Policy Options to Improve the Framework for Housing and Housing Finance

Although economies in South Asia share a common need for expansion in the housing and housing finance markets, each country is at a very different level of market development; and specific policy directions have been suggested in each country appendix to address carefully the specific areas of importance in each system. Four common priority topics emerge across the region and are noted below: (1) land administration, (2) market information provision, (3) access to long-term funding, and (4) servicing low-income groups through innovative housing finance solutions.

Efficient Land Administration

A number of steps remain to be taken to improve landownership, registration, and titling processes in South Asia. Clear and consistent laws and regulations on land registration and titling must be put in place and enforced. In each country, a designated authority should be assigned to take charge of dealing with land-related regulations and titling procedures. The titling processes need to be made less costly and more efficient because cumbersome procedures involving many steps lead to corruption and inefficiency. Stamp duty and legal charges should be reduced significantly. Land registration should be carried out in a transparent manner with clear recordkeeping. Computerized information and registration systems, property and ownership databases, and cadastral surveying would increase transparency and the enforcement of creditor rights. Land transfer procedures also need to be revised, simplified, and homogenized across different country regions. As land administration systems become simpler, cheaper, faster, and more reliable, an increasing number of transactions will be formalized, thus eliminating uncertainty in property ownership and easing ambiguities resulting from application of traditional and Islamic laws.

Housing and Housing Finance Information and Transparency

The availability of ready and easy-to-consult information on property prices and real estate data; housing supply and demand; construction; and various housing finance data and pricing information, including credit records, is indispensable for the smooth functioning of the housing and housing finance markets. It is important to provide periodic surveys to the market, including collection, analysis, interpretation, and publication of data on the performance of the housing and housing finance sectors. The data should be electronic and available by subscription to all paying parties. Relevant information to collect includes

- housing supply information, such as new construction and sales, vacancies, quality and condition of property, prices, and dwelling characteristics;
- housing demand data, such as demographic trends and housing needs, characteristics of occupants of the existing stock (crowding indicators), affordability (availability of income indicators are of paramount importance for this), and buyer's intentions;
- housing finance data, such as sensitivity of monetary indicators to residential and commercial property exposures of lenders and investors (for example, inflation rates, interest rates), fiscal indicators and degree of reliance on housing-related developments (such as property taxes, construction industry contribution to GDP and employment), lending volumes by category of financial institution, loan characteristics (loan-to-value ratios, debt service ratios, prices, locations, borrowers); and
- construction input data, such as production capacity, price of materials, labor and land, and availability and quality of materials.

Long-Term Funding Availability through Mortgage Refinancing

South Asian housing markets lack long-term funds. This paucity of funds puts non-banking financial institutions on an unequal footing with banks, which can benefit from their deposits as a source of cheap funding. To address liquidity and risk of term mismatch, international best practice suggests the creation of a mortgage refinance facility, a type of housing fund that takes mortgages off the balance sheets of financial institutions and injects the required liquidity so further mortgage lending is possible. The same effect can be achieved by securitization in countries where the institutional and developmental prerequisites for securitization are present. A mortgage refinance facility also prepares the market for securitization in the long run.

A secondary mortgage facility is a financial institution designed to support long-term lending activities by primary mortgage lenders. Its core function is to act as an intermediary between mortgage lenders and the bond market, with the objective of providing long-term funds at better rates and under better terms and conditions than lenders might be able to obtain if acting alone. The liquidity facility would be able to issue its own private bonds, thus separating market long-term debt from interest rate subsidies and enabling more efficient and transparent targeting of the subsidy. A facility could refinance all eligible lenders (both banks and finance companies) that provide as collateral high-quality mortgage loans. The facility would issue low-risk private bonds among institutional investors. This mechanism would centralize funding requirements, catalyze the primary market for housing finance, provide matching funds at an acceptable cost, encourage discipline by requiring higher lending and servicing standards, and provide some form of institutional support to help build the link to securitization in the long term.[1]

Expanded Housing Finance to Low-Income Groups through Product Innovation

In view of the very low incomes and widespread inability to afford housing in South Asia, expanding access to housing finance to lower-income groups will remain the main challenge. The customer base will broaden naturally in response to reduced intermediation costs, more competition, more efficient institutions, fixed (and lower) interest rates, and longer loan maturities. Tax-deductible mortgage payments would make mortgages further affordable to the middle-income groups. Strengthening the enforceability of mortgage rights would have the additional effect of extending mortgage finance to lower-income groups because financial institutions would become less sensitive to client income and would rely more on the value of the enforced collateral instead.

Pure market-based solutions are likely to work for many currently underserved lower-income customers, as experience in India shows (annex C2 of appendix C). The “employer-facilitated” model is a fundamental business innovation that makes the provision of low-income housing attractive to the private sector. Alternative models are required for the informal sector (self-employed and salaried unorganized employees). Further innovative products and instruments include the contractual savings scheme, mortgage product customization, reengineering of lending processes to allow for better risk mitigation and client segmentation, an interest risk mitigation fund, and a financial guarantee facility (see the “Policy Options to Improve the Framework for Housing Finance” section of appendix C). Significantly scaling up South Asian housing finance markets crucially hinges on product innovation, which would bring down lending costs, customize loans to client needs, enable financial institutions to better manage risk, and help extend supply farther down the income scale. Innovations and rapid scaling-up of housing finance markets require active capacity-building efforts for financial institutions, developers, regulators, and other housing market participants. These efforts could include streamlining for small-mortgage processing, new product development, demand aggregation, risk assessment, loans servicing, consumer information and protection, and defined business standards.

Microfinance will be of central importance in extending the outreach of the housing finance market, particularly in rural areas and for house upgrades and maintenance in urban slums. To solidify the link between microfinance and housing, the policy maker would need to tackle three challenges: (1) improving the commercial sustainability of microfinance housing products, (2) strengthening the microfinance regulatory framework, and (3) extending microfinance for housing to urban households.

Below a certain income and affordability level, pure market-based solutions will not be enough; and home ownership will need to be promoted through a combination of market-based levers, policy initiatives, and direct support from the government. When even those measures are inadequate, rental housing remains the only solution. Detailed studies of the existing rental framework are required, with a view to streamlining efficiency and protecting both tenant and landlord. Some of the more effective levers that could be used to bridge the affordability gap are smaller-size units, low-cost technologies, standard construction norms, tax exemptions, credit guarantees, and land policies geared to low-income groups.

Targeting the lower-income groups where unsubsidized housing is not affordable would require assistance programs that target bankable lower-income households and a scheme designed to leverage public spending by market resources. The most efficient subsidy schemes are those that are directly allocated to the beneficiaries and that include a preliminary savings requirement as an eligibility criterion to trigger a leverage effect with private resources. The assistance scheme could be linked to the savings-for-housing scheme, given the synergies between the two mechanisms. Savings-for-housing schemes would go a long way toward spreading housing finance outreach by helping lower-income savers in building up downpayments. Islamic finance can play a considerable role in enlarging housing finance access because it often targets customers with lower-than-average incomes.

Note

1. A best-practice example is that of Malaysia's national mortgage corporation Cagamas Berhad.