Housing

By Sabah Almoayyed

Intellect Resources Management WLL
August 2020

INTELLECT RESOURCES MANAGEMENT W.L.L.

Taking Housing Finance to Low Income Borrowers

Presented by: Sabah Almoayyed
July 11th, 2012

INTELLECT RESOURCES MANAGEMENT W.L.L.

Table of Contents

Background to Problem of Housing Finance to Low Income Groups

Low Income Groups face various problems in financing their homes, significant ones being:

- Inability to afford houses priced highly
- Inability to access finance at low rates and to obtain it at low risk premium

To redress this it is necessary for:

- Government inducement of flow of funds to the housing sector
- Supply Side measures to be taken
- Demand Side measures to be taken

A) Government Inducement of Fund Flows to Housing Sector

Market forces alone will never house a nation's poorest citizens. Hence, government inducement: being midway between total intervention and laissez-faire.

These are some steps Government may take to induce funds flow to the sector:

- Creating a conducive capital environment
- Fostering public-private partnerships
- Providing subsidies and financial contributions
- Directing Credit/Funds flows to the Housing Sector

Creating a Conducive Capital Environment

Creating a Conducive Capital Environment

Create Adequate Legal Framework

- Capital flows and its priced by the risk in the investment
  - If legal framework is weak, flow impeded/cost hiked
  - Legal framework should exist in the theory and practice i.e. rights/enforcement practically possible/quick

- Create Adequate Market Structures by developing e.g
  - Transparent/reliable primary and secondary capital markets
  - Means/methods for aggregating, selling financial instruments (e.g. securitizations)
  - A fair, robust commercial and investment banking system
  - A range of structured, diverse real estate capital market instruments (e.g. bonds, sukuks, reits)
  - Specialized Housing SOEs to stimulate markets (e.g. Thailand GHB)

Fostering public-private partnerships

- **Rationale for Harnessing private sector funding on a participatory basis**
  - Experience shows that government's are often not the best in execution/implementation

- Conversely, private sector although strong in implementation, is constrained by its risk appetite/risk-return paradigm
- Hence, pooling the efforts of government, private sector helps open the market as well as to effectively implement.

- **PPPs- an ideal methodology for co-opting**
  - The South African experiment is a good example. Under the South African 2003 Financial Charter, government identifies and encourages whilst private sector delivers the outcome.
- **Expectation from Government**
  - Clean boundary rules, Prompt and Consistent administrative guidance, Even handed selection and Judicious enforcement of law.
  - Acknowledge the private sector's profit motive
  - Protect against political pressures and journalistic overzealousness
- **Expectation from Private Sector**
  - Commitment on basis of free market discipline
  - Have real equity at stake, financial accountability
  - Accept financial risk e.g. not seek transfer risk to govt. through bail out in case of mishaps

Providing subsidies and financial contributions

- **Rationale for Government Support**
  - For low income group, even with the synergy of public-private partnership, the final housing cost is unaffordable/difficult to attain. Hence, need for Govt. support.
- **Examples of government support**
  - variety of ways:
    - by providing land for such projects on a nil cost basis or on highly concessionary terms;
    - by increasing the supply of higher-density inclusionary zoning in exchange for a portion of the created value
    - by extending appropriated grants, such as down payment assistance or loans;
    - by giving ongoing subsidies or partial waivers of repayments or
    - by extending fiscal incentives
- **Balancing of Support mechanisms**
  - The art lies in designing the right mix and augmenting it with appropriate subsidies. Too little and the whole effort may fail; too much and Govt. fiscal position may not be able to absorb on a sustained basis.

Directing Credit/Funds Flow to the Housing Sector

At times, it becomes necessary for the Govt. to take measures to direct credit/funds into the Housing sector. Some measures are noted below.

- **Credit Direction**

Credit direction involves the mandating of funds flow to the housing sector. Examples of credit direction.

India: Concept of "priority lending" used to quantify lending targets for flow of funds from Commercial banks to the priority segment (including housing). Preferential cost also prescribed, driving down the housing finance burden to the poor.

USA: Statutory approach e..g. Fair Housing Act 1968, Equal Credit opportunity Act 1974 to overcome impediments to flow by practices such as "redlining". Also, Community Reinvestment Act (CRA) to promote fund flows to low-income borrowers.

Point to note in the background of sub-prime crisis: Such CRA loans not riskier than loans to the higher income borrowers as per former CEO of Fannie Mae

- **Contractual Approach**

Under this, the govt. leads in the matter by fostering an agreement and buy-in with the private sector on its role.

South Africa (example), where govt. envisaged the Community Reinvestment Bill and, the private sector responded with the Financial Sector Charter (FSC), under which the how income would be funded either directly or through other wholesale institutions.

Directing Credit/Funds Flow to the Housing Sector

Mortgage Guarantee System

- Mortgage Guarantee Schemes are risk mitigants offered to private sector leaders, usually by the state.
- The individual structuring may vary in its details but essentially if the loan to the affordable segment borrower goes sour, the guarantee kicks in and the lender is protected from the effects of the delinquency.

Channelizing Domestic Savings

Access to domestic savings with the least intermediation is a key factor in ensuring the viability of social housing schemes. Some means used to mop up savings are:

Bond market: Issuance of Housing Bonds, to directly tap the savings market, permitting availment of Long-term concessional loans to specialist wholesale institution for onward lending.

Pension Funds: These are significant repositories of domestic savings. Some countries have devised means of channelizing at least part of these savings towards the housing sector by regulatory and other incentives.

Insurance Market: Another significant repository of individual savings is the insurance sector. Directing part of the savings reflected by insurance corpus holdings is also a means of boosting the funding available to the housing sector.

Contractual Savings: Some countries also operate a Contractual Savings structure under which the individual is encouraged to steadily build up funds for meeting his future housing needs, with some preferential treatment thrown in by the State to incentivize such fund building.

Dis-intermediated Savings: There are also alternative models where the savings in the economy is directly accessed and routed through to the social/priority housing sector i.e. basically a dis-intermediation model as in the French system of Caisse Des Depots.

(B) Supply Side Measures

Meaning of Supply Side Measures

- **Increasing physical stock of appropriate housing**
    - These include all measures to increase the availability of housing stock, whether owned housing or rented, whether horizontal (villa) or vertical (apartments).

- **Main means of stock increase- Rental/Ownership**
- There is no standard global preference for one over the other. Choice influenced by cultural/economic considerations.
- Netherlands: mainly through subsidized rental; Spain mainly through subsidized ownership
- Bahrain: Strong preference for Villas and Ownership.
- Influenced by cultural needs and scaling-up potential to accommodate extended families.
- Trend sought to be changed due to large welfare housing need and pressure on land.

Meaning of Supply Side Measures

Short run introduction of Supply side incentives

- In the short to medium term, supply side incentives are quite effective
- In longer run, demand side subsidies are more efficient as they are more closely linked to income.
- **State as Supplier – Role & Evolution**
    - State often starts as sole supplier of low-income housing, later evolves due to execution/capacity/financial constraints to a facilitatory role.
    - Bahrain example – State as Sole Supplier

Rental Units:

- Rental apartments are considered only as a stop-gap arrangement until an ownership unit is delivered to the citizen.
- MOH delivers rental unit if eligible citizen is not given an ownership unit and up to 5 years is charged an affordable rent. It has provided Rental Units at subsidized rates, to about 21,434 households.
- Thereafter, if he does not get an ownership unit but continues to reside in the rental unit, no rent is charge to him i.e. accommodation is free (i.e. state bears the entire cost).

Meaning of Supply Side Measures

State as Supplier – Role & Evolution

- Bahrain Example State as Sole Supplier

Ownership Units:

- Affordable housing (most often in the form of villas) is built by the Ministry of Housing and sold to eligible Bahrainis at the construction cost.
- The price of the house is collected in monthly installments over a period of 25 years through Eskan Bank, the specialized financial housing institution of the state. No finance charges are added to the initial purchase price.

- **Rental Assistance:**

  In terms of Households on waiting list, the State gives a rental allowance of BD 100 to about 33,000 beneficiaries.

- **Extent of Bahrain State Role as Sole Supplier**
  But with a current waiting list of about 50,000 houses, involving about USD 5.7 billion (excluding land/infrastructure cost and incremental demand due to population growth), the role of the State as sole supplier is showing signs of evolving to that of being a facilitator.

Meaning of Supply Side Measures

Some measure that have been used globally to incentivize on the supply side are noted below:

- **Capped profit**
  - Profit/mark up restrictions e.g. in China where a profit limit of no more than 3% of the development of development cost is stipulated on affordable housing schemes.
- **Density Bonuses**
  - Density bonuses e.g. in the US, are granted for projects in which the developer agrees to include a certain number of affordable housing units.
- **Direct Grants**
  Varied methods have been used e.g.
  Cash grant: A cash grant of one-time specified percentage of the agreed project cost or by way of running subsidies for a specific period. These raise the project IRR to a level that interests the private developers.
  Free/Concessional Land: At times, the whole or part of the land cost is borne by the State e.g. in Bahrain, in the land grant mechanism is being used for the delivery of affordable housing through Eskan Bank, which has been tasked in developing 2500 housing units on lands received as grant from the state.
  Off take guarantees: Where cost structure is acceptable to the developer, but there is marketing risk impeding project, the state may seek to neutralize this risk for the developers by giving off take guarantees.
  Administrative Incentives: Classification changes. Land classification shifts form commercial to residential use could increase housing stock.
  Processing Preference: Malaysia and Canada are good examples on the positive impact of the streamlining of administrative requirements through fee waivers and fast-tracking procedures.
  Combination of measures:A notable example is Malaysia. The state has established public-private business partnerships; land for low-income housing is given as grant; streamline administrative procedural aspects have been streamlined; an inclusionary housing quota of 30% affordable units in any new development allowed; additional incentives given for developers exceeding the 30% quota (e.g. fast tracking windows, lower land premiums, subsidized infrastructure and utilities, etc.).

(B) Demand Side Measures

Meaning of Demand Side Measures

- **Objective of Demand Side Measures**

The demand side measures address the problem by looking at the matter from the borrower's side.

Examples of Demand Side Measures

- Measures that tackle the affordability in terms of eligibility, loan norms (LTV ratio, DSR ratio, etc.) are some examples of Demand side measures
- Demand side measures also impact the affordability to borrower by reducing the cost through Govt. Capital Grants and Housing Allowances.

Meaning of Demand Side Measures

One time subsidies

To households for purchasing, building, completing or repairing (new or existing) unit

- **Adaptation of one-time subsidies**
  In Bahrain, Capital grants have been effectively given although in two modified forms as follows:
- Concessional Interest: Loans are given for Purchase, Construction or Repairs to eligible borrowers under a loan program, and is popularly called as "social loans". The loans are by Eskan Bank, the financial housing arm of the state, with the credit risk being underwritten by the state. The first element of grant comes in the pricing of these loans. A fixed rate is applied over the loan tenor (maximum 25 years) as against floating rates available in the market from other housing finance lenders, Further, the rate is on a highly concessional basis of 3%. The subsidized pricing relative to market rates may be considered to be a grant over the loan period.
- Waivers of Outstanding: Waivers of Outstanding: Additionally, from time to time, substantial portion of the outstanding loans of the borrowers are waived by the State (e.g. 50% in 2006, then 25% in 2011) i.e. effective capital grant of 75%.
- These are regular ongoing subsidy to households that covers some of the costs for housing.

These appear in two main forms:

- **Norms based:** Here, the household receives a fixed subsidy. Shortfall vis-à-vis market price is to be paid by it, and excess retained.
  In Bahrain, such housing allowance is given @BD 100 p.m. to 5 year wait-listed eligible beneficiaries.
- **Burden limit**: Here, the government only pays the difference between what it deems that the household is able to pay and the housing-related expenditure.
  In Bahrain, in case of loans given through Eskan Bank, the monthly installment amount that can be recovered from the borrower is capped at 25% of the salary. Again, under a "Fast Track" scheme under formulation, excess of the EMI over 25% is expected to be borne by the state.

Eligibility Norms

Demand Side measures addressing eligibility norms attempt to make it easier for the individual to qualify for and avail of funding. The factors addressed include.

- **EMI (Equated Monthly Installment)**
  EMI is important as the residential income of the borrower depends on its relative to his gross

income (i.e. the Debit Service Ratio – DSR)
In fixing the appropriate EMI/DSR, attention should be given to the borrower's ability to bear future interest rate hike especially interest rates are at all time low, as in current period.

- **The Down Payment**
  The Down payment required to avail a loan is reflected in the Loan to Value (LTV) ratio. This indicates the borrowers' equity in the house.
  A low equity may encourage default. But, in case of low-income groups, as they need the property for self-occupation, this negative correlation is not considered to be as strong: hence, these are sometimes dropped to as low as 5%

- **The Mortgage Loan Tenor**
  The loan length is often linked to the earning period of the borrower. It is usually around 25 years but even stretched to 40 years at time. Longer the loan period, lower the EMI and hence affordability.

Summary:

- Making housing finance available and affordable to the lower income groups involves government encouragement and actions on both supply and demand side.
- Demand side – permits such low-income borrowers to qualify for funds
- Supply side - makes units available at lower prices, so that the loan amount/EMI reduces making it affordable.
- Overall Government support and subsidy would facilitate such housing to reach the low-income groups, along with the systemic, financial market and institutional development measures.