HOUSING FINANCE

Sources of finance

Housing may be acquired through purchase, rental, self-help or cooperative construction and inheritance. Subsidies are provided in many developed countries to households which purchase as well as those which rent. Creation of self-sustaining finance systems to meet the need for affordable finance of the people when purchasing, building or improving their dwelling units has been an important component of national and local policies for the achievement of the goal of shelter for all. Housing finance enables households to become owners, but the variation of the level of owner-occupation between countries is not only related to the majority of the national housing finance system or national prosperity. The relationship between housing prices and household incomes, regulatory and legal frameworks concerning mortgage credits, the degree of competition between lenders, and government policies to support home ownership are all among the factors that contribute to the variation of owner-occupation levels between countries.

Housing finance is provided in most countries by specialized housing finance institutions and private banks. Under stable economic conditions with low levels of inflation and interest rates, housing finance systems work well, and although much variation is observed between countries, middle and higher income groups use most of the mortgage credits. In inflationary economies, particularly in developing countries, affordable housing credit is difficult to obtain even for middle and upper-income groups. Many developing countries have therefore set up public sector housing finance institutions. These usually provide loans at interest rates below the market or even the inflation rate, using funds from budget allocations and captive savings in the public sector, such as reserves of insurance institutions and pension funds. The contribution of mortgage credits to housing acquisition in developing countries is much smaller than in industrialized ones, as households in the former rely predominantly on their own savings often supplemented by informal loans from friends and relatives.

Reaching the poor

In industrialized countries, specialized housing finance institutions have lost most of their privileges, while some restrictions to their operations have been lifted as a result of the mortgage market liberalization policies pursued during the last two decades. Increasing competition among lenders may create more favourable conditions for lower income households to access mortgage credits.

In a number of developing countries, on the other hand, public housing finance institutions or banks have become ineffective or have even collapsed. Insufficient flow of new financial resources to compensate interest rate subsidies, poor management and political interference lead to gradual decline of the value of assets of public funds that are used for this purpose. The number of "non-performing" loans increase during inflationary periods or economic crises, leading to large-scale default. Attempts to stabilize inflation through interest rate increases (demand management) make it more difficult for public housing banks to serve low-income groups. Barriers to the provision of housing finance to the poor include the mortgage as the lending instrument, the cost of funds and the risk of default. The conventional form of securing a housing loan is through the mortgage loan, a highly formalized legal instrument which requires a clear title to the land, valuation of the property and registration in a land register, all calling for costly professional help, that the poor may be unable to afford. Furthermore, regular repayment obligations may be an impediment to moderate-to-low income households without regular incomes.

The risk of default is closely linked to the fact that housing loans are relatively large sums in comparison to the income of the borrower. The borrower's ability to repay the loan is the first risk to be considered, since defaults present a cash flow and income problem for the lender. Long-term mortgage risks would raise costs of borrowing funds over time, while a lender's income from housing loans may be locked in at a lower level. Furthermore, in the case of less-developed regulatory and legal frameworks for mort-

Did you know that in Africa a house costs 12 times the annual median income, and only six in highly industrialized countries?

gages, the financing institution is not able to easily convert mortgaged property into liquid funds in case of default by the borrower. It must enter into often lengthy and costly legal procedures before the property can be sold.

What governments and cities can do

In many developing countries, the creation of an adequate regulatory and legal framework to deal with all aspects of mortgage finance to safeguard the interests of lenders without disregarding the rights of borrowers is a necessary first step. Special programmes within government budgetary limits and with the contribution of civil society organizations are needed to make mortgage finance affordable for low-income households.

Cities can help overcome some of the barriers to financing shelter for the poor. One of the main roles cities can play is providing access to land through subsidies at low cost and clear title, which is the most important basis for housing loans. A well-designed land management and registration system can increase people's access to housing and credit considerably, a key principle which recurs throughout this chapter.

Cities can also stabilize long-term property values through extension of main lines for water, sewers, roads, electricity and other essential public services in the vicinity of poor communities.

Local authorities also need to open channels for dialogue with community organizations on land and tenure issues to expand the range of alternative finance mechanisms. Various forms of community land holding exist which could be recognized as collateral for lending. Some of these have become the basis for micro-credit lending schemes.

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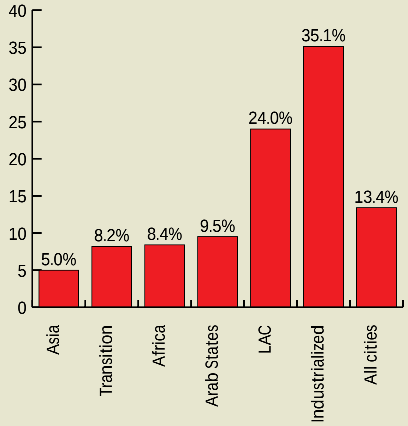
Mortgage-to-credit ratio



The Mortgage-to-Credit ratio is a measure of the relative size of the housing finance sector and its ability to provide households with the funds necessary to smoothen consumption patterns over time. If mortgages form only a small part of total credit, it is likely that housing finance institutions are poorly developed, or face legal or institutional constraints making it difficult to meet the demand for housing finance. Least developed mortgage sectors are in Asia, Transition countries, Arab States and Africa, accounting for less than 10% of total credit.

Micro-credit schemes

Over the last decade, savings and loan (S&L) groups at the community level, supported mainly by NGOs and international donors, have become increasingly important in financing shelter for the poor. These S&L groups allow low-income households to gain access to credit *as a community*.

When settlers organize themselves into stable associations, some of the usual financing criteria can change. Not only are individual regular incomes considered, but also informal earnings of all members of the association, where the community as a whole acts as guarantor for the repayment of individual loans. Thus the amount and means of repayment can be adapted to the income flow of the different community members. Loans are secured by the many binding ties between the members (i.e., social capital). Social guarantees and peer pressure work particularly well when additional loans to other group members need to be made available, which are themselves dependent on good individual repayment performance.

Moreover, the community association can be effective in collecting monthly rental or amortization payments from all members. The association keeps individual records of accounts for the monitoring of all collections and payments made by its members. This is in addition to keeping records of the community loan account, showing the total monthly dues and the total remittances made for the said loan. The relevance and the diversity of community-based movements is confirmed by many examples, such as Grameen Bank housing loans in Bangladesh,[9] the programme of the Urban Community Development Office[10] and the Community Mortgage Programme[11] which have demonstrated the feasibility of this approach. Experience has shown that communities where individual incomes are in the lowest quintile have an excellent record in loan repayment.

In 1997, Homeless International (an international NGO) decided to support a relocation scheme that had been developed by SPARC (a local NGO) in cooperation with the community, the City of Mumbai and Citibank. The initial proposal promised to reduce the financial risk to the private bank by incorporating an assured sale of at least six apartment blocks in the early stages of the project. Citibank further suggested that a standard guarantee arrangement, with Homeless International taking the top slice of the risk (i.e. the first 20 percent of defaults), could be agreed locally without referring the decision to Citibank headquarters or to other agencies in India. The agreed mechanism is as follows: Homeless International Guarantee Fund receives funding from European Commission funds, Barings Endowment and Airways Charitable Trust. It uses these funds to guarantee a Citibank wholesale loan in local currency to the community to be relocated, which is supported by SPARC and organized into a cooperative. With a 20 percent guarantee, Citibank lends five times the value of the foreign exchange guarantee in local currency. The local community organizations are responsible for the loan repayment to Citibank.

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Linking Community-Based Housing Finance to Formal Finance in Cochabamba, Bolivia

In Cochabamba, 70 percent of the population lived in poor housing conditions and most families also faced problems with access to basic services. The government therefore legislated to strengthen financial services at the municipal level. Homeless International provided a US$50,000 guarantee to a financial institution, which in turn lends for house construction or renovation to individuals or the community at a rate of 11 percent for 12-18 months, with options for further credit after repayment. Around 100 families have benefited from the scheme.

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