Proceedings: Housing Finance Seminar Goa, India

PROCEEDINGS:

HOUSING FINANCE SEMINAR

GOA, INDIA

MARCH 14-17, 1984

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This was indeed a conference I was sorry to see close. An extraordinary group of housing finance professionals spent two days trying to come to grips with operational and resource mobilization problems which at time makes our task seem truly herculean. We are all dedicated to providing shelter opportunities for low income people.

In today's housing environment the basic question which confronts us remains the same: How can we best help people own a home of their own? The chairman of HDFC, Mr. H.T. Parekh, had an answer; he has built an organization dedicated to this very goal: "We must capture the energy and creativity of our best minds to address the problems of the least fortunate; we must avoid the quick-fix, the burdensome subsidies, and the 'let the government do it' approaches. We must combine the business of doing business, and the compassion of social justice to build institutions and programs which are practical, affordable and lead to the creation of better shelter."

AID's partnership with people like Mr. Parekh and our other colleagues at this seminar goes back over two decades. The ideas and concepts explored in this seminar are largely a product of these two decades. They reflect how far we have come, how different our approaches often have been, and how far we must go to fulfill our goals. We agree on the basic issues though we may disagree on specifics but this is the learning experience: We learn through the diversity of our approaches.

During this seminar, we agreed to continue our efforts, to learn from our mistakes and to seek new alternatives posed by the ever changing environment to enhance opportunities for people to invest in their future.

Peter Kimm
Director
Office of Housing and Urban Programs
Agency for International Development

Housing Finance System
For Lower Income Groups in Germany

Presented by:

Dr. Willi Dieter Osterbrauck
President
International Union of Building Societies
and Savings Associations

It is a great pleasure for me to convey warm greetings from nearly seventy member countries of the International Union of Building Societies and Savings Associations and to extend the best wishes to you all for a successful seminar and for a good business in this year! I would like to thank our hosts very much for this impressive seminar, the United States Agency for International Development and the Housing Development Finance Corporation Limited, India.

I. The Housing Situation in Germany

In a world with a population which is steadily growing - we have just learned the latest estimates indicating a world population of more than 4.5 billion people - it is of paramount importance, particularly for those who feel responsible for urban development and settlement policy and for housing, to work together.

Housing is a basic human requirement throughout the world. An important element in people's efforts to attain an adequate dwelling is the practice of saving with building societies. This type of saving is an excellent example of how co-operation is possible in a community of people who are keen to establish homes suitable for families and to acquire property and develop it.

The basic concept that joint efforts, both by the individual citizen and by the State, are necessary in the field of housing has been accepted in the Federal Republic of Germany for a long time.

Our Housing Act, which has been the principal legal basis for the public assistance of housing in our country for more than 25 years now, contains the following statement:

> "The aim of public assistance is to eliminate housing shortages and enable broad sections of the population to become home-owners. Assistance is intended to permit all sections of the population to be provided with adequate housing in accordance with the various housing requirements concerned and in particular to ensure such provision in the case of those who are not in a position to do so themselves."

The extremely high housing output in Germany is the result of a combination of the initiative of those seeking housing, the willingness of the population to save, economic growth, the efficiency of the housing enterprises and the construction industry as well as the public assistance provided by the state in the form of tax incentives and selective subsidies.

The most important pre-condition was no doubt the creation of incentives for private investment. However, it would not have been possible to meet the basic housing requirements of the population without complementary state assistance.

To maximize efficiency, a broadly based set of instruments for providing public assistance was introduced.

II. Housing Finance Instruments

There has been a shift in the relative importance of the various instruments in the course of the last 30 years in connection with the general growth of the economy and the associated rise in incomes and also as a result of decisions about priorities in public budgets. While direct State aid from public funds and tax assistance towards the financing of housing predominated at first because the capital market was not yet able to cope with demand, it became possible later to leave the financing of housing increasingly to the capital market. In this context, the State aid for "saving-to-build" schemes proved to be an increasingly strong support. The proportion of people using building society funds to acquire owner-occupied property now stands at a little over 75 percent.

The origin of all the savings and home loan systems which exist in Europe lies in England. Most of us know that the first building society was founded in Birmingham in 1775, and that it was a "terminating building society." This system worked on a collective principle whereby the applicant for a home had in a first stage to give his help either as physical work or by contributing to the funds of the society so that, in a second phase, and in accordance with fixed rules, he could get his home or his loan for a home with the mutual help of the group of like-minded people.

This type of collective building society was replaced by about the middle of the 19th century by the "permanent building society" which operated the so-called open system of savings and home loans. This has proved very successful in the U.K. to this day (and proceeding from Great Britain, it has spread to most of the countries of the Commonwealth and has been successful in many other countries). Under this system the borrower does not have to have been a saver with the building society. Deposits in the form of "shares" are accepted without limitation so that basically it is for the building society to decide the extent to which it lends out its funds on long-term mortgages. Apart from the U.K., the other country in Europe where this system operates is the Republic of Ireland.

In contrast to this, the collective principle - or closed system as it is also called - was revived more than 60 years ago on the European mainland. The first Bausparkasse in Germany to operate on this principle was founded in the early 20s. It was very soon copied. In spite of early hostility and difficulties, Bausparkassen of this kind are operating very successfully in Germany and Austria today. In a modified form this system operates in France as "credit differe." France is giving active consideration at the moment to introducing the system into Spain and Senegal. Technical help and advice has been sent from Germany to Greece, Turkey and Tunisia to assist those countries to introduce similar savings and home loan systems.

A condition of the present collective system operated by Bausparkassen is that there must be a period of preliminary saving which is set by a fixed scale and during this time the saver earns the right to a favourable building-saving loan on fixed terms. The building-saving loan is settled out of accumulated savings and deposits and loan repayments, and must always and without exception be used for housing purposes. It is a basic requirement of the system that borrowers have been savers and only savers can be borrowers and this is the reason why it is a closed system.

A third system of housing finance which spread from Prussia to most of the countries of Europe during the 18th century and still plays an important part today is that of the mortgage banks. On the basis of claims against borrowers, which are secured by mortgages on real property, bonds are issued and these are taken up by the investing public or by institutional investors. In this case, just as in the open system, savers and borrowers really have nothing to do with each other. According to the original idea of the mortgage and bond system the loan was made at a fixed rate of interest for a term corresponding to that of the bonds issued. Of course nowadays fluctuations in the capital market often give rise to periods of widely varying interest rates or short fixed terms.

Mortgage banks have an important role to play within the European Community in Denmark, Germany, France, Italy and the Netherlands, as well as in countries outside the European Economic Community - Norway, Sweden and Finland.

This survey shows that out of simply original forms in the 18th century many national variations have now arisen. They were able to succeed within a national financial system against the competition of other financial institutions. The development was also influenced by differing tax systems and differing measures for encouraging savings and home ownership. Differences in the mentalities of savers and borrowers also play a real part as do national characteristics which cannot always be explained rationally.

The present situation in Europe is, as we said at the outset, influenced by the objectives of the treaties which established the European Economic Community, and especially by the freedom of establishment, the freedom to provide services and the freedom for movement of capital. The actual situation in the housing credit sector is still nowhere near these ideals. As well as the fact that most countries' legal systems do not allow their institutions to operate in another country in the European

Community, there are further obstacles which it is now almost impossible to overcome. These are the different national currencies, the differences in the aims of national economic policies, the consequent sharp fluctuations in rates of exchange and the strict limitations on capital movements in certain countries. The markets for savings and housing finance are thus closed national markets for which there is at present neither a way in or out.

III. Saving Through a Building Society or Bausparkasse or a Similar System

Saving for building systems exist in six of the eight countries under survey. In Italy such a system has however only been offered by some individual savings banks up until now but a general introduction of such a system is envisaged. Saving for building is, however, unknown in Denmark and the United Kingdom. In Denmark, however, some banks and savings banks do offer forms of savings which, after a certain period, bestow the claim to a loan but, on the one hand, prior saving is not always a condition for granting credit and, on the other, the loans may be used for purposes other than housing. In the United Kingdom however the assets-side business of the building societies is almost exclusively devoted to granting housing construction loans but there is not, however, a saving for building system where the borrower must necessarily have saved with the institution in advance. A point common to all saving for building system is that the customer must first of all have an account at the credit institution in question on which certain inpayments must be made and that on the basis of this prior saving he obtains a claim to a loan which must be used for housing. The details of the various systems are however different. In Germany the saving for building business is reserved for special building societies, in Belgium, Italy and Luxemburg, saving for building systems are offered by the savings banks or other groups of institutions and, in France and the Netherlands, there are both specialized institutions and such system at other groups.

In Belgium saving for building (Belgian expression "saving for housing") was introduced by the CGER in 1970. Other institutions followed this lead subsequently. In the Belgian system the customer saves a set amount for a set period of time and has then a claim to a loan which bears a certain relation to the amount saved. The situation at the CGER is as follows: each quarter the customer pays a sum which has been fixed in advance but which may be adjusted each year for five years. The loan is five times as high as the amount saved including interest where an absolute maximum amount is fixed. The advantage of this system lies in the certainty of obtaining a loan and in the low interest rate charged on the loan. In Belgium there is no legislation which reserves saving for building to certain groups of institutions.

In France there is the system of building societies (Societes de Credit Differe) which is described as "credit differe" (deferred credit) and the system called "epargne logement" (saving for housing) at the banks and savings banks. Both systems are run on similar principles but the market share of the building societies is not significant. It will therefore not be taken into consideration here. In the system practised by the banks and the savings banks, a distinction is made between saving for building passbooks and saving for building plans. A common feature of both forms is that private persons must save for a certain minimum period (on passbooks 18 months, 4 years on plans) in order to have a claim to a loan at preferential conditions. In the case of saving for building passbooks there is no obligation to make periodic payments but a certain sum must be paid at a given time in the case of plans. This system offers the following advantages: a loan at preferential conditions, a state saving for building premium to the amount of the total interest, a preferential position for the allocation of special building loans and premiums as well as the possibility of obtaining supplementary loans. The saving for building business may only be carried out by institutions which have special permission to do so. All the savings banks and most banks have this permission. Furthermore, a distinction is made between institutions which may accept saving for building deposits (e.g. all savings banks) and those which may grant saver's building loans (e.g. only the savings banks which have concluded a special agreement with the state).

Under the Luxembourg saving for building system (Luxembourg expression "saving for housing") the customer who wishes to obtain a saver's building loan must have a saving for housing account for at least three years the balance on which must not drop under the limit of 10,000 Flux (approx. 200 UA) during this period. The total amount of interest credited during this period must account for a minimum of 6,000 Flux. In such a case the credit institution is obliged to grant the applicant a loan amounting to at least 150 percent of the balance on the account which is however subject to a certain maximum amount. The Luxembourg system may be offered by all accredited credit institutions. The advantages of the system lie in the claim to a loan, to a saving for building premium to the amount of total interest, to a state guarantee of up to 85 percent, thus 25 percent over the lending limit of 60 percent and to other grants in some cases. A German Bausparkasse has also been operating in Luxembourg since 1 February 1977.

In the Netherlands the customer must pay an amount at regular intervals during a fixed waiting period which consists of a contribution to the savings and the cost. Savings which are allocated according to a fixed system may be used to construct housing immediately. When the waiting period has expired the saver obtains a mortgage loan. The advantage of this system is first of all that because of the collective system the customer obtains his own home faster than through individual saving and he also obtains benefits which we would not have received on his own. Saving for building business is not reserved for certain groups of institutions in the Netherlands. Other institutions besides the building societies are also involved.

Under the system in the Federal Republic the saver, having concluded a contract with a building society, commits himself to paying a minimum of 40 percent of the contractual sum in regular instalments (also exceptional case of 1 non-recurrent payment). After a minimum period of 18 months he can request allocation (provision of the contractual sum for credit balance on account and saver's building loan). The saver's building loan is usually secured by a junior charge in the land register. The main advantages of this system are the state promotion of saving for building, the claim to a saver's building loan and the low rate of interest on the loan. Saving for building business may only be carried out by building societies set up under private or public law in the Federal Republic.

The high level of productivity of the building societies is evidenced by the roughly 15 million citizens in the Federal Republic of Germany who are currently saving with building and loan associations and who have concluded more than 16 million contracts with these institutions.

Building savings amounting to more than DM 500 billion - corresponding to a volume of building output of approximately 1.4 million dwellings - is waiting to be allocated and converted into owner-occupied property.

The government of the Federal Republic of Germany will continue in the future to support the willingness to save for building purposes reflected in the number of savings contracts concluded.

Home-ownership consolidates the economic position of the property owner, especially in times of fluctuating conditions on the capital market such as we are experiencing at present all over the world. However, the formation of owner-occupied property involves substantial advantages not only from the point of view of the individual investor. From the State's point of view as well, it concerns a type of investment that has many positive effects. The formation of owner-occupied property through new house construction expands the supply on the housing market and thus helps to improve the general level of housing provision - for the tenant as well.

When a tenant is not in a financial position to rent a suitable dwelling on his own, we help actively with the aid of a specific individual form of assistance (housing allowances). Some 1.5 million tenants receive a grant towards their rent amounting to more than DM 100 on average per month.

By promoting the growth of home-ownership we are helping to ensure that tenants have an adequate supply of dwellings available for rent at their disposal. An this is achieved more efficiently this way than through the direct promotion of the construction of rented housing. The reason for this, as is well-known to savers with building societies, is the greater willingness of property owners to bear financial burdens.

IV. State Measures for the Promotion of Housing Finance

As an alternative to the tax relief on savings with building and loan association, the Federal

Republic of Germany began as early as 1952 to grant State premiums for savings with building societies, graduated according to the number of children in the household. This assistance was granted at the beginning as a specific measure to encourage the construction of housing. In the meantime, the main emphasis has shifted to the promotion of wealth formation among broad sections of the population.

In spite of these tremendous efforts in housing policy, the proportion of households in the Federal Republic of Germany living within their own four walls - 40 percent of all households - is still substantially lower than in other comparable countries.

There are detailed provisions on the financing of housing construction in the Federal Republic which lay down the prerequisites and scope of promotion measures. All types of promotion are possible. The focal point of the promotion of new buildings lies in the field of the construction of housing which benefits from tax privileges. The builder or the first buyer can set off his own home against a higher rate of tax. If the object is destined for own use the land transfer duty is dropped as is the land tax for 10 years. Within the framework of the construction of housing promoted by public authorities the owner is provided with state funds in the form of loans with favourable interest rates, interest subsidies, guarantees and/or interest and/or redemption subsidies. The promotion of modernization or upkeep of old homes has increased in importance over the last few years. The most frequent measure here is the payment of interest subsidies. Not everybody benefits from the promotion measures. They are linked to certain income ceilings and also to categories of housing (e.g. size of floor space). Certain types of subsidies can only be granted to certain customers. There are prohibitions on the promotion of second residences.

Despite the existence of the Bausparkassen system the relative cost of housing in West Germany is high. For this, and other reasons, the German government has created a savings incentive program designed to ease the burden of homeownership. The incentive program began after World War II as a means of encouraging long-term savings in general. This was deemed necessary on account of two reasons. First, almost the entire country was destroyed during the war and had to be rebuilt. Second, a currency reform in 1948 destroyed 90 percent of the savings already held. The system that was designed consisted of savings bonuses paid by the government to people willing to save for a long time. These premia are paid in addition to the interest paid to the saver by the savings bank or Bausparkasse.

There are three government savings incentive plans: the investment savings premium, the home savings premium, and the workers capital accumulation allowance. While they all have different provisions they all have the same goal --encouraging people to save. The investment savings premium is simply a long-term savings incentive. A premium of 14 percent (plus 2 percent for each child) is paid annually on the first 1,600 DM saved each year by a married couple whose income does not exceed 48,000 DM. For a single person the amounts are reduced by one-half, i.e., the income limit is 24,000 DM and the maximum qualifying amount is 800 DM. Savings can be deposited at any financial institution and must be on deposit for a seven year period. Withdrawal of savings before the end of the seven years results in forfeiture of the savings premia.

The third savings incentive program is the worker's capital accumulation allowance. Under this program, wage and salary earners may save up to 624 DM per year and exclude that amount from taxable income. This saving may be either the saver's own funds or a supplemental benefit funded entirely by the employer. In practice, the majority of wage and salary workers have this savings made for them by their employers. The government will augment this allowance with a premium of 30 percent. That is, for the 624 DM saved, the government will add a bonus of 187 DM to the savings.

The capital accumulation allowance may be invested in any number of ways including stocks and bonds, savings accounts, or with a Bausparkasse on a home-savings contract. The interesting feature of this savings incentive is that it can be combined with one of the other two savings incentives plans. It is not possible to have both a home savings account and an investment savings account at the same time, but it is possible to have one of those and to use the workers capital allowance as part of the savings contribution. The government will pay the bonus on both the workers capital allowance (30 percent) and either the home savings account (18 percent) or the investment savings account (14 percent). The effect of that is to provide a large incentive for people to save to buy their own house.

Since the home savings premium is limited to certain families or individuals whose income is below the maximum income level, the premium cannot be claimed by everyone. That does not prevent them from either entering into a home savings contract or receiving tax relief on it. For a family whose income is above 48,000 DM they are allowed a deduction from taxable income of funds deposited in a home savings contract up to a maximum of 5,700 DM per year. This would result in a tax saving of approximately 1,000 DM, depending on individual circumstances.

The building societies have so far been successful in introducing potential home-owners at an early stage to the long-term saving processes which are a necessary step on the way to acquiring owner-occupied property.

In solving the housing policy problems of the eighties we are pinning our hopes on private initiative which we will continue to promote within the State's financial limitations. The building societies in the Federal Republic of Germany, and also worldwide, are therefore partners with whom we wish to co-operate closely and from whom we expect substantial help in solving these problems.

An important aim of our current housing policy is to raise this level of home-ownership and to enable every second family or every second household to become home-owners by the turn of the century. We therefore naturally also expect the building societies to continue providing the important services they have provided in the past. The building societies still have a large field of operation where their efficiency and imagination are called for.

I was very much pleased to hear in Melbourne last year my friend Deepak Parekh reporting the introduction of a save-as-you-earn deposit scheme to promote household savings with HDFC. This scheme is modelled on the Bausparkassen-system of Germany and will be marketed with special reference to lower income households.

Another great help for homeowners are repayment/subsidies for lower income groups and families with more than three children and for senior people. A German world for these subsidies was introduced into the housing finance terminology, namely WOHNGELD.

HDFC has started in India as a unique type of institution in a developing country as I have seen so often in Central and South America, in Africa and in the Near East. Started as a building society, the future of HDFC can be a national level institution and may encourage the foundation of many local or regional or national institutions in order to strengthen the Indian capital market by introducing novel financial instruments and by mobilizing additional resources specifically for housing investment. As President of the International Union I add the word Homeownership. The Union will stimulate the development activities by means such as seminars, an international school, experts for staff-training, advertising, organization and computer-affairs.

You will not be alone. You have friends in the Union and in AID. Thus, I wish to you the best and I am convinced that you will do the best.

From left to right: Mr. Phromburi, Government Housing Bank, Thailand; Mr. Soejatman, P.T. Papan Sejahtera, Indonesia; Mr. Tuccillo, National Council of Savings Institutions, USA; Mr. Alvarez, Ministry of Human Settlements, Philippines; Mr. Hagger, USAID/Colombo, Sri Lanka; Mr. Piyasena, State Mortgage and Investment Bank; Mr. Thaemann, USAID/New Delhi, India; Mr. Narad, Ministry Works and Housing, India.

Presentation by Mr. Willi-Dieter Osterbrauck, President IUBSSA

Operational Problems and Potential for Low Income Lending

Presented by:

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General Manager
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India

This paper will cover HDFC's activities and experiences in low-income lending and will include some suggestions as to ways in which lending for low-income housing can be increased.

In India, various definitions of "low income" are in use. To my mind it is less important to fix a kind of cut-off level of income for this purpose; what is more important is to adopt a need-based approach. Thus, for instance, a family not having appropriate accommodation in relation to certain basic requirements such as supply of water, sanitation facilities, minimum space having regard to size of family and privacy, should be as much a target of housing finance policy as a family which falls within an absolute definition of low income. For discussion purposes, we may accept the USAID definition of "low income" which is any income below the median family income in a particular area. In the urban areas in India, HDFC and USAID agreed that the median family income was Rs 1,200 per month ($120 per month) in 1981 based on a study conducted by the Tata Institute of Social Sciences in 1979.

At HDFC, we have adopted a need-based approach. A family not owning any residential unit and desiring to acquire one is eligible for HDFC financing. To further reach families with low monetary incomes, we have adopted special policies and are conciously striving in other ways to increase the availability of our funds for low-income people.

Before I get into the operational problems that HDFC encounters in lending to low income families, I would like to give you a brief idea of HDFC's activities. HDFC was set up in October 1977 as a specialized housing finance institution to provide loans to individuals and companies. Before HDFC was set up, individuals directly had limited access to housing loans. Those who were policy holders of the Life Insurance Corporation of India (LIC) could obtain relatively small amounts of funds from the LIC against their policies. Although its principal business is life insurance, the LIC provides a large amount of housing finance to the Government's Housing and Urban Development Corporation (HUDCO), apex cooperative societies, state governments and state government organizations for housing in addition to the modest amount it provides to its individual policy holders. HUDCO supplemented the availability of housing finance from LIC and other insurance companies by issuing bonds guaranteed by the Government.

All these funds reach individuals indirectly. Thus, an individual buying an apartment constructed by a state housing board could get the benefit of a hire purchase facility, the funds being made available to the state authorities from LIC/HUDCO. Individuals could also obtain finance from apex cooperative housing finance societies out of the funds raised by these apex societies from LIC; however, individuals had to approach these apex societies in a group organized as a primary cooperative society. Therefore, an individual did not have the possibility of obtaining housing finance in accordance with his needs. Further, there was no attempt at channeling private savings directly for housing; all primary savings reached borrowers through a chain of intermediaries.

HDFC

HDFC provides housing loans to individuals in accordance with their needs and based on the repayment capacity of each individual. HDFC has an absolute ceiling as to the maximum loan it can provide to an individual in order to spread its resources to as many people as possible. HDFC has progressively higher rates of interest for higher loan amounts in order to assist the small borrower with housing finance at lower cost. The term of the loan can extend up to twenty years for small loans to facilitate low income individuals. HDFC does not provide housing finance for acquisition of a second dwelling unit, again with the idea of channeling assistance to people with greater housing need.

HDFC provides loans only for the first unit acquired by an individual. As of December 31, 1983, HDFC had sanctioned total loans of approximately Rs 2.25 billion ($225 million) for 68,000 units in 250 towns and cities. The average size of the loan to an individual was Rs 40,000 ($4,000) and the typical dwelling unit cost Rs 90,000 ($9,000).

Of total loans to individuals, the income breakup is as follows:

Gross Monthly Income*	HDFC loans to individuals by income group
(Rs)	(Number of Units) (%)
Up to 1000	13
1001 - 2000	42
2001 - 3000	26
[illegible] and above	19
	100

*of husband and wife

For reference, I may mention that the GNP per capital in 1982-83 was estimated at Rs 2,500 ($250), giving a family income of about Rs 12,500 ($1,250) per year.

While we have not conducted any formal survey in this regard, it is estimated that the bulk of HDFC loans is to individuals with family income substantially below the median income of the population buying dwelling units in the urban areas.

PROBLEMS IN LOW INCOME LENDING

The principal problem in low income lending arises from the paucity of affordable housing. In the recent past, there has been rapid inflation, especially in the construction sector. Unfortunately, incomes, especially of the salaried classes have not grown at the same pace, resulting in a much reduced savings capacity. With interest rates also going up during this period, housing has become less and less affordable. The response of house buyers has been to reduce the cost of the dwelling unit by going in for smaller dwelling units than what they would have otherwise acquired, accepting a more distant location with the attendant transportation problems, and cutting down on specifications. In fact, the specifications are often reduced to a level where the life of the dwelling units is severely affected.

What is imperative in the current situation is to increase the availability of affordable housing. For this, in the Indian context, urban land, which is currently frozen under the Urban Land Ceiling Act, should be made available freely for housing. Changes would also have to be made in the rent control legislation to permit redevelopment of old areas in the prime localities. To my mind, improving the availability of affordable housing is the first task that needs to be addressed if housing is to be made available in greater measure to low-income individuals.

Coming to lending, one of the problems that HDFC has encountered is in assessing incomes of low income applicants. Self-employed individuals with small incomes are not required to pay income tax and so there is no possibility of verification of income from their tax returns. HDFC has resorted to innovative techniques for this purpose. For instance, while lending to a cooperative society of small traders in a small town in Gujarat, our credit officer had to spend hours with vegetable vendors and small grocers at their stalls by the roadside to estimate their incomes. HDFC has occasionally found that such people do not even have bank accounts; they have then to be encouraged to open a bank account and deposit a small sum every month in those accounts to enable them to service our loan conveniently.

Many of these borrowers are not literate and are not even in a position to complete an application form for a loan. The problem is further compounded because there is no uniform language for communication.

HDFC has to help out individuals in deciding on the loan amount to be applied for, as well as in completing the forms. More importantly, individuals have sometimes to be educated about the obligation to repay the loan in a timely fashion. In the past, there have been various occasions when government and government agencies have provided loans, especially in small towns and rural areas, which have then been written off resulting in individuals developing the belief that loans need not be repaid.

An interesting problem that HDFC has encountered concerns collection mechanisms in respect of borrowers whose income is irregular, as in certain self-employed cases, or on a daily basis, as in the case of workmen. For instance, HDFC has provided loans on a pilot basis for a housing project in a tribal area. The loans range from Rs 1,000 ($100) to Rs 3,000 ($300) per dwelling unit and the cost of the dwelling units is a maximum of Rs 5,000 ($500); the borrowers include agricultural laborers earning about Rs 10-12 per day during the sowing and harvesting seasons and possibly nothing for part of the year. HDFC, along with a local voluntary agency in that area, is encouraging these individuals to save on a daily basis out of their income to facilitate repayment of the loan. HDFC is also discussing with agencies the possibility of setting up a service agency in each village which would be responsible for collection of the loans for a small fee.

All these factors greatly increase the cost of servicing loans to low income individuals. Coupled with this is the fact that the loan amount is small. Therefore, the profitability of loans to low income individuals is not very attractive. In case of arrears in repayment of such loans due to illness or loss of employment, the lending agency would have little choice but to reschedule such loans. Fortunately, HDFC has not had occasion to reschedule any loan, but the possibility always exist.

POSSIBLE WAYS OF INCREASING LENDING TO LOW INCOME INDIVIDUALS

The key characteristic of low income borrowers is their low saving capacity. There are several possible lending policies which would make it more convenient for such individuals to obtain a house.

Reducing the Downpayment: As a result of their low saving capacity, low income individuals have only a limited accumulation of savings. Reducing the downpayment required by lending agencies would help in facilitating such individuals in acquiring a dwelling unit. In other countries, the downpayment has been reduced to as little as 5 percent with the help of mortgage insurance. In an inflationary environment, I submit that even without mortgage insurance it should be possible to reduce the downpayment substantially. However, in the current context of relatively high housing prices, reducing the downpayment by itself will not help the large majority of people who are limited by their repayment capacity in the loan they can obtain.

Long-Term: One way of enhancing the loan available to individuals is by increasing the term of repayment of the loan. In India, we currently lend for a maximum period of fifteen years; in case of low income individuals, HDFC stretches this period up to twenty years. Further increasing the term would help in increasing the loan amount to individuals.

__Lower Rate of Interest:__ Reducing the rate of interest would similarly enhance the loan amount in respect of individuals. For this purpose, HDFC is studying a contractual scheme on the lines of the German savings and loan scheme under which individuals save at a low rate of interest, say 5 percent, and, after qualifying, can obtain a housing loan at 7 percent. This scheme would operate in a free-market environment and without subsidies; fiscal incentives for such a scheme would be of great help to small savers. The viability of this scheme depends to some extent on such fiscal incentives and also on the manner in which it is implemented. In India, informal credit unions and "chit funds" (mutual associations of savers) have always flourished; their suitability for housing is limited because of the difficulty in elongating the terms for which the savings are available.

__Step-up Future Repayment:__ In the case of young borrowers, whose income in the future is expected to increase, HDFC is trying out a repayment plan where the loan instalment increases in steps every few years. This plan enables an individual to service a larger loan using the inflated income stream of the future.

Various other possibilities exist for enhancing the loan available to individuals. One of the practices adopted in many countries is cross-subsidising interest rates with higher income borrowers subsidizing lower income borrowers. This practice is fraught with problems. Any subsidized program cannot last indefinitely even where a government is subsidizing a program. What is not viable in a market environment should be adopted only with great caution.

Suggestions are often made for accepting a higher percentage of income toward repayment of the housing loan. HDFC has selectively attempted to do so where the past savings history of an individual justifies it; in other cases it would put needless strain on the borrowing family coupled with unacceptable risk for a lending institution. However, flexible loan instalment plans, especially those using balloon payments out of accumulated savings (as distinct from repayment capacity based on income stream), have considerable merit.

One approach that needs to be developed further is to encourage individuals to move upwards in housing as their financial circumstances change. Where land availability is not a constraint and individuals can build single family dwelling units, a lending institution can encourage individuals to build modular type dwelling units which can be expanded as and when the financial circumstances of the individual improves. Alternatively, mobility from one dwelling unit to a better one should be encouraged; thus an individual can acquire an affordable dwelling unit and later on as the circumstances improve, move to a better unit, instead of altogether avoiding acquisition of a dwelling unit.

A government-assisted refinancing institution would greatly help in making available funds at a reasonable price for low income lending. The assistance from the government need not come by way of a direct funding of an institution; instead, such assistance can be by way of a government guarantee which would make funds available to the institution at a relatively lower rate of interest and these funds could be earmarked for the purpose of packages of loans made to low-income individuals. In the context of the current structure of interest rates in India, an intermediary institution of this type would have an important role to play in channeling resources into low-income housing at a reasonable cost.

Mortgage insurance would help in the development of a secondary market and, more importantly, encourage lending institutions to lend to low-income families. As I have said, I do not believe loans to low-income individuals are unacceptable risks; however, mortgage insurance would reduce the perceived risk in low income lending. Mortgage insurance would necessarily add to the cost of the loan to the individuals; it should be a requirement for lending only when the total population of insured borrowers is fairly large, so that the cost of insurance is kept to a minimum.

HDFC has been encouraging housing for low income families through the provision of financial assistance to companies which provide housing for low income workers usually in less developed parts of the country. An inncvation that HDFC had done is to lend directly to such workers with the assistance of the company's guarantee. Many companies are required under agreements with their labor unions to provide housing loans to workers. These loans can be channeled by a housing finance institution through a company helping a large number of such low income individuals to avail housing loans.

CONCLUSIONS: The principal problem in low income lending arises from the shortage of affordable housing. Housing can be made more affordable by taking steps that would help increase the supply of housing such as removing legislative hindrances that restrict land available for housing and modifying rent control laws; encouraging innovation in techniques of construction, building materials and design of dwelling units; and designing the flow of relatively lower-cost, long term funds for housing. Development of special techniques for low-income lending such as a higher loan-cost ratio, step up repayment plans and innovative collection mechanisms is a less difficult but nevertheless important requirement to increase lending to low income individuals in a prudent, pragmatic and socially desirable way. Government and non-Government agencies have to work together in this task.

Low Income Lending for Housing
in Indonesia

Bank Tabungan Negara Operation
and Experience

Presented by:

Prayogo Mirhad
President, Bank Tabungan Negara

I. INTRODUCTION

1. Housing is a basic need next to food and clothing. The concept of housing is no longer a house as a means of dwelling, but it is the provision of comfortable shelter in an environment conducive for good and healthy living. The need for housing can only be met if one is in a position to buy or rent in conformance with his income.

Therefore, the following questions must be answered:

- How to provide houses which fulfill the required quality.

- How to build houses which are within reach of the society to buy or rent.

- How to finance housing development.

- How to enable the society at large to buy or rent those houses.

2. Since the New Order Government of Indonesia came to office, a greater interest has been paid to

low-cost housing. Ever since the implementation of the five Year Development Plans, the Government has developed programs which are basic in nature to overcome housing problems of low and middle income families. However, considering the funds available, low cost housing development should be carried out in stages.

3. Before discussing low cost housing programs which have been implemented in successive Five Year Development Plans, one must first look into the housing shortage in Indonesia.

Based on the 1970 census, Indonesia had a population of about 120 million. Assuming an average family size of five, the housing need for 1970 was computed at 24 million.

The same census indicated that there were only about 22 million houses, thus leaving a shortage of about 2 million houses. If the shortage were to be solved in 20 years, then each year approximately 100,000 would have to have been built over and above the number needed to provide for population increase. That means 0.8 units per 1,000 people per annum. The population increase in Indonesia is 2.4 percent per annum. Therefore, to meet the need for housing arising from the annual population increase, the following number of houses would have to be built:

2.4% x (120,000,000 : 5) units = 576,000 units, or

4.8 units per 1,000 people per annum.

In addition, for repair and other renovation work to keep existing houses at an acceptable standard, some 2 percent per annum is estimated, or

2% x 22 million units = 440 thousand units, i.e.

3.7 units per 1,000 people per annum.

Based on the above computations, the number of houses to be built annually is as follows:

0.8 + 4.8 + 3.7 =

9.3 units per 1,000 people per annum.

4. The above calculations indicate that, apart from the housing stock available, there is a significant housing gap. In addition, the existing housing stock is not always found in acceptable residential areas. There are some slum areas called "kampungs." Two ways of handling the problem were identified:

a. New housing programs to reduce the housing gap due to the population increase.

b. Rehabilitation programs of "kampung" environments and existing residential areas, known as the Kampung Improvement Program (KIP) and Urban Renewal Program.

II. GOVERNMENT HOUSING POLICIES

The involvement of the Government in providing low cost housing is in the framework of national development.

In this respect the Government has formulated policies and directives which are found in the successive Five Year Development Plan Programs:

a. In the First Five Year Development Plan, housing development programs were still very simple with stress on research and development, such as research on housing technology, in the field of policy and programs, training, technical exhibitions, etc.

b. In the Second Five Year Development Plan, low cost housing policies were directed towards the increase and utilization of the results of the research, guidance to the local building material industry in mass housing development, the availability of an effective and efficient funding system, and the creation of institutional units needed to carry out housing development on a national scope. The institutions established were as follows:

   - The National Housing Board, whose tasks were to formulate policies and to supervise policy implementation and housing development in a broad sense.

   - The National Housing Development Corporation (NHDC) which is a nonprofit body functioning in the preparation and implementation of low cost housing development projects.

The Housing Bank which functioned as a source of home ownership finance for low cost housing. Currently this function is carried out by the Bank Tabungan Negara (State Savings Bank/BTN).

c. In the Third Five Year Development Plan, the Government continued to increase its programs. For this, the Government decided on the following housing development programs:

1. The National Housing Development Corporation (NHDC/PERUMNAS) low cost housing projects spread over 77 towns, i.e. 27 provincial capital cities, 33 towns serving as Centers for Area Development and 17 sub-district capital towns, which will be related to the Housing Loan Scheme (KPR) of the BTN.

2. Private companies (Private Developers/Non-NHDC/Non-Perumnas) which also utilize the KPR of the BTN are assigned a target to build 30,000 houses.

3. Improvement of slums in urban areas covering an area of 15,000 hectares will take place in 200 towns spread through Indonesia.

4. Expansion of Pilot Programs in Rural Housing Rehabilitation will be increased from 1,000 villages in the Second Five Year Development Plan to 6,000 in the Third Five Year Development Plan.

III. THE BANK TABUNGAN NEGARA (STATE SAVINGS BANK)

The Bank Tabungan Negara (BTN) was established by law no. 20 in 1968, the only savings bank owned by the Government. Considering that the Housing Bank mentioned in the Second Five Year Development Plan was not founded yet although the need existed for such an institution, the Minister of Finance in 1974 appointed the BTN to provide loans to prospective buyers.

Thus, the functions and responsibilities of the Housing Bank mentioned in the Second Five Year Development Plan have been carried out by the BTN by providing loans to low and middle income groups to enable them to buy houses built by both NHDC (PERUMNAS) and Private Developers (Non-NHDC).

1. Housing Loans

The housing loans provided by the BTN are for the purchase of houses for self-occupancy.

a. General Requirements

1) Eligibility : Limited to the purchase of one house for self-occupancy.

2) Credit Terms : Ranges from 5 to 20 years.

3) Security : The house and the land.

4) Loan to Value : Maximum 90% of the BTN valuation of the house and land.

5) Repayment : Monthly installments.

6) Lending rate :
- 9% p.a. for Non-NHDC/ Non-Perumnas houses.
- 5% - 9% p.a. for NHDC/ Perumnas houses.

b. Requirements for Prospective Borrowers

1) Indonesian citizen

2) Not owning a house yet.

3) Having a fixed income at least three times the monthly installment with the maximum of Rp 200,000 - Rp 300,000 monthly income.

4) Adults or married and in a position to perform legal actions.

c. Housing Requirements for Purchase Through KPR: This specific loan can only be granted for the purchase of houses falling under the category of simple housing as stipulated by the Government, as follows:

1) Floor Space

A minimum of 36m2 and a maximum of 70m2, for Non-NHDC/Non-Perumnas built houses.

2) Size of Lot

A minimum of 60m2 and a maximum of 200m2.

3) Selling Price

(a) Ceiling

The selling price per square meter may not exceed a certain amount, which varies from region to region.

(b) Ratio

The ratio between the selling price of lot and the house may not be different than 1 : 1. This means that the price of the lot may not exceed that of the house.

d. Resources of Funds: There are three significant resources of funds for housing loans for low and middle income groups. The first is funds allocated by the Government from the State Budget. The second is credit provided by the Bank Indonesia which is the Indonesian Central Bank The third is funds accumulated by BTN from savers.

The government funds may only be used for the purchase of houses built by NHDC/Perumnas, whereas funds accumulated from BTN's savings activity National Development Savings Scheme (TABANAS) blended with credit from the Central Bank, is used for the purchase of houses built by private developers (Non-NHDC). For Non-NHDC housing loans, 90 percent of the amount needed is provided by the Central Bank at an interest rate of 3 percent p.a.

With regard to this savings activity, the BTN cooperates with the Perum Pos dan Giro (the Postal Service), which has 1,141 branch offices. These offices provide service to TABANAS savers on behalf of BTN.

In terms of savers and amount of savings, the development of TABANAS during the period of 1974 - 1980 is significant. However, relative to the trend of increase in KPR loans, the funds available through TABANAS are inadequate.

e. Loans Transacted: To get an overview of the achievements of the BTN with its 11 branch offices, Table 1 provides significant figures of annual KPR loans transacted from 1976 through December 31, 1983.

The mobilization of resources for housing development should be distinguished as follows:

1. To meet social needs for housing.

2. To have working capital for institutions operating in the field of housing development.

3. To develop the sectors of building construction and building components.

A. PERFORMANCE OF BTN AND PERUM PERUMNAS AND THE DEMAND FOR URBAN HOUSING

The performance of the BTN and the Perum PERMNAS in the last few years are very encouraging. Through the end of 1981, the Perum PERUMNAS built about 105,000 housing units and the BTN granted around 71,000 KPR loans. For the following year, BTN issued Commitment Letters for about 10,000 housing projects to private developers.

Such performance indicates the ever increasing demand for housing and KPR loans. A rough estimate of the housing demand in urban areas in Indonesia is around 200,000 units until the year 2000.

B. REQUIRED FUNDS AND PRESENT SOURCES

At an average cost of Rp 3 million per house -- i.e. the average amount paid for one house through the KPR of the BTN in 1981 -- some Rp 600 billion per year is required to build 200,000 houses per year. Against this, in semester I of 1982, the BTN had "only" provided KPR loans in the amount of Rp 71.5 billion. However, this is already 30 percent more than the same period in 1981 and is almost twice as much as that for 1980.

From the beginning of 1976 until the end of September 1982, the BTN provided KPR loans for about 71,000 units at a value of Rp 311.85 billion. Against this, Rp 206.73 billion or 66.29 percent came from the Bank Indonesia, Rp 82.15 billion or 26.35 percent from the state budget (Government partnership), and the balance of Rp 22.97 or 7.36 percent from the surplus of TABANAS savings.

C. RESOURCES FOR DEVELOPMENT OF 200,000 URBAN HOUSING UNITS PER ANNUM

1. Existing Resources

Existing resources will remain very important, especially to finance mortgage loans. Assuming that there are five members in a family, the housing need in Indonesia to keep up with population increase, is 4.8 units per 1,000 people per annum as mentioned earlier. Therefore, with a population of 147 million, some 705,600 housing units per annum are needed.

The ability of families to build houses on their own is estimated at 2.5 units per 1,000 people or 365,500 units. Therefore, the balance must be met with the assistance of, or sponsored by, the Government which is 2.3 units per 1,000 people or 338,000 units per year. This, in turn, is broken down into 160,000 units for urban areas and 178,000 for rural areas.

If it were projected linearly until the year 2000, then the housing need in urban areas -- just to keep up with the population increase -- is 200,000 units per year.

Resources available to the BTN currently are excess reserves of the BTN itself, Government partnership and credit from the Bank Indonesia. If the cost of 200,000 housing units per annumw as to be Rp 600 billion and it were attempted to accomplish just half of it (almost equivalent to the total of KPR loans from 1976 through September 1982) through the KPR of the BTN by use of available resources (assumed to be proportional to resources for the KPR of the BTN until the end of September 1982), it is obvious that it is beyond the ability of the BTN, especially through its own resources which at present come from the surplus of TABANAS savings.

2. <u>Steps Required</u>

Facing problems stated earlier, there is a need to adopt an integrated policy based on long term conditions, including:

a. Increasing the mobilization of public savings related to housing incentives.

b. Increasing government participation in the form of subsidies or long term soft loans for financing housing development projects.

c. Mobilizing resources from domestic financial institutions at feasible terms for long term credit disbursement.

d. Developing a model and a system for reliable housing development projects which provides housing within reach of the low and middle income social groups.

IV. PROBLEMS THE STATE SAVINGS BANK (BTN) HAS TO DEAL WITH

1. The Bank Tabungan Negara (State Savings Bank) is chiefly supposed to provide House Ownership Credits (KPR) for low and middle income members of the society, namely those belonging to the group of the public with an income ranging from the 20th to the 70th percentile. Considering that the rate of increase of the prices of houses and land is greater than the rate of increase of incomes of the people in general, the BTN House Ownership Credits appear to be utilized by people having an income in the top 30 percent of the income distribution. If the prices of houses and land continue to increase faster than incomes, the sizes of both the houses and the land on which they are built will have to be steadily decreased. Under such circumstances, the most suitable type of houses to be made available might be core-houses with a floor space of 18 to 21 square meters on land respectively measuring 60m2 and 90m2, or even sub-core houses with a floor space of 15m2 on land measuring 60m2. Such core and sub-core houses

are presently built by the National Housing Development Corporation (PERUMNAS), while non-Perumnas undertakings have so far not been allowed to build houses of a floor space of less than 36m2.

2. From the figures on the House Ownership Credits (KPR) for houses built by the National Housing Development Corporation and by other housing development undertakings (non-Perumnas), it appears that within a period of 8 years (from 1976 up to and including 1983) the State Savings Bank's borrowers have reached a total of 270,000 with an average loan of Rp 2,985,000 per person. It is, therefore, evident that loan processing costs as well as the loan maintenance costs will be considerable. To meet these high costs, the State Savings Bank has been resorting to other possible ways and means of generating income.

3. Although the houses that can be bought by means of house ownership credits provided by the State Savings Bank are low-cost houses, they are structurally sound, although the materials with which they are built are not first class. Viewing such houses as security for a loan it does not appear to present a problem because the increase in the price of land in Indonesia is at a relatively rapid rate, especially land that has become a human settlement. Normally, the owners or occupants of low cost houses obtained through house ownership credits provided by the State Savings Bank, improve these houses, in terms of floor space or quality, often completely obliterating the traces of the original structure. They appear to have the money to make these improvements but not enough to buy a completely furnished house ready for occupancy. It is like having a piece of cloth too wide to be used as a handkerchief but too small to be used as a table cover.

4. Basically, the housing ownership credits provided by the State Savings Bank are designed for

people with fixed and regular income. Even if they have other sources of income, they should also be of a regular nature. Theoretically, such people would have no difficulty in paying back the loans. But in practice, in view of the increase of prices of the staple foods of the people due to the fairly high-rate of inflation (some 12 percent per annum), in addition to the fact that the average income of the people is relatively low, repayments are not taking place as smoothly as originally expected.

5. The payment of housing ownership credits (KPR) by installments is usually taken care of by the pay-master. Each month on pay day the pay-master deducts from the salaries of the borrowers the installments for further payment to the State Savings Bank through a bank appointed for this purpose, or directly to the treasury of the BTN branch office concerned. Theoretically, this way of payment of installments leaves no chance of arrears. But in practice, the arrears still prevail, partly due to lack of discipline on the part of the paymaster in making the deductions, partly due to misuse of funds by the paymaster or because of other reasons.

Other methods of payment should be resorted to, such as door-to-door collection by BTN personnel, appointment of private collectors coupled with certain safeguards, or the establishment of certain collecting points in the form of other banks or apparatuses of the BTN itself.

From a personal observation at several Branch Office pay-desks on certain dates, one can see long lines of BTN customers waiting their turn to pay their house ownership credits (KPR). This fact proves that, in general, they prefer to come and pay at the Branch office pay-desks themselves. This fact should be considered as a basis for the promotion of this service.

6. While a credit remains a credit (not a gift), and has to be paid back, the housing ownership credits (KPR) provided by the State Savings Bank (BTN) have some political significance. For this reason, the way of dealing with arrears should be taken through a wise and careful approach. Reminders should be issued making the customers realize the need of paying back their loans through installments. They should be reminded of the possible serious consequences of the confiscation of the house they are occupying as the result of failure to pay their installments. However, considering that a home is for the family and the most important necessity in life next to food and clothing, they generally realize the importance of paying back their loan. Study has indicated that arrears are generally only of a temporary nature, caused by fairly large irregular expenditures of the family forcing them to postpone the loan payment and pay it when the right times comes. It must also be recognized that if foreclosure under the law is resorted to, a judicial proceeding would take some time. And so far, unless very necessary, the State Savings Bank (BTN) does not seek such a remedy.

7. Pursuant to the task set forth by the Government, the State Savings Bank gives priority in providing house ownership credits to the low income group of the society. The demand for house ownership credits from the low income group of the people is quite high, which is demonstrated by the fact that as mentioned earlier in the paper, the need for housing continues to increase each year. One way of overcoming this problem would be for the Government to allow private developers to build houses with a floor space of less than 36m2, which, so far, is the sole right

of the NHDC/PERUMNAS. There are at present approximately 300 private developers in the different parts of Indonesia. To stimulate private developers to build small-size houses, it would be necessary to fix the standard prices of buildings per m2 for small-size houses, higher than the prices per square meter of larger houses.

8. The State Savings Bank also has a program of providing even lower cost houses in cooperation with the ASTEK (Labour Insurance). Although very simple, the construction of such houses is still reliable. Half of the walls are made of brick and the other half of wooden planks or woven bamboo, without ceiling, etc. In short, the construction of this type of house is adjusted to the purchasing power of the group of the target population without prejudice to the quality of the construction work. The State Savings Bank is also considering possibilities of providing building material loans linked with the Kampung Improvement Program (KIP), which is a government program with World Bank aid for the improvement of conditions in kampungs. The program covers improvement of footpaths, drains, gutters and sanitation, but does not cover improvement of the houses.

9. The graduated payment mortgage is another effective way of overcoming the lack of financial ability of a person to get a house of a larger size within his purchasing power. However, I am of the view that this is not feasible in Indonesia yet because most Indonesians have practically no understanding of this type or method of payment. This method may be applicable only in certain instances. I hope to learn more about this type of loan at this Seminar since I have heard something about graduated payment mortgages during a seminar in Bangkok in 1981.

10. Currently, the State Savings Bank (BTN) requires its future borrowers to save part of the

down payment with the Bank. The savings method used in this case is the "TABANAS" (National Development Savings Scheme), a general savings scheme of national scope, not a type of savings especially pertaining to housing. Since it is only a temporary deposit in connection with the provision of an advance payment, the funds collected from this type of savings are, in practice, not sufficient to meet the BTN's long term need for funds. Within the framework of obtaining sufficient long term funds, the State Savings Bank also requires its borrowers to maintain an account with a balance at least twice the monthly installment. The philosophy behind this requirement is that those who have been granted Housing Loan Schemes (KPR) help those who do not have such BTN facilities by savings. I strongly believe that programs to provide low cost houses in the developing countries need to be implemented through programs of savings such as at savings and loans or building societies are more suitable. But I have also heard people saying that savings for housing finance provided through contractual savings plans are also good. Which one is true?

11. At the present, the Housing Loan Schemes of the State Savings Bank for non-NHDC/non-PERUMNAS houses carry an annual interest of 9 percent, while Housing Loan Schemes for NHDC/PERUMNAS houses carry an interest ranging from 5 percent, 7 percent and 9 percent, although the 5 percent rate usually applies, namely if the house purchased carries a price not exceeding Rp. 1.500.000. In view of the fact that the market interest rate presently stands at approximately 18 percent per annum, it is obvious that recipients of housing loan schemes of the state savings bank are enjoying fairly large subsidies. These subsidies are made available by Bank Indonesia in the form of funds (liquidity credits) in large amounts (90 percent), with a relatively low interest rate (3 percent per annum), in addition to funds from the government carrying no interest. the extent of the

government funds received by the state savings bank within the framework of the housing loan schemes for NHDC/PERUMNAS houses from 1978 through the end of 1983 totalled Rp 406.7 billion.

These figures are solid proof of the Indonesian government's earnestness and seriousness (including Bank Indonesia) in its bid to overcome the housing problems in Indonesia. However, it is the policy of the Government that the funds originating from the Government or Bank Indonesia will be diminished from time to time. In this context it is necessary to mobilize the funds from the society through various means, meeting the large and long term needs for funds within the framework of providing houses to the public.

12. What is mortgage insurance? If it is seen as an insurance cover for securing smooth mortgage loans, it is non-existent in Indonesia. What we have in Indonesia is Credit Insurance guaranteeing the Bank over a risk of a stalemate of small credits granted to financially weak businesses. An Export Credit Insurance has meanwhile been recently introduced. In its relation to mortgage loans, general insurance (fire insurance) is used for safeguarding securities (houses) and often added with Credit Life Insurance. In Indonesia, we need to know what mortgage insurance is about, who receives the cover, who pays the premium, etc.

CONCLUSION

These are a few things that I can present before this Seminar. Having a relatively small experience, I wish the participants of this Seminar will share their experience with me. While that State Savings Bank has its unique ways of granting its Housing Loan Schemes, it has proved that it has done much to help the people at large. One thing is clear. namely, that the approach that I have mentioned above had to be taken by my Government. Other kinds of approaches may be needed in the future.

Thank you.

From left to right: Mr. P.P. Shaw, HDFC, India; Mr. Orendain, National Home Mortgage Finance Corp., Philippines; Mr. D.S. Parekh, HDFC, India; Mr. Kim Jim Ho, Korea Housing Bank; Mr. D. Gardner, NCSI, USA.

Participants viewing slide presentation

Home Financing in Indonesia
Resource Mobilization Problems and Potential

Presented by:

F. Soejatman, President Director
PT Papan Sehahtera
Indonesia

As we all realize the importance of home financing, I am especially pleased to have been given the opportunity to participate in this seminar. Since housing finance is new in Indonesia, I have to admit that I still have much to learn about home financing. I am also sure I will learn from all of you, particularly those coming from countries where home finance has develoned into a more advanced stage.

What I will be able to do is to inform you of some of the problems we have encountered in Indonesia rather than to speak of a sophisticated system of home financing. This is so due to lack of specialized savings and mortgage lending institutions. So, the major part of what I am going to present here contains more of the expectations on what I believe should be done by the system, both the government and the private sector, to promote and encourage home ownership.

Financial Market

As Indonesia's economy continues to expand, the country's financial institutions, and especially the banking sector, play an increasingly vital and important role. The banking sector is comprised of state commercial and development banks, a state-owned saving bank, private national banks, foreign banks and regional development banks. The state banks, owned and operated by the national government, have always played a dominant role within the overall Indonesian banking sector.

At present, we have five state commercial banks, namely, Bank Bumi Daya (BBD), Bank Dagang Negara (BDN), Bank Eksport Import Indonesia (BEII), Bank Negara Indonesia 1946 (BNI 1946) and Bank Rakyat Indonesia (BRI). Aside from these banks, we have one development bank and a savings bank, namely Bank Pembangunan Indonesia (BAPINDO) and Bank Tabungan Negara (BTN). There are also about seventy private national banks, ten foreign bank branches and about twenty regional development banks operating in Indonesia.

In addition to the banking sector, the financial system also includes a broad range of institutions including 12 non-banking financial institutions, 83 insurance companies and 22 pension and social insurance funds. Although small in number, the state banks control about 70 percent of the gross assets of all the banks followed by the private national banks, about 14 percent, the branches of foreign banks, approximately 10 percent and the regional development banks about 6 percent.

Approximately one-half of the liabilities of the banking sector consists of deposits. Half of these deposits are in the form of time and savings deposits which are the principal instruments used in Indonesia to mobilize domestic funds. The longest term of a time deposit is 24 months which currently pays between 16-18 percent per annum.

Insurance companies, corporate pension funds and public social insurance funds play an important role in the financial sector as mobilizers of long-term funds through contractual savings programs. These longer-term sources are appropriate for long-term housing loans. However, because they do not specialize in this area, approximately 70 percent of insurance company investments are held in the form of bank fixed deposits. Only recently have part of these funds been invested in the bonds issued by three corporations, one being a state development bank, another a state highway corporation and the third, PT Papan Sejahtera, the housing mortgage finance institution I represent.

The Government reactivated the stock exchange in 1973 and actively promoted the development of a securities market; however, progress in this area has been slow due in part to the lack of adequate instruments and to the preference for short-term savings instruments. As stated earlier, the state banks accept fixed deposits up to 24 months at interest rates ranging between 16-18 percent per annum. Interest proceeds are tax free.

Due to lack of specialized savings institutions, the government sponsored a National Development Saving Scheme (TABANAS) with its primary objective to encourage small savers to participate in financing the country's economic development. All of the state banks and a number of private banks participate in the scheme. Total aggregate value of the savings deposits at the end of 1982 was about Rp.476 billion (US$ 476 million). This, to my opinion, is an appropriate source of funds for home loan financing.

Since the reopening of the stock exchange in 1973, there were only 20 companies that have gone public by selling shares through the stock exchange. Despite incentives given to investors, the market has developed very slowly. Only in 1983 did the market witness the entry of bonds into the stock exchange. The first issue by the State Highway Corporation had a coupon rate of 15.5 percent p.a., followed by the State Development Bank (BAPINDO) and PT Papan

Sejahtera bearing the same coupon rates. These bonds are all with 5-year terms.

The main investors have been state controlled pension and social insurance funds with a continuing market for these bonds practically non-existent. Towards the end of last year, the State Highway Corporation issued the second batch of bonds with a higher coupon rate of 16.5 percent p.a.

Housing Finance

At present, there are only two institutions engaged in home loan financing. Bank Tabungan Negara (BTN), a state savings bank, began its home loan activity in 1975 when the Government restructured the bank to specialize in chanelling Government funding into low-cost housing finance for low-income families. Accordingly, BTN financing is limited to households whose incomes do not exceed Rp. 200.000, - (US$ 200 equivalent) monthly for the purchase of homes costing no more than Rp.10.6 million (US$ 10,600 equivalent). BTN will finance up to 90 percent of the cost of a home at an interest of 9 percent per annum on terms ranging from five to fifteen years.

There are however, a substantial number of households not qualifying for BTN, a state savings bank, began its home loan activity in 1975 when the Government restructured the bank to specialize in chanelling Government funding into low-cost housing finance for low-income families. Accordingly, BTN financing is limited to households whose incomes do not exceed Rp.200.000,- (US $200 equivalent) monthly for the purchase of homes costing no more than Rp.10.6 million (US $10,600 equivalent). BTN will finance up to 90 percent of the cost of a home at an interest of 9 percent per annum on terms ranging from five to fifteen years.

There are however, a substantial number of households not qualifying for BTN financing. This group of families at a somewhat higher income level has to rely largely on accumulated savings and assistance from relatives and represents a demand for middle class homes. In response to this demand, housing developers, employers and insurance companies have become involved in extending housing finance. Amounts available through these sources, however, are limited. Facilities available through employers vary in terms but are often extended at low interest rates, with repayment periods normally ranging from 5-10 years. Life insurance companies sometimes provide loans to policy holders, normally with maturities that extend up to five years at an annual rate of interest of 18-24 percent. It usually requires a term life insurance for the value of the loan, and a down payment of 20 percent.

In many cases, developers extend term credit for their sale of houses with two to five years term, and a down payment as high as 50-60 percent with interest rates of 24-36 percent per annum. In these kinds of transactions, conditional sales agreements are used whereby the developer maintains ownership of the property until final payment is received.

In order to make housing more affordable to a broader segment of the population, the Government, through the central bank, Bank Indonesia, sponsored establishment of a housing finance institution. This company, PT Papan Sejahtera, was inaugurated in March 1980. Although the company is the second institution engaged in housing mortgage finance, it is however, the first and, to date, only housing finance institution in Indonesia to be majority-owned by private investors and to operate on a commercial basis. It is essentially designated to provide mortgage loans to middle income families to purchase middle class non-luxurious houses.

In addition to the contribution expected of the Company in term of increasing the affordability of housing as well as the supply of housing finance, the Company is also expected to serve as an appropriate vehicle to stimulate the development of a domestic bond market by introducing the use of medium-term bonds as its principal instrument for raising resources.

Funding

The Company started its operations using funds provided by paid up capital of Rp.5 billion (US$5 million equivalent) and loans from shareholders. Both the Bank Indonesia, the Central Bank, and the International Finance Corporation (IFC) extended loans equivalent to US Dollars 5 million, both with twelve years maturities. The loan from Bank Indonesia is in local currency while from IFC it is in US Dollars.

For the second stage of its operation the Company obtained its funding from a bond issue, in July 1983, and a Bank Indonesia loan. Proceeds from bonds issued represent 40 percent of total funds needed, while the Bank Indonesia loan accounts for 60 percent. It is obvious that as far as funding is concerned the Company depends very much on the Government, namely the Central Bank, and particularly because this loan has been granted with a subsidized rate of interest.

The bonds were issued with a 15.5 percent coupon rate plus 1.6 percent per annun cost of issue, resulting in a total cost of 17.1 percent per annum. The loan of the Central Bank bears an interest rate of 7.5 percent and since this loan represents 60 percent of the loanable funds, the eighted cost of funds for both loans is 11.34 percent per annum. With a lending rate of 15 percent per annum, the Company's gross margin is 3.66 percent per annum.

Problems and Potentials

As has been presented earlier, Indonesia's financial market is still in an early stage of development. Instruments available for investments are limited to time deposits issued by Government banks as well as private banks. Time deposits of the Government banks are exempted from income tax. The going rate, at present, ranges from 16-18 percent per annum.

Since the reinstatement of the stock exchange in Indonesia in 1973, the financial market witnessed the entry of stocks as a new investment vehicle. These stocks bear similar concessions to the state bank time deposits mentioned earlier. In 1983, bonds issued by three corporations came to the market. As stated earlier, the first one was the State Highway Corporation (JASAMARGA). The coupon rate of its first issue was 15.5 percent while the second issue at the end of last year was at 16.5 percent per annum. The second corporate bond issue was the State Development Bank (BAPINDO) with a coupon rate of 15.5 percent. This issue took place right after the JASAMARGA's first issue.

Finally, there was the issue of PT Papan Sejahtera, my organization. As indicated earlier the coupon rate was 15.5 percent and the issue took place before JASAMARGA's second issue.

As can be noted, the coupon rates for the latest issues have increased from 15.5 percent to 16.5 percent. This was due to developments in the financial market which became not only volatile but reflected a constant increase in the price of money.

In line with the Government austerity program, the central bank abolished a number of subsidized funding programs formerly extended to the banking sector, primarily to the state banks. This forced the banks to go into the market for funds and resulted in increases in the price of funds. As indicated earlier, the banks are willing to pay 18 percent per annunm for 24 month maturities. Furthermore, the Government sector is presently also in the market for money. One clear example is the bonds issued by the two other corporations. As a result, the market developed adversely against home loan financing, and of course PT Papan Sejahtera.

On the other hand, as indicated earlier, there is, in fact, potential long-term sources of funds. The main problem we are facing in tapping these funds is that PT Papan Sejahtera has to compete with other industries that are prepared to pay much higher interest rates. We all know that in order to increase affordability to purchase a house, mortgage finance needs lower interest rates.

From various types of public policies that are in use around the world to promote housing finance and private home ownership, one can see that there are direct and indirect approaches governments can make. The direct approach to promote housing is the one more frequently followed by the developing countries. The government either builds houses and/or provides the financing through a state-operated mortgage lending institution.

The indirect approach is where government channels assistance through the private financial system. Government assistance to housing works to lower the cost of a house to the individual purchaser or to lower the operating cost of financial institutions specializing in home mortgage financing, so that the mortgage lending rate can be lowered so as to be more affordable to borrowers.

In the absence of a private financial system that can support the encouragement of home financing, the Indonesian Government directly channels its funds to build houses through the Government-operated housing development corporation (PERUMNAS). PERUMNAS builds houses for lower income families, mainly civil servants. The Government also channels funds through BTN and, in part, provides funds for PT Papan Sejahtera. I strongly believe that the Government will have to continue to follow this approach for a number of years.

In the long run, however, the Government will have to explore the use of legislative and regulatory powers to facilitate housing finance. There are a number of possibilities such as direct production subsidies to builders or buyers, creation and encouragement of mortgage lending institutions, creation of a secondary mortgage system, interest rate regulations designed to channel funds into mortgage lending corporations, tax concessions for buyers and lenders, and channelling TABANAS funds, at least in part, to housing mortgage corporations.

Tax incentives for builders could be extended if builders build non- luxurious houses. This will, in effect, reduce the cost of houses and further encourage housing construction. In a country like Indonesia where housing construction is still done in a traditional way, this will also help the country to ease unemployment pressure.

Tax incentives for buyers may be in the form of a reduction of the sales tax or even abolishing it. It could also allow buyers to deduct from taxable income, or from taxes due, all or part of the installments for house payments.

Tax incentives to mortgage lenders may work in the following way. Taxes, along with other operating expenses, are a normal cost of doing business. These costs are paid by mortgage lenders out of the spread between the interest rate charged to borrowers and interest rate paid to depositors or lenders. If all costs except taxes are equal, the institution which enjoys a lower tax rate because of its specialization in mortgage lending will have a lower operating cost. As a result, it will be able to make a profit equivalent to that of other financial institutions even when it charges a lower rate on loans. In a situation where borrowing rates are high, tax incentive is mandatory to attract new investors to go into mortgage lending operations. In other words, this encourages creation of new mortgage lending institutions.

It is about time for the Government to explore the possibility of the creation of a secondary mortgage market similar to the one prevalent in the US and in other developed countries. In such a secondary mortgage market, securities composed of packages of mortgages originated by mortgage finance institutions could be sold to institutional investors, principally insurance companies and pension funds. The Government would define the type and minimum amount of collateral to back the securities. For example, to qualify as collateral, a mortgage must be a first lien, and would have to be registered with the Agrarian Office.

As has been briefly mentioned earlier, there is a substantial amount of savings funds in the banking sector, primarily the state banks. This is an ideal source of funds for home loan finance. Channelling these funds to housing mortgage institutions will help the institutions ease the liquidity pressure by providing long-term funds. The role of the central bank in this respect is very important.

Concluding Remarks

To conclude my remarks, I would like to reemphasize the crucial role of the Government. Considering the continuous pressure on housing needs, the Government has taken the best steps it could afford to take. Direct involvement in promoting home ownership, primarily for the lower income families, was given priority. But in times of monetary restraint when the Government is determined to reduce subsidies and when the financial market has developed into a situation where it adversely affects the availability of funds for home financing, without a corresponding decline in the demand for housing, there do not seem to be other choices except to go further beyond the existing policies.

The use of the legislative and regulatory powers appears to be mandatory to assure promotion of home ownership. Regulations may have to be issued to make bonds issued by mortgage finance corporations more attractive to investors but that, in raising funds from the public, these corporations shall not directly compete with bonds issued by other sector, particularly the Government sector. Incentives appear also to be crucial for promoting home ownership.

New mortgage finance institutions should be encouraged and creation of new instruments to channel funds available in the market is essential to reduce Government direct subsidies.

Although housing finance is still new in Indonesia, I do believe that given thoughtful considerations, we in Indonesia, the Government together with the private sector, will be able to reduce the pressure for housing needs to a tolerable stage.

Resource Mobilization: Problems and Potential
A Case of the Korea Housing Bank

Presented by:

Jin Ho Kim
Managing Director
The Korea Housing Bank

1. The Housing Finance System in Korea: A Synopsis

Before looking into the methods for resource mobilization of the Korea Housing Bank, I'd like to briefly introduce you the financial system of Korea. Financial institutions in Korea largely fall into four categories; monetary institutions, non-monetary institutions, quasi-monetary institutions and the securities market.

Monetary institutions include the Bank of Korea, which is the central bank of the Republic, and depository money banks. The latter consists of commercial and special banks. There are seven nationwide commercial banks, ten local banks, forty-two foreign bank branches, and six special banks geared specifically to pursue Government policies. Of these six special banks, the Korea Housing Bank plays the major role in housing finance and the others, such as the Citizens National Bank and the National Agricultural Cooperatives Federation, are only partially involved in housing finance aside from their main banking businesses. Life insurance companies are also engaged in housing finance as a non-monetary financial intermediary.

As for housing fund resources, banking institutions depend largely on various types of deposits from the private sector. It should be noted that housing funds are not raised from mortgage investors in Korea in the absence of the secondary mortgage market.

The housing sector is largely divided into two categories; the public sector and the private sector. In the public sector, housing funds are being raised through the Government's budget, foreign loans and proceeds from the sale of public bonds and lotteries pursuant to the Housing Construction Promotion Law. In the private sector the Korea Housing Bank, the Citizens National Bank, and The National Agricultural Cooperatives Federation and insurance companies raise funds through deposits and premiums.

In the public sector, the Central Government provides the state-run Korea National Housing Corporation (KNHC) with funds for the construction of rental houses and condominiums. It also supplies the National Agricultural Cooperatives Federation with rural housing improvement funds, and assists other public housing projects. Additionally local governments carry out public housing construction projects on their own with funds from their own budgets, Central Government contributions and the National Housing Fund.

On the other hand, the Korea Housing Bank plays the pivotal role in extending housing loans to the private sector. It held more than 77 percent of the total outstanding balance of housing loans at the end of 1982 in the private sector.

2. The Korea Housing Bank:

2.1 History, organization and operation

The Korean Government established the Housing Funds Depository at the Korea Development Bank in

May, 1957 in order to promote housing construction. The main sources of the Depository Funds were from Government contributions and financial aid from the United Nations Korea Reconstruction Agency and the Agency for International Development.

In the meantime, the Government felt the need for a separate banking institution to mobilize and manage housing funds for the private housing sector. Accordingly, the Korea Housing Bank Act was enacted on March 30, 1967, and thereby the Korea Housing Bank commenced its business on July 10, 1967.

The paid-in capital out of the authorized capital of 50 billion Won was 24 billion Won as of Dec. 31, 1983; 92.9 percent or 22.3 billion Won of the paid-in capital was invested by the Government and the remaining 7.1 percent (or 1.7 billion Won) by other financial institutions, including banks and insurance companies. The outstanding balance of total assets reached 2,419.4 billion Won at the end of 1983.

The basic operational policies are formulated by the Operational Board which is composed of ten members, including four representatives from the Government, two housing specialists and three private investors, under the chairmanship of the president of the Korea Housing Bank. The Board of Directors is responsible for other important matters. It consists of the president, executive vice president and four managing directors.

The bank has 13 departments, 2 offices and 6 attached offices at its head office plus a representative office in Tokyo. We also provide nationwide customer services through our 138 branch offices. The total number of employees stood at approximately 6,500 as of Dec. 31, 1983.

The Bank manages two different accounts; one is the Korea Housing Bank (KHB) account concerned with the private housing sector and the other is the National Housing Fund (NHF) account, the operation of which is entrusted to the Bank by the Government.

2.2 Resource Mobilization for the KHB Accounts

The principal sources of the Bank funds are its own capital, deposits from customers and long-term borrowings from the Government. Of these, deposits constitute the primary source of the Bank funds. There are three types of deposits. One type includes demand deposits such as passbook deposits, checking accounts and temporary deposits. The second type includes time and savings deposits such as savings deposits, time deposits, installment savings deposits and workers' property formation deposits. The third type represents specialized deposits offered exclusively by the Korea Housing Bank such as housing installment savings deposits and housing subscription time deposits. Some of the major funding sources will be identified and briefly examined as follows.

2.2.1 Housing Installment Savings Deposits (HISD)

The Housing Installment Savings Deposits scheme, offered only by the Korea Housing Bank pursuant to the Korea Housing Bank Act is designed to match savings deposits with home loans. A subscriber who has completed monthly installments over a specified period of time is eligible for a housing loan for housing construction, home purchase, home improvement or housing-site purchase within the limit of the contract period.

The Bank pays interest on the paid-in installments for the accumulated number of months, and the compounded interest is added to the principal annually. The amount of the monthly installments is determined in such a manner that the accumulated principal and interest added annually total the contract amount when the contract period is due.

Upon receiving a housing loan, one must make interest payments on the loan in addition to the existing monthly installments over the remaining contract period. The table below illustrates installment schedules subject to change with different terms and contract amount.

Table 1. HISD Deposit Scheme

Unit: Time

AMOUNT/PERIOD	3 yrs	5 yrs	8 yrs	10 yrs	15 yrs	20 yrs
5 mil. Won or less	9	12	12	12	12	18
8 mil. Won or less		15	18	18	18	24
10 mil. Won or less		18	21	24	27	30

Upon maturity of the deposit, the total amount of paid-in installment combined with the accumulated interest is to be set off against the loan.

The contract amount ranges from a minimum of one million Won to a maximum of ten million Won, and contract periods vary from three years up to twenty years. Most subscribers carry accounts worth 8-10 million Won with a twenty-year contract term. The interest earned through the Housing Installment Savings Deposits (HSID) is eight percent per annum whereas the interest charged on the loan is 10.5 percent per annum. Both of these rates are subject to change as publicly determined interest rates vary. Partial or full repayment of the loan is allowed at any time before maturity. There is no prepayment penalty.

As of the end of 1983, the paid-in installments accounted for 11.9 percent of the total deposits.

2.2.2 Housing Subscription Time Deposits (HSTD)

The HSTD is designed to give subscribers a priority in purchasing a newly constructed condominium unit by private builders in three metropolitan areas. The head of household who wants to purchase a condominium unit should deposit a specified amount corresponding to the desired floor space for a set period of time. The amount of the deposit by desired floor space is as follows.

Table 2. HSTD by Floor Space

FLOOR SPACE	AMOUNT OF DEPOSIT
85 square meters or less	2 million Won or more
100 square meters or less	3 million Won or more
135 square meters or less	4 million Won or more
more than 135 square meters	5 million Won or more

Presently subscribers who have deposited for over 9 months secure the first priority in purchasing newly constructed private condominium and over three months the second priority. The interest rate on the HSTD is same as that applied to general time deposits. The interest rates vary by periods as follows:

Table 3. Interest Schedule for HSTD

PERIOD	INTEREST RATE P.A.
1 month - less than 3 months	4.0%
3 months - less than 1 year	6.0%
1 year - less than 2.5 years	9.0%

This deposit scheme is exclusively offered by the Korea Housing Bank pursuant to the Construction Promotion Law. The amount of deposits outstanding with this scheme constituted 14.2 percent of the total deposits as of 1983.

2.2.3 Workers' Property Formation Deposits (WPFD)

The Workers' Property Formation Deposit was planned to assist low-to-medium income employees for asset formation. Accordingly the participants earn the highest yield of all current savings schemes in Korea.

Two types of Workers' Property Formation Deposit schemes are available; one from monthly payments and the other from bonuses. Contract periods vary from one through five years, but most subscribers carry a three-year account.

Due to the high rate of the yield, only limited number of workers are eligible including the ones that earn 400 thousand Won or less per month and are employed overseas. Overseas employed workers are eligible for one-year subscription plan. The two-year plan includes working women and military officers.

The total yield on maturity consists of interest from the Bank combined with legally entitled government subsidies and voluntary subsidies from the subscriber's employer.

The Workers' Property Formation Deposit scheme was initially offered by the Korea Housing Bank and a few other institutions, but it has recently been extended to almost all commercial banks, and investment and trust companies. Therefore, the Bank must compete with other financial institutions to attract customers. Unlike other institutions the Bank offers the subscribers housing loans as an incentive when they meet specified deposit requirements. The yield on the WPFD vary with the deposit periods as follows:

Table 4. Schedule on WPFD Yields

PERIODS	INTEREST FROM THE BANK	LEGAL SUBSIDY	VOLUN-TARY SUBSIDY	TOTAL
1 year	7.6% p.a.	10.2% p.a.	1.8% p.a.	19.6% p.a.
2 years	8.0% p.a.	11.5% p.a.	1.9% p.a.	21.4% p.a.
3 years	8.0% p.a.	12.3% p.a.	2.6% p.a.	22.9% p.a.
5 years	8.0% p.a.	13.0% p.a.	2.9% p.a.	23.9% p.a.

As of the end of 1983, its balance accounted for 18.1 percent of the total deposits.

2.2.4 Other deposit plans

Aside from the deposit schemes above described, the Bank offers passbook deposits, checking accounts, temporary deposits, household checking deposits, savings deposits, time deposits and installment savings deposits with the same terms as those of commercial banks. However, the three deposit schemes contribute to the Bank's major housing funds.

2.2.5 Housing Debentures and other Bonds

From June 21, 1968, the Bank issued government-guaranteed Housing Debentures which normally matured in two-to-three years. They contributed greatly to the fund-raising of the Korea Housing Bank in the early years. However, the Bank decided not to issue them since 1979, partly because the Bank's short term repayment burden was too heavy coupled with high interest rate and partly because it found other resources to mobilize. For the same reason, the Savings Bonds secured through the Matured Workers' Property Formation Deposits have not been issued since 1981. The bonds were sold to support the ones that had subscribed to the Workers' Property Formation Deposits.

Except for some special depository system offered exclusively by the Korea Housing Bank pursuant to the acts concerned, there is no support from the Government pertaining to interest rate or tax relief. But on income earned through the Workers' Property Formation Deposit scheme, which is the only deposit scheme receiving tax relief in the KHB account, interest income tax and inhabitants tax are remitted.

Interest rates on deposits (up to 9 percent per annum) and on housing loans (up to 10.5 percent per annum) are the same as those of commercial banks. The long-term housing mortgages can't be put on the market in the absence of the secondary mortgage market. And consequently the resources once invested in long-term housing loans are locked in for about ten to twenty years. Accordingly, we must make continued efforts to mobilize resources for long-term housing loans through the short-term deposit money market.

2.3 Resource Mobilization for the National Housing Fund (NHF)

The Government revised the Housing Construction Promotion Law on April 7, 1981, and separated the public housing fund accounts from the Korea Housing Bank accounts in order to support public housing construction projects effectively.

The National Housing Fund was thereby established on July 20, 1981, and placed under the direction of the Minister of Construction, with its actual management entrusted to the Korea Housing Bank. The Korea Housing Bank receives service fees from the Government, which is calculated on the basis of average assets balance of the National Housing Fund.

The National Housing Fund finances public housing construction, and consists of Government contributions or deposits, various pension funds, funds from sales of the national housing bonds, the Olympic lottery, as well as national housing pre-emption subscription deposits. Major sources of the NHF are identified below.

2.3.1 National Housing Bonds (NHB)

There exist two different types of the National Housing Bonds. Both types are government-guaranteed and sold in the securities market. The type I bonds are purchased on a compulsory basis by those who want to obtain permits for gambling business, entertainment business, building construction, property registration, new car registration, and various licensing activities. The bond yields a five percent fixed interest earnings per annum with a maturity period of five years. This makes the bond investment rather unattractive and they can't be redeemed unless sold compulsorily.

The type II bonds are issued in order to absorb 'speculative profits' from sales of newly constructed condominiums. New condominium units, particularly the ones that are produced by the government-designated builders, are sold at government-guided sale prices, which are very low as compared to market prices. The gap between the two generates 'premium' and causes home investors to speculate on newly built condominium units.

Accordingly the government decided to capture the premium rather than to let it slip into the hands of speculators and devised an open bidding system whereby any qualified home buyers are allowed to bid up for the condominium units. The potential home buyers must write down how much they are willing to purchase the type II bonds. The right to purchase the units depend on the amount of pledge that one makes for the bond. Thus, the government easily draws funds, through this practice, in the amount of bond sales. The bond carries a 3 percent fixed interest rate and matures in twenty years. All the revenues from the bond sales are put into the NHF specifically earmarked for the low income rental housing construction.

2.3.2 The Olympic Lottery

The housing lottery tickets have been sold to the general public since 1969 in order to raise housing funds. In 1981 alone 51 lotteries were issued and grossed over 15 billion Won worth of lottery revenues. The net revenue amounted to 6.12 billion Won with prizes and operating expenses deducted. This housing lottery has been consolidated into the Olympic Lottery since 1982. The per ticket price has been quintupled and the prize moneys have also expanded considerably. The new lottery system, therefore, has twin objectives of raising funds for both Olympic facility construction and housing development. Prizes range from 100 million Won for the first prize to 500 Won. After deducting prizes and expenses, 35 percent of the sale proceeds will be used as loanable funds to finance national housing construction, while the larger share of the revenue (65 percent) will be used for the preparation and operation of the Olympics.

2.3.3 National Housing Pre-emption Subscription Deposits (NHPSD)

All the prospective purchasers of the NHF-financed national housing units are required to subscribe to the National Housing Pre-emption Subscription Deposits (NHPSD). They have to make a fixed amount of deposit in the range of 20,000 Won up to 100,000 Won each month to be qualified. The amount of monthly deposit directly corresponds to the size of a publicly supplied dwelling unit to purchase. To be eligible, the subscribers must be homeless heads of household and reside in the district where the housing units are to be built.

Normally one is eligible for the purchase of a public housing unit upon one year of NHPSD subscription, but the actual purchasers are often decided on the basis of the amount of paid-in installments among the eligible competitors because would-be purchasers generally outnumber the supply of national housing units. The deposits carry a six percent interest per annum.

Tax relief is given to interest income from National Housing Pre- emption Subscription Deposits. While three kinds of taxes such as interest income tax, inhabitants tax and defense tax are levied on the interest income from the other accounts in the National Housing Fund, only the defense tax is levied on income earned through the National Housing Preemption Subscription Deposits.

3. Competitors in housing finance and their methods of resource mobilization

Commercial banks or investment and trust companies rarely deal with long-term housing loans, but insurance companies, the National Agricultural Cooperatives Federation and the Citizens National Bank are partially involved in housing finance. However, they are neither as competitive as the Korea Housing Bank in housing finance, nor do they have their own deposit schemes such as the ones prevailing at KHB.

4. Korea Housing Bank's advertising policy for resource mobilization

The Bankers' Association of Korea discouraged excessive advertisement among its member banks until 1981. However, it has decided to allow them to do so since 1982 in anticipation that deregulation would promote banking services and specialization in banking businesses. The Korea Housing Bank competes with commercial banks in soliciting household deposits and actively promotes its services and various deposit schemes through advertisement. It employs mass-media such as newspapers, T.V. broadcasts, billboards as well as local branch offices throughout the country for effective promotion. Emphasis is placed on various incentives built into the deposit schemes for the prospective home buyers.

5. A new scheme for resource mobilization

As indicated the Bank has only a few limited methods available for housing fund resources mobilization. They do not generate enough funds to meet the financial needs for the prospective home buyers on a long term basis. The Bank borrows short, but must lend long to assist low and moderate income families.

A new plan has been conceived to rectify this situation. It attempts to help the newly wed couples purchase homes much earlier than they normally can under the present system of housing finance. Newly weds earn relatively high income. It is not unusual nowadays that both husbands and wives work and have a joint bank account. Thus, a large number of them can afford to make mothly payments. But they can hardly secure lump-sum money large enough to put a downpayment at the initial stage of their married life. Parents could subsidize them, but the amount of money required for downpayment is an enormous burden for most of the middle class parents.

The new scheme under study will offer a long-term high-yielding savings scheme for them so that they can help their children purchase homes once they grow up to marry in 10 years or longer. This scheme will also contribute to the Bank's resource mobilization on a continuing basis. Obviously the Bank will have to promise the subscribers a lump-sum amount of money to pay for the downpayment on their children's behalf as well as a housing loan to the children for home purchase.

The scheme, though tentative at this point, is under a serious consideration to make workable. Some of the details are as follows.

a. A parent should subscribe to the plan jointly with his or her children who are minors.

b. The maturity of the scheme should be at least ten years or more.

c. Monthly installments should be decided according to the desired floor space of housing units that the depositors want to purchase after the maturity.

d. When monthly installments are decided, an inflation rate should be considered less the loan-to-value ratio be too high.

e. The interest rate of the deposits will be a little higher than the current one.

f. Tax incentives should be given to the principal and interest of the deposits on maturity.

g. If a subscriber deposits for more than the contract period, he is eligible for a housing loan amounting to the difference between the principal plus interest and the market value of the house purchase.

6. Conclusion

We have outlined the resource mobilization methods of the Korea Housing Bank for the private sector and those of the National Housing Fund for the public sector.

In Korea, the secondary mortgage market does not exist. Consequently, resources are mobilized only through the primary market and the housing finance market operates on a small scale. Thus, of practical importance is the fact that the Korea Housing Bank should secure long-term and stable resources through long-term savings deposits, such as the new scheme previously mentioned. But, in carrying out the long-term savings plan, two important factors are at issue; one is that the interest rate should be relatively high; the other is that tax relief on the long-term savings plan is required as an inducement.

Operational Problems and Potentials of Low Income Lending

Presented by:

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and

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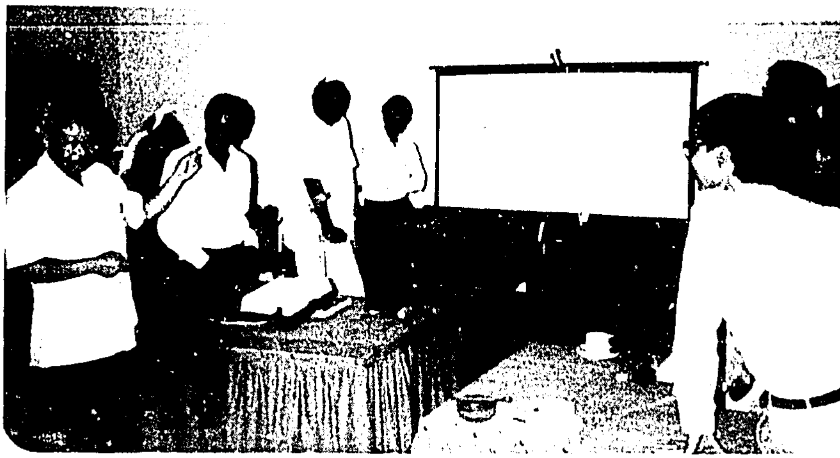
Sources of Housing Finance

In Malaysia, the various financial institutions providing end-finance to house purchasers can be broadly categorized as follows:-

Group	Total lending extended as at 31st December 1982 (Malaysian Dollars)*
Commercial Banks	$3,497.8 million
Government Staff Housing Loans	$3,359.0 million
Licensed Finance Companies	$1,085.1 million
Housing Credit Institutions	$1,449.5 million

(Appendix 1)

There are two housing credit institutions of which Malaysia Building Society Berhad (MBSB) is one of them. Its lending operations cover the whole of Peninsular Malaysia. The other is the Borneo Housing



Presentation by Mr. Teah Kim Theam, Malaysia Building Society Berhad

From left to right: Mr. Lall, National Institute of Public Finance and Policy, India; Mr. Osterbrauck, International Union of Building Societies and Savings Associations, West Germany; Mr. Kimm, Office of Housing and Conference Co-Chairman; Mr. Parekh, Housing Development and Finance Corporation and Conference Co-Chairman, India; Mr. Munjee, Housing Development and Finance Corporation, India; Mr. Theam, Malaysia Building Society.

Mortgage Finance Berhad which serves Sabah and Sarawak, the two states in East Malaysia.

With mortgage assets at M$1,089.5 m (US$480 million) at 31st December 1982, MBSB is the single largest provider of end-finance in the private sector.

Outline of MBSB

The history of MBSB dates back to the pre-independence period. Incorporated in Singapore as the Federal and Colonial Building Society in 1950 by the Commonwealth Development Corporation (then called the Colonial Development Corporation), as its wholly owned subsidiary to provide housing credit, it was renamed as the Malaya Borneo Building Society Ltd., (MBBS). In 1954 when the then Malayan Government became the major shareholder. In 1956 MBBS extended its business operations to the Borneo territories, but handed over these operations to a company now known as the Borneo Housing Mortgage Finance Berhad on June 1, 1959.

Following the separation of Singapore from Malaysia in 1965, there arose a need to rationalize MBBS undertakings and operations since some 75 percent of its mortgage assets were situated in West Malaysia and the Malaysian Government was one of its two major shareholders. Hence, a reconstruction exercise was undertaken, whereby the Singapore operations were hived off and sold to the Singapura Building Society Ltd., which was incorporated for such a purpose. In accordance with the Scheme of Arrangement, MBSB was incorporated on March 17, 1970 following which the undertakings and operations of MBBS in Peninsular Malaysia were transferred to MBSB effective from March 1, 1972 and, on completion of the restructuring, MBBS remains a wholly owned subsidiary of MBSB with only two ordinary shares of $1.00 each.

MBSB is an exempt finance company approved by the Central Bank of Malaysia and is required to submit to the Central Bank Monthly Returns on Deposits and Statement of Assets and Liabilities. By virtue of being an exempt finance company, however, MBSB could undertake borrowings which include acceptance of deposits from the public without a license from the Central Bank.

MBSB is also granted a Prescribed Corporation Status which exempts MBSB from issuing a prospectus for mobilization of deposits from the public. In addition, MBSB qualifies as an "approved company" under the Trustee Investment Act, 1965, which enables it to tap trustee funds, which are basically long-term in nature. In this respect, since the early 1960s, the Employees Provident Fund supported the activities of MBSB by providing it with long term funds in the form of debentures which remain today as one of MBSB's major sources of funds for its operations.

MBSB's Profit and Loss Statement and Balance Sheet as of December 31, 1983 are attached as Appendix II and III respectively.

End-Finance Operations

For the period from 1971 to 31st December 1983, MBSB has approved a total of 73,826 loans amounting to M$1,769 million. Loan released during the same period amounted to M$1,669 million. The number of active mortgage accounts also increased from 20,376 at the end of December 1970 to 55,156 at the end of December 1983 with total mortgage assets of M$1,226.16 million.

In the spirit of the country's current Five Year Development Plan - the 4th in the series whereby the Government is committed to a house owning democracy, end-finance arrangements are standardized so that they could be conveniently followed by all commercial banks and licensed finance companies in their dealings with eligible house buyers purchasing low and medium cost houses. The step was taken to ensure the easy availability of relatively cheap housing credit to the lower income groups.

By definition, houses costing M$25,000 and below are regarded as low cost houses whilst houses costing more than M$25,000 but less than M$50,000 are defined as medium low cost houses. Houses costing above M$50,000 but less than M$100,000 are considered medium cost houses and houses above M$100,000 are generally regarded as high cost houses. In a scheme known as the Special Housing Loan Scheme, house purchasers who satisfy certain criteria, as detailed below, are eligible for loans of up to 100 percent if they are buying residential houses costing up to M$50,000 and 90 percent in the case of houses costing M$50,001 - M$100,000. The maximum repayment period for the loan is 20 years and the interest rate charged is pegged at 10 percent p.a.

The following conditions to be satisfied under the Scheme are:-

(a) For low cost houses, the income of the applicant and spouse should not exceed M$750 per month. For medium cost houses, no maximum income is specified.

(b) The borrowers must satisfy the financial institutions of their ability to repay the loan by monthly installments. The normal practice of the banks in assessing an applicant's ability to repay is based on the rule of thumb that the monthly repayment of principal and interest should not exceed one-third the applicant's (and spouse's) monthly income.

(c) To ensure an equitable allocation of resources and to discourage excess demand for housing, the lending institutions have to ascertain that:-

(1) applicant will occupy the house he is purchasing

(2) applicant does not own another house, and

(3) applicant is a "first-timer", in that he does not already have a housing loan with any financial institution.

The Special Housing Loan Scheme was mooted because different banks adopted varying and often inequitable methods in granting end-financing. Some banks were only interested in financing houses costing above M$100,000 because of the prescribed maximum interest rate of 10 percent per annum on loans for houses costing M$100,000 and below imposed by the Central Bank. The outcome was that developers could not obtain end-finance for some of their cheaper houses, and buyers of such houses therefore had to seek end-financing elsewhere, often incurring many problems in the process.

Since MBSB is not under the purview of the Central Bank, there is no requirement that the Scheme must be followed. However, in keeping with the aspirations of the Government in providing ready access to credit at reasonable interest rates to potential house purchasers of lower priced houses, MBSB has its lending terms closely modelled on the Special Housing Loan Scheme. The scheme also extends loans for high cost houses where interest rates range from 12-14 percent p.a. However, mindful of its social role, MBSB has given more weight to loans for houses in the lower priced range as is illustrated by Appendix IV which shows loan approvals according to price and income ranges. MBSB's major source of funds for the above lending operations which MBSB terms as its Normal Housing Finance Program (NHFP) are long-term debenture loans from the Employees Provident Fund. Other sources include fixed deposits received from the public, overdraft facilities from commercial banks and shareholders' capital funds.

Apart from the NHFP, MBSB has its own Low Cost Housing Finance Program (LCHFP). This is a unique program made possible only by the Central Bank and EPF making funds available at a low interest of 4.138 percent (weighted average). Implemented in January 1977 during the tenure of the Third Malaysia Plan, MBSB managed by 31st December 1983 to give end-finance loans to 34,284 applicants to the tune of M$526.64 million.

The LCHFP program is confined to houses costing M$25,000 and below, and constructed in projects specifically approved by MBSB. Eligible purchasers of houses in such approved Schemes would qualify for loans up to 90 percent of the value of house. Applicants who are also members of the Employees Provident Fund may finance 10 percent of the purchase price by drawing on the deposits standing to their credit with the EPF. All loans made under this program are charged an interest rate of 5.5 percent per annum and the maximum repayment period of the loan is 20 years, provided the age of the borrower does not exceed 65 years at the end of the repayment period. Other conditions of the LCHFP are that the applicant should be a Malaysian citizen, the income of the applicant should not exceed M$500 per month (except if he is a member of the EPF in which case this stipulation does not apply), the applicant and/or spouse should not already own a house and the monthly repayment on the loan should not exceed one-third of the monthly income of the applicant and the spouse.

Appendix VI analyzes the 34,284 loans in terms of income ranges. One can note that about 77.6 percent of the number of loans approved were for those earning M$500 and below per month. Of this, the target income group that benefitted most from the LCHFP were those earning M$301-M$500 per month which constituted about 66.5 percent of the total loans approved.

The latest data on income distribution in Malaysia is not available. However estimates indicate that in 1981 about 48 percent of the urban households in Malaysia were earning below M$750 per month whilst another 40 percent were earning between M$750-M$2,500 per month. The remaining 12 percent of urban households were earning above M$2,500 per month.

Operational Problems in MBSB Context

In the implementation of the LCHFP and the NHLP, particularly in relation to the loans granted to the purchasers of the lower cost houses, MBSB encounters problems of varying intensity in several areas but, happy to say, none has proved insurmountable. There is no denying, though, that considerable efforts are directed into resolving problems as and when they emerge in order to keep them under manageable control.

Some of the more significant problems that need to be highlighted are as follows:-

(a) Due to the relatively low level of education of the borrowers under the LCHFP, there are instances where the application forms are not properly completed.

(b) At times, the particulars given by the applicant in the application form differ from the particulars filled-in in the Statutory Declaration Form. The Statutory Declaration Form is sworn by the applicant in the presence of a Commissioner of Oaths declaring that he meet the eligibility criteria stipulated under the LCHFP.

(c) Since all borrowers under the LCHFP have to take a mortgage reducing life insurance policy, the premium being advanced by MBSB as a loan over and above the loan given for the purchase of the house, the applicants need to fill in an Insurance Proposal form. The common problem here is that the information provided is not accurate. At times, the proposals are not even signed by the applicant.

(d) Delays in security documentation is another common problem faced in lending to low income groups. Generally, the delay in security documentation is caused by the borrower's difficulties in meeting all the legal fees and disbursements involved which average about M$300. The reason is apparent since the borrowers are in the low income category and usually have difficulties in raising the requisite sum of money. Should the applicant lack the funds required, the applicant would delay going to the solicitors. This holds back security documentation and consequently loan releases by MBSB.

(e) The payment of the initial 10 percent of the house price is another problem area. Faced only by non-EPF house purchasers, many find it difficult to raise that kind of money for payment to developers. Consequently, these purchasers delay in signing the Sale and Purchase Agreement which in turn causes delay in submission of their loan applications for consideration and with it all the attendant problems.

(f) Developmental delay, such as those caused by the developer's tardiness in submitting the list of selling prices, lateness in balloting or selection of candidates by the State Government are often contributory problems relating to mortgage lending.

(g) Collection of monthly repayments from low income borrowers could well emerge as a potential problem that will require a lot of effort to prevent it from getting out of control. It is a recognized fact that no borrower wants to default in his monthly commitment and stands the risk of losing his property through foreclosure considering that the house, besides providing shelter, most probably constitutes the person's single largest asset. However, in present inflationary times which relentlessly eat into the earnings of the low income groups, it is not unexpected that borrowers sometimes fail to meet the monthly installments, especially when other urgent issues crop up which make demands on their limited financial resources. Added to this is semi-literacy, prevalent to quite a large group of the low income borrowers, which lead them either to miscomprehend or ignore the implications of not keeping their loan accounts up to date.

MBSB's experience so far in this area is rather satisfactory. The number of loans in arrears of a more serious nature totalled 290 out of 31,831 active accounts as at 31st December 1983. This constituted only 0.91 percent, which is not alarming. In terms of mortgage assets, the amount in arrears comprised only 0.05 percent.

It must be emphasized that this result was achieved through a systematic approach that involves very close follow-up actions.

(h) Another problem is with respect to foreclosure proceedings in cases where the title of the land is a Land Office Title. Due to the land laws of Malaysia, all Land Office titles are registered with the Land Office and hence all foreclosure proceedings for such titles have to be heard before the Collector of Land Revenue. Owing to the closely known community and, to a smaller extent, some degree of social pressure, the collectors are more inclined (quite unlike the courts) to favour the defaulted borrowers by giving the defaulting borrower extension of time to settle the arrears. This would cause at times inordinate delays in foreclosure proceedings.

(i) The most common problem faced in terms of lending for low cost houses under MBSB's NHFP is the determination of the income. As in the case with other financial institutions, one of the conditions for qualifying for a housing loan from MBSB is that the monthly repayment of the loan should not exceed one-third of the income of the borrower and the spouse. However, as some of the borrowers for the low cost houses are in the category where they cannot produce documentary evidence of regular income (such as hawkers, petty traders), it is sometimes necessary to interview the prospective applicant to ascertain the income which is time consuming.

Savings Schemes

Until mid-1983, MBSB had two savings schemes. Apart from collecting funds for relending purposes, the other objective was to give priority of housing loans to savers. Given the singular nature of MBSB's business which involves long term loans at reasonable interest rates, MBSB has not been able to offer very attractive terms to savers compared to commercial banks and licensed finance companies. Consequently, the Fixed Term Savings Scheme was discontinued leaving only the Fixed Deposit Scheme still active.

An element of loans on special terms was built into this scheme. A depositor, by having in his account a certain sum of savings, is able to apply for a housing loan 18 times the amount in his account subject to the loan not exceeding a certain percentage of the selling price or valuation, whichever is lower, of the house he intends to buy. The percentage of 85-95 percent is higher than the standard 75-85 percent of the valuation/selling price for a non-depositor loan applicant.

Mortgage Reducing Life Insurance Policy

Mortgage insurance is not a feature of end-financing in Malaysia. What financial institutions adopt in this country is the Mortgage Reducing Insurance Policy that covers the life of the insured (i.e. the borrower) over the period it takes him to repay the loan in full. It involves the payment of a single premium which is arrived at based on several factors like the amount of loan, the repayment period, mortgage interest rate, age and health of the insured. The amount covered decreases progressively each year and the coverage lapses at the end of the repayment period. In the event of death, the claim is payable to the financial institution towards settlement of the deceased borrower's loan account.

The rationale behind the Mortgage Reducing Policy is twofold. First and foremost, the policy protects the borrower's dependents in the event of his untimely death against the risk of not being able to meet the mortgage loan repayments. Secondly, it is to the benefit of the financial institution as it eliminates a potentially bad loan account.

Despite the advantages to be derived from the policy, some financial institutions do not compel their borrowers to take up the policy so as not to load more financial burden on them. MBSB adopts this practice in relation to its NHLP but for its LCHFP, it is made compulsory. However, the single premium is advanced by MBSB on behalf of its borrowers on top of the loan approved, allowing them to repay it over the agreed repayment period in monthly installments.

Low Income Lending Potential

The potential market for housing loans to low income families in Malaysia is certainly large. It has been envisaged that under the Fourth Malaysia Plan, 923,300 housing units are required to meet increasing population needs, to meet replacements and to cover the backlog in housing stock. Of these, 266,500 units will be in the low cost category. Like in the past, the public sector will play a significant role in the construction industry but the private sector is also expected to contribute more actively, particularly in undertaking the construction of low cost houses.

The Government has taken various steps towards encouraging developers to build low and medium cost houses, some of which are as follows:-

(a) The Federal Government has directed that all low cost houses be given flexibility from the stringent enforcement of the provisions of building by-laws and other related laws.

(b) As a matter of policy, private developers are required to build 30 to 50 percent of their houses in a project in the form of low cost houses.

(c) To overcome the shortage of skilled labor in the construction industry, the Government has increased its training programs.

(d) The Ministry of Land and Regional Development has taken steps to ensure that applications for conversion must be processed within three months. The idea is to cut down holding charges which could enable the developer to price their houses lower.

(e) The Government has agreed on the need to increase the density of housing. Higher densities would encourage private developers to construct more medium and low-cost units.

(f) The Government has decided to undertake privatization which would be in the form of the Government farming out lands to the private sector for building both high cost as well as low cost units. The private sector would, in turn, give the Government all the low cost units which would be sold by the Government to eligible purchasers. The Kuala Lumpur City Hall, the Penang Development Corporation and a number of other State Development Agencies have initiated the privatization scheme.

A significant constraint in lending to lower income earners is the availability of credit at reasonable interest rates and the need to strike a balance between the affordability of the borrowers and the corporate goals of lending institutions.

To ensure that commercial banks and licensed finance companies continue to make available credit to would be house purchasers, the Government has issued directives to these financial bodies:

(a) in the case of commercial banks, make new firm commitments to individuals to finance the purchase of at least 20,000 units of newly constructed houses costing M$100,000 and below.

(b) in the case of licensed finance companies, make new firm commitments to finance the purchase of at least 5,000 units of newly constructed houses costing M$100,000 and below.

MBSB will continue with its NLHP with more of a slant towards lending to medium and low cost houses at 10 percent interest rate per annum. Considering that MBSB's main source of funds comes from debenture loans from EPF at 9.25 percent p.a., it is important that MBSB has to have a mix of lending between the 10 percent interest rate and the higher interest rate charged on loans to purchasers of high priced houses, such that a weighted average lending rate of at least 11 percent is achieved to cover borrowing costs and the other operating expenses and leave a reasonable profit margin. In this respect, the Board of directors of MBSB have adopted a lending strategy for MBSB such as that there is a balance between loan approvals for the 10 percent interest rate segment and the higher interest rate loans. As a rough guide, the mix of lending by MBSB between the 10 percent interest rate loans and the higher interest rate loans is approximately 55/45 percent.

In building low cost houses during the tenure of the Fourth Malaysia Plan, the Government decided that these houses could either be sold or rented so that a broader spectrum of the population could have access to low cost housing. By virtue of its specialized role in housing credit, MBSB has been appointed by the Government as financial principal for the rental scheme whereby MBSB will assume responsibility for renting out the units, for loan management and for maintenance of the houses during the rental period. The Scheme will mainly involve the construction of flats based on the condominium concept with the objective of optimising land use by having a higher density. The units will be rented out to selected tenants for 25 years and the tenants will be given the option to purchase the units if they stay in the unit for 10 continuous years. The total rental collected during the 10 years will be deducted from the original cost of land and building plus accrued interest to determine the purchase price. The purchase price may be paid in cash or the tenants can opt for a 15-year loan from MBSB.

The selection of tenants is based on the following criteria:-

(a) The householder's income must not exceed M$750 per month.

(b) Neither the tenant nor the spouse should own a house at time of application.

(c) They must be Malaysian citizens who are married and have stayed in the same area for 5 years.

The sources of funds for this scheme will be arranged for and provided by the Federal Government. The objective for MBSB is to finance as many units as possible subject to the quantum of funds available.

APPENDIX I
SOURCES OF HOUSING FINANCE
($M)

As at end	Commercial Banks	Finance Companies	Building Societies	Housing Loans Division
1970	88 1 (28 6%)	25 8 (8 4%)	193 6 (63 0%)	— (—)
1975	500 9 (39 5%)	141 6 (11 2%)	337 1 (26 6%)	287 4 (22 7%)
1980	2,232 5 (45 2%)	619 8 (12 5%)	986 0 (20 0%)	1,103 0 (22 3%)
1981	2,811 4 (40 4%)	833 4 (12 0%)	1,214 0 (17 5%)	2,093 0 (30 1%)
1982	3,497 8 (37 2%)	1,085 1 (11 6%)	1,449 5 (15 4%)	3,359 0 (35 8%)

Note: Figures in parentheses indicate the percentage of the market share

APPENDIX II
MALAYSIA BUILDING SOCIETY BERHAD
(Incorporated in Malaysia)

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 1983

	1983 M$'000	1982 M$'000
GROSS OPERATING REVENUE	108,781	95,819
NET PROFIT BEFORE TAXATION	42,742	35,594
After charging/(crediting):-		
Bank overdraft interest	23	26
Interest on fixed term loans	52,117	46,290
Interest payable on deposits	3,311	4,803
Depreciation of fixed assets	825	830
Rent of buildings	484	416
Directors' emoluments	253	229
Auditor's remuneration	40	36
Provision for staff retirement benefits	459	81
Profit on sale of fixed assets	(16)	(8)
TAXATION	18,031	16,513
NET PROFIT AFTER TAXATION	24,711	19,081
Unappropriated Profits Brought Forward	427	551
Available for Appropriation	25,138	19,632
Appropriations:-		
Dividends less income tax		
Paid		
Dividends on redeemed preference shares	19	17
Interim ordinary dividend of 8% (1982-8%)	3,678	3,678
Proposed		
Dividends on preference shares	182	214
Final ordinary dividend of 13% (1982-12%)	5,977	5,517
Transfer to Capital Redemption Reserve	777	779
Transfer to General Reserve	14,000	9,000
	24,633	19,205
Unappropriated Profits Carried Forward	505	427

APPENDIX III
MALAYSIA BUILDING SOCIETY BERHAD
(Incorporated in Malaysia)

BALANCE SHEET AT 31 DECEMBER 1983

	1983 M$ '000	1982 M$ '000
CAPITAL EMPLOYED		
Share Capital	80,787	81,564
Capital Reserve	17,838	17,838
Capital Redemption Reserve	8,327	7,550
Share Premium	44,445	44,445
Revenue Reserves		
General reserves	42,616	28,616
Unappropriated profits	505	427
Shareholders Funds	194,518	180,440
Provision for Staff Retirement Benefits	917	469
Loans and Deposits		
Debenture Loans (secured)— redeemable during 1985/2003	423,550	360,750
Bank Negara Malaysia Loans (secured)— redeemable during 1985/2005	331,111	307,738
Special Housing Loan (secured)— redeemable during 2001/2008	167,308	143,921
Deposits maturing after 12 months	17,301	16,209
	1,134,705	1,009,527
EMPLOYMENT OF CAPITAL		
Fixed Assets	2,920	2,513
Investment in Subsidiary Company	—	—
Mortgage Loans Receivable after 12 Months	1,023,077	914,423
Current Assets		
Mortgage loans receivable within 12 months	203,081	175,080
Other debtors, deposits and prepayments	1,795	1,098
Deposits with financial institutions	—	22,239
Cash at banks and in hand	1,155	2,392
	206,031	200,809
Less Current Liabilities		
Debenture Loans (secured)— redeemable during 1984	7,200	5,300
Bank Negara Malaysia Loan (secured)— redeemable during 1984	9,750	5,249
Special Housing Loan (secured)— redeemable during 1984	2,681	3,573
Bank Overdraft (unsecured)	3,888	—
Deposits maturing within 12 months	32,593	53,458
Other creditors and accruals	16,747	18,233
Taxation	18,305	16,674
Proposed dividends (net)	6,159	5,731
	97,323	103,218
Net Current Assets	108,708	97,591
	1,134,705	1,009,527

APPENDIX IV
MALAYSIA BUILDING SOCIETY BERHAD
NUMBER OF LOANS APPROVED BY PURCHASE PRICE RANGE
(Low-cost Housing Finance Program)
(M$1=US$0.44)

Year	$8,000 & below	$8,001–$12,000	$12,001–$16,000	$16,001–$20,000	$20,001–$25,000	Total
1977			Not available			2,648
1978	392	1,942	2,611	3,650	—	8,595
1979	532	312	987	5,027	—	6,858
1980	118	119	873	6,341	—	7,451
1981	(119)	1	172	3,008	486	3,548
1982	—	5	408	2,640	812	3,865
1983	—	—	197	961	161	1,319
Total	923	2,379	5,248	21,627	1,459	31,636
%	2.92	7.52	16.59	68.36	4.61	

APPENDIX V
MALAYSIA BUILDING SOCIETY BERHAD
NUMBER OF LOANS APPROVED BY INCOME RANGES

(Low-cost Housing Finance Program)

(M$1 = US$0.44)

Year	$300 & Below	$301–$500	$501–$700	$701 & Above	Total
1977	646	1,620	270	122	2,648
1978	1,688	5,484	864	559	8,595
1979	932	4,595	780	551	6,858
1980	530	5,717	795	409	7,451
1981	52	2,395	696	405	3,548
1982	49	2,206	867	743	3,865
1983	16	780	287	236	1,319
Total	3,913	22,797	4,559	3,015	34,284
%	11.41	66.50	13.30	8.79	100.00

APPENDIX VI
MALAYSIA BUILDING SOCIETY BERHAD
RANGES OF LOANS APPROVED
(Low-cost Housing Finance Program)
(M$1=US$0.44)

Year	$8,000 & below	$8,001– $12,000	$12,001– $16,000	$16,001– $20,000	$20,001– $25,000	Total
1977	139	927	1,369	213	—	2,648
1978	703	2,220	3,653	2,019	—	8,595
1979	655	712	1,813	3,678	—	6,858
1980	167	871	4,388	2,025	—	7,451
1981	(109)	119	2,040	1,083	415	3,548
1982	13	444	983	1,889	536	3,865
1983	3	94	522	639	61	1,319
Total	1,571	5,387	14,768	11,546	1,012	34,284
%	4.58	15.71	43.08	33.68	2.95	100.00

Shelter Finance: The Philippine Experience
Resource Mobilization Problems and Potentials

Presented by:

Florencio B. Orendain
President
National Home Mortgage Finance Corporation

INTRODUCTION

The time was the seventies. The housing situation in the country was turning from bad to worse. Years of neglect in the housing sector were showing and it soon became obvious that if no decisive action was taken to ease the housing shortage, Philippine cities of the future would be no more than slum colonies, decaying and spawning greater problems, social economic and environmental.

The housing backlog, defined as unacceptable dwellings and dwelling requirements of doubled up and hidden families, was estimated by the national Economic and Development Authority (NEDA) at 989,000 as of 1970. This backlog was projected to increase at the rate of 225,000 per year for the period 1970-75 and by 300,000 per year for the period 1975-1980. For the 1970-2000 period, the total number of dwelling units needed was estimated at 17.5 million, of which 16.5 million units or 94.4 percent were alloted to house future households and to provide for future replacement.

There were many reasons for this bleak scenario.

1. The financial sector concentrated on short term lending and gave low priority to housing credit because of its retail, long term and

low-yield nature which is contrapuntal to the banks' short term and high cost source of funds.

2. The cost of home acquisition was prohibitive. Low volumes, slow turnovers and high cost of money forced developers to impute high margins into prices of houses and lots. The gap, therefore, between incomes and prices became even wider so that only a distinct minority composed of families from the upper middle-income and the high income sectors could afford their own residences.

3. For the great majority, there was inadequacy of wages to meet even basic needs, more so, other requirements. The wage structure set standards for minimums and did not seek to upgrade the affordability levels of Filipino wage-earners resulting in a nation of dis-savers. Only 7 percent of the population could afford to save.

The government had undertaken housing programs to arrest the situation. Unfortunately, these programs were shortlived and did not offer any meaningful solutions to a worsening problem. Private sector involvement in these programs was minimal and it is, perhaps because of this, that the programs were not sustained.

A NEW BEGINNING

In 1978, the newly created Ministry of Human Settlements under the First Lady, Madame Imelda Romualdez Marcos as Minister, took stock of the housing situation and decided to do something about it.

The problem was defined into more manageable components and thus came about the present delineation of the shelter system into marketing, production, regulation and finance.

Much of the problem was on the finance side. Production and marketing are ultimately functions of finance. Given an appropriate financial package, the right volume in terms of housing demand and market certainty together with the ensuing economies of scale, would bring about the needed incentives to induce the right housing prices. Regulation was never a problem and, in fact, the government sought to further liberalize industry regulations so that market forces could dictate the kinds of housing units which would suit the financial capacities and other needs of the buying public.

Three government agencies under the Ministry interlink and interact closely with the private sector to produce a shelter finance mechanism. These are the National Home Mortgage Finance Corporation (NHMFC), the Home Development Mutual Fund (HDMF) and the Home Financing Corporation (HFC). The system has been in operation since 1979 and has withstood the initial testing that accompanies the introduction of anything new. The private sector has responded positively, and wariness at the start has been replaced with a fully supportive position.

NHMFC is a government, non-bank financial institution created by Presidential Decree No. 1267 to increase the availability of home financing loans to Filipino home-buyers through the development of an active secondary market of home mortgages. Made operational in 1979 as an attached agency of the Ministry of Human Settlements, NHMFC, through the operation of the secondary mortgage market, complements the Home Financing Corporation (HFC) which provides the necessary mortgage insurance and credit guarantees and the Home Development Mutual Fund (HDMF) or Pag-IBIG, which mobilizes savings for shelter finance.

THE SHELTER FINANCE SYSTEM

Tapping Private Savings for Shelter Finance

A provident savings system specifically for housing otherwise known as the Home Development Mutual Fund (HDMF) or Pag-IBIG*, began operating in 1979. HDMF was originally developed as the shelter savings component of NHMFC that would provide the corporation with a long term and low cost source of funds to support its secondary mortgage operations. It was then a voluntary savings system among private and government employees. The Fund became mandatory for the employed sector in July 1981 and was spun-off from NHMFC as a separate corporate entity.

*Pag-IBIG is a Filipino word meaning love. It was made an acronym for Pagtutulungan sa kinabukasan. Ikaw, Bangko, Industriya, Gobyerno. Translated this means "Working together for Your Future - You" (meaning the Employee), the Banking Institutions, Industry (meaning the Employer), the Government.

1. Philosophy of the Fund

The Fund is founded on the philosophy of self-reliance - that the road to a better tomorrow stems from one's own efforts. Savings is preparation for the future and it speaks of self-denial and sacrifice, important ingredients for the achievement of dreams and goals - such as one's own shelter.

The Fund seeks to make savings a habit and a way of life for all working Filipinos by instituting an automatic, regular, and convenient savings system.

One's savings will answer not only his personal, but his family's future needs. His savings pooled with the savings of others will provide for a meaningful source of housing finance which will enable families to afford decent houses which they can call their own.

While the Fund has prioritized housing as a benefit area because of the urgency of the problem, it will not stop at this. Fund management realizes that eventually people's savings could be a prime source of funds for national development. Always, however, it shall ensure that the members' interest is supreme and all investments of the Fund shall redound ultimately to the benefit of the members.

2. Nature of the Fund

The HDMF is distinct as a savings system. It covers both employees from the government service and the private sector and other working groups. It is private in character, owned wholly by the members, administered in trust and applied exclusively for their purpose.

The Fund consists primarily of employees' monthly contributions (3 percent of basic pay with P/3,000 basic monthly salary as a maximum, and the equal contributions of the respective employers which are credited in the name of the employees.

3. Membership Coverage

Membership in the Fund is defined under three separate books of coverage:

Book I - covers mandatorily all employees who are members of the Social Security Systems (SSS) and Government Service Insurance System (GSIS).

Book II- covers self-employed persons and other working groups on a voluntary basis.

Book III- covers the overseas contract workers on a voluntary basis.

4. Fund Benefits

The Fund offers its members two major benefits, provident savings and housing loans.

(i) Provident Savings Benefits

The Amount a member saves with the Fund is matched equally by his employer, hence, doubling his savings. These combined savings earn fixed dividends of 7.5 percent per annum, compounded monthly, aside from additional variable dividends that may be given by the Fund depending on its surplus earnings. Since 1981, the fund has declared annually a variable dividend of 2.5 percent. The member receives his total savings from the Fund upon membership maturity of 20 years or in the event of retirement, total disability, insanity, permanent departure from the country or death. His provident benefits are tax-free and government-guaranteed.

(ii) Housing Loans

A Book I member may obtain a housing loan equivalent to 48 times his basic monthly salary but not exceeding P/100,000.00. Members under Book II or Book III are entitled to a loan amount equivalent to 36 times the basic monthly salary. The loan bears nine percent (9%) interest and is payable monthly over a maximum period of 25 years. The loan may be used to build a new housing unit, purchase a house-and-lot package, improve an existing house, acquire a lot or acquire an apartment the member is presently occupying. The member may borrow jointly with 2 other members to enable them to pool resources for a better and expectedly higher priced house.

Secondary Mortgage Market Operations

To ensure a continuing flow of funds for home acquisition and indirectly sustain housing construction, NHMFC has developed the Secondary Mortgage Market System (SMMS). The system has increased the availability of affordable housing loans by assuring participating lending institutions of profitability and reducing their liquidity risks through NHMFC's mortgage purchase commitment program. At the same time, NHMFC mobilizes the flow of funds into shelter finance through the sale of securities to investors.

NHMFC has two main activities related to the operation of SMMS. These are mortgage buying and mortgage trading through securities selling.

1. Mortgage Buying & Trading Operations

The mortgage buying or banking operation of SMMS is conducted with accredited public and private financial institutions, such as commercial and thrift banks, and investment and financing institutions. Accreditation is made on the basis of application and satisfaction of institutional standards on mortgage origination and buying.

At the request of an accredited institution, NHMFC makes a firm and forward commitment to purchase an allocated block of home mortgages to be originated by the institution according to NHMFC's lending criteria, and to be delivered according to a stipulated delivery schedule. Actual purchase is effected upon delivery of the mortgages to NHMFC. The originating bank, however, continues to service the payments by the borrowers on the mortgage loans.

The functions of the accredited financial institutions relative to the mortgage buying operations are all under "fee arrangement" as against normal "margins banking."

NHMFC's shelter finance program covers primarily the following types of loans:

(i) Pag-IBIG member loan - This is a 9 percent interest-bearing loan that may be obtained only by members of Pag-IBIG or the Home Development Mutual Fund (HDMF) with a maximum loan term of 25 years.

(ii) Open-Housing Loan - Non-Pag-IBIG members or any individual with the appropriate credit and contract capacities may obtain this type of loan, which bears 16 percent interest per annum with a maximum loan period of 15 years.

(iii) Pag-IBIG with Open-Housing Loan - This may be obtained by Pag-IBIG members who need and have the credit capacities for home loans bigger than the Pag-IBIG loan entitlement. The Pag-IBIG and Open-Housing guidelines govern the terms or conditions of the respective portions of the total loan.

(iv) Pari-Passu Loan - This involves a regular loan granted by the originating institution to the same borrower(s) and against the same collateral used for a Pag-IBIG and/or Open-Housing mortgage loan purchased by the NHMFC, on a pro-rata sharing basis.

(v) Home Improvement Loan - This is a variation of the Pag-IBIG member loan, the purpose of which is to improve the livability and/or extend the life of a residential unit owned by the member-borrower.

2. Fund Sourcing Through Securities Selling

To support its mortgage buying activities, NHMFC has developed a fund generation scheme whereby certificates are floated, backed-up by mortgages it has purchased which are held in trust by a Trustee Bank, the Development Bank of the Philippines. Two types of securities have thus been issued, the Bahayan Mortgage Participation Certificates (BMPC), and the Bahayan Certificates (BC).

(i) Bahayan Mortgage Participation Certificates (BMPC)

Bahayan Mortgage Participation Certificates are risk-free government securities for housing backed by a pool of mortgages and a liquidity mechanism for investors. Directly issued by the NHMFC, BMPCs are fully and unconditionally guaranteed by the government.

BMPC yields are guaranteed and payable quarterly: for Series A, 8.5 percent per annum of par value, tax free; and for Series B, 14 percent per annum, taxable. BMPCs are sold by NHMFC to primary issue purchasers/dealers at par value less 2 percent discount. Available payment terms also serve to increase their effective yields.

The certificates are eligible as non-risk assets of banks and non-bank financial institutions, as reserves of life and non-life insurance companies, as collateral security for domestic standby letters of credit, as performance bonds of firms in contracts for government projects and as alternative investment outlets for the statutory deposit and security fund of insurance companies. Each BMPC also provides for a sell-back option date of six years from the date of issue.

(ii) Bahayan Certificates (BCs)

With the final sale of the P/1.0 billion authorized BMPCs of NHMFC, the Central Bank of the Philippines (CB) approved the corporation's application for an additional P/2.0 billion issue. The new issue, now called Bahayan Certificates (BCs), carries a 9 percent per annum interest and a maturity period of two years.

The BCs have the same eligibilities as the BMPCs. However, the mode of sale of BCs differs from that of BMPCs in that BCs are sold by auction or negotiated bids through the CB.

Banking institutions and trust companies submit tenders to CB for the account of customers, provided the names of customers are set forth in such tenders. Persons other than banking institutions and trust companies may submit their tenders only for their own account.

3. Relationship of NHMFC Securities to Other Government Issues

In line with the CB's rationalization of government borrowings, the special features and privileges offered by all government securities were made uniform. Except for Central Bank Certificates of Indebtedness (CBCIs) and the Treasury Bills (T-Bills) issued by the Ministry of Finance, which are relatively short-term in nature, the BMPCs and the BCs have enjoyed and are enjoying relative competitiveness in the market. Whilst the NHMFC securities cannot compete with commercial instruments in terms of yield, the relative financial security they offer to investors have worked in their favor especially with the present economic uncertainties.

Mortgage Credit Insurance and Guarantee System

To secure and support the housing finance program of NHMFC, an existing government home mortgage insurance program of the Home Financing Corporation (HFC) was revitalized. HFC functions primarily to insure mortgages and extend credit guarantees to financial institutions and developers actively participating in the national shelter program. HFC insurance and guarantees make the loan instruments risk free.

With the security provided by HFC, the shelter finance program has succeeded in generating greater participation from the private sector.

Functional Relationships

The functional linkages among HDMF, NHMFC and HFC has resulted in a synergistic system which has effectively built a foundation for housing finance that is premised on reliability, consistency, predictability and service.

HDMF and NHMFC, particularly, have a symbiotic relationship, for each one is vital to the operation of the other.

HDMF provides NHMFC the liquidity mechanism for its secondary mortgage market system. HDMF places its funds in trust with NHMFC and is guaranteed a 12.75 percent p.a. interest - enough to cover HDMF's operating expenses and the cost of members' dividends, annually set at 10 percent, plus other benefits (e.g. P/1,000 death benefits and in the near future, small construction loans and educational loans).

NHMFC, on the other hand, purchases 9 percent HDMF mortgages and at the same time invests HDMF funds in high yielding government securities to cover the negative trading margin resulting from the 9 percent yield rate on HDMF mortgages and NHMFC's 13 percent composite cost on the sale of BMPCs and BCs. In addition, NHMFC is able to use the HDMF as a leverage in the sale of its securities since HDMF provides a strong liquidity support.

PROBLEMS

The initial introduction of the shelter finance system met with considerable skepticism from the public. The system was the first attempt of the government to integrate public and private sector participation in the housing effort and it was the first time that a secondary mortgage market system was introduced in the country.

To begin with, the system had to operate in an unfavorable environment. It was not easy to convince people of the benefit of saving for future housing when they were hardly earning enough to meet their daily basic needs. Furthermore, the inadequacy of earlier government housing programs challenged the ability of the present system to do better. An extensive information campaign had to be launched to convince the people of the merits of the new system. It was not until the first housing units were delivered to Pag-IBIG members that mandatory members became comfortable with their monthly contributions and self-employed employees volunteered for membership in the Fund.

The financial community was equally negative in their initial response to the new system. Not only did it want assurance of its profitability, it likewise demanded certainty of its liquidity.

While the shelter finance system has been able to weather acceptance and operational problems by straightening out initial bugs in the systems, such as those concerning loan documentation and processing, it finds that it still has to hurdle several stumbling blocks. Government's support to the system is lacking. In the five year period (1979-1983), since NHMFC began operations, the government's equity contribution to the corporation has totalled only P/195 million, a small amount compared to the capitalization received by other government programs.

The lukewarm attitude of government toward intervention in shelter finance only serves to heighten the need for oneness of the participants in the housing industry, especially those from the private sector, since shelter, when placed in competition with other national needs such as education, defense, agriculture, etc., often has to contend with the left-overs and the residual.

It is to the credit of the housing industry that, despite a general economic slowdown, it has continued to grow and the housing market has not diminished. In fact, NHMFC finds that it has to strengthen and further its fund sourcing capacities in order to meet the increased mortgage origination activities of banking institutions without impairing the liquidity of HDMF fund investment. In less modest terms, NHMFC is now faced with the reality of growing demand and accordingly, it has started steps towards the adoption of a "true" secondary mortgage market system which will involve seasoning of mortgages and a trading mechanism where instruments issued will be primarily "pass-through" rather than debt.

PERFORMANCE

Despite the initial setbacks suffered by the shelter finance system, it may now claim the following achievements:

a. The establishment of long-term savings fund for housing investments.

b. The creation of a viable secondary mortgage market which provides for:

- service standards for banking and mortgage purchase transactions for home loans;

- equal opportunity for homeownership to qualified borrowers; and

- increased private sector participation in housing finance.

Individually, the agencies in the shelter finance system report the following:

HDMF

Pag-IBIG collections as of December 31, 1983 amounted to a total of P/1.73 billion from a total membership listing of 2.1 million employees and 84,000 employer participants. Collections average P/100 million monthly. Benefits have been continually upgraded to respond to members' needs.

NHMFC

Total mortgage purchases as of December 31, 1983 totalled P/2.84 billion from 71 accredited banks and financial institutions. This amount represents 22,488 housing units acquired by 38,069 Pag-IBIG members and other qualified borrowers under NHMFC's housing finance program.

Supporting the above mortgage purchases is the sale (as of December 31, 1983) of P/1.0 billion worth of BMPCs and P/0.61 billion worth of BCs. The balance was financed from NHMFC's equity and income from investments.

To further expand the services of the home financing program, particularly towards low income Pag-IBIG members and other qualified borrowers, lending guidelines have been liberalized and new loan schemes introduced. Among such liberalized lending measures introduced this year were loan-tacking for three unrelated Pag-IBIG members, capitalization of origination fees, the Graduated Amortization Plan, and financing for apartment acquisition and lot purchase.

HFC

Through HFC, the government has extended credit guarantees and insurance in the amount of P/3.79 billion, P/1.79 billion of which was granted to cover individual borrower's loans and P/1.99 billion to developmental loan guarantees.

FUTURE DIRECTIONS AND STRATEGIES

At an average of P/158 million in mortgage take-outs a month as indicated in NHMFC's 1983 performance, funds generated from its main instrument must proportionately increase to sustain the home financing program, as well as to respond to the needs of an increasing Pag-IBIG membership.

In the long-run the need to reinforce government commitment for availability and affordability of home financing loans may necessitate difficult policy decisions for NHMFC such as a possible increase in the interest charges on both Pag-IBIG and open-housing loans. In the short run, trading losses in the operation of the secondary mortgage market system, require greater government support in the form of the refunnelling of housing revenues into the shelter finance system and thus enabling it to replicate investments and self-sustain for the continued benefit of home borrowers. This may be effected through an interest subsidy program to support the viablity requirements of the SMMS with capital infusions to NHMFC sources from revenues directly attributed to housing.

At the same time, the expansion of the secondary mortgage market can shift to a new phase with the more active participation of originating banks. Through the seasoning of mortgages, whereby banks will be motivated to keep their originated mortgages for at least five years and source liquid capital through their own issuance of Pass-Through Certificates, mortgage originations can be further sustained and the secondary mortgage market system expanded with more active trading of mortgage papers and faster and wider circulation of finance for home-lending.

Pag-IBIG, on the other hand, will continue to mobilize savings even while it is faced with the problem of erosion of savings by inflation. It will, however, explore alternatives so that returns to the members' money will increase enough to offset the effects of diminishing real values.

CONCLUSION

The shelter finance system can be considered to have been in full operation for only the past four years. It is difficult to judge the success or failure of the system over such a short period and the system still has a long way to go before it can claim maturity. The path has not been very smooth and the system may still have to go through a lot of tests and refinements. So far, however, it has made an initial impact on the housing industry and has succeeded in demonstrating the potential of generating private sector participation in the task of providing homes for more families.

Discussions duri.ıg coffee break. From left to right: Mr. Narad, Ministry Works and Housing, India; Mr. Piyaszna, State Mortgage and Investment Bank, Sri Lanka; Mr. DeVoy and Mr. Gary, AID Regional Housing and Urban Development Office, Thailand.

Presentation by Mr. John Tuccillo, National Council of Savings Institutions, USA. Sitting from left to right: Mr. H.U. B!jlani, Chairman, HUDCO, India; Mr. W.D. Osterbrauck, President IUBSSA, West Germany; Mr. P. Kimm, Director, Office of Housing and Urban Programs, AID, USA; Mr. H.T. Parekh, Chairman, HDFC, India.

Resource Mobilization: Problems and Potential

Presented by:

Sirivat Phroonburi
Chief, Project Division
The Government Housing Bank, Thailand

INTRODUCTION

The government Housing Bank was established by the Government Housing Bank Act BE. 2496 which became effective on the 20th of January 1953. The purpose of the Government Housing Bank is to provide financial assistance to the public in the acquisition of residences appropriate to their station in life.

At present, the Government Housing Bank (GHB) has paid up capital of 350 million baht or about US $15.2 million which is contributed by the government. The activities of the Bank are under the supervision of the Board of Directors which consists of a Chairman and other directors who include representatives of the National Housing Authority (NHA) and the Ministry of Finance and the Managing Director by tit˜e. The organization of the GHB is composed of eight divisions, three offices and twenty sections with a total staff of 420 officers.

Its main activities consist of providing loans to two broad categories of borrowers: mortgage loans to individual borrowers and short term credit to developers for infrastructure and housing construction. The highest priority is to assist individual borrowers to purchase housing, to undertake building extensions and repairs and to purchase land and houses from real estate developers.

LENDING SERVICES

MORTGAGE LENDING

The GHB provided mortgage financing to 3,395 individual borrowers amounting to US $36.5 million during the year ending December 31, 1983, compared to 5,217 individual borrowers and US $4.9 million during 1982. This represents a decrease of 34 percent and 25 percent, respectively. The 1983 loans comprised the following:

1. Mortgage loans in the amount of US$12.2 million to 1,375 individual borrowers for purchasing their own shelters.

2. Mortgage loans amounting to US$21.1 million to 1,630 individual borrowers for housing units under projects.

3. Housing schemes for employees in the amount of US$3.2 million to 390 individual borrowers.

Of all the financial institutions in Thailand, the GHB is the most important source of housing finance. In 1980, it contributed about 33 percent of the total housing finance supplied by financial institutions. Cumulatively, as of December, 1983, the GHB had provided US $454 million in long term loans to 56,750 individual borrowers.

SHORT-TERM CREDIT FOR INFRASTRUCTURE AND HOUSING CONSTRUCTION

As of December 31, 1983, short term credit extended to real estate developers was US $116.6 million allocated among approximately 193 projects, 139 of which were located in the Bangkok Metropolitan Area while the remaining 54 were implemented in various provinces.

The GHB realized a net profit of US $7.8 million in 1983 compared to US $5.2 million in 1982 which means an increase of US $2.6 million or about 50 percent.

SIGNIFICANT CHANGES IN GHB FINANCIAL CONDITIONS

The total assets as of December 31, 1983, were US $465.6 million, compared to US $492.3 million at the end of 1982, signifying a decrease of US $26.7 million or about 5 percent.

With regard to liabilities, there was a decrease in interbank accounts of US $96.2 million against long-term borrowing of US $307.2 million which means an increase of 23 percent over last year.

MOBILIZATION OF FUNDS

The GHB has been mobilizing funds through borrowing, sales of bonds and deposits. The amount outstanding as of December 31, 1983 was US $382.2 million, comprising:

1. Deposits - There are four types of deposit services for the general public, namely:

Current Accounts. This service affords account holders convenience in business and other transactions. It is similar to accounts offered by commercial banks, bearing no interest. Only a minimum initial deposit of 10,000 baht (or about US $435) is required to open a current account. At present, there are about 1,000 accounts totaling US $565,000 whose holders are mostly real estate developers.

Savings Deposit. Account holders may open an account with an initial deposit of 100 baht, (or about US $4) which may be withdrawn without notice. Such deposits are currently earning an interest of 9 percent per annum and are exempted from income tax. Presently there are about 17,254 accounts totaling US $1.5 million whose holders are mostly general householders.

Time Deposits. This type of account is an important funding source for the GHB. Depositors may open an account with a minimum deposit of 500 baht (or about US $22) with varying interest rates according to the deposit period as follows:

- from 3 to 6 months, the interest rate is 11 percent per annum
- from 6 months to less than one year, the interest rate is 12 percent per annum
- from 12 months to less than 2 years. The interest rate is 13 percent per annum.
- and more than 2 years, the interest rate is 13.5 percent per annum

Interest on these deposits is taxable. Depositors for this type of account are mostly real estate developers and the state enterprises. At present, total deposits are US $72.5 million.

SAVINGS FOR A LOAN SCHEME

This scheme is suited for depositors who plan to borrow for building or renovating their homes. In order to qualify for a loan, the depositor must already have made monthly deposits of at least 400 baht. (or about US $22) for a minimum period of two years. The interest paid is 13 percent per annum and is exempted from income tax. Upon completing the two year-term, the depositor can borrow up to 75 times the amount of the monthly deposits made.

For example: for a monthly deposit of 1,000 baht, the depositor can borrow up to 75,000 baht (or about US $3,260). However, the loan amount must not exceed 100 percent of the appraised value of the house or 500,000 baht (about US $21,740), whichever is lower.

2. Sale of Bonds - Another source of the Bank's funds comes from the sale of bonds which are guaranteed by The Ministry of Finance. The GHB was allowed to sell the amount of US $87 million in 1980 and by the year 1982 all the bonds were sold out. These bonds bear the interest rate of 13 percent per annum with a ten-year maturity period. Interest paid on these bonds is tax-exempt.

Recently, the GHB has successfully floated bonds worth 60 million. Swiss Franc. The underwriting agreement was guaranteed by The Finance Minister on behalf of the Thai Government. This is the first Swiss Franc bond ever floated by any organization in Thailand.

The bond carries a maturity period of seven years and the coupon rate is 6.5 percent.

3. Long-Term Borrowings - The main source of funds is long term borrowings which accounted for US $220.2 million in 1983. Of this 36 percent was derived from domestic borrowings and 64 percent from foreign loans.

A recent positive sign is that a National Housing Policy which outlines broad areas of attention and actions to be taken was approved by the Government. The issues concerning housing finance were prominently featured and strategic measures for improvement were, for the first time, explicitly stated. On the macro-scale, these include a planning provision to shift the total savings in the country, including the resources of the securities market and other sources of long-term capital such as provident funds, life insurance funds and so on, toward housing finance. The promotion of housing cooperatives was also called for. Finally, the Government Housing Bank would be expeditiously developed into a truly nation-wide organization with extensive branch network and resources to serve the housing finance needs of the country.

The Policy and Planning of GHB in 1984

1. The GHB plan to expand activities and services for housing loans in the future.

2. The GHB plan to extend its branch network in the Bangkok Metropolitan Area and also in provincial areas to generate increased deposits and to make it more convenient for borrowers to make repayments.

3. To help carry-out government housing finance policy the GHB will take over the future long-term financial responsibilities of the National Housing Authority.

4. To promote housing cooperatives, the GHB will grant short-term loans for project infrastructure and then make long-term loans for housing units in the project.

5. Other plans call for setting up a project credit department, a training program, more rigorous credit assessment procedures and loan supervision.

6. The new head-office building will be completed in 1986, and the old head office will become a branch bank.

APPENDIX I

Source of Funds as at December 31

	Amount of :	Millions US$	
Domestic Borrowings	**1981**	**1982**	**1983**
Short-term Borrowings			
(Promisory notes)	14.3	6.5	1.2
Bank of Thailand	26.1	43.4	43.4
Government Savings Bank	21.7	21.7	93.5
Ministry of Finance	3.6	3.6	2.7
Krung Thai Bank	-	21.7	-
Total Domestic Borrowings	65.7	96.9	140.8
Foreign Borrowings			
Manufacturers Hanover			
Company Limited	9.5	6.3	3.2
Bank of Tokyo	23.0	17.3	11.6
The Long Term Credit Bank			
of Japan			
(10,000 million yen)	44.6	42.8	43.1
(5,000 million yen)	-	-	21.5
Total Foreign Borrowings	77.1	66.4	79.4

APPENDIX II
DOMESTIC LONG-TERM BORROWINGS

	Ministry of Finance	Bank of Thailand	Government Saving Bank	Sales of Bonds
Date of draw-down	September 11, 1973	December 8, 1981–March 8, 1982	February 1, 1983	July 29, 1980–December 31, 1981
Amount of loans	US$3.6 million	US$43.5 million	US$93.5 million	US$87.0 million
Terms	13 years	10 years	15 years	10 years
Grace period	10 years	5 years	5 years	Redemption after 2 years
Interest rates	6% for the amount of US$2.7 million	5%	2.5% over fixed desposit rate	13% for the amount of US$38.6 million
	8% for the amount of US$0.9 million	—	—	13.5% for the amount of US$48.4 million
Front-end fee	—	—	—	0.2% of the amount sold
Payment installments	4	6	60	—
Repayment schedule	September 11	—Interest April 30 and October 31 —Principal US$21.74 million on December 8, 1986, and from December 30, 1987, to 1991 at the amount of US$4.35 million annually	Semiannually	Semiannually
First repayment commencing date	September 11, 1983	December 8, 1986	January 31, 1988	
Amount of loans at December 31, 1983	US$2.69 million	US$43.48 million	US$93.48 million	US$86.96 million

APPENDIX III
FOREIGN LONG-TERM BORROWINGS

	Manufacturers Hanover Ltd	Bank of Tokyo	LTCB (old)		LTCB (new)	Swiss Bank
Currencies	**US$**	**Yen**	**Yen**		**Yen**	**Swiss Franc**
Date of loan agreement	August 9, 1977	December 22, 1977	September 7, 1979		December 3, 1982	February 15, 1984
Amount of loan	20 million 7 years after first drawdown	8,000 million 8 years	10,000 million *Tranche A* 4,000 million 10 years	*Tranche B* 6,000 million 15 years	5,000 million 10 years	60 million 7 years
Grace period	2 years after first drawdown	3 years	7 years	10½ years	5 years	7 years
Repayment principal interest	11 equal semiannual repayments quarterly or semiannually	11 equal semiannual repayments semiannually	7 equal semiannual repayments semi annually	10 equal semiannual repayments semi annually	11 equal semiannual repayments semiannually	single payment annually
Interest rates	Years 1-5 1¼% over 3 or 6 months LIBOR Years 5-8 JLTPR 0.2% Years 6-7 ¼% over 3 or 6 months LIBOR	Years 1-4 JLTPR 0.1% Years 6-10 JLTPR 0.2%	Years 1-5 8.4% Years 6-10 JLTPR 0.2%	Years 1-5 8.4% Years 11-15 JLTPR 0.3%	JLTPR 0.2%	6.5%
Fees	Commission charge ½% Management fee ½% Agency fee US$1,500 per annum	Commission charge ½% Management fee ½% Agency fee US$1,500 per annum	Commission charge ½% Management fee ½% Agency fee 200,000 yen per annum		Commission charge ⅜% Management fee ½% Agency fee 300,000 yen per annum	Front-end commission 1.75% Swiss stamp tax 0.165% Agency commission. 0.25% face value, 0.125% redemption value
Amount of loan at December 31, 1983	3.64 million	3,680 millions	10,000 million		5,000 million	
Interest Rates at December 31, 1983	10.1875%	9.1%	8.4%		8.6%	

Recent Events in the U.S. Housing Finance System

Presented by:

John A. Tuccillo
Vice President and Director
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National Council of Savings Institutions

The housing finance system of the United States is undergoing a period of change on a scale matched only by the activities that surrounded the system's creation in the 1930s. It is probable that we are currently observing the birth of a new system, one that relies far less on a federal presence than did its predecessor. Until quite recently, the system was anchored by specialized housing lenders who were created by federal actions and who operated within the limits prescribed by federal legislation. These primary mortgage lenders were reinforced by a group of federally sponsored secondary market facilities and were supplemented by other private firms (Figure 1 displays the funding structure). The flow of funds through the housing finance system originated with household savings purchased by housing finance institutions and resulted in an increase in purchasing power for those who wished to acquire housing. For the most part, the prices that the institutions paid for funds and the rates that they charged to relend those funds were controlled, directly or indirectly, by federal action.

This system worked admirably, from its inception in the early 1930s well into the 1960s. Americans became one of the best-housed populations in history, at a very affordable cost. The financial institutions that existed throughout this period were regarded as conduits for a high national purpose. Interest rates and prices remained stable and federal regulation worked for the benefit of all.

Beginning in the mid-1960s, however, an over-expanding economy exposed several fatal weaknesses in the housing finance system. During this period, growing federal deficits and monetary policy experimentation drove up interest rates and prices, including the prices households were demanding for the use of their savings. This meant that housing lenders needed to bid higher rates, or otherwise face the loss of funds and thus their ability to do business. Where this could be done, lenders found their profit margins disappear as the return on their long-term assets remained fixed. But in many cases, the regulatory structure restricted their ability to raise interest rates, and the lenders began to lose funds. Moreover, once rates abated in 1975 and 1976, household savings returned at a much slower rate than they had exhibited prior to the rise. The previously captive audience had become aware of alternatives.

These initial episodes weakened, but did not destroy, the system, because the levels reached by interest and inflation rates were modest. The loss of some funds, however, brought housing lenders to the realization that changes were needed in the instruments at their disposal. As a result of lenders' lobbying, federal regulators made some modest adjustments, with the vague promise of more to come. But when stability seemed to be returning in the early 1970s, the system resumed its former ways of doing business. Yet, this time, new elements of competition for funds had been introduced into the system that could not be excised. The more progressive lenders began to see that the past was not to be repeated and began to adjust. They moved away from mortgage investment and diversified their portfolios. Unregulated intermediaries, like mutual funds, noted the mobility of household savings and developed instruments that were better tailored to the preferences of savers and were designed to be immune from macro-economic spasms.

Thus, far from being a cure, the "return to stability" was but a remission. In the mid-1970s, economic volatility resumed and interest rates and inflation rates sored to levels previously unknown in this country. The regulatory structure began to erode. In 1972, the President's Commission on Financial Structure and Regulation, known as the Hunt Commission, had recommended that all depository institutions be granted similar powers and be brought under the same, flexible regulatory umbrella. These suggestions had remained dormant so long as the system behaved. With rising interest rates and the resulting shortage of funds for housing, however, they received more attention. Several financial-reform plans surfaced and worked their way through Congress, only to die because of lack of interest, conflicting goals, or poor design.

The free market, however, was not nearly so negligent. As inflation rates rose in 1977 and 1978, unregulated intermediaries, such as money market funds, increasingly attracted household savings. Free of the government interest rate controls placed on traditional mortgage lenders, these intermediaries could pass through whatever the market offered as a reward to deposits of virtually any size. The funds attracted to unregulated institutions generally did not flow to housing investment, and without this raw material the old housing finance system cracked and began to break apart.

The years immediately preceding the Reagan Administration were a period of extreme stress for the U.S. housing finance system. Inflation raged at record levels; household savings were drained by unregulated institutions; high mortgage rates forced buyers and sellers to deal outside of the intermediary system; and companies like Sears Roebuck and Company and Merrill Lynch, Pierce Fenner & Smith established or acquired new mortgage lending facilities. Thus buffeted, savings and loan associations began to disappear through failure or merger in unsurpassed numbers. The system was in trouble and beginning to shatter.

Beneath this tumult, however, a new system was emerging. Beginning in the early 1970s with the financial studies produced by the Hunt Commission and then by the U.S. Federal Reserve System and the Congress, a body of analysis was growing that would provide the theoretical and practical guidelines for real reform of the housing finance system. In general, these studies did not take issue with the existing system so much as point out its essential limitations. No set of reform proposals was adopted during the 1970s. However, a consensus was developing that there was a right way to approach reform and that lessened reliance on regulation and on a special status for housing finance was the direction to follow.

At the same time, the market reacted to the decline of the official housing finance system by creating a variety of institutions, instruments, and arrangements designed to direct flows of funds to housing. The market reasoned, for example, that if a fixed-rate mortgage in an inflationary world were unattractive to investors, then new types of vehicles that shielded the return mortgage investment could be developed; furthermore, if money market funds grew and reduced the power of thrifts to attract funds for mortgage investment, the secondary market could be used to liquefy asset holdings and to allow new lending; and if life insurance companies and pension funds were no longer willing to supply funds to housing, private firms would devise new arrangements to fill this gap in the market. Over the course of the 1970s, a variety of new instruments were introduced, and firms that had previously been strangers to mortgage market found it profitable to participate. All were reactions to the troubles of a higher regulated financial subsystem.

In response to the difficulties experienced by the traditional housing finance institutions and the changes that were occurring in the private market, regulators began to ease the restrictions that had made the system so vulnerable to inflation. While interest rates were still restrained by administered ceilings, new types of accounts were authorized that effectively circumvented existing ceilings and competed with unregulated intermediaries. Similarly, the new mortgage instruments that had been invented by the private market were authorized for regulated institutions. This activity culminated in the Depository Institutions Deregulation and Monetary Control Act (DIDMCA), which went into affect in 1980, the last year of the Carter Administration. This law schedule is the end of the deposit interest-rate restrictions and generally freed up the power of regulated institutions to bid for funds against other firms. It thus officially recognized that the old system that had served for almost fifty years was defunct and authorized its replacement by a new, free-market system.

In its early years, the Reagan Administration enunciated a program of housing finance measures designed to continue the momentum established by the events of the 1970s. Since the deregulation of the financial market and the fostering of private activity were in philosophic harmony with the Reagan program, this task was gladly accepted. The Administration attempted to advance the birth of a new system in three ways. First, the policy body charged with implementing DIDMCA, the Depository Institutions Deregulation Committee (composed of the heads of the major financial regulatory agencies), moved aggressively to eliminate all restrictions on the liabilities of depository institutions. During 1981 and 1982, this body authorized a variety of new types of accounts with interest rates tied to market rates, including an account that competed directly with money market mutual funds. By mid-1982, the structure of interest rate regulation, scheduled to disappear by 1986, was effectively gone.

Second, the Administration introduced a companion piece to DIDMCA, which eventually became the Garn-St. Germain bill, whose purpose was to deregulate the asset side of financial institution portfolios. The passage of this measure was prompted by the dire situation of thrift institutions, but it would have been necessary in any case, since DIDMCA had freed these firms to bid as necessary in order to attract funds but had given them little latitude to seek out profitable investment for these funds. Despite the changes that had occurred in the mortgage instrument, fixed-rate (and therefore risky) mortgages were still the norm. The Garn-St. German bill gave these institutions the power to diversify their portfolios, thus enabling them to better withstand the risks that accompany financial intermediation.

Finally, private secondary-market participation was encouraged through other types of regulatory and tax initiatives. Building on recommendations contained in the 1982 report of the President's Commission on Housing, the Administration relaxed U.S. Department of Labor rules for pension-fund investment, Securities and Exchange Commission (SEC) registration rules, and Federal Reserve margin requirements. All these rules had acted as structural barriers that reduced private firms' incentives to enter the secondary mortgage market. These changes have already led to the entry of one new private secondary-market entity, the Residential Funding Corporation, and have encouraged similar plans from other private firms. To further this activity, the Administration proposed to move the federally related secondary mortgage market firms -- the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) -- into the private sector and to phase out the Government National Mortgage Association (GNMA) out of existence. While these last policies have yet to be achieved, they remain on the administration's agenda.

These actions were consistent with what can fairly be listed as the four goals of the Reagan Administration in the area of housing finance:

1. Reduction of the federal presence in the housing sector.

2. Encouragement of the private sector.

3. Expansion of the use of new mortgage instruments.

4. Assurance of adequate and affordable credit for housing.

Despite the early movement toward these objectives, there has been a gap between the Administration's rhetoric and its actions. Yielding to political pressure and to economic conditions, the Administration has not pursued some policy actions that would be consistent with its goals. The failure to begin to cast off the federally sponsored secondary market institutions -- Fannie Mae and Freddie Mac -- is an obvious example.

The Administration must accept part of the blame for general economic conditions, which have adversely affected housing. The Reagan fiscal program, which combines large tax cuts with substantial increases in military spending, has caused budget deficits of unprecedented size that in turn have contributed to record-high real-interest rates. These interest rates have hampered the Administration's ability to reach the goal of affordable housing credit.

High real-interest rates also have indirectly led to the Administration's failure to achieve the first two goals listed above. The federal share of the mortgage market has increased. High real-interest rates have reduced the amount of federally supported or guaranteed mortgage credit, but at the same time, other mortgage credit has dropped further, increasing the federal share. In addition, the high real costs of housing have led to widespread Congressional support for the continuation of state and local authority to use the tax-exempt borrowing privilege to provide low-rate mortgage funds.

A similar problem occurs with goal number two. The private-sector involvement in the mortgage market is growing at an unparalleled rate. But, simultaneously, the FNMA, the largest mortgage investor, has, if anything, increased the government's contingent liability at a faster rate. Once again, the unanticipated jump in interest rates made it impossible to pursue the goal effectively. Because of financial conditions, privatization of the FNMA could not have been achieved without major financial disruptions. The result is that privatization has been delayed and the private sector must compete against subsidized institutions in all but a small share of the market, that is, loans that exceed the limits of the federally related agencies. Moreover, if pending legislation succeeds, the FNMA will be permitted to expand even into this high-priced portion of the market.

The event just described point to the crucial role of interest rates in the future of the housing finance system. The announced objective of the Reagan Administration's housing finance program is to establish a system that will attract a continuous and sufficient supply of savings to keep investment costs low, while lessening the special advantage of the housing sector in capital markets. If the housing system achieves this long-term objective, then both the housing sector and the economy as a whole will be strong and able to provide sufficient shelter for a growing population. On the other hand, a return to high inflation rates and high interest rates will severely test this new system and will determine ultimately whether it is flexible enough to succeed where the previous arrangement failed.

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