and extend homeownership to 75 percent of housing. Since his inaugural speech, Gordon Brown has been explicit about his desire to further expand opportunities for homeownership and enhance the features of an asset-based social security system. Labour's approach to housing marketization has in most respects become more intense than the Conservatives. Facilitating the accumulation of housing wealth has become an explicit target of policy, fitting a more neo-liberal model of household independence and market based provision.

#### ***An American homeownership dream***

The American system of owner-occupation that developed over the last century bears familiar marks of policy manipulation. Homeownership has largely prospered subsequent to policy initiatives that have been reactive to political and socio-economic developments. The system illustrates a particular interaction between the state and capital based on the assertion that the public sector should place very limited controls on private interests. Ownership of land and individual sovereignty are legally and symbolically more integrated in the practice of owner-occupation. Homeownership orientated housing policy has also been considered critical to the maintenance and growth of an infrastructure of developers, financial service providers, planners, realtors etc, and has thus been politically popular, in part, because of its myriad of constituencies (Buchholz, 2002).

The rate of homeownership at the beginning of the twentieth century was considerably high, but was not the majority tenure and not characteristically stable. From 1900 to 1920 the rate slightly decreased from around 47 to 45 percent (see figure 1). This was in part due to immigration with populations becoming ever more concentrated in urban areas. Another factor was the affordability of the tenure. The demands of large down payments (50 to 60 percent) and short-term mortgages (typically 6-11 years) made owner-occupied

housing unaffordable for many. The government's approach to housing was essentially to leave it to the market, despite demographic and urban pressures and the inequity of the finance system. The booming economy of the 1920s led to a housing construction and market surge with the rate of homeownership notably increasing. The 1929 stock market crash and subsequent economic depression led to a 4 percent drop in owner-occupation rates. In the early-1930s, there were around 1,000 mortgage foreclosures a day (Listokin, 1991). The Savings and Loans finance system supporting home purchase also contributed to economic decline as only local savings could be used for mortgage loans, fragmenting the supply of funds and leaving lenders little capital to fund further mortgages during economic downturn.

The New Deal interventions (1933 to 1943) readdressed the government's role and established a comprehensive network of assistance for households across income groups. Restructuring and subsidizing home purchase finance was central to this and involved the introduction of government backed mortgage guarantees and greater federal regulation of lending. While there was displacement of the market system, this approach still sought to support the private sector rather than replace it. The Federal Home Loan Banking system was established in 1932 and the passage of the National Housing Act of 1934 established the Federal Housing Administration (FHA). The 1930s also saw the establishment of the Federal Savings and Loan Insurance Corp (FSLIC), the Federal National Mortgage Association (Fannie Mae) and the Reconstruction Finance Corp (RFC) (table 2). The new system improved the flow of mortgage finance and conditions for borrowers. The FHA guaranteed mortgages and regulated fixed-term low-interest rates, while Fannie Mae replenished the supply of lendable money by issuing securities in a secondary market.

Federal housing policy represented a substantial intervention by the state, necessitated by the evident inadequacy of the market housing system. Nonetheless,

the approach based on federal mortgage guarantees provided stability without de-commodifying the housing system. Although the Public Works Act (1933) and the United States Housing Act (1937) established a small public housing sector, the main aim was to create employment and support the construction industry. Capital interests were imperative and legislation required local housing authorities to limit public rental housing, since it was feared that increases could drive down private sector rents.

Homeownership began to grow dramatically in the 1940s and 50s along with economic growth and suburbanization (by almost 20 percent by 1960). However, social and economic transformations in the 1960s stimulated shifts in government subsidy and housing policies. Demographic pressures of rising numbers of divorced and single-parent households led to greater pressure on the rental sector. Another critical factor was socio-political unrest and growing demands for civil rights. The Government began to perceive a need to improve the quality of life in central city neighbourhoods, especially for black communities. Federal housing programmes, in line with the 'War on Poverty' began to provide more subsidized rental housing. This was largely achieved, initially, through the subsidization of construction projects. Homeownership was still fuelled by the low-interest mortgages of the federal housing loan system and sweetened by MITR, but primarily enjoyed by white, middle-income households. The section 235 programme for low-income homeowners was also established although the results were largely uneven (Bratt, 2007).

Inflation in the 1970s slowed economic growth and boosted interest rates, making homeownership less affordable and reducing flows from savings into the mortgage market. The role of federal finance organizations was subsequently expanded. While Fannie Mae had been privatized in 1968, in 1970 the Federal Home Loan Mortgage Corporation (Freddie Mac) was also introduced in order to develop the secondary market. Freddie Mac bought

mortgages on the secondary market, pooled them and sold them on as mortgage-backed securities (MBS) on the open market. Fannie Mae and Freddie Mac became ostensibly independent but assumed the status of Government Sponsored Enterprises (GSEs). Because of this status they pay lower interest-rates as there is a market assumption the government will step-in if difficulties arise. They thus offer better MBS rates with advantages passed on to borrowers through cheaper and securer mortgages. Essentially, securitization and the regulation of housing finance have been considered central to an efficient mortgage system. However, subsidies and state sponsorship appear more important than the miracle of securitization and market competition (Poole, 2003). The government has effectively subsidized owner-occupation and intercedes in the market, but in ways that sustain the perceptions of free market relations.

In the 1980s homeownership rates actually dipped. However, in the mid-1990s the Clinton administration re-embraced tenure biased policy, explicitly targeting an increase in homeownership rates by two or three percent by 2001. Their programme had four goals: to make homeownership more affordable, to eliminate barriers, to enable families to better manage responsibilities and rewards, to make home purchase administration simpler. There were also moves to end discrimination in lending which had led to low rates of black homeownership. The policy focus did not involve radical reform in legislation, but rather addressed issues of access for lower-income groups normally excluded from the housing market (Frey, 2001). The G.W. Bush administration placed the expansion of homeownership among low-income and minority groups even more centrally in policy agendas (aiming to increase minority homeownership by 5.5 million families by 2010). The approach was more interventionist and subsidy orientated than that of the Democrats. Measures specifically addressed reducing the high-cost burden of down-payments for low-income families. Concomitant measures

taken on the supply side included \$2.4 billion tax credit for developers to build affordable single family housing. There was also extra funding for Self-help Homeownership Programmes. In 2006 the Expanding American Homeownership Act was further introduced. Under Bush, the property sector and house-prices initially boomed and by 2004 homeownership reached 69.2 percent. In 2006, however, market conditions reversed, later revealing overextension in the subprime mortgage market in particular. Subsequently, stability has been eroded and the government has had to step in to guarantee mortgage rates for mid-range homeowners.

#### ***The great Australian dream***

It has been suggested that Australian homeownership policy has significantly contributed to a process of suburbanization, associated with a particular type of single family housing on its own land with a garden that embodies the aspirations and sentiments of a 'working man's paradise' (see Beer and Blair, 2000; Paris, 1993; Stretton, 1970). Kemeny however (1986), argues that homeownership has dominated as a direct result of government engineering because of its 'close affinity with a range of conservative political beliefs' (p 251). Indeed, homeownership has been directly nurtured by considerable subsidy in numerous forms and guises over the century. However, the consensus concerning tenure strongly reflects Australia's particular socio-political pathway and construction of welfare-labour relations, or 'workfare' system. Castles (1985) argues that labour movements have adopted a different political strategy to those in Europe, which has not been based on expanding social wages (social security, welfare benefits, etc.), but on ensuring that wage-levels were kept above the minimum, which in combination with low marginal tax rates ensures that worker's living standards are maintained. Essentially, a powerful working-class has turned to a high private-wage strategy over a social-wage one. As the number of working-class homeowners has grown, the benefits of high wages have been transferred into housing properties,

which have subsequently augmented in value to constitute what is perceived as an asset-base for household security.

At the turn of the 20th century, homeownership constituted around half of housing stock, much of which was owned outright. The first scheme to promote homeownership came about in 1919 and provided easier access to owner-occupied housing for World War One veterans. Schemes to encourage lower middle-class and affluent working-class private house purchase were later introduced through the 1928 Commonwealth Housing Act. For the government, the main obstacle in its objective of expanding owner-occupation was the limited ability of ordinary working people to obtain credit. In order to promote housing purchases they needed to make potential buyers more competitive than private landlords. This required developing an infrastructure of home-purchase lending, and involved subsidizing savings banks and building societies in order to redirect funds. Measures taken across different states effectively institutionalized and normalized borrowing for homeownership throughout the 1920s and 30s. Nevertheless, the impact on tenure growth was essentially limited and between 1921 and 1947 homeownership increased just a few points to 53 percent.

The creation of the Commonwealth Housing Commission (CHC) in 1944 and subsequent Commonwealth State Housing Agreements (CSHAs) initiated a period of rapid growth in homeownership. Private landlordism at this time also came under considerable attack through the Landlord Tenant Act (Hill, 1959). The increase in homeownership was rapid and dramatic (figure 1). As well as government sponsorship, a series of factors contributed to the continued surge in homeownership consumption: the establishment of a financial infrastructure; increased prosperity; a post-war surge in immigration and acute housing shortages. Essentially, homeownership grew under relatively ideal conditions along with policy mechanisms which, on the one hand, undermined private renting and, on the other, underpinned private purchases. In the

1950s and 60s owner-occupied households received considerable tax breaks as well as, often, direct assistance from the government. There was considerable political consensus in the early post-war period over homeownership. Indeed, Liberal (conservative) Prime Minister Menzies found considerable support for owner-occupied housing policy among labour-unions. Even the communist unions campaigned for the release of funds to build owner-occupied housing, and for further control of interest rates as a way of stimulating the economy and overcoming housing needs (Troy, 2000). For the government, housing also constituted a mechanism to regulate economic growth, immigration and family formation.

In the 1980s, governments began to question whether homeownership was such a good thing after all. Growth of the owner-occupied sector led to rigidities in labour markets as well as over-investment in housing property, which inhibited economic performance. There was further concern with over-sizing of homes and suburban spread. Also, by the 1980s it was becoming clear that tax benefits provided to homeowners as an indirect housing assistance were poorly targeted and overwhelmingly benefiting the rich (Flood and Yates, 1987). In 1986, the Federal Government deregulated the finance industry and removed many advantages of preferred access to funds. It was also apparent that the direct assistance scheme for home-buyers was, rather than facilitating homeownership, only advancing the entry by a few years of households who would have entered the market anyway (Bourassa et al., 1995). This scheme was suspended in 1990.

In the late 1990s, Howard's Liberal government began to refocus on property ownership in terms of developing an economic-liberal agenda. There was a dramatic boom in housing property values and a significant expansion of house price to income ratios. Household mortgage debt also increased substantially from 45 percent of total household liabilities in 1990, to 69 percent by 2001, while net housing equity

declined from 89 to 74 percent (ABS, 2002). With the housing market boom, property became increasingly important as an economic investment. Individuals were encouraged to invest and speculate in order to build up enough equity to provide security for themselves and their families. At the same time, growing numbers of households found themselves excluded from the owner-occupier housing market by house-price inflation stimulated by over-investment. In 2000 direct assistance for homeowners was re-introduced (First Homeowners Grant). This measure was thought to help make homeownership more affordable, but inevitably fed inflation (Productivity Commission, 2003). This grant has no means testing and no restriction on the value of the property. Substantial imbalances have emerged in the housing system, which are not unrelated to the pronounced imbalances in financial advantages. The tax system provides most assistance to older, outright homeowners whereas younger, low-income homeowners receive the least (Yates, 2003, p 20).

## CONVERGENCE AND DIVERGENCE

The development of the housing systems in Britain, America and Australia demonstrate considerable diversity, challenging the notion of policy or system uniformity within an Anglo-Saxon market-liberal model, or consistency in housing system approaches across the 'liberal' welfare regime. Tables 1 and 2 illustrate these differences and the various market intervention measures taken to support homeowners, and figure 1 shows the different trajectories of homeownership increases. The following analysis first focuses upon key points of departure between these societies in terms of dimensions of commodification and ideology before going on to address critical points of convergence. The unified model of market-liberal homeownership set out has been considerably significant in driving housing markets more globally, but in itself has begun to show signs of exhaustion and vulnerability.

### Commodification

Harloe suggests (1995) that in liberal

**Table 1: Housing profiles in Anglo-Saxon homeowner societies**

	<b>Britain</b>	<b>USA</b>	<b>Australia</b>
Homeownership rate	70%	69%	68%
Social/Public rented housing	Housing Assoc 8.2%, Council Housing 10.7%	2%	5%
Private rented/other housing	11%	29%	27%
House-price increase 1997-2005	154%	73%	114%
Mortgage-debt/GDP ratio	73%	69%	82%

*Sources: ABS, 2007; DCLG, 2006; US Census Bureau, 2006*

capitalist regimes, where there are greatest opportunities for capital accumulation, there is least likelihood of de-commodification in the housing sector. However, in terms of the welfare system and the role of housing within it, each country demonstrates variation in levels and dynamics of de-commodification. Although Britain has largely been orientated towards free markets and possessive individualism, there have been sustained periods when Labour governments have successfully nurtured de-commodified forms of public rental housing. In the post-war period particularly, along with the expansion of the welfare state and in response to massive housing shortages, Local Authorities established a

large social housing sector. The expansion of homeownership up to 1980 occurred in parallel with public housing sector growth, which de-commodified relations in the housing system as almost a third of households relied on the state as a provider and had artificially set rents. The social rental housing sector in Britain thus stands out among liberal homeowner societies. It still constitutes 19 percent of housing (table 1). However, housing policy was not central to the welfare state and public housing provision was not a means by which the political left sought to undermine either private homeownership or commodified relations more generally. The reverse case is more evident as housing was central to

Conservative policies in the 1950s and 1980s which sought to undermine the social-collective features of housing objects and their de-commodified consumption. Commodification of housing has since become so embedded that its reversal, a return to direct state provision, is now almost unimaginable. New Labour has persisted with the commodification of housing, and subsidized forms are, in future, likely to be distributed under market conditions.



**Table 2: Pathways and Features of Anglo-Saxon homeownership systems**

	<b>Britain</b>	<b>USA</b>	<b>Australia</b>
Key Events for Homeownership Policy	<p>1923 and 1924 Housing Acts: subsidy for private and public construction</p> <p>1945-1950 Labour Welfare State: Local Authority mass public-housing construction</p> <p>1955 Conservatives set out Property Owning Democracy, homeowner construction increases</p> <p>1974 First restrictions put on Mortgage Interest Tax Relief (MITR)</p> <p>1980-1988 Right-to-Buy legislation</p> <p>1985-1986 Housing finance deregulation</p> <p>2000 MITR finally abolished</p> <p>2000 White Paper: 'Quality and Choice, A Decent Home for All'</p> <p>2003 Low Cost Homeownership Task Force</p> <p>2005 Plan to expand homeownership to 75%</p> <p>2006 HomeBuy</p>	<p>1932-1942 Federal Housing Association, Federal Savings and Loan Insurance Corp, Reconstruction Finance Corp and Federal National Mortgage Association (Fannie Mae) established</p> <p>1944 'GI Bill': veteran home-loans introduced</p> <p>1949 Housing Act, Section 502</p> <p>1965 Housing and Urban Development (HUD) dept elevated to cabinet agency</p> <p>1968 Fannie Mae privatized (Ginnie Mae takes over public functions), Section 235</p> <p>1970 Federal Home Mortgage Corp (Freddie Mac)</p> <p>1987 Section 235 ends</p> <p>1990 First HOPE scheme</p> <p>1994 Clinton homeownership reforms</p> <p>2002 American Dream Down-payment Act, Funding extended for self-help homeownership schemes</p> <p>2007 Expanding American homeownership Act</p>	<p>1919 War Services Homes Act</p> <p>1928 Commonwealth Housing Act</p> <p>1931 Mortgage Relief Act</p> <p>1936 Australian Housing Trust</p> <p>1941 Building Societies Act</p> <p>1944 Commonwealth Housing Commission</p> <p>1945 Commonwealth-State Housing Agreements</p> <p>1947 Landlord Tenant Act</p> <p>1964 Home Savings Grant Act</p> <p>1982 Home Deposit Assistance Scheme</p> <p>1983-1990 First Home Owner Scheme</p> <p>1986 Federal deregulation of finance</p> <p>2000 First Homeowner's Grant re-introduced and in 2001 increased for those building or purchasing a new home</p>
Measures to Support Owner-occupation	<ul style="list-style-type: none"> <li>- Mortgage market deregulation</li> <li>- Right-to-buy for public and housing authority renters</li> <li>- Shared-ownership, shared-equity and low-income homeownership schemes</li> </ul>	<ul style="list-style-type: none"> <li>- Securitized mortgage market through GSEs making credit cheaper for homeowners</li> <li>- Mortgage guarantees</li> <li>- Tax Relief on Mortgage Interest</li> <li>- Subsidized down-payment and self-help schemes</li> </ul>	<ul style="list-style-type: none"> <li>- Mortgage market deregulation</li> <li>- Homeowners grants for first-time-buyers</li> <li>- Substantial tax advantages for owner-occupiers, especially un-mortgaged ones, and buy-to-let (negative gearing)</li> </ul>

There has been consistent political resistance to public welfare goods in the USA, with housing as no exception. Despite considerable government subsidization to facilitate cheaper rental housing for poorer households, funds have largely been distributed to private construction companies rather than in forms that would de-commodify consumption or promote dependency on the state. Direct user subsidies are available (Housing Choice Vouchers) for low-income renters, but support individuals in the private market rather than provide an alternative to it. A small residual of government rental housing has been provided (2 percent) as a basic, temporary safety-net for the poorest households. There have been points historically where housing conditions have required considered intervention, although intercessions have rarely challenged the interests of private enterprise. Despite the resistance to welfare policies, owner-occupied housing is the target of direct subsidies and constitutes a form of social housing (compensating the market position of low-income groups). The housing market is also a point of considerable state intervention: the FHA guarantees mortgages; GSE securitization supports fixed-term, lower-interest conditions. Nevertheless, expanding owner-occupation has exaggerated inequalities between owners and non-owners and stretched the resources of lower-income families. It has also enhanced individual market dependency and vulnerability to economic fluctuations.

In Australia (5-6 percent public renting) housing commodification and de-commodification follows yet a different pattern. While the influence of labour movements has been considerable, the political left has not forced through substantial welfare housing measures. A hegemonic consensus has formed, following the logic of the 'workfare' system, asserting that access to private homeownership is important to working-class interests and a source of collective solidarity. Indeed, homeownership was seen to expand expectations of worker's rights (Troy, 2000). While the features of

Australian housing and welfare have not been as de-commodified as in Britain, they are also not as focused as in America on private enterprise or as resistant to goods provided on the basis of citizenship rights and in competition with markets.

#### ***Ideological divergence***

We can consider features of ideological divergence in terms of two dimensions: tenure discourse and hegemony. Tenure discourse denotes the meanings and values associated with tenures which have influenced policy preferences. Although we should be cautious of essentialist claims of a cultural tenure predisposition, there appears an alignment in America and Australia around a 'tradition' of housing self-provision tied up with the immigrant-settler origin of both nations. Homeownership has been integrated with a 'national dream' which mythically epitomizes a way of life and values of a society. These dreams have often been borrowed in political rhetoric, with the discursive assumption that homeownership gives individuals a 'stake in the country' and is important in nation building. It is more difficult, however, to square the British case with the homeowner dream. The experience of tenure transfer is more extreme with only ten percent homeownership less than 90 years ago and a large and relatively successful post-war social housing program. Britain demonstrates greater historic ambiguity in tenure ideologies and only in recent decades has rental housing become so stigmatized.

Hegemony is an ideological dimension that has been, historically, at the heart of tenure policies. Between world-wars, in all three societies, a consensus formed mooting the expansion of working-class homeownership as a potential antidote to both the decline in the private rental sector, on one side, and labour-union agitation, social unrest and demands for the expansion of citizenship rights, on the other. There was also an assumption that homeownership would improve civic responsibility and encourage support for conservative political parties. Or put in more cynical terms, enhanced dependency on waged-labour and property

relations (engendered by mortgage requirements) would encourage bourgeois ideologies of property ownership, and support false-consciousness (Berry, 1986). While there is limited evidence that owner-occupation has political effects or 'improves' citizens, politicians and planners have, arguably, pursued tenure policy strategies with the intention of consolidating conservative hegemonies, or at least undermining collectivistic ones. In post-war Britain, Macmillan, Eden and Thatcher specifically identified housing policy as a means of building a conservative hegemony, just as Menzies had in Australia. In the US however, the conservative aspects of homeownership were not so evident politically. Although homeownership represented a bulwark to bolshevism in the 1920s (Vale, 2007), American political parties have not relied on homeownership as an equipoise of political power to the same extent evident in political discourses in the other Anglo-Saxon homeowner societies where there has been a stronger lobby for direct state housing provision.

#### ***Convergence***

Despite international differences in the evolution of homeownership systems, housing approaches have demonstrated growing convergence in recent decades. Specifically, Anglo-Saxon homeowner societies have experienced greater housing market and finance deregulation, further decline in social-rental-housing sectors, greater expansion of homeownership, and increasing orientation around an asset-based form of welfare. Moreover, in the last two-decades housing policies and discourses have consolidated housing relations around practices complementary to these system changes, to constitute housing objects as private commodities that are most effectively provided by markets and consumed by purchase rather than rent. King (1996) considers the re-signification of 'dwelling' from an activity of living in a home to a marketized object as a transformation that fundamentally realigns social relations under capitalism. The same practices have simultaneously undermined the status of housing as a merit good that can be best supplied by the state. At the

same time, the viability of rental housing (private or public) has also been diminished as the category of the tenant has been decoupled from notions of full and responsible citizenship. Mature adulthood 'requires' the eventual market 'investment' in a housing property in order to provide individual and family security (Ronald, 2008).

Despite the diverse historic pathways of housing systems and uneven patterns of de-commodification, the emergent trend is convergent around a particular type of commodification. Harloe (1995) identifies a process of 're-commodification' across western societies, which in the countries we have considered is more or less pronounced depending on preceding levels of housing de-commodification. Shifts in policy are clearly convergent with a specific tenure policy model that aims to expand the tenure to as many households as possible, especially lower-income ones who have traditionally relied on private-renting or state provision, while shrinking the social-rental housing sector to a residual. The purpose of the private-rental sector is to fill the gaps, supporting a housing-ladder into homeownership.

We may therefore, provisionally, identify three stages of development in Anglo-Saxon homeownership approaches. The first stage began in the 1920s or 30s, marking an initiation of state intervention in the housing sector. This period also coincides with a rise in working-class political mobilization, global decline in systems of private landlordism, and failures in housing finance. Intervention involved accepting a government role, identifying homeownership as the most appropriate tenure for both economic and socio-political reasons, and establishing a framework of financing and construction to support the growth of the tenure among the lower-middle and working-classes. This step was usually balanced by some elementary public housing provision for the very poor. The second-stage involves a form of moratorium in state support of homeownership, or at least a fragmentation of housing policy strategies involving other

tenures. This occurred in Britain in the early post-war period and involved the mass-construction of public rental housing by Local Authorities. In America it developed during the 1960s and 70s which saw substantial state resources go into rental housing as a means of dealing with housing needs of urban minorities and low-income families. In Australia the moratorium is less extreme, but was evident in the 1980s when authorities began to question homeownership policy, withdraw direct-assistance and reconsider tax allowances. The third-stage that these homeowner societies have entered most recently may be considered a period of 'total homeownership policy' representing a point in the status of the tenure where it is almost universally considered the 'best' or 'natural' way to produce and consume housing. The viability of rental tenures is simultaneously undermined and stigmatized, and tenure perceptions become polarized (Ronald, 2008). This shift arguably began in Britain in the 1980s under Thatcher and the 1990s in the US and Australia. The strength of commitment to homeownership has been reinforced by rapid house-price inflation and expansions in global finance.

This transformation and convergence constitutes the movement from diverse Anglo-Saxon types to a more consistent market-liberal homeownership model. The common ideological orientation of homeownership has become primarily neo-liberal, restructuring responsibilities for welfare between the state, the individual and the market, with a fundamental transference of risks, should economic or household circumstances change, to individuals. The concept of 'asset-based welfare' strongly embeds housing property ownership with the neo-liberal restructuring of governance and welfare systems. It denotes a shift away from a welfare state to a social investment state, where the role of government is to build up individual capacity and self reliance (Sherraden, 2003). Investments by individual households in properties or financial products which augment over time provide a base from which to procure welfare services from the market. Groves, Murie and

Watson (2007) identify how policy measures have increasingly sought to encourage people to fend for themselves in older age through acquiring property and building up wealth through buying and selling houses (p 190). The neo-liberalization of housing and welfare are thus intertwined and strongly pronounced in Anglo-Saxon homeowner societies.

Policies generate practices that encourage households to believe they are best-off attempting to accumulate individual reserves through investment in their own housing properties in order to ensure economic security, and that the market is the most effective means of facilitating this. In this way homeownership practices help shift emphasis from the government to the market. This process involves a multiplicity of discourses that restructure perceptions of housing objects in terms sympathetic to the operation of markets. Individualization and marketization also erodes expectations of, and rights to public goods, thus undermining 'universal citizenship' in favour of a form of citizenship achieved through property ownership (Gamble, 1988). Discursive processes constitute homes as commodities and summon-up particularly types of market-investor subject. While government actions reflect, constitute and reinforce such discourses, individuals have, to varying degrees, embraced the restructuring of housing practices around market 'risks' (constituted as choices and opportunities) and realigned expectations of citizenship rights and state responsibility for individual well-being and thus their own subjugation to neo-liberal market relations. Furthermore, evidence suggests that values of economic prudence, security, status, permanence and adulthood etc, have become embedded with owner-occupation in these contexts, and that these values support the assertion that homeownership is 'natural' and creates 'better' households (Richards, 1990; Murie, 1998; Gurney 1999).

The constitution of housing as a market object undermines the viability of housing as a de-commodified good and the state as a housing provider. The process of commodification is ostensibly stronger in

the British case due to the historic embeddedness of social-housing, and as such 're-commodification' may mark a more radical shift in relations between individuals and the state. In America and Australia, housing commodification has been more embedded and resisting de-commodified practices in homeownership policy have not been such a concern. This is apparent in comparisons of subsidization measures for homeowners. Whereas the US and Australia have provided incentives and subsidies that undermine market mechanisms (subsidized federal mortgages, mortgage interest tax-deductions and first-time-buyer's grants), British homeownership subsidies have been more commodified or complementary to market-competition (table 2). Discounted purchase of public-housing and shared-ownership have thus been primary incentives.

#### **A financial model**

Arguably, most significant in the alignment of Anglo-Saxon homeownership around a market liberal model is the convergence of systems around housing finance practices, which have become increasingly dynamic, sophisticated and far reaching. Housing systems were increasingly marketized and deregulated in the 1980s and 90s in line with a shift to 'total homeownership policy'. Economic globalization and the deepening of flows between local and international markets accelerated and expanded the scope of housing finance systems (Zhu, 2003). Expansion was also in part due to increasing sector competitiveness and supported by the redistribution of risks from intermediaries to borrowers and third parties. Other economic and regulatory changes also enhanced market competitiveness: growing numbers of loan insurance mechanisms; valuation systems based on current market values; high loan to value ratios and long duration loans; foreclosure laws which allow relatively quick repossession, etc., (Stephens, 2003, 1014). Housing markets have consequently become more dynamic and volatile following mortgage market liberalization and deregulation, characterized by speculative booms and busts. They are, furthermore, more interconnected, and

while this may facilitate a broad distribution of economic risk, it also makes each country more vulnerable to the economic vicissitudes of others.

Market orientated housing systems now sit within a wider context of global financial integration and global competition. Although individual real estate transactions appear parochial and are mediated by local mortgage systems, a 'complex and diffuse institutional architecture' determining qualification, borrowing levels, interest rates and repayment periods exists (Forrest, 2007, p 40). Moreover, the architecture of this system is opaque with limited knowledge of where money originates and who bears the risks. Trade in mortgage asset portfolios means that local lenders are usually part of an investment chain and locked into the international capital market. Concomitant with the growth of international housing finance in and around market-liberal societies has been the decline of state capacities to respond to housing needs and demands. National governments have increasingly relied on, and handed powers to international markets and financial agents, adopting a form of governance that provides little for citizens directly but instead requires management of market systems and risks. Dymski and Isenberg (1998) suggest that this necessitates greater government activity rather than less. Indeed, mortgage securitization in America has required government underwriting of mortgages and, since 2007, has necessitated drastic steps to cover borrowers and some lenders from the fall-out of the subprime crisis.

#### **Global influence**

In recent years, the market-liberal model of financial deregulation and pro-homeownership policies has promulgated neo-liberal systems and ideologies in an increasing number of international spheres. The global prescription for housing policy reform has been a 'concoction of privatization, marketization, de- or re-regulation and institutional fragmentation' (Forrest, 2007, p 43). In developing and transition economies in particular, housing marketization and privatization have been

regarded as prerequisites for broader social and economic transformations. Housing finance has been a particularly effective backdoor for technologies and forces of commodification and neo-liberalization because of its role as both macro-economic driver and individual-mediator of household wealth. Even developed countries with strong social housing and public welfare traditions have sought to privatize housing, driven by pressures of national competitiveness and attracted by what was, until very recently, a successful image of globalized financialization. In the last decade, homeownership rates have thus grown the most dramatically in developed societies that have historically been least orientated towards homeownership (Atterhög, 2005). The Netherlands, for example, despite the embeddedness of its social housing sector, has seen homeownership grow from 45 to 55 percent of stock between 1990 and 2006, with house prices increasing 92 percent between 1997 and 2005, and housing debt, as a percentage of GDP, increasing from 43 to 111 percent between 1992 and 2005. Such societies have also become enmeshed in global networks of housing financialization through their banking sectors and have proved vulnerable to global shifts in real estate. For example, the German finance sector, despite low homeownership rates, secure mortgage conditions and a relatively inert housing market, suffered substantially from recent US subprime crashes because of the involvement of German banks in mortgage securities trades.

#### **Convergent issues**

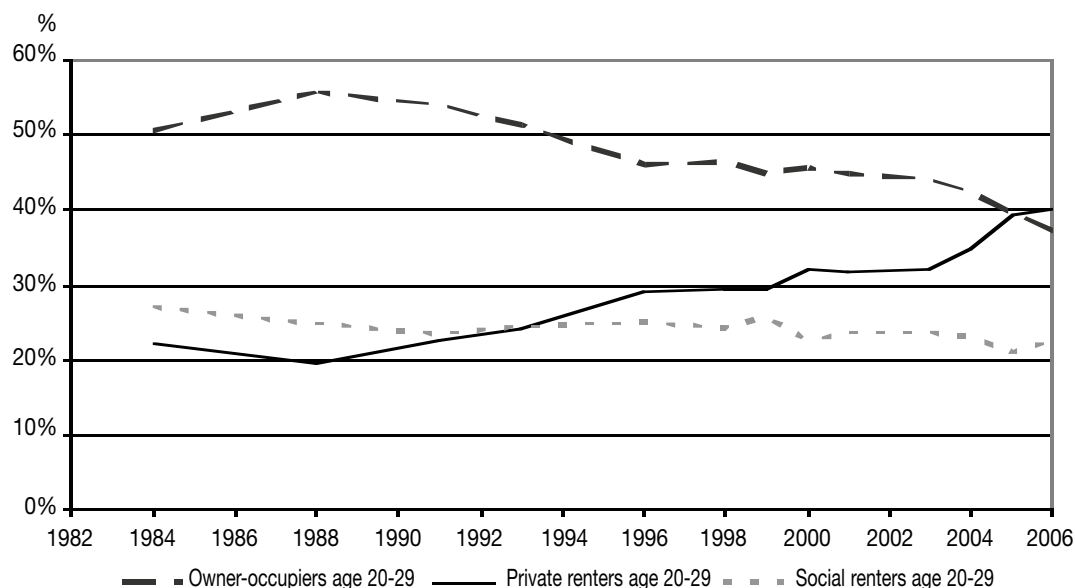
In the last few years, market-liberal convergence in Anglo-Saxon countries has also begun to have destabilizing effects in housing and social systems. Specifically, poor affordability in context of less secure labour market conditions and the decline of public social safety-nets have forged a significant divide between generations of homeowners and would-be house buyers. One outcome has been a marginal decline in homeownership rates in the last two years. Indeed, despite diverse national trajectories, home ownership rates peaked at around 68-70 percent in the 2000 before

beginning to drop (figure 1). It appears that the main driver of this decline is falling rates of homeownership among younger cohorts. The decline in young first-time-buyers (FTBs) in Britain is illustrated in figure 2. While FTBs once made up nearly 50 percent of annual market transactions, the figure is now only 30 percent, constituting a 40 percent reduction between 1986 and 2005. Nevertheless, declines do not reflect any change in preferences as the overwhelming

majority of households still aspire to this tenure (Pannell, 2007). In Australia too, the rate of owner-occupancy among 25-34 year olds dropped by 10 percent between 1981 and 1996. Government responses have sought to enhance accessibility and affordability in the housing market through measures to support home purchase, rather than developing other tenures. The advancement of homeownership subsidies that once aimed to stimulate growth in the

sector have now become necessary to slow decline and ensure a flow of young people into homeownership. Subsequently, after almost a century of decline, rates of private renting in the UK have increased from 9.8 to 10.8 percent of housing between 2000 and 2005.

**Figure 2: Tenure trends of young households in the UK**



Source: Survey of English Housing, 2006

A significant divide is emerging between owners and renters, and between older owner-occupiers, with substantial housing equity, and young ones with considerable debt and mortgage commitments. Those with greatest housing wealth, who entered the market before recent rapid house price inflation, have increasingly sought to maximize their wealth by further investment in housing. Between 1998 and 2004 the value of outstanding buy-to-let mortgages in Britain rose from £2 billion to £47 billion (Pensions Commission, 2004). By 2006, buy-to-let purchases accounted for 12 percent of total purchases, up from four percent in 2002. In Australia too, as many as a third of homeowners own at least one other property, and in the US second

property purchases now account for 40 percent of sales (NAR, 2006). Second-home investors have effectively extended the limits of house-price inflation and priced-out many potential FTBs. Moreover, new homebuyers are entering under more precarious conditions that stretch household budgets, although it is unlikely that they will enjoy the same gains made by previous generations. The long-term outcome in Anglo-Saxon societies (with growing imbalances between working and retired populations, and expected pensions shortfalls), will be an increasing polarization of wealth and greater dependence on state provision among younger and socially marginal groups. Homeownership policies that hoped to facilitate the greater capacity

of households to provide for themselves may thus be driving greater in-affordability and reducing capacity, necessitating a more substantial state role in market and system regulation. The broader social and economic effects may also be considerable, and associations are already being made between declining accessibility to homeownership in societies where it is deemed necessary for secure family life, and declines in family formation and fertility rates (Mulder, 2005).



## Conclusions

It is evident that there have been diverse, ideologically charged system pathways in the proliferation of owner-occupied housing in the Anglo-Saxon societies examined here. These countries arguably represent the most influential examples of a market-liberal model, although there is even further diversity when one considers housing histories in Ireland, Canada and New Zealand, etc. There has, however, been considerable alignment in recent decades around a particularly neo-liberal homeownership model that structures more commodified housing practices. This model has increasingly constituted a form of 'tenure imperialism', channeling and prescribing internationally a singular view of private housing provision, finance and consumption. The cultural ideal of homeownership has fed fatalistic policy realignments around the superiority and inevitability of markets, which have been mutually reinforced in the last decade by house price inflation and mortgage credit globalization.

The market-liberal homeownership model now stands at a crossroads. The economic climate is shifting and it is likely that government promotion of owner-occupation in the next decade will proceed under considerably less favourable conditions. Problems of both affordability and credit availability will dominate the housing agenda, with governments required to intervene even further in guiding and regulating the market. Nonetheless, the market-liberal homeownership model is unlikely to diminish much as the restructuring of welfare and pension systems has been bound up with the past expansion of homeownership and house prices. This means that governance, the maintenance of power and political legitimacy, as well as economic stability, now necessitates the support of homeowners and housing market conditions.

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# Better Foreclosures make for Better Access to Mortgage Lending

By Bruno De Gasperis, Managing Director, Asteimmobili.it SpA

## INTRODUCTION: Italy, a case study

In Italy the average length of foreclosures - until a few years ago - exceeded 60 months, with peaks above 90 months. Currently this situation is slowly improving, however many Courts still perform no better. This inefficient credit recovery process brought about a number of consequences:

- an enormous and growing backlog of pending cases in most Courts, where the number of new filings exceeded the number of those settled each year;
- a constantly deteriorating outlook of Court activity;
- a decreasing confidence of citizens in their ability to enforce their rights, a feeling also affecting the economic activity as a whole;
- excessive legal costs;
- additional financial losses for lenders, due to the length of time their credit remained outstanding.

Additional, negative consequences of the inefficiency of the judicial auctions were:

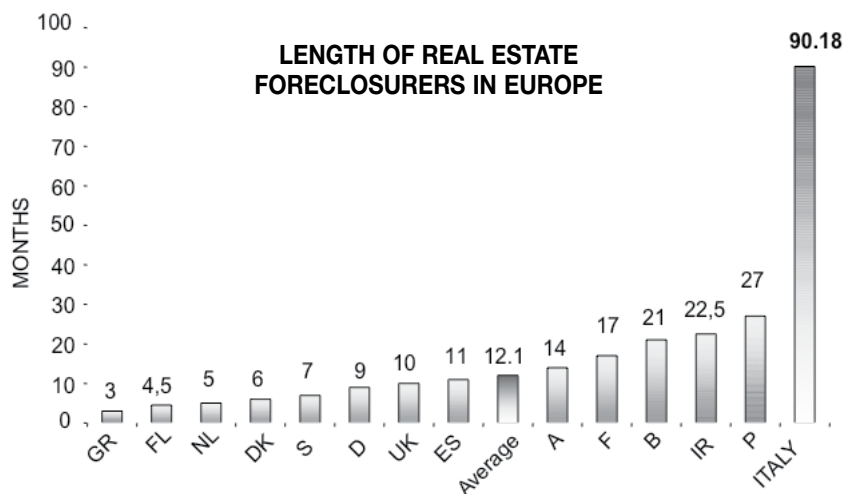
- very low selling rates (approximately only 5% of all the auctions concluded with a sale), further adding to the backlog and workload of Courts;
- extremely unsatisfactory sales prices, which on average barely reached 50% of the corresponding expert valuation. This increased the losses of the creditors (mainly banks), since while their credit outstanding kept growing (due to the interest accruing throughout the long-lasting procedure), it could be only partially offset by the amount recovered through the sale.

The reasons for this unacceptable and deteriorating situation were the following:

- the general public had no easy access to the notice of auction (issued by the magistrate supervising the foreclosure), which is the relevant information for anybody wishing to participate to the

auction. This notice was published with very succinct ads on the local newspapers which only courts practitioners could really spot and understand. Thus, people would simply not show up at the sale for mere lack of information; as a consequence, many sales were concluded at the 2nd, 3rd or even 4th attempt, with substantial discounts over the expert valuation of the repossessed property;

- even those who received the information were often discouraged by the tiresome effort to collect the auction documentation, which required physically going to Court, filling out formal applications and generally ended up in the need of some form of legal assistance, which obviously had to be paid for;
- a condition to the actual participation to the judicial action was the availability of substantial cash, both for making the initial admission deposit and, later, for the payment of the balance in case of a winning bid;
- all the above (reduced attendance, obscure legal bureaucracy and large cash requirements) jointly conjured to render judicial auctions a very suitable prey for so called "professional bidders": usually people well connected to the Courts and trained on the foreclosure procedure, systematically monitoring the auctions of a given Court and reaping the benefits of cheap deals. Sometimes they could prevent sales to other bidders by exploiting legal instruments (like making a late bid in the excess of 1/6 of the price offered by the winning bid) but more often their behavior included some illegal dealing, like scaring off other potential buyers with physical threats just outside the Courtroom.



Source: ISTAT and EMF year 2004

### **Difficult foreclosures: a concern for lenders, borrowers and Courts alike**

As we have seen, foreclosure inefficiency had a widespread impact on the economic activity and on the social behavior of the entire community: in the banking system economic consequences were only more direct and visible, since low credit recovering ratios even for secured lending could not go unnoticed by banks.

Credit losses and cost of lending have an obvious correlation, which in Italy was more evident under the preparation for the fast approaching Basle 2 Accord implementation, concerning banks' capital adequacy and prudential supervision.

The new supervisory approach – which became effective in Europe on January 1st, 2008 – links the banks' capital adequacy to the riskiness of their portfolio. Credit risk is assessed through the use of public ratings or the calculation of internal ratings by the banks themselves: both alternatives are based on the assessment – among others – of the Loss Given Default ratio (LGD), which is just another terminology for expressing banks' ability to bring back the money they lent, in case a default occurs.

As a consequence, in Basle 2 the performance of the judicial proceedings to foreclose on mortgaged assets is given an explicit impact on banks' solvency ratios. A riskier loan requires more regulatory capital; this raises the cost of capital for the bank, which in turn will transfer this additional cost to its risk-adjusted loan pricing policy. Eventually this mechanism makes for an additional premium to be added to the final cost of lending: in other words, the inefficiency of the foreclosing procedures has to be factored into the banks' lending rates.

Applying a "rule of thumb" such premium was estimated by some market practitioners in up to 100 basis points. While this figure might have been overestimated, it is a fact that banks in Italy do include a specific margin for this purpose. Such premium is applied by both domestic and International banks, being a consequence

of the malfunctioning of the local courts. Indeed, the presence of International banks in the Italian retail credit market has not been significant for many years and the difficulty to foreclose was often claimed to be a major cause for that.

Having mentioned the Basle 2 Accord might lead to the conclusion that the link between foreclosure performance and lending rates is only applicable in those countries which decided to implement the Accord. That would be mistaken: the same can be said for countries where banks are not complying with the new capital adequacy rules, because the underlying rationale (of adjusting the lending rate to the credit risk) is (or should be) pure common sense in any banking environment.

If lenders are concerned, borrowers are too. The latter are affected in two ways: (i) their cost of borrowing is higher in comparison to countries where executions are quicker; and (ii) fewer lenders are prepared to enter the mortgage market (only over the last 6-7 years a few international banks have really begun to expand into the Italian retail credit market).

The third party involved in the matter is the judicial system, which also can benefit by better auction performances. We have seen that courts were overwhelmed by the number of foreclosures they had to deal with, and every year the balance of settled cases vs. new ones was negative, so that their backlog grew steadily in many local jurisdictions.

### **A new practice without a new law: better advertising, better marketing, better sales**

As shown, reasons for the unsatisfactory situation of foreclosures in Italy were several, some stemming from the judicial system itself (malfunctioning of the Courts, insufficient number of magistrates, burdensome legal provisions, etc) some other more dependant on the individual behavior of the many parties involved.

A comprehensive solution would require a wide range of initiatives involving a number

of players: a new bankruptcy law (Parliament), some improved practices in the functioning of the Courts (Ministry of Justice, Presidents of Courts), specific training of magistrates on the use of modern Information and Communication Technology (ICT) and, of course, some major uphaul of the auction mechanism (judges, economic agents, possibly Ministry of Justice).

Conceiving an all-encompassing project would have been an overwhelming task. This has discouraged most involved parties from actually making the first step forward, leading to a standstill that lasted for years. Eventually the initiative was taken by the banking system, through its industry body (Italian Bankers' Association) which – while lobbying the Government to act in its own domain (new law, new Court functioning) – also launched a self-help project concerning the issues that could be dealt with more quickly and independently from legal or regulatory measures.

The choice was made to focus on the inefficiency of the judicial auctions, the last stage of foreclosure, where approximately 50% of the repossessed property value was lost. Reasons for this inefficiency had already been clearly identified (see above) and solutions too. It was believed that an independent effort – with some cooperation by the magistrates managing the foreclosures – could be successfully based on better marketing techniques for repossessed properties and use of cheap and accessible technology.

The final project objective was to achieve better auction sale prices in a shorter timeframe (possibly at the first sale attempt).

Immediate objectives included:

- inducing a larger number of participants to the judicial auctions;
- increasing transparency and bidding competition;
- allowing a much easier access to the documentation relevant to each sale (judge's notice of auction, expert valuation, cadastral certification and mapping, starting price, date of auction, rules of participation etc);



- making loan finance available to prospective bidders so as to overcome the cash requirements to participate at any judicial auction.

**The project: a new internet Portal was born ( [www.asteimmobili.it](http://www.asteimmobili.it) )**

The Internet was identified as the instrument which could allow the achievement of the project objectives. The Italian bankruptcy law at that time required advertising the judicial auctions only in the press, while use of any other media was simply an additional possibility very seldom implemented by order of the interested magistrate (in case he did, the relevant publicity cost was to be borne by the foreclosure) or by request of the creditors (in this latter case at their expense). So, at the time the project was conceived (2001) internet advertising came as a big innovation which not every Court was prepared to accept.

The idea was that a web Portal would allow a much more effective advertising of foreclosures, reaching far beyond the circulation of local newspapers and - most important of all - carrying a lot more information. Space in a daily newspaper is extremely expensive and so auction advertising is normally done in a very succinct way, barely mentioning the name of the judge in charge of the case, the date of the auction and the starting price. Not enough for anybody to decide to invest several thousands euros in a dwelling, which by the way could not be visited.

The Internet was a breakthrough in this respect, not only because each announcement is cheaper (currently 120 euros per ad) but also because it bears no space limits and all the relevant documentation can be uploaded onto the website. Legal documents, photos, videos and satellite maps etc. all fit in and so are only "a few clicks away" from anybody's computer.

A Portal was created ([www.asteimmobili.it](http://www.asteimmobili.it)), managed by a joint stock company (Asteimmobili.it SpA) whose original

shareholders was a group of 15 banks. Its mission was (and is) to promote more efficient legal foreclosures and increase transparency of public auctions. Benefits were expected for all the parties involved, namely:

- *creditors*, who would recover their loans more quickly and to a larger extent;
- *debtors*, who would benefit from a better chance to pay back their loans and still walk away with some money left;
- *investors*, who would freely exploit the opportunities of this substantial real estate market niche.

Share capital of the new company was not a significant issue, since the investments needed to start the website were relatively affordable (however in 2006 the Italian law has set at 450,000 euros the minimum share capital of companies running such websites).

The business model is straightforward: the website is accessible for free without mandatory registration of the users; each auction announcement is paid for by the foreclosure itself (in case publicity is ordered by the judge's "Order of sale by auction") or by the creditors (whenever the publication is made at their request, as a supplement to whatever publicity is ordered by the judge).

From the operational point of view the uploading process is the most labour intensive stage, since it is based on collecting, scanning and digitally storing the documentation relevant to the foreclosure, almost without exception existing only on paper.

Initially it took some promotion to talk judges into this new venture; however, eventually a number of courts - led by the magistrates who had been at the forefront of the fight against the low auction performance - understood that internet advertising made economic sense, because its (cheap) cost could be very easily compensated by a better sale price, especially for items of substantial value as for real estate ones.

So they got on board and started including

internet advertising in their "orders of sale by auction". The new website quickly gained in popularity and its success was regarded as a "good practice" to be adopted by as many courts as possible. In 2006 a law was eventually passed to render auction advertising mandatory also in the internet.

**Facts and figures of the Web portal**

The portal features 3 different search possibilities:

1. by geographic location;
2. by court;
3. by price level.

The company has so far finalized commercial agreements with over 70 courts throughout the whole Italian territory for the provision of publicity services. Its visibility has soared, reaching 152,000 single users and having almost 3 million pages visited during December 2007, with a steadily growing trend.

Budget revenues for 2007 are estimated in excess of 8.5 million euros, enough to extract a slim profit. However, it is not only by corporate revenues and profit that a project like this should be measured. What matters most is the impact it has relative to its main objectives, namely to increase auction sale prices and reduce length of foreclosure proceedings. In this respect, over the period January 1st - October 31st, 2007 the Portal published information concerning 11,615 real estate judicial auctions, whose cumulative starting price totalled 467 million euros. Sale prices of the same auctions eventually summed up to 566 million euros, thus showing a remarkable increase of about 100 million euros (or 21%) over the starting cumulative sale price. This was achieved by having an increased number of auctions which concluded a sale at the 1st attempt, thus also making the foreclosure shorter.

While these positive figures - relating to just the first 10 months of 2007 and to only 70 courts (overall there are 162 in Italy) - may not be due solely to the introduction of



internet promotion (other innovative measures were in the meantime also introduced to improve foreclosure performance), they do provide a rough and ready measure of the great economic value of any such initiative, to be compared with the modest investment required to get it started and going.

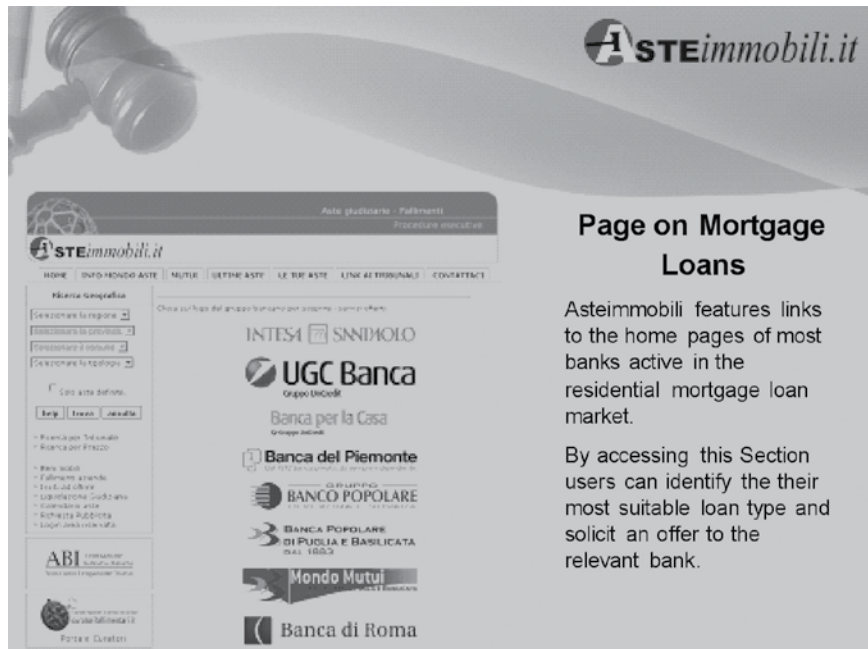
### Loan finance for judicial auction participants – an added feature to the Project

We have briefly mentioned in the introduction paragraph that one major constraint to auction participation was the substantial cash requirements imposed on bidders by the Italian bankruptcy law. In essence, any bidder has to:

- make a cash deposit equal to 10% of the auction starting price in order to be granted participation in the auction by the judge overseeing the foreclosure;
- make a cash payment for the balance of the sale price within 30 days from auction date in case of a winning bid.

However, the Italian Parliament in 2005 passed an amendment to the Bankruptcy law which allows banks to grant mortgage loans to bidders in a judicial auction, so that the (granted) loans can be used as cash to pay for the price due in case of a winning bid. Technically speaking, the mortgage becomes legally enforceable only by its inclusion in the “delivery order” to the winning bidder signed by the judge of the foreclosure. Yet, on practical grounds, the new law provision does permit auction participation to those prospect buyers who do not have enough cash of their own.

Having said that, the project was quick to incorporate this new element - which also needed to be publicized - and created a specific page on its website featuring links to the home pages of most banks active in the residential mortgage loan market. By accessing this section of the web portal, users can identify their most suitable loan type, simulate the relevant repayment plan and solicit an offer by one of the listed banks.



### One more step forward: introducing online judicial auctions

The successive goal – or just the “next” project to be implemented – will be introducing online judicial auctions. It might sound like an old idea by now, due to the fact that auctioning in the web is already a widespread practice, with some outstanding success cases. Yet, auctioning as a part of a foreclosure is quite a different story from what we have grown accustomed to in the regular market.

Foreclosures must follow legal provisions, which in turn were thought of at a time when the Internet did not exist. Fitting the “dotcom rationale” into a legal framework for collateral execution, especially for a repossessed real estate property, is much more complex than auctioning a camera or a table freely put on sale by their owners. Indeed, online legal auctions are still unheard of in the Italian Courts, as well as in the courts of many other countries.

So, approximately in Spring 2006, the Asteimmobili initiative was expanded to this new field of research, with the objective to develop a specific and totally new bidding

Platform which could be constantly monitored and governed by the Magistrate running the foreclosure.

One further requirement was to allow interaction between multiple bidders from remote locations with the physical auction being held at the Court premises. In other words, since the traditional auction methodology could not be simply dropped out, the system was to allow both a traditional auction and an online one to take place at the same time and to develop jointly, with the online auction duly complying with the same procedural formalities devised for the traditional one (online payment of admission deposit, personal identification of bidders etc.).

The task was challenging but the rewards, in case of success, extremely appealing. A much larger audience would be allowed to participate and bid; a quicker and more streamlined procedure could be enforced, further reducing the length of the execution; possibly a lot more items – even of lesser value, such as movable assets - might be auctioned out at a better price, with a lot of additional economic value to be recovered from foreclosures compared to the old practice.

It was decided to tackle the issue starting not from real estate assets but rather focusing on the judicial auctions of movable ones, however setting a floor value of 20,000 euros. A team of judges experienced in the foreclosure proceedings was asked to act as a tester group and the new project got underway.

The new bidding platform will start testing in five Courts (the first sale due is a Ferrari belonging to a bankrupt company) in February 2008. If the testing phase will prove successful (through Spring 2008), a new release of the platform is scheduled by November 2008 to accommodate online judicial auctioning also of real estate assets.

Preliminary results show that online auctioning might well be the major innovation in foreclosure procedures over the next few years, providing a true "killer application" for a really transparent and efficient judicial auction, both for immovable and movable assets.

### **A Management Information System (MIS) for Courts and Creditors**

While meeting its development and immediate objectives, the Project also brought about two important "by-products", the first of which is the ability for both courts and creditors to monitor the performance of their judicial auctions and act accordingly.

It might be regarded as an obvious notation that courts would know all too well how many foreclosures they handle each year, whether they grow or diminish in number, if the sales are mostly accomplished at their first attempt or at later ones and so on and so forth. However, this is not always the case. Even if a national statistical scheme is in place and running, figures are normally too old (a five year delay is common in Italy) and too aggregate to actually be of any practical use. Even creditors, namely banks, are not always running a full scale MIS for their foreclosures.

The project has thus successfully implemented a statistical feed back service to Courts and creditors on auctions'

performances, covering all the major indicators needed to spot whether and why foreclosures in certain jurisdictions are "dragging their feet". The service is currently provided for free, as a courtesy, but its value is substantial and the initial promotional launch may soon be phased out in favour of a commercial offer.

Practical uses for such MIS are several: in one case a Court highlighted that its judicial auctions almost never concluded a sale at the first attempt, showing a puzzling divergence compared to other Courts also using – among other innovations – internet advertising. After closer examination it emerged that reasons for this were too optimistic expert valuations of the real estate assets being foreclosed, so that starting auction prices were set at a level too high compared to the free market. When the Court eventually decided to review its list of appointed valuers and implemented a different valuation code, the performance of its judicial auctions quickly mirrored that of other similar Courts.

Another interesting by-product of the Asteimmobili project is the establishment of a rather unique database of expert valuations and auction sale prices, each relevant to a specific foreclosure being advertised. Together the two time series make for a very reliable source of comparables, listed by address (city, street number, zip code) and featuring a detailed description of the auctioned properties. This information can be helpful for both professional users and the general public to assess the most likely market price of a property. This is especially true in such environments where official statistics on the real estate market are scarce or not updated, be it for taxation reasons (as in some developed countries, Italy included) or lack of resources (as in several developing ones).

### **Conclusions**

The Asteimmobili project yielded an immediate and evident return to all parties involved and therefore was generally regarded as a success story. Overall, it

delivered improved marketing for repossessed properties – both immovable and moveable – and started a new Courts awareness of the economic consequences of their judicial auctions.

Monitoring auction performances and improving them received thus a widespread consensus, under the motivation that a better credit recovery will have a positive impact on mortgage lending, eventually allowing lower interest rates to final borrowers and more aggressive credit policies by banks.

It also prompted the introduction of other facilitating innovations, both legislative (a new bankruptcy law) and regulatory (new operational practices in Courts) aiming at the same target. Thanks to this progress – a true "Institution building" one – it has now become common place for most Italians thinking to buy a dwelling to check first what judicial auctions are due in their court of interest, go through the relevant documentation, see photos, read expert valuation, learn about auction procedure, download application forms etc., at no cost and without actually ever going to Court.

This boosted auctions popularity and participation, also fighting some illegality which normally affects this kind of sales.

Eventually, the Courts adopting the new practices managed to raise the auctioned prices gained for repossessed properties by 10-20%, which is a lot of money when applied to all the foreclosures outstanding. This improved efficiency is good for creditors, debtors and investors alike, in a so-called "win-win" solution.

### **Project Benefits**

#### **1. Lenders**

- higher sale price
- shorter length of foreclosurers
- lesser legal and administrative costs
- access to database of auctioned prices & expert valuations
- granting additional mortgage loans (only banks)

## **2. Courts**

- quicker settling of foreclosures
- transparent and really public judicial auctions
- reducing backlog of pending foreclosures

Project requirements are basic, although mandatory: internet access is a must, making it feasible only in countries where the “digital divide” is not too deep and computer literacy is sufficiently widespread, otherwise the number of users would be too limited.

## **3. General public/Home buyers**

- access to auction notice and relevant legal documentation
- larger real estate market
- access to lower-than-market prices for dwellings
- safe purchase (no hidden liens on the property)

Apart from this, the project appears to be beneficial just about anywhere, with the only exception for those countries where judicial auctions perform perfectly and quickly: a somewhat slim chance that should leave open a plethora of possibilities.

## **4. Borrowers**

- lesser debt to repay following lesser amount of defaulting interest
- auctioned sale price closer to market price
- lesser legal costs

Thus the project is likely to be beneficial to most countries, be they developed or developing ones, with a special mention for the latter, where institutional building is still underway and external aid is often required to deliver solutions which could accommodate a still inadequate economic and legal environment.

Actually this seems to be the major feature of the Asteimmobili project: its implementation proved independent from legal or regulatory measures; basically it was designed as a self-help initiative, started and managed on a strictly free market basis. With very little seed capital required, it thrived in a political and legal environment which had proved to be so adverse to any innovation as to render Italy the country where foreclosures lasted longest and performed worst in Europe.

This makes the project especially fit for adoption by International donors in their development work in most countries, whereby a small budget for Technical Assistance (and possibly for start up capital) could yield extremely significant and quick positive results in the field of mortgage lending.

# Chile's Housing Finance: A Story of Success?

By Inder J. Ruprah and Luis T. Marcano

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## I. Introduction

Chile is an interesting case study of housing finance. Since its return to democracy in 1990 the country is often held up as a beacon for other emerging market countries to follow. Generally, it has had a stable macroeconomy (sustained high economic growth and low and decreasing inflation) combined with falling poverty rates. Specifically, it has one of the highest ratios of mortgage debt outstanding to GDP in an emerging market (about 14% mortgage to GDP). But, also it has a large number of - and a changing set of - public housing programs whose design is to complement private finance and provision to maximise the production of houses.

The net result has been an increase in owner-occupancy rates of over eight percentage points from 1992 to 2003. The largest increase, admittedly from low levels, has been for the lowest two household income quintiles.

In this article we narrate the details of the Chilean success in terms of increasing affordability; increasing depth and increasing sophistication of mortgage markets; and an innovative set of public housing programs. In particular, they account for the large increase in owner-occupancy rates of the lower two household income quintiles and the impact on welfare indicators of publicly subsidised housing solutions. We also discuss the problems: high delinquency rates of publicly provided mortgages; re-incidence of inadequate housing of households living in houses bought with public assistance; and growing social problems associated with the residential segregation resulting from public housing.

## II. Affordability.

In the early nineties the proportion of households living in inadequate housing (a deficient physical condition of the dwelling, lack of access to basic services and overcrowding) represented about 1.3 million

of the 3.8 million households. This high level of shortage can be linked to low affordability derived from low household income and inaccessible financing.<sup>1</sup> Since then affordability has improved significantly. In 1990, the percentage of households being unable to access a house at market conditions was 84%, and the households' average income gap was 54% below the affordability line. By 2003, the proportion of households unable to afford a house had fallen to 61% with an income gap reduced to 29%.<sup>2</sup>

The increase in affordability was due to the increase in household income, and the fall in interest rates for a given change in the price of a house. One third of the improvement in affordability was due to the net income effect. This captures the change in real household income and the change in the relative price of houses relative to other goods and services.<sup>3</sup> Two thirds of the improvement in affordability, was driven by the reduction in mortgage interest rates.

<sup>1</sup> See Hulchanski (1995) for a discussion on affordability.

<sup>2</sup> The affordability approach requires defining a benchmark with which households' income can be compared. This can be used to calculate the number of households whose real income is below that required to buy a typical house with a market mortgage with no down payment. The affordability index is defined as below:

$$\text{Afford.Index} = \frac{\text{Mean\_Household\_Income}}{\text{Monthly\_Payment}} \quad \text{where} \quad \text{Monthly.Payment} = \frac{H \cdot i_t}{[1 - (1 + i_t)^{-n}]}$$

$H$  in which, is the median house price by region.  $i_t$  is the interest rate at moment  $t$  and  $n$  is the maturity of the loan, (20 years in this case) The affordability benchmark used in this paper is that household income where mortgage payments for a typical house represent less than 30%. The "typical" house corresponds to a dwelling of 60 m<sup>2</sup>. The price of reference is the median price adjusted by geographic location (municipality) per square meter multiplied by the size. The house "affordability" line, is the household income and is the un-affordability aversion parameter. With  $a=0$  is obtained incidence and with  $a=1$  is obtained the income gap

<sup>3</sup> Real household income definition used is:  $(Y/P)/(Ph/Pnh)$  where  $Y$  is household income,  $P$  is the consumer price index,  $Ph$  is the housing component of  $P$  and  $Pnh$  is the non-house component of  $P$ . We used the housing component of the consumer price index because no housing price index is available. However, Cox and Parrado (2006) calculate an index of house prices, using a combined hedonic and repeated sales technique, for the Greater Santiago Metropolitan area. They find a similar result " ... we find that the recent sustained rise in home prices coincides with the sustained increase in disposable income and the decreasing trend of long-term interest rates, factors that have strongly driven the expansion of mortgage loans."

However, most of the improvement in affordability has been for the top three quintiles. For the lowest two quintiles there has been practically no change (see Table 1). Hence the increase in home ownership of the lowest two income quintiles cannot be accounted for by the increasing affordability of houses.

Table 1: Percentage of households below the affordability line

	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5	Total
1990	100.0	100.0	98.6	89.2	33.3	84.2
1994	99.8	99.1	93.7	71.0	20.8	76.9
2003	99.5	90.1	69.5	37.5	11.4	61.6

Note: % of households

Source: Planning Ministry (MIDEPLAN) Socio-Economic Survey (CASEN)

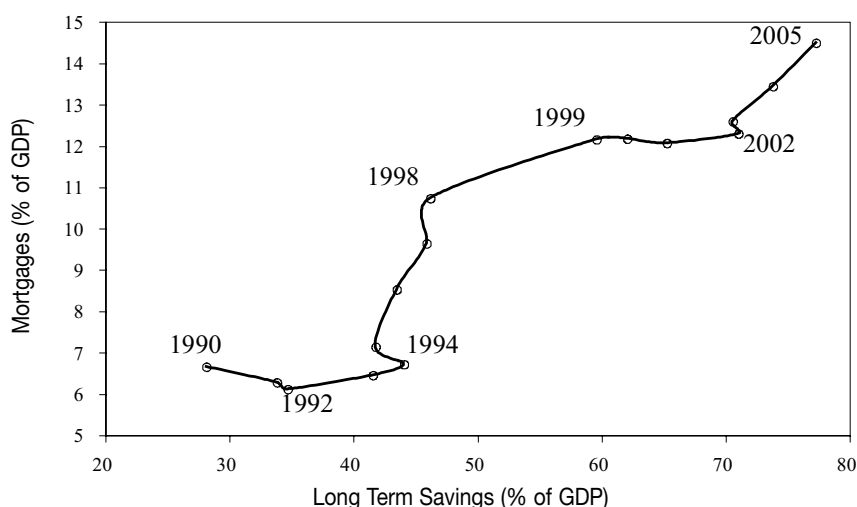
### III. Mortgages.

The fall in interest rates mentioned above captures the country's sustained success in macroeconomic stability that has been accompanied by an increase in the depth and efficiency of the private market's supply of mortgages. Two specific favourable factors have also played a critical role: the introduction of an inflation adjusted index unit that lets financial institutions protect the real value of their assets and the pension reform in 1980 which created a privately run compulsory capitalisation system.

Thus, the depth of mortgage markets in turn coincides with the increase in savings particularly in private pension funds. In Chart 1 is shown the increasing depth of the mortgage market (value of outstanding mortgages as a percent of GDP), and its positive temporal association with long-term savings. Long-term savings are defined as savings with a tenor greater than a year. However what is mainly driving the mortgage market is pension savings.

At the same time, there has been an active process of innovation in financial products that facilitated the transition from primary to secondary market of mortgages. The three main instruments are used in the primary market: Mortgage Bills, Endorsable Mortgages and Non-Endorsable Mortgages.<sup>5</sup> Although Mortgage Bills were the main instrument representing 86% of outstanding mortgages in 1995, by 2005 the Non-Endorsable Mortgages had become 55%, a change partially due to changed tax exemptions introduced in 2000. All instruments are indexed to the consumer price index, and have long maturities. Regarding the secondary market albeit legalised in 1994 it has taken off since 2000.<sup>6</sup>

CHART 1: RELATION BETWEEN MORTGAGES AND SAVINGS



Source: Superintendencia de Bancos e Instituciones Financieras - SBIF

A striking characteristic of the Chilean mortgage market is the active role that the public sector plays in it. For example, the pipeline risk of the mortgage generation process is borne by the borrower rather than the lender as for any assisted loan there is a government subsidy or guarantee to partially offset a price fall between the origination and sale of the bond. Moreover, the Urbanization and Housing Ministry (MINVU) finances the origination costs, provides insurance for the loan and assumes auction responsibility for the house in case of default to private actors in the mortgage market that offer credit to public housing subsidy recipients.

<sup>4</sup> A simple bivariate OLS regression, of mortgages on different types of long-term savings indicates (as only 16 data points are used) that an increase of pension fund balance of one percent of GDP results in an increase of 0.25% in mortgages to GDP ratio.

<sup>5</sup> Mortgage Bills are uniform instruments regulated by the Central Bank of Chile. Its maximum loan-to-value ratio allowed is 75%, and the originator transfers the interest rate risk to investors. Endorsable Mortgages corresponds to traditional mortgages, they are securitizable, and the maximum loan-to-value ratio allowed is 80%. The Non-Endorsable Mortgages are similar to Endorsable Mortgages but less regulated regarding their financial terms, no loan-to-value ratio restrictions, no ceiling of interest rate, and they are not required to have insurance on the underlying asset.

<sup>6</sup> See Tapia 2006 for a detailed description of the instruments and evolution of the mortgage market

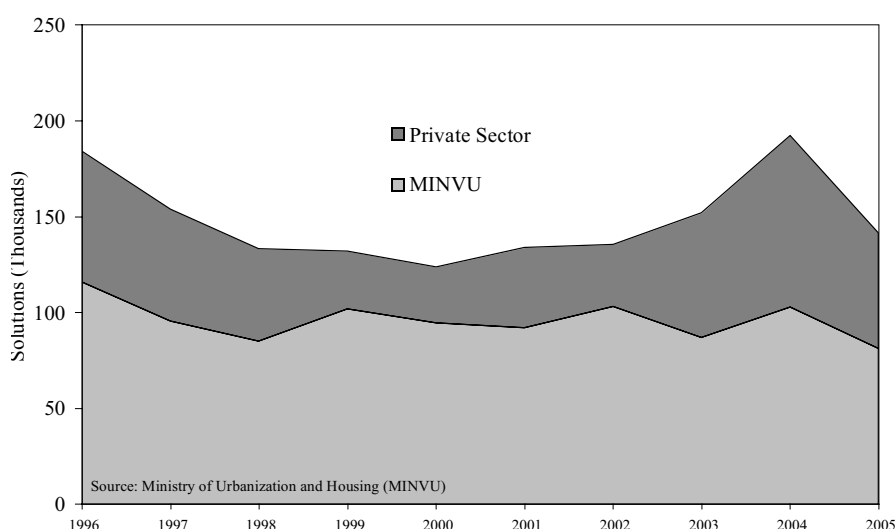


The relative role of the different actors in the provision of mortgages in the primary market has changed. The number of mortgages grew 100% from 1998 to 2003. The break down of market share was as follows: private (39%), Banco Estado, a government owned commercial bank, (38%), and the Urbanization and Housing Services (SERVIU), the operational arm of the ministry of housing, (18%). The relative importance of the providers for the individual quintiles changed as well. While the percentage importance of private financial entities had been 5.5% in 1998 for all segments, the growth of 705% meant its market share has increased to 22% in 2003, although they remained as the third most important provider behind Banco Estado (40%) and SERVIU (33%).

However, the rapid growth of the mortgage market has not increased access to the lower income households. Accessibility by households to mortgages is obviously highly positively correlated with the household's income. The total pattern is a monotonic increase from low to high income, a pattern repeated for Banco Estado and private financial banks. In contrast SERVIU mortgages have an inverted "U" shaped pattern. However, what is worrying is that although the overall size of the market is increasing, simultaneously, there is a decrease in accessibility for the lowest three household income quintiles from all providers.

Thus, just like affordability, the rosy aggregate figures of the mortgage market cannot help in accounting for the increase in housing ownership amongst the lower income households.

**CHART 2: PUBLIC ASSISTED AND PRIVATE CONSTRUCTION OF HOUSES**



#### IV. Social Housing Programs

With neither the aggregate improvement in affordability nor the increasing depth of the mortgage market growth explaining the increased ownership of lower income households the answer must lay with public housing programs.

By 2005, the budgetary outlay on public housing programs was US\$ 628.5 millions ie 3.2% of government expenditure in that year and 110% more in real terms compared to 1990. Expenditure grew steadily until 1996 and thereafter fell until 2002 whence it again started to increase. However, the total size in terms of the number of solutions of the social housing programs has not significantly varied over time. Chart 2 shows the number of housing solutions of the social housing programs

and the number of private solutions. For the period 1996-2003 public housing solutions were 94 thousand per year with a standard deviation of 5.3. Private sector solutions were lower; they averaged 52 thousand per year, with a higher standard deviation of 19.7.

The difference between the standard deviations of the public and private solutions suggests a different relation between the two with respect to the business cycle. While the private sector shows a high pro-cyclical pattern with respect to real GDP growth the public sector appears to be anti-cyclical. Given that the construction industry is pro-cyclical (as picked up by the private sector solutions relative to GDP per capita growth) the anti-cyclical behaviour of the public housing programs suggests possible macroeconomic level benefits, including employment generation, which are not studied in this report.

Chilean public programs are based on an ABC (Spanish for savings, voucher and mortgage) structure. The housing ministry essentially manages two sub-types of programs: direct financing and provision as well as assistance, which complements private market solutions. Within each program there are two modalities, individual and collective. The programs' specific voucher value and the priority in queuing are

**Table 2: Incidence and Change of Incidence by Provider**

	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5	Total
<b>In 1998</b>						
SERVIU	77.9	60.7	53.6	40.6	25.7	48.8
Banco Estado	18.7	35.8	42.1	49.8	55.6	42.9
Private Financial Institution	0.8	1.5	2.5	6.2	14.7	5.5
Other	2.6	2.0	1.8	3.4	4.0	2.8
<b>Change 1998-2003</b>						
SERVIU	-5.9	20.5	17.4	34.0	34.0	
Banco Estado	1.1	3.6	20.2	35.5	39.7	
Private Financial Institution	0.5	1.5	4.5	8.7	84.8	

Note: % of households

Source: Planning Ministry (MIDEPLAN) Socio-Economic Survey (CASEN)

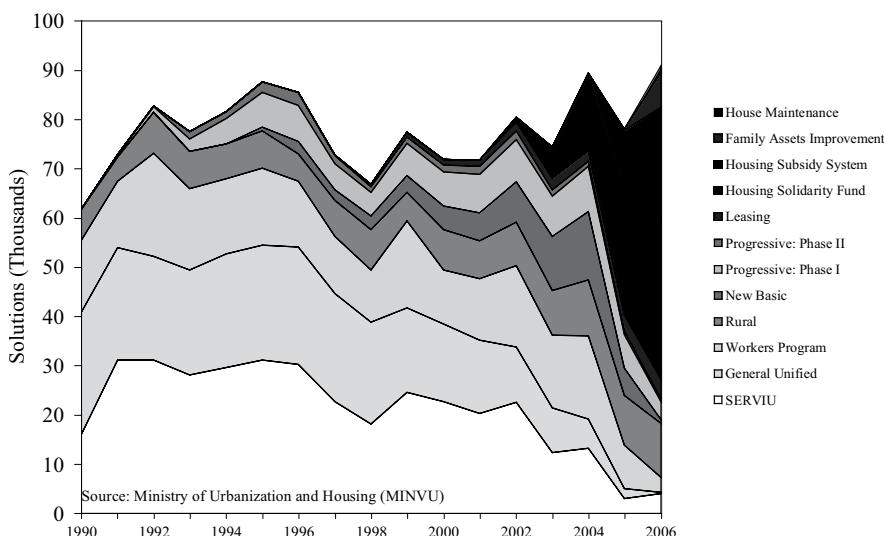
based on publicly available scoring method.

There are two delivery systems. They refer to the type of construction: first, construction by SERVIU (the operational arm of MINVU) and delivery to the beneficiary; second, the beneficiary receives a voucher and hires a private construction firm. Chart 3 shows the gradual decline in the direct public production (SERVIU) of houses. The chart also shows that direct production was mainly in two programs Progressive and Basic<sup>7</sup> (in 1995 the private option was introduced in this program). Both began to be wound down from 2002 onwards with the consequent sharp fall in direct production since then.

There are two modalities. Modality refers to an individual or collective application. Almost all the programs have both options. The collective option requires applicants to form a legally registered Housing Committee that is charged with complying with the application process. Often poor households are assisted by NGOs in the application process.

Eligibility and the targeted population differ from program to program although they share some common eligibility criteria and have overlapping targeted populations. House savings accounts are a minimum requirement for eligibility of the programs and consist of a minimum quantity combined with sometimes a minimum seniority of the saving account. The second typical requirement is that an applicant must have an updated file of the Social Assistance Committee (CAS from the Spanish), a national information system which gives points regarding the "needs" of the household.<sup>8</sup> The CAS points are used as

**CHART 3: NUMBER OF HOUSING SOLUTIONS BY INDIVIDUAL PROGRAM**



one element in defining priority among applicants. Note there was no income upper ceiling of the households for eligibility until recently when pro-poor programs were introduced.

Although there has been continuity in Chile's housing policy the set of public housing programs are characterized by an almost continuous change, a change involving modifications of an existing program or the closing of existing programs as well as the introduction of new programs. A major change occurred after 2002 when more poverty targeted programs were introduced and many traditional programs, including some that had been introduced in the early nineties, closed.<sup>9</sup>

The public housing policy has been successful in its primary aim; reducing the housing shortage. A simple back-of-the-envelope calculation shows that without the public assisted provision of housing the

country's housing needs would have reached 42% in 2003 instead of the observed 18% of households.<sup>10</sup> The incidence, ie distribution of beneficiary households across income quintiles, reveals that the largest percentage is households in the lowest two income quintiles. Hence, public programs have been pivotal in accounting for the large increase in owner-occupancy rates of the lowest two income quintiles. However, this story of success has not been free of problems.

## V. Problems

There have been at least three main problems with the country's public housing programs. First, a much higher delinquency rate of publicly (SERVIU) provided mortgages relative to privately provided mortgages. Second, a significant re-incidence of households living in sub-standard conditions whose houses were originally provided through one of the public

<sup>7</sup> For a detailed description of the programs see Ruprah & Marcano (2007).

<sup>8</sup> It is a homogenous information system with national coverage but decentralized as the information is collected at and by municipalities who finance this task. The system is used to identify households in need; to target social programs and is often used to rank applicants to social assistance programs. The social programs do not contribute to the cost of CAS. The system provides information by household, on thirteen variables corresponding to five dimensions: housing quality, education, occupation, income and wealth of households. See O. Larranaga (2005)

<sup>9</sup> These include Progressive Housing Program (1991 year introduced) now closed, Leasing (in 1996); Basic (1994) now closed. Housing Solidarity Fund (in 2000), Housing Without Debt (in 2001), Housing Subsidy and Patrimony programs (both in 2004), and Improvement of SERVIU Houses (in 2005). The housing programs that existed in 1990 and that still function are Workers Program and the Rural Program.

<sup>10</sup> The figure of 42% is calculated by adding to the observed shortage rate of 18% the cumulative number of public housing solutions from 1992 to 2003.

programs. Third, the creation of social problems associated with residential segregation. These problems may account for the rather poor findings regarding impacts on the welfare indicators other than the materiality indicators.

Public mortgages have had consistently higher delinquency rates, around 10 times higher than private ones over a differential maintained over the business cycle. In 2002, the policy response to the high delinquency rates has been to eliminate mortgages for poor households and to introduce a social housing program with an AB (Spanish for savings and voucher) design, ie with a voucher and a small amount of household savings. Thus instead of attributing the higher delinquency rates to the problem of moral hazard the government attributed it to the problem of incapacity to pay. Hence the government has also avoided policy measures to induce private financial entities to move down market. However, for higher income families mortgages have been maintained and incentives to the private providers enhanced: a decreasing origination subsidy to lenders and the removal of the ceiling on state loan-loss guarantee with a 25% loss sharing.

The problem of re-incidence of housing shortages is that of the total number of households living in inadequate conditions in 2003 about 12% had been previous beneficiaries of one of the social housing programs. The re-incidence of housing problem of beneficiaries varies considerably between the programs with the highest to lowest re-incidence being Rural to Workers Program. Due to inadequate maintenance, publicly provided houses have deteriorated over time. As a result, owners fall back into housing needs household category. According to Brain and Sabatini (2006) there is no incentive to do so for the owners of social housing. While the price of land has increased about 14 times from 1990 to 2004 the prices of social housing units have remained stable. There are no returns from investing in the house. To some extent the

government has recognized this problem as it has introduced the program "Maintenance of SERVIU Houses" in 2005.

In a series of papers Sabatini (2001, 2003) has documented the increase in the price of land and, the resulting geographical location of public housing and the ensuing result of residential segregation. Statistical analysis by Vargas (2006) confirms the hypothesis that housing subsidies result in segregation in the case of the capital, Santiago. He calculates a number of segregation indices, a number of control variables, and a log likelihood function of a housing subsidy on an isolation index. He concludes "*...housing policy has raised exogenously RS [residential segregation] by the mechanism of buying cheap soil in far from the center locations to build social dwellings.*" (P18).

Evaluations by residents in social housing areas are telling. Rodriguez and Sugranyes (2005) report that using a social housing survey about 65% of residents reveal that they want to leave, citing as reasons difficulties with neighbours, problems of delinquency and drugs followed by problems of isolation from urban centres and lack of services and parks.

The negative results turn on its head the claimed virtue of the Chilean model of complementarity between the public and private sectors. The system, it is argued, is trapped in an undesirable equilibrium with no incentives to change. One actor is the public sector that by seeking lower costs, locates the poor where they already live, ie where land is relatively cheaper. This creates housing areas with extremely high density without public amenities. Another actor is the private construction companies which construct social housing units where economies of scale and limited budgets also locate housing areas in the periphery with high density. There is little competition as few companies can meet the annual quotas of construction. Note that the government returns 65% of the value added tax for construction of social housing. Thus

the actors are trapped in producing low quality solutions on a massive scale.

#### IV. Results

Housing policy objectives are not limited to putting roofs over households; increasing owner-occupancy rates is expected to improve the households' welfare.

Using impact techniques the following was found (see Ruprah and Marcano 2007). Impact techniques essentially compare the values of welfare indicators of beneficiary households with similar non-beneficiary households. The impact of the program is taken as the difference in their average values.<sup>11</sup>

Of the increased owner-occupancy rates ownership from 1992 to 2003 about 85% can be attributed to MINVU's programs. The largest beneficiaries were households in income quintiles three and four, followed by the lowest two income quintiles.

The impact of the programs on the quality of households' composite materiality indicator (a simple index of potable water and sewerage access, electricity connection, quality of floors, ceilings, walls, and overcrowding) is positive and statistically significant for all the programs. However, a statistically significant impact on desirable welfare (a reduction in poverty, an increase in school attendance, a reduction in infant under-nourishment) effects was not found; different programs had different effects including perverse effects. This finding reinforces the argument of the negative effects of residential segregation and excessive density of the housing solutions. Nonetheless, in terms of cost-benefit, the average annual rate of return of public programs was 14.5%. Underlying these aggregate figures are largely differing numbers for the individual programs, which ranged from a minimum of 10% to a maximum of 24%. Further, the changing relative importance of the programs with its consequent increasingly pro-poor bias has implied that the aggregate annual value of

<sup>11</sup> See Blundell et al 2002.

the net present value calculations of the country's housing programs has shifted from negative values in the early nineties to positive numbers after 1995.

## VI. Conclusions

If success is judged with respect to a massive increase in the stock of houses and an increase in owner-occupancy rates then the Chilean story is one of success. If success is judged with respect to an increasingly deep and sophisticated (in terms of actors and instruments) mortgage market then the Chilean story is one of success. If success is judged by a complementary role between the public sector and the private sector in the financing and production of housing solutions then the Chilean story is one of success. These dimensions of success are often mentioned to promote the Chilean model of public-private housing finance and production and in particular to promote throughout Latin America the country's public housing programs that are based on savings-voucher-credit design.

However, the success in mortgage markets has been accompanied by a decrease in accessibility for the lower two household income quintiles. Moreover, the complementary role of the public and private sector has resulted in a system that produces excessively dense housing solutions in an undesirable equilibrium. Without questioning the success of the country's public programs focused on maximizing the number of housing solutions with minimum public costs today there is an emerging consensus that the policy has created a number of avoidable problems associated with "poor with roofs".

Thus, Chile's success in reducing housing shortages has come at a cost. A lesson that is important for other countries who have copied the Chilean ABC housing program design such as Guatemala, Colombia, Honduras, Nicaragua, amongst others and which, unlike the Chile of today, insist on mortgages in programs aimed at the poor and aimed at maximizing the number of housing solutions.

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# From Renters to Owners: The Case of Germany

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## Summary

In cooperation with the German Property Federation (Zentraler Immobilien Ausschuss) and five real estate companies a mail survey among renters and recent owners was conducted in order to learn more about the attitudes of households toward self-occupied property. One important finding is that only a minority of 9 percent of renters would like to buy their apartment. The most often named reasons for the disinterest are fear of financial distress and uncertainty in regard to the social stability of the neighborhood or the surroundings. Yet the results for the owners show that the financial burden of the purchase is limited since mortgage payments do not much exceed former rent payments, in particular for low-income households. To become more interested in buying property respondents would welcome measures like a redemption option, allowances for additional purchasing costs or equal treatment of property and pension plans in taxation. For younger households old-age provision has become the most important motive for buying a home. That owners also use other forms of old-age provision like pension plans shows that self-occupied property is not a substitute but a complement to other retirement arrangements.

## Introduction

Over the last years international investors have acquired huge stocks of residential

property in Germany. Private equity funds like Cerberus, Oaktree or Fortress assume that rents and prices in the German real estate market will surge in the near future since market prices have remained flat during the last 10 years while all other major OECD countries, except Japan, experienced a housing price boom (OECD, 2005). Their main focus is on hitherto public properties because they presume that the housing stock is under-managed and the financing structure inefficient (Just and Reuther, 2005). In addition, they pursue a strategy of selling the property to the current tenant. Since Germany's home ownership rate (43 percent) ranks low in international rankings, they assume a backlog demand for self-occupied property.

The first experiences of the privatized enterprises with the sale of flats to tenants have been modest. Deutsche Annington, Germany's largest landlord with a stock of currently 220,000 flats, has only sold 2.5 percent of its units in 2006, although 5 to 6 percent were originally planned (Deutsche Annington, 2007). Others, like the formerly state-owned GSW in Berlin which owns 65,000 apartments, sell less than 1 percent of their flats per year to the current tenants. Nevertheless, in the future a higher demand for owner-occupied property is expected since private old-age provision has gained importance. Recent reforms of the pay-as-you-go retirement system have reduced the replacement rate of statutory pensions by 10 percentage points to 40 percent and made them liable for taxation.

Against this background it is particularly interesting to know more about the attitudes of tenants in order to estimate the potential for future sales. With respect to old-age provision the experiences and motives of new home owners are also of importance since it is unclear whether ownership substitutes or complements other forms of savings. Rational portfolio optimizers would divide their savings between different asset categories. However, since the purchase of property can bind the bulk of private households' capital funds it is uncertain if home owners continue to diversify their pension portfolio.

In cooperation with the German Property Federation (Zentraler Immobilien Ausschuss) and five real estate companies (Alt & Kelber, Deutsche Wohnen, GSW, Patrizia and Treureal) a survey was conducted by mail to shed light on these questions. This survey is unique since only tenants and recent purchasers of multi-family apartments have been contacted. The answers, therefore, allow an insightful assessment of a residential property market of high interest for the public.

In the following, the key results of the survey will be presented after an introduction of the methodology and some descriptive statistics of the tenants.

## Methodology

The questionnaire was sent to 6,351 households, 3,250 renters and 3,101



owners. The overall response rate was 17.5 percent. Given the detailed questions on rents, mortgage costs and purchase prices this result is appropriate, particularly since the scope for employing conventional techniques to reduce the non-response rate was limited (Goyder, 1987). The real estate companies refused to hand out address data for fear of discontent among their customers. Therefore, in addition to the questionnaire only a reminder two weeks later was sent to the households by the real estate companies. It was not possible to address non-responding households individually.

Altogether 405 owners and 704 renters completed the questionnaire. The renters are concentrated in the Rhine-Main Region (Frankfurt) and in Berlin while the surveyed owners are predominantly located in the west and south of Germany. The age structure of the owners and renters is similar. Over 50 percent of both groups are older than 60 years. This seems to be typical for the included condominiums which were built mainly in the sixties and seventies. As a consequence families are underrepresented. Only 27 percent of the owner households and 15 percent of renter households consist of more than 2 persons. Striking differences can be found in regard to disposable income. Whereas 5.8 percent of the renters have a net household income of more than 3,250 Euro per month, the corresponding share of owners is 10.5 percent. Even more striking is the gap in the share of low-income households. 5.9 percent of the owners dispose of less than 1,250 Euro per month compared to 35.1 percent of the renters. A detailed description of the income distribution of both groups can be found in table 1.

Although the average owner has a higher income than the average renter, the median income of the respondent owners is lower than that of all German households. According to the most important German household income survey (Einkommens- und Verbrauchsstichprobe, EVS) the average monthly household income in 2003 was 2,885 Euro while it was in the range of 1,750 and 2,249 Euro for the owners who responded. This could be expected insofar as households in one-family dwellings are

**Table 1: Respondents' Income**

Percentage of renters and owners in the respective income class

**monthly net household income in Euro**

	less than 1,250	1,251- 1,750	1,751- 2,250	2,251- 2,750	2,751- 3,250	more than 3,250	not specified
renters	35.1	26.8	12.4	8.2	3.3	5.9	8.4
owners	5.9	22.5	22.7	18.3	10.6	10.5	9.5

excluded in the survey.

The questionnaires differ for renters and owners in some aspects. Both groups were asked about socio-demographic characteristics (for example household income, age, and household size), their attitude towards home ownership, their old-age provision and the (former) rent. Owners were additionally asked why they purchased the property, how much they had to pay for it and how much they have to pay for the mortgage. Renters, in contrast, were questioned upon their willingness to purchase the home they live in and, if not, why. Other questions sought to get more information about the contentedness of renters with the rented home and the residential surroundings.

**The willingness of renters to buy their home**

Renters were asked whether they would like to purchase the apartment they live in. Most of them denied this. Only 9.6 percent said they would like to purchase. 5.4 percent said they have not thought about it yet, and 2.9 percent gave no answer to this question. The overwhelming majority of 83 percent expressed no willingness to buy. An empirical model, a Logit-Model, was used to find out which factors increase the possibility to state unwillingness. It turns out that older persons and households with low per capita income are less prone to buy. This could be expected since it is common sense that the demand for property increases with income and that the relevance of forming property decreases with increasing age. Furthermore, renters who appreciate the price-quality ratio of their apartment and who pay a low rent per square meter are more likely to be

interested in buying. Apparently these households expect to maintain their favorable level of housing costs by purchasing. In addition, the social stability of the residential surroundings plays a significant role. Landlords, therefore, should invest in the social stability of their residential district not only to prevent vacancies but also to enhance the possibility of selling the homes to tenants. However, the effects of these factors on the probability not to refuse a purchase are only moderate. Given median values for all variables a positive evaluation of the social stability of the residential surroundings increases the probability by only 3.3 percentage points. The same applies to persons who are 15 years younger than the median with otherwise median characteristics. The detailed results of this analysis are available upon request.

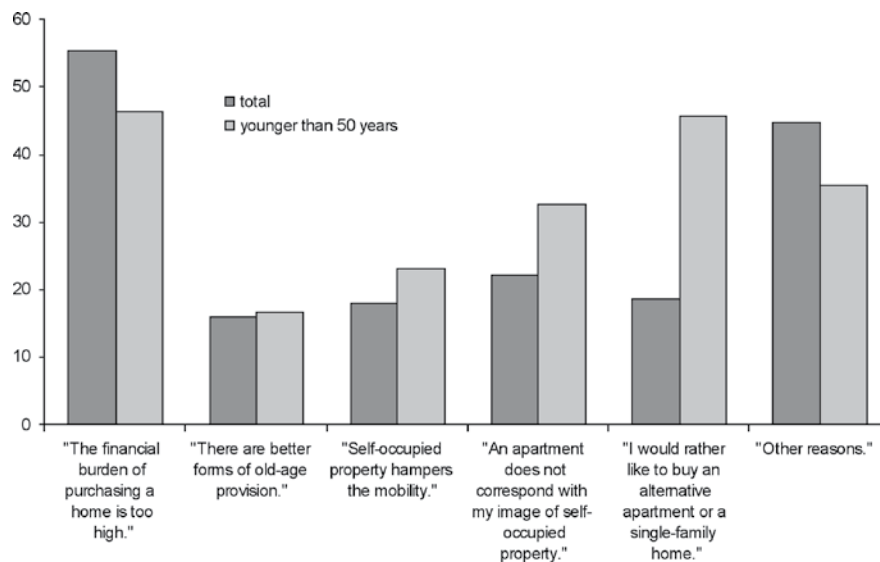
The findings suggest, nevertheless, that there is an unused potential for selling apartments as the major landlords currently sell considerably less than 9 percent of their residential stock to their sitting tenants.

**Reasons not to buy**

The renters who denied a willingness to buy were also asked about their reasons. The results can be found in figure 1.

With 55 percent, most respondents say that the financial burden of the purchase of property is too high. The second most frequent answer was "other reasons".

Respondents who chose this response were also asked to name those reasons. A fair number of persons stated that they are concerned about the social stability of their

**Figure 1: Reasons of renters not to buy**

residential district and are therefore less prone to purchase property. Compared with these two response categories the other offered reasons for not buying, like decreased mobility or the availability of alternative ways to provide old-age security, are less important. For the persons less than 50 years of age, however, the desire for an alternative property, particularly a one-family home, is remarkable. Younger households apparently only want to become owners if the property they can afford matches their expectations.

The most pronounced fear concerns financial distress. A cross-check with the owners, however, suggests that this fear might be exaggerated. Compared with former rent payments, 29 percent of the owners pay the same or less for their mortgage including principal. In the income class up to 1,750 EUR per month the share even amounts to 50 percent. Hence, a large part of the owners manage to accumulate wealth with a lower monthly burden than as a renter. The low interest rates during the last years have apparently allowed for this comfortable situation. Nonetheless, a better information policy by real estate companies about mortgage possibilities might be a way to mollify some concerns of renters. In this context it is also worth noting that 84 percent of respondent owners pay a

mortgage premium which equals or is less than the maximum they have planned. The purchase of property is therefore a well-founded decision.

#### Measures to promote property

One way to take away concerns is to provide better information. The other, more direct way refers to financial incentives. Residential real estate companies are currently pondering measures to make property more attractive. One idea refers to the additional costs of a real estate purchase like notary fees and the transfer tax. These costs amount to 5 to 6 percent of the property value and can in most cases not be financed with a mortgage. Residential enterprises are therefore considering an allowance to these fees dependent on the household income. Ideally, these allowances should be shared with the local municipality which has a special interest in attracting young families. Another measure under consideration is a redemption option for the property. In case of unemployment, bereavement or some other personal contingency, the company would offer the customer a return to the renter status without financial loss. A third measure discussed is help in case of a resale to a third party. Asked about their preference the respondents favored the

redemption option. 27 percent of all renters said that such an option would make the decision for self-occupied property easier. Among families and persons under the age of 50 years the share is nearly twice as high. The popularity of this measure stresses the presumption that in particular fear of the future prevents households from purchasing property. The willingness to pay for this option has not been tested, however. The allowance for notary fees and transfer taxes also received support but compared with the redemption option to a minor extent. Only 20 percent found the idea of help in case of a resale relevant for their purchase decision.

Politicians also discuss allowances for self-occupied property. Since 2002, savings for old-age provision are supported by family allowances and tax deductibility for contributions. According to the grand coalition this pension scheme – the so-called "Riesterrente" – shall be extended to self-occupied property in 2008 since avoiding rent payments is an alternative to secure pension payments. Against this background renters were asked whether the inclusion of property in this subsidized private pension scheme would alleviate their decision for property. Younger households (less than 50 years) clearly agreed. 28 percent stated that such a measure would make the decision for purchasing property considerably easier and 40 percent said it might ease the decision. Interestingly, this share grows with increasing income even though the financial gains from the allowance decrease with income. The signalling effect of putting property on par with other asset forms like life insurances seems to have an effect independent of the actual financial advantage, however.

#### Self-occupied property and old-age provision

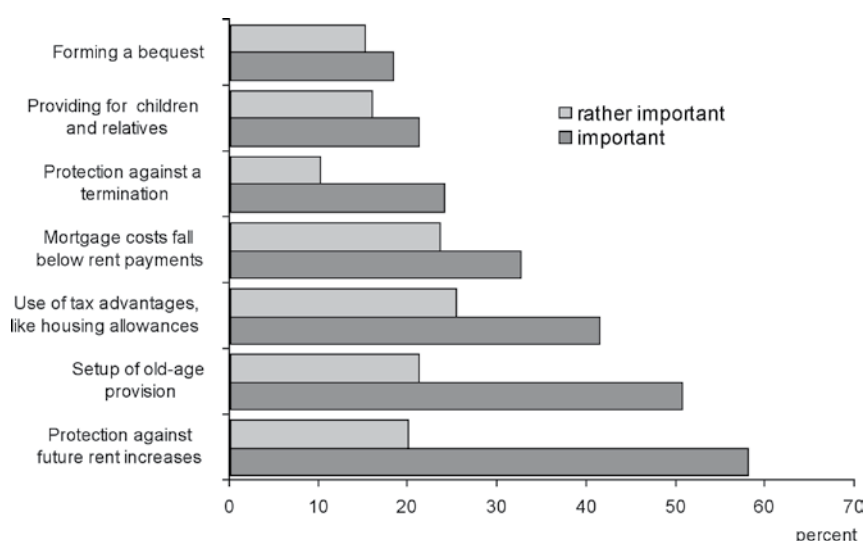
One of the main goals of the survey was to learn more about the significance of self-occupied property in personal pension plans. Therefore, owners were asked about the reasons for buying their apartment. As it turned out owners highly value the

protection against rent increases which property provides. 78 percent answered that this aspect was an important motive for their purchase. The second most frequent answer was the possibility to accumulate capital for old-age consumption. It was given by 72 percent of all respondents and 81 percent of those under the age of 50 years. Other motives for purchasing are of considerably less relevance. In particular the possibility to bequeath the property is only of minor importance as figure 2 displays.

The respondents were also directly questioned about their attitude towards self-occupied housing as a vehicle for old-age provision. Only a minority of 9 percent repudiated the idea of property as a form of providing for their old age. 30 percent regard self-occupied property as the most important means for old-age provision and 51 percent consider it a reasonable complement to other forms of pension saving. In each income group less than 10 percent stated that property is not significant for old-age provision. With increasing income, however, a growing share of respondents agrees with the idea of property as a complement rather than the most important means for old-age provision. This could be expected since households with higher incomes are able to rely on different pillars for their old-age provision. In contrast, households with low incomes often bind the bulk of their capital in housing when buying property.

A substitution process cannot be confirmed, however. Only 6 percent of the respondents stated that they terminated a pension plan in order to finance a mortgage. On the other hand, 78 percent of all owners younger than 50 years have a pension plan. In contrast, among renters of the same age group those with a pension plan make up only 51 percent. Even if renters and owners with equal incomes are compared, the share of owners with pension plans exceeds that of the renters in all income groups (figure 3). This result was also confirmed with a Logit-Model which is a special regression model to estimate the probability that a binary dependent variable assumes a certain value

**Figure 2: Motives for purchasing a formerly rented home**



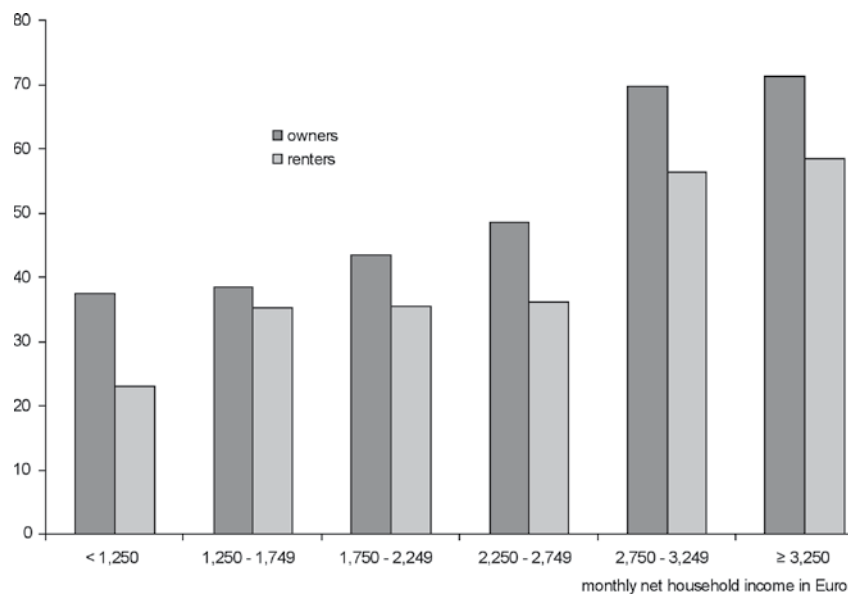
– in this case having a pension plan. The statistical probability of a pension plan increases significantly with household income and decreases with age. In addition, tenure has a significant effect on the probability of a pension plan. Given median values for all other variables, home owners have a 7 percentage point higher probability of having a pension plan than renters. Although owners accumulate wealth with their self-occupied property, pension plans are more widespread among them than among renters. Taking a closer look at those respondents with pension plans, renters' contribution payments exceed those of owners by 44 Euro per month on average. However, the average property value of owners' homes amounts to 90,000 Euro. Assuming a loan-to-value ratio of 80 percent and a principal of at least one percent of the mortgage per year the monthly principal payment equals roughly 60 Euro. Since principal payments are, like contributions to pension plans, a means to form capital, home owners on average save more than renters.

The findings in regard to households' old-age provision confirm other studies on this topic. Recently Di, Belsky and Liu (2007) presented an empirical analysis for the United Kingdom which shows evidence of a link between capital formation and home ownership. For Germany especially Braun

and Pfeiffer (2006) have suggested this link. The reasons for the correlation between homeownership and wealth are, however, still unclear. Some experts assume a habit effect. Since home owners usually have to bear a high financial burden during the first years after purchasing a home, they are forced to save money. Later, when a larger part of the mortgage is paid back, home owners have greater financial leeway but because they are accustomed to saving, they choose to use their higher disposable income for additional savings. In the case of the respondents in this survey, however, the purchase occurred within the last four years. Hence it seems to be more likely that households which are more aware of the need for old-age provision are more likely to buy a home. From this point of view, home ownership is a self-selection process for individuals who want to save. Nonetheless, homeownership might be a favorable starting point for the individual's old-age provision since self-occupied property is a form of capital which can be experienced and designed individually.

## Outlook

The overall message of the survey can be divided into two parts. Firstly, it shows that there is a potential for selling apartments to the sitting tenants. Sales by German real estate companies are still well below the 9

**Figure 3: Owners are more likely to have a pension plan**

percent of renters who are interested in buying their home. Furthermore, their interest can be stimulated by different measures. Better information about mortgage finance possibilities seems well advised since most renters fear financial distress when purchasing a home. The results for owners suggest, however, that most households do not experience a financial squeeze. Especially households with small incomes often manage to finance the purchase of property with current costs lower than those they would face as renters. Real estate companies can also make purchases more attractive by offering incentives like a redemption option or an allowance for taxes or notary fees. These additional purchasing costs often hamper the purchase of self-occupied property since they have to be paid with equity and can usually not be financed by a mortgage even though banks are becoming more flexible in this respect. In addition, the planned inclusion of self-occupied property into the subsidized private pension scheme ("Riesterrente") will most likely give the formation of property an impetus. After all 28 percent of the respondents under the age of 50 years stated that the decision to acquire property will become considerably easier if allowances and tax advantages can be utilized for the amortisation of a mortgage.

Secondly, the survey has given insight into the role self-occupied property plays in the context of old-age provision. For younger households the formation of capital for retirement consumption is the most important motive for purchasing a home. In addition, for the majority of the owners self-occupied property is a complement rather than an alternative to other assets like life insurances. Nearly 80 percent of the owners younger than 50 years have a pension plan which exceeds the corresponding share of renters by more than 25 percentage points. In addition, if contributions to pension payments and principals for mortgage contracts are combined, owners on average save even more than renters with pension plans. This result confirms other studies on this topic and might be due to the fact that owners are more aware of the need to save for old-age provision than the majority of the renters. Nevertheless, housing property appears to be a good starting point for an individual retirement plan since property is a more appealing asset than, for example, a virtual investment in stocks via an occupational pension plan.

All in all, the survey points out that housing property is an important pillar of German households' old-age provision. Therefore, the inclusion of self-occupied property in

the subsidized private pension scheme as announced by the ruling grand coalition seems overdue. Yet other obstacles like high additional purchasing costs – for instance transfer tax and notary fees – as well as the exclusion from occupational pension schemes still hamper the purchase of property. Real estate companies can also play a major role in stimulating the formation of private housing property. They can make the purchase of an apartment by the current tenant more attractive by providing better information on financing possibilities, improving residential surroundings and removing certain risks. Especially a redemption option which allows for a return to renter status in case of unexpected personal events would make a purchase easier for households with uncertain perspectives. Given a better framework the increasing need for old-age provision will likely give the formation of self-occupied property a boost over the next years.

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## Short CV

Dr Michael Voigtländer was born in Leverkusen, Germany, in 1975. He studied economics in Münster, Westphalia, and Cologne. Afterwards he was a research assistant at the University of Cologne in the economic policy department. Since 2005 he is a research fellow for real estate economics at the Cologne Institute for Economic Research. In January 2008, he was appointed head of the Research Center in Real Estate Economics. In addition, he is a lecturer at the Rheinische Fachhochschule Köln, University of Applied Sciences.

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# Housing Development and Housing Finance in Britain – some lessons for emerging markets<sup>1</sup>

By Mark Boleat, Boleat Consulting

There is an acceptance in many emerging markets that functioning housing markets can make a significant contribution to economic growth and improved standards of living. Those countries naturally look at experience in other countries, and there are many international and national agencies and commercial organisations willing to provide access to such experience.

The British housing market has useful lessons for emerging markets. The British model can best be described as a free market operating within a legal framework governing land ownership, planning, building standards and mortgages, and sound prudential regulation of financial institutions. In the British model there are few special arrangements for housing. This model is attractive to other countries; it is implemented primarily by removing obstacles rather than creating new institutions, and requires minimal public funding.

However, the model is not well understood or documented, largely because it is an informal model that has evolved and which does not have specialist institutions to champion it.

This article provides a succinct description of the British model, aimed specifically at an international audience.

## House building

Almost all new houses in Britain are built by private sector developers. Most are built speculatively – that is they are designed and building is commenced before they are marketed. This is a specialist business, and to a large extent a local or regional one as a comprehensive understanding of local land and housing markets is essential for success.

Developers fund their activities through a mixture of internally generated funds and bank loans secured on their developments. Developers generally have not had difficulty in obtaining the finance they need. This is partly because they have had a good track record, partly because they can offer some security in the form of land with planning permission, and partly because for most of the last 30 years market conditions have been benign with a strong demand for housing and restricted land supply resulting in rising land values. Large developers typically use bank finance secured on the whole of their assets, while smaller developers are more likely to use bank loans secured on specific sites.

## Building standards and warranties

Building Regulations are designed to ensure that all construction work is safe. They also provide for energy conservation and access

to and use of buildings. The Regulations set out the type of work to which they apply, the notification procedures that must be followed and the requirements that must be met. These requirements cover 14 areas: structure, fire safety, site preparation and resistance to contaminants and moisture, toxic substances, resistance to the passage of sound, ventilation, hygiene, drainage and waste disposal, combustion appliances and fuel storage systems, protection from falling, collision and impact, conservation of fuel and power, access to and use of buildings, glazing and electrical safety.

The Building Regulations are readily accepted and rigorously enforced. They are effectively administered and are not seen as a bureaucratic obstacle to development, but rather as an essential safeguard.

Neither a purchaser nor a mortgage lender nor even a surveyor can be expected to identify hidden faults in new houses. If a house has been standing for 30 years then it is a reasonable assumption that if there were any faults in the construction then they would have come to light. This is not the case with a newly built house. If a new house does turn out to be faulty then in law the buyer would have a remedy against whoever sold the house, in practice the developer. However, builders can go out of business leaving the home owner with the

<sup>1</sup> This article is an abbreviated version of the author's book *Housing Development and Housing Finance in Britain*, published in March 2008 by the International Real Estate Network. Copies are available on [www.boleat.com](http://www.boleat.com) and [www.intrean.org](http://www.intrean.org).

problem, and also pursuing a legal case is likely to be prohibitively expensive for most people. Related to this is the position of second and subsequent purchasers who have no contractual relationship with the builder and therefore are unable to take legal action against it even if it can be shown that the builder was negligent.

Where a person purchases a house before it is started ("off plan") or during the course of construction, he faces a different risk, that is that the builder will go out of business and will not complete the house.

Recognising the need for consumer protection in this area, builders took the initiative to ensure that new houses were covered by an effective warranty scheme. This has been achieved through the National House Building Council, which sets standards that have to be met over and above the Building Regulations, provides for the inspection of properties during the course of construction and provides a warranty against major structural defects and the failure of the builder to complete the home.

### Land tenure and registration

Single family homes are almost always owned on a freehold basis through which the owner owns the land as well as the building. Under what is technically called "fee simple", ownership continues as long as the owner has heirs and is as near as one can get to absolute ownership.

Apartments are generally owned on a leasehold basis, that is the owner owns a right to occupy or to sub-let the apartment until a given date, but the land and the structure of the building is owned by a different person, the freeholder, to whom a rent has to be paid. New leases have typically been for 99 year periods. As the lease become shorter over time so the investment aspect diminishes and the property becomes more comparable with a rental unit.

Britain has systems of land registration that provide for the registration of title which

then has a state guarantee. The Land Registry is responsible for registering title to land and recording dealings (for example, sales and mortgages) with registered land in England and Wales. The register describes -

- The land - a geographical description of the land with reference to a plan and a legal description of the property. If the property is leasehold then details of the lease will be included. Any covenants for the benefit of the land, such as a right of way over adjoining land, are also included.
- The owner of the land and his address.
- Third party charges registered against the land such as mortgages and restrictive covenants.

The process of register details is both efficient and cheap. The whole system is fully computerised. The register is open; anyone can obtain details for a particular property for a modest fee.

### The house purchase process

In England and Wales, with the exception of some new houses which are sold directly by the developers, those selling houses usually do so through estate agents. The agent markets the house and conducts the sale negotiations on behalf of the seller. Various marketing techniques are used. Many agents take advertisements in local newspapers. Increasingly website marketing is used, and the Internet is now the first port of call for prospective house buyers. A number of websites have been established on which estate agents and developers advertise their properties for sale. Potential buyers can search by area, price and type of house. Having identified a particular house the potential buyer then contacts the agent. A prospective buyer will, after obtaining what information he can from the Internet, typically visit or telephone agents in the area where he is seeking to buy, and explain what roughly he is looking for; the agent then provides details of relevant properties on its books.

The agent charges a commission to the seller, payable when a buyer is found. A typical agency fee is 1.5% - 2% of the selling price, but the range is from 1% to 2.5%.

### Regulation of mortgage lending

Most mortgage loans are arranged by intermediaries, such as insurance brokers and estate agents. Until recently mortgage intermediaries were not regulated. As mortgage products became more complicated in the 1990s, and as other financial intermediaries were increasingly subject to regulation, so the demand for regulation of mortgage intermediaries grew.

The Council of Mortgage Lenders, the trade body for the mortgage lending industry, established a voluntary mortgage code for lenders and intermediaries in 1997. This has now been superseded by statutory regulation by the Financial Services Authority (FSA). FSA rules regulate the whole relationship between customers, intermediaries and lenders and concentrate mainly on disclosure of information.

### Mortgage products and lending

While housing finance as an activity is regulated by the Financial Services Authority, any organisation is free to provide loans for house purchase on any terms it wishes. There are no statutory restrictions on the amounts that can be lent, either in absolute terms, in relation to the value of the property or in relation to the income of the borrower. There are also no restrictions on the type of mortgage, in particular how the rate of interest is determined and can be changed.

There are currently two principal types of mortgage loan in respect of the way interest rates are determined. The traditional British mortgage instrument is the variable rate loan. In theory the rate can be varied at any time by the lender. In practice the rate moves broadly in line with money market rates, typically about 200 basis points above the three month money market rate. To attract new business, lenders generally offer a discount for the first few years of a loan. The main instrument for new loans is a fixed rate for two years. At the end of the fixed period another fixed rate is offered or the loan reverts to the standard variable rate.

### Lending criteria

Lending criteria are fairly straightforward. The key variable is the income of the borrower. The maximum loan is typically 3.5 times income. Where there are joint borrowers 2.5 times joint income is typical. Lenders will want to satisfy themselves about the security of the income. Where a borrower is self-employed then a lender will want clear evidence of actual earnings over a reasonable period of time.

A lender will normally undertake a credit reference check. If a borrower has defaulted on any type of loan this will be taken into account and may make it difficult for the person to obtain a loan on the usual terms. Lenders share information on borrowers through credit reference bureaux. These record publicly available information such as any court judgments for debts, electoral roll information and bankruptcies. Also, it is now a condition of most borrowing that relevant information on repayment patterns is recorded with the bureaux. Records are therefore available to a lender on other loans and whether repayments are on schedule. Mortgage lenders also share information on possessions, both by court order and voluntarily.

Where a loan is for more than about 80% of the value of the property then lenders charge a higher interest rate, typically 40 basis points more, as high percentage loans carry a greater risk. This is generally known as a "higher lending charge".

### Mortgage lenders and funding

Britain has a huge mortgage market. Loans outstanding at the end of 2006 were over £1,000 billion. In comparative terms, Britain has one of the largest mortgage markets in relation to the size of its economy. Outstanding mortgage loans are roughly equivalent to GDP. Of the major industrial countries the USA and Denmark have high mortgage/GDP ratios of around 100%, while at the other end of the spectrum France and Italy have ratios of under 30%.

Well over 90% of all mortgage loans in

Britain are made by deposit taking institutions, and mortgage lending is regarded as a mainstream mortgage lending activity rather than a specialist activity to be conducted by specialist institutions. The deposit taking institutions can be divided into four broad categories –

- The building societies – mutual institutions that are required by law to concentrate on taking retail deposits and making mortgage loans.

- Retail banks that previously were building societies. They have generally diversified their sources of funding and to a limited extent extended their areas of lending.
- Retail banks that have absorbed or merged with former building societies.
- Retail banks that have developed with their own mortgage business and have not acquired former building societies.

The following table shows the major mortgage lenders and their status using the categorisation above.

Mortgage lender	Type of business	Loans Outstanding End-2006 £bn	Market Share %
HBOS	Bank, formed by merger of Bank of Scotland (bank) and Halifax, formerly the largest building society	220.0	20.4
Abbey National	Bank, former building society, acquired by Spanish bank, Santander	101.7	9.4
Lloyds TSB	Bank, including acquisition of Cheltenham & Gloucester, former building society	95.3	8.8
Nationwide	Building society	89.6	8.3
Northern Rock	Bank, former building society	77.3	7.2
Royal Bank of Scotland	Bank	67.4	6.2
Barclays	Bank, including acquisition of Woolwich, former building society	61.6	5.7
HSBC	Bank	39.1	3.6
Alliance & Leicester	Bank, former building society	38.0	3.5
Bradford & Bingley	Bank, former building society	31.1	2.9
Bristol & West	Former building society, subsidiary of Bank of Ireland	23.0	2.1
Britannia	Building society	21.5	2.0
Portman	Building society, merged with Nationwide in 2007	16.1	1.5
Yorkshire	Building society	13.5	1.3
GE Money Home Lending	Specialised lender, wholly owned subsidiary of General Electric	11.7	1.1
GMAC-RFC	Specialised lender, subsidiary of Residential Capital Corporation	11.3	1.0
Standard Life Bank	Subsidiary of Standard Life insurance company	10.4	1.0

Source: *Housing Finance Review*.

Mortgage loans in Britain can be funded in any way the lender chooses, from retail deposits through to unsecured wholesale funding, covered bonds and securitisation. There is no legislation governing any of the specific forms of funding. Some lenders rely wholly on retail deposits, others wholly on securitisation. The large lenders generally use all types of funding although with retail deposits predominating.

It is not possible to give precise figures for how mortgage loans are funded as the large banks do not hypothecate all of their funding to particular categories of loan. In very round terms the outstanding stock of mortgage loans is funded as follows –

Retail deposits	60%
Mortgage backed securities	20%
Covered bonds	5%
Other wholesale funding	15%

The use of covered bonds and mortgage backed securities increased significantly in recent years – until the credit crunch in August 2007. Since then there have been no issues of either type of security, causing difficulties for those lenders that relied most heavily on them. The largest such lender, the Northern Rock, a bank, faced a liquidity crisis and had to be rescued by the government.

### Prudential supervision of mortgage lending

Building societies were first subject to specific capital requirements in 1959. Over time those arrangements converged with those for the banks. From the beginning of 2007 the Basel 2 arrangements are being implemented in the European Union through the Capital Requirements Directive.

In addition to capital requirements for credit, operational and market risk, Basel 2 also sets out requirements for internal capital adequacy assessment and supervisory review and public disclosure of risk and capital information. The basic requirement for a ratio of risk weighted assets to capital of 8% remains. The special nature of residential mortgage lending continues to be recognised, with the basic risk weighting reduced to 35% - equivalent to a ratio of 2.8%.

Lenders can choose between a number of measurement approaches. The simple “standardised” approach provides for the 35% risk weighting for mortgage exposures of 80% or less of the property’s value with a marginal risk weight of 75% for the excess proportion, although this can be reduced if the lender purchases credit risk insurance. This approach is expected to be adopted by the smaller lenders.

Larger lenders will generally opt for the Retail Internal Ratings Based (IRB) Approach. This involves using their own data in respect of default information. The quality of that information and procedures and systems generally have to meet high and consistent standards. The general view is that adoption of IRB approach should reduce the weighting to under 20% - equivalent to a capital ratio of 1.6%. This will give lenders adopting this approach a competitive advantage over others, and over time will encourage even small lenders to move to the IRB approach.

Basel 2 is expected to have a significant effect on mortgage products and pricing in Britain and other countries. Margins are likely to narrow on “prime” loans reflecting lower capital requirements, and widen on sub-prime loans. Lower capital requirements will reduce the incentive to securitise as a means of managing capital, but at the same time make mortgage backed securities more attractive to hold.

### Relevance of the British experience to emerging markets

It is dangerous to seek to transfer practices in respect of housing and housing finance from one country to another. The British housing development and finance systems have developed over a period of many years, in response to particular circumstances. However, every country’s experience with housing has lessons for other countries – on how things might be done and how they should not be done.

The lessons for emerging markets from the British experience naturally follow on from the analysis earlier in this paper.

The rule of law, a sound economy and a

stable society are taken for granted in Britain and in many other countries. If they do not exist then the task of encouraging investment in housing is difficult.

Clear ownership or occupancy rights are essential if people are to be encouraged to invest in their own housing or to engage in housing development. This requires a legal framework in which contracts are enforceable and an efficient and effective system for recording ownership of property. The Land Registry in England and Wales, similar agencies in other countries and international agencies are able to help emerging markets put the necessary systems in place. However, full scale title registration will not help the poorest people who are unable to access formal finance. They simply need security of tenure, which will encourage them to invest in their housing largely through doing work themselves.

The availability of land for new housing development is not a problem in some emerging markets; rather the problems are unpermitted development which can adversely affect the value of houses, space and other standards which are unrealistically high given the means of the inhabitants and the lack of availability of essential utilities. Britain’s utilities are not ideal – much of the infrastructure is very old and needs modernising. However, it is taken for granted that the necessary infrastructure and utilities will be provided for new developments in a timely and efficient manner, the developer meeting the costs either directly or through planning agreements.

In many developing countries there is no large scale housing development. Even where a large site is available the developer has to build units individually as the potential purchasers are able to pay for the work. This is inefficient because economies of scale, which potentially are massive, cannot be achieved, and it is also undesirable for those people who do buy because they will be living in the middle of a building site for many years. Ideally, builders should be able to develop a site as a single operation. For this to happen they need access to bank funding to finance

work in progress, and potential buyers need to be able to obtain long term house purchase loans.

Purchasers of new housing need some assurance that their houses are structurally sound and free from major defects. This can be achieved in various ways including regulation of building standards. However, if the resources to do this effectively are lacking there is a risk that such controls simply become a bureaucratic obstacle offering scope for corruption rather than protection for the public. In such circumstances it might be better to allow developers to develop their own arrangements, backed up by insurance.

Perhaps more importantly, in developing countries buyers frequently have to pay a large initial deposit and are at risk if the developer fails to complete the house. An insurance arrangement like that offered by the National House Building Council provides valuable protection to buyers of new houses, and should be an essential part of the consumer protection framework in any country.

A strong surveying profession and expertise in valuing make a significant contribution to the efficient functioning of a housing market. These cannot be created overnight, and data needs to be built up on which valuations can be based. The government must take responsibility for ensuring that a database of information on property transactions and values is built up and is readily accessible.

Mortgage lending will develop of its own accord if the conditions are right. There is no need for the government to create a "National Housing Bank", or to pass laws specific to mortgage lending or to create a "Mortgage Regulatory Authority". These may well create obstacles to mortgage lending rather than encourage it. Mortgage lending is a banking function that should be regulated by the banking supervisor. Retail banks should generally be mortgage lenders. There is room for specialist non-bank lenders, funded on the capital markets, but they should be subject to

compatible regulation by the banking regulator.

Large scale, safe, mortgage lending is essential both to enable people to buy homes and to bring down the cost of mortgage loans to a reasonable spread over the cost of funds. The 50 – 200 basis point spread that exists in the UK and many other industrialised countries will not be achieved in emerging markets for many years to come. However, substantially reducing the spread, which in some countries is over 15 percentage points – ten times that in the UK, will make a far greater contribution to increasing investment in housing than anything that a government initiative could achieve.

Minimising bad debts and economies of scale are crucial in reducing spreads. Mortgage lending needs to be on a large scale if the fullest possible benefits are to be obtained. Whether wholesale or retail sources of funds should be attracted is essentially a tactical decision.

Emerging markets need to increase the depth and breadth of financial markets as an objective in its own right, and at the same time remove any obstacles to banks financing house purchase. It may be thought that if banks are lending to finance house purchase then those funds cannot be used to finance essential industrial investment. This is a short sighted view. Strengthening the financial system and an expansion of mortgage lending go together. Even very poor people will invest in their own housing. They are more likely to open a bank account and to become more a part of the formal economy if the bank can help them fund house purchase. More generally, the banks are more constrained by a shortage of suitable lending opportunities than they are by a shortage of funds.

There is a strong correlation between economic development and the size of the mortgage market. This is not to suggest that mortgage lending is a driver of economic development, but rather that the two go together and that house purchase lending should not be seen as competing

with industrial investment in a zero sum game.

In the USA, the mortgage debt/GDP ratio is about 90%, in Western Europe it averages 45%, in Central Europe 7% while in developing countries it is just 2%. However, it should be noted that countries in a similar stage of development have widely differing mortgage debt/GDP ratios. An EMF study (2004) showed that in Western Europe the residential mortgage debt/GDP ratio ranged from 13% in Italy to 100% in the Netherlands, with an average of 45%.

### Removing obstacles

Governments in emerging markets should concentrate on removing obstacles to mortgage lending. Such obstacles include–

- The inability of lenders to realise the mortgage security in the event of the borrower failing to make the necessary repayments. This inability may result from laws which misguidedly give excessive protection to the borrower, or an inability to use a satisfactory law effectively either because of the time that it takes (ten years is common in some countries) or the courts interpreting the law in a way that defeats its purpose. A mortgage loan should be the cheapest finance available to individuals because of the security it offers to the lender. If that security is reduced or removed then the loan is in effect unsecured and must carry a corresponding interest rate.
- Related to the previous point, the apparently minor point of delays in registering transfers of ownership and registration of mortgage charges. This puts the lender at risk between the time when it advances the money and the time when it has security. The likely response of a bank is not to lend the money until it has the security, which may mean that it will not lend at all or that the bank or another institution has to provide expensive bridging finance. Efficient land registry procedures do not necessarily require substantial investment; often competent management is all that is needed.

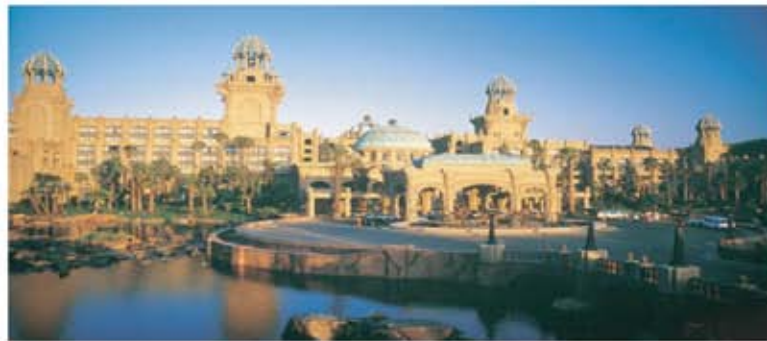


- Unreasonable restrictions by the banking regulator, such as unrealistically low limits on the amount of lending on the security of property.
- Legislation or regulation which attempts to control the terms of mortgage loans, for example whether loans should be at a fixed or variable rate, or the imposition of lending criteria. These will inhibit the development of the market. Market forces combined with prudential regulation provide the necessary safeguards to borrowers.
- Directed lending, for example a requirement to make loans to certain sections of the community or on certain types of property that would not otherwise qualify for a loan. In the early stages of development of a mortgage market it is proper that lenders concentrate initially on “safe” lending. As they gain experience and as the volume of their lending increases so their unit costs fall and they are better placed to extend their lending to wider sections of the community. Pushing the banks to liberalise their lending criteria prematurely will increase their costs and be counter-productive.

Does the British experience suggest that there are positive steps that governments might take to develop mortgage lending? The simple answer is no, but that does not mean that that is the position in emerging markets. Some “pump priming” may be necessary to help the market develop, but it needs to be carefully targeted and time limited so as not to build in subsidies and distortions for the longer term.



**INTERNATIONAL UNION FOR HOUSING FINANCE**  
**27<sup>TH</sup> WORLD CONGRESS, SOUTH AFRICA, 2008**



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