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ENTER INFORMATION ONLY IF NOT INCLUDED ON COVER OR TITLE PAGE OF DOCUMENT

1. Project/Subproject Number

Delivery order #4

2. Contract/Grant Number

PDC-1008-I-00-9066

3. Publication Date

6/15/92

4. Document Title/Translated Title

Housing Finance and the Shelter Sector in Algeria

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6. Contributing Organization(s)

Abt. Associates Inc.

7. Pagination

62

8. Report Number

9. Sponsoring A.I.D. Office

PRE/H Office of Housing and Urban Programs

10. Abstract (optional - 250 word limit)

11. Subject Keywords (optional)

1.	4.
2.	5.
3.	6.

12. Supplementary Notes

13. Submitting Official

Mike Pulley

14. Telephone Number

663-2532

15. Today's Date

6/15/92

16. DOCID

17. Document Disposition

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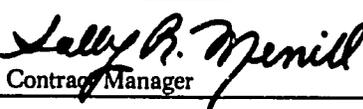
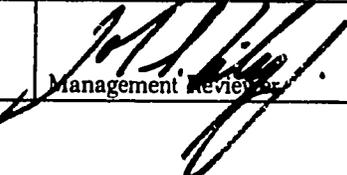
**HOUSING FINANCE AND THE
SHELTER SECTOR IN ALGERIA**

November 1990

Sally R. Merrill
Stephen B. Strauss
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Prepared for:
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EXECUTIVE SUMMARY

Algeria is in the midst of rapid and fundamental economic reform. At the time that this report was prepared, a number of important legislative and regulatory initiatives had either just taken effect, were about to take effect, or were proposed but not formally adopted. Algeria is moving quickly from a non-market economy, in which the means of production were largely publicly-owned and managed, to one in which market forces are being introduced and the private sector is being encouraged. Thus, while it is too early to assess completely the consequences of the reforms, it is certain that these reforms will dramatically affect the economy and society as a whole.

Policy reforms have been introduced in numerous areas, including trade and exchange regimes, price controls, fiscal policy and the role of parastatals. Major changes have also been introduced in the financial sector: it is these reforms that will most significantly impact the evolution of housing finance in Algeria. For example, the Central Bank is moving the interest rate structure towards one of market-determined rates. The commercial banks will now operate as autonomous businesses; they must raise their own funds and are free to lend in all sectors of the economy, based on their own assessments of risk and return. The banks are no longer forced to lend to public companies and can freely compete for mobilization of household savings. Finally, a number of shelter sector reforms have been initiated regarding better targeting of subsidies for low income rental housing and sale of the public housing stock.

Based on an assessment of the reform program across all sectors, it is clear that important progress has been made toward the liberalization of the economy and the approach to economic policy making. Major concerns still exist, however, with regard to the evolution of a shelter sector strategy, particularly with regard to the desired structure of housing finance and the role of the private sector in housing supply. These concerns can be summarized as follows:

- The future structure of the housing finance system has not been adequately clarified. Current policies with regard to CNEP (Caisse Nationale d'Épargne et Prévoyance), the publicly-owned institution which until recently has had a monopoly on lending for housing finance, are not consistent with either the movement toward market competition or the introduction of new institutions into the system.
- Although the Central Bank is moving toward a market rate interest structure for the commercial banks, CNEP is apparently not included in this reform and will still lend at concessionary rates. This precludes effective competition from the commercial banks and isolates housing finance at CNEP.

- Because of a variety of bottlenecks in the provision of housing, the supply is particularly inelastic, resulting in higher than expected costs. While Algeria has begun making the transition to private ownership of the public housing stock, the effort faces problems regarding the sale and completion of existing units. At the same time, the ability of the small private sector to play an expanding role in housing production is limited by difficulties in its access to building supplies, land and credit.

Thus, there are fundamental principles at issue here involving the appropriate mode of public/private cooperation and viable participation by the private sector. The role to be played by CNEP, the relationship between CNEP and the commercial banks, the relationship between public and private builders and developers, and the targeting of subsidies, are all at issue.

The present framework for CNEP's activities, for example, poses problems with regard to the future role of the existing banks and the possible introduction of new housing finance institutions. Because CNEP is not being encouraged to raise its rates to market levels, competition is unlikely to emerge. CNEP subsidies are not being targeted to low income households but rather extend far into the middle class. Thus, the "playing field" for housing finance is not level.

With regard to housing supply, shortages of building materials, inefficiencies in production, and excessive standards have led to high costs. In fact, shortage of housing units rather than lack of mortgage financing has been a major bottleneck in Algeria. Public developers still enjoy considerable privileges over private companies with regard to land and building supplies. Adequate construction finance has not been available to private builders. In addition, reforms to rent control and facilitation of the sale of public units would assist in relieving housing shortages.

The recommendations offered in this report attempt to respond to these basic concerns. In considering reform of its housing finance system, as well as other shelter sector policies, Algeria faces issues common to those in many developed and developing nations: defining an appropriate institutional structure, reducing constraints to supply, reforming subsidy policy, and enhancing effective competition. Because CNEP has been the only institution providing formal sector mortgage financing, transition to the competitive structure is that much more difficult. In addition, however, it should be emphasized that Algeria also faces problems of economic liberalization and privatization similar to those facing Eastern Europe and the Soviet Union. At this time, therefore, it should not be expected that global prescriptions for a fully redesigned system of housing finance and production could be accomplished.

Although a feasible pace of reform may be difficult to determine, an overall, enabling strategy, particularly with regard to the structure of housing finance, is nevertheless required. Our

most important recommendations are summarized under the two themes developed in the remainder of this report: a framework for housing finance and facilitation of housing supply. We suggest a combination of technical assistance to CNEP, the commercial banks, and private builders, as well as collecting the basic information needed to better formulate policies. The recommendations include:

- **DEVELOPING A FRAMEWORK FOR HOUSING FINANCE**

A first important step is clarification of the structure of the housing finance system in the long-term. This calls for a better understanding of CNEP's role. A decision must be taken as to whether there will be competition and multiple lenders in housing finance or whether CNEP is to remain isolated from the greater financial sector. We strongly recommend that a competitive environment be established.

One option is for CNEP to become a "leading" institution in encouraging market-based competition. As noted, it is also the only institution with housing finance experience.

In any event, once an appropriate role for CNEP is established, a number of areas of assistance are salient. These include technical assistance to both CNEP and the commercial banks, development of a legal and regulatory system for housing finance, and encouragement of eventual participation by new private sector institutions.

- **TECHNICAL AREAS THAT NEED TO BE ADDRESSED IN CNEP**

Technical issues that might be addressed with CNEP include its potential role in helping develop housing finance and preparation of a long-term financial strategy based on market interest rates and competition.

Also, CNEP might consider establishing a rediscount facility for commercial banks. Because of its past monopoly in housing finance, CNEP has mobilized a large volume of savings and thus is currently liquid.

- **TECHNICAL ASSISTANCE TO COMMERCIAL BANKS**

Once a strategy for competition is formulated, the commercial banks would benefit from assistance in developing mortgage and construction lending. A housing construction loan guarantee fund has also been suggested to assist the banks in construction finance and in lending to private developers. Privatization of one or more banks should also be assessed.

- **TECHNICAL AREAS THAT NEED TO BE ADDRESSED IN HOUSING SUPPLY**

A number of areas might be addressed to help ease the constraints to housing supply and encourage the private sector, including technical assistance to existing private companies, assistance in the sale of public housing, studies of rent control and standards, and studies of privatization of the public developers.

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1.0 INTRODUCTION AND OVERVIEW OF RECOMMENDATIONS

1.1 Financial Reform Policies in Algeria

Algeria is in the midst of rapid and fundamental economic reform. Policy changes are being introduced in trade and exchange policy, tax and budgetary structure, management of parastatals, price controls, and private ownership. Changes in monetary policy and the structure of the financial system are among the more important examples of the increasing market orientation; these reforms have begun to set the stage for the evolution of a system of housing finance.

In April 1990, the Algerian Popular Assembly passed the Money and Credit Law granting the Central Bank greater autonomy, particularly concerning monetary, credit, and foreign exchange policy. This law, along with other reforms aimed at banks and public enterprises should assist Algeria in creating a more dynamic and efficient financial and monetary system. The Central Bank will encourage an active money market and work with the newly autonomous commercial banks to help them develop market rate funding sources such as bonds and depositor savings. The interest rate structure for commercial banks should, in the near future, be limited only by the newly established 20 percent usury ceiling; lending and deposit rates may be based on "market" forces within that limit. In addition, the banks can, in principle, compete for both funds and business, since they have been "despecialized", and are free to lend in any sector, including housing.

While the structure and health of the financial sector are crucial in the eventual development of a system of housing finance, progress in a number of "supply-side" factors is a necessary complement to making progress in the provision of shelter, particularly for low income households. Thus, reforms have also been initiated regarding ownership of housing units, housing subsidy policies, and sale of public housing.

Specific reforms which will, if fully implemented, have the most significant impact on housing finance and the shelter sector overall include the following:

Ownership of Land and Individual Housing

- Sale of public housing units to occupants (implementation is well advanced though far from complete);
- Establishment of a framework for private housing development activity (some recent implementation has occurred);

- Proposal of a law relating to commercial disposition of land owned by national and local governments (enactment was foreseen in June 1990, but political uncertainty may exist);

Banking and Credit System Reform

- The Central Bank has been reconstituted as a monetary and regulatory authority separate from the Finance Ministry (which itself has been reconstituted);
- The five commercial banks are no longer constrained to financing specific sectors only. Implementation is underway, though the legacy of the previous "domiciliation" system will remain (for example, the Crédit Populaire d'Algérie-C.P.A. holds the overwhelming bulk of this country's housing construction loan portfolio). This reform inserts competition into the banking system for the first time.
- The Banks will also be required to operate as autonomous businesses without direct Treasury support. They will need to fund themselves by raising deposits in financial and money markets.
- Public sector companies now must also operate as autonomous businesses under their new "participation fund" shareholders. This requires that lending banks must examine borrower risk and viability and cannot assume government financial backing of borrowers. Banks, in turn, are no longer forced to lend to public companies.
- The interest rate structure has shifted toward market-based rates. The Central Bank's "base" rate has moved to ten percent and the "usury cap" rate to 20 percent, an interbank money market now operates (the highly liquid CNEP is the largest contributor of funds), a "financial" (bond) market is in preparation to permit banks to raise long-term funds, and personal saving can now be remunerated by commercial banks at rates well in excess of those for demand deposits. The stated goal is to achieve positive real interest rates by 1992 as well as to improve the structure of rates.

Housing Sector Financial Subsidies

- Household savings for housing will no longer flow to the Treasury (via the CNEP).
- Interest rate subsidies on mortgage loans granted by the CNEP to individual households for the purchase of lower-priced units will be in the form of specific interest-differential transfers from the Treasury to the CNEP. (However, as discussed below, the subsidies in CNEP loans still reach too far into middle-income levels.)

- Specific government subsidies for low-income ("social") rental housing will be channeled through a new institution, the National Housing Fund, created for this purpose and funded by a specific entry in the national budget. Subsidies are to be targeted to more needy households.
- In principle, the CNEP no longer has a monopoly concerning the mobilization of household savings aimed at financing housing purchases; "de-specialization" of banks gives the latter the ability to do so.

In summary, the potential impact of these reforms and the progress that has been made already towards liberalization of the Algerian economy is extremely significant. **With regard to the development of a system of housing finance, however, these efforts need to be extended in order to develop a framework suitable for the future evolution of the system.** For example, viable participation by the private sector and an appropriate mode of public/private cooperation must be addressed.

The outstanding issues impact both demand and supply and thus affect mortgage lending, construction lending, and the production and rehabilitation of units. Subsidization of mortgage interest rates for middle income households, for example, has the perverse effect of putting pressure on prices and making housing less affordable for all, since there is no stimulation of supply to counter the boost to demand. This is particularly difficult in the Algerian situation since a variety of rigidities have made the supply of housing especially inelastic. Furthermore, the supply problems stem not only from inefficiencies in production but also from rent control and excessive standards which hinder the production of housing affordable to lower income households. In addition, problems in land titling and registration will hinder a viable system of collateralization and deter development of mortgage lending by the private sector.

1.2 Structure of This Report

The remainder of this chapter summarizes some of the major problems and issues facing housing and housing finance in Algeria and provides a number of recommendations for study and reform based on an assessment of these problems. Chapter 2.0 discusses in more detail the current system of housing finance and the recent changes made in financial sector policies. Housing supply and housing need are examined in Chapter 3.0 while Chapter 4.0 examines savings, inflation, and

interest rates. Chapter 5.0 details several recommendations felt to be of high priority at the present time. Finally, an overview of the macroeconomic situation in Algeria is provided in Appendix I.

1.3 Problems Facing the Housing Sector

The following summary of issues facing the housing sector provides the context in which recommendations will be made. The major issues include public/private cooperation, housing supply, the role of CNEP, savings, inflation, and interest rates, and privatization and competition.

Public/Private Cooperation and the Emergence of Competition

- CNEP interest rate policies have not been altered. This places competing commercial banks and other potential housing lenders at a disadvantage.
- Subsidy policies that "subsidize those who could pay " for housing services continue to distort the market and effectively hinder the entry of private or public sector competition (as well as constituting a continual drain of public resources).
- The commercial banks will, for some time, remain at a distinct disadvantage in raising funds and in garnering the expertise to compete in construction and mortgage lending.
- Public construction companies and public housing development agencies still enjoy considerable privileges and competitive advantage over private companies, creating a de facto monopoly in their industry. Even though private construction companies exist, they are small, less experienced, and not as effectively connected to sources of supply, land, and credit. In addition, there are very few full-fledged private sector developers.
- Despite the financial reforms now being undertaken, the private sector appears to retain a fair degree of skepticism with regard to the outcome of the liberalization. Indeed, there is little indication yet that banking reforms are greatly assisting private sector access to either domestic financing or foreign exchange.
- A legal framework for an active housing market, with private-to-private transactions does not yet exist.

Savings, Interest Rates, and Inflation

- Historically, Algeria has had a high rate of household savings and until very recently the rate of growth of savings has remained strong. During 1989 and 1990, however, household savings plummeted dramatically. Although both an increase in inflation and a reduction in "forced" savings due to economic liberalization may be factors in this fall, the situation is complicated by the fact that data are insufficient and the composition of savings is apparently not fully understood by the Central Bank.
- Similarly, the actual level of inflation is also a matter of debate. Unofficial estimates place the rate of inflation at over 20 percent in 1990, which thus exceeds the so-called usury ceiling. This suggests that real interest rates may be more negative than thought. This provides at least one explanation for the sharp drop in savings as a proportion of household income. **Negative real rates offer a poor environment in which to begin a resource mobilization campaign by the commercial banks.**
- The current structure of interest rates is not adequate. Because such a high share of total deposits are short-term or demand deposits, the banking system is more highly vulnerable to inflation and various external shocks. Furthermore, this structure will impede progress toward long-term lending, including obviously construction and mortgage lending.
- Algeria has a so-called "liquidity" overhang: the growth of both domestic credit and money/quasi-money has consistently exceeded the growth of real GDP. This situation fuels inflation, which as discussed above, impacts the savings rate through both the increased cost of consumption and negative rates of return on savings accounts.

The Role of CNEP

- The issue of creation of a "level playing field" between CNEP and the commercial banks was introduced above. **CNEP is not under the control of the Central Bank and has not raised its deposit or lending rates.** This situation has a number of detrimental impacts. CNEP deposits grew despite negative rates because other institutions were not established to mobilize savings and because mortgage interest rate subsidies were deepest for depositors. The likelihood of competition coming into being is certainly reduced if CNEP maintains an effective monopoly through subsidized rates.

Privatization of State-Owned Banks and Construction Companies

- Privatization of state-owned companies, would help assure that the system will be market oriented and that the private sector can flourish. Nevertheless, while property rights are rapidly evolving, full-fledged privatization of state-owned means of production is apparently not being considered.
- Similarly, privatization of one or more of the state-owned banks may ultimately be the best means to introducing fully effective competition and breadth of services. It is not clear whether this is being considered.

Also, eventual establishment of private sector financial institutions is more likely if the public banks are seen to be moving toward some share of private ownership.

Housing Supply

- In addition to the problems facing the private builders, as mentioned above, a variety of other problems impact the supply of housing. An adequate number of acceptable units is apparently not being built and many units remain unfinished.
- Problems such as shortages of building materials, inefficiencies in production, and excessive standards have led to particularly high building costs (that is, higher than neighboring countries with similar circumstances). In addition, deficiencies in management and financing have contributed to problems in land management and land and infrastructure development.
- There are strong indications that considerable latent housing supply exists which could be mobilized if a series of measures were implemented, including increased availability of building materials for private builders, completion of infrastructure in existing subdivisions and ZHUN, and the revision of rental laws to encourage rental of vacant units and development of a private rental market.

Finance Policy Objectives and Summary of Recommendations

Development of an effective system of housing finance is increasingly understood to be a long-term growth and deepening of the financial system. As a result, a growing number of developing countries are now formulating sector-wide policies and a legal framework

designed to support private sector participation. It is also the case that a policy body and/or institutional leader have often been important in nurturing a housing finance system.

Ultimately, it will be desirable to encourage development of the housing finance system in Algeria according to the following principles:

- Increased market orientation through interest rate policies, targeting of subsidies, separation of loans and grants, and development of long-term instruments;
- Increased involvement of the private sector, including encouragement of private and joint sector banks, and financial institutions specializing in housing. The ability of the public and private sectors to compete on an equal footing is crucial to this evolution. Privatization of public institutions can be an important aspect of this strategy.
- Increased attention to legal issues which form the framework of a housing finance system, including development of regulatory and supervisory systems specific to housing finance, and attention to issues such as titling, foreclosure, rent control, and standards.

In considering reform of housing finance, Algeria faces issues common to those in many developed and developing nations. In addition, as noted in the summary, Algeria is addressing problems of economic liberalization and privatization similar to those facing Eastern Europe. At this time, therefore, it should not be expected that global prescriptions for a fully redesigned system of housing finance and production could be accomplished in the short-term. Thus, as well as suggestions for overall structural change, several specific recommendations are offered, which can be implemented no matter what the pace of overall reform of the financial sector. These recommendations are, however, consistent with long-term change.

Table 1.1 summarizes our recommendations with regard to CNEP, the commercial banks, construction and development, public housing, and rent control and other regulatory and supply issues. The approaches include technical assistance with regard to:

- Development of an institutional strategy for CNEP;
- Enhancement of the ability of existing banks to develop mortgage and construction lending;
- Encouragement of the private sector through strengthening of existing companies, fostering new companies and/or privatization of public banks and development companies.

Table 1.1
Recommended Technical Assistance, Studies, and Surveys

Institution/ Sector Type of TA/Study	CNEP	Banking Sector/Financial Institutions	Construction Sector/ Developers	Public Housing/ Rent Control
Developing a Strategy for Housing Finance	Financial Strategies for Market Oriented Operations and Effective Subsidy Targeting	Technical Assistance in Developing Mortgage and/or Construction Lending	Technical Assistance to Existing Private Sector Companies	Studies on Strategies for Sale, Maintenance and Rehab of the Public Housing Stock
Surveys and Data Collection	Household Income/Expenditures Study for Use in Targeting and Planning by CNEP and the Commercial Banks			Studies of the Hoarded Housing Stock/Standards Building Materials
Private/Joint Sector Institutional Development		Investigation of the Feasibility of Joint or Private Sector Financial Institutions in Housing Finance		Formulation of Housing Cooperatives for Sale and Management of Public Housing
Housing Finance Institution Building	Formation of Rediscount Facility for Housing Finance Lending	Housing Construction Loan Guarantee Fund (Central Bank/Ministry of Finance)		
New Financial Tools/Regulations	Studies of Alternative Mortgage Instruments			Studies of Rent Control Regulations and Impacts
Privatization		Studies of Feasibility of Privatizing one or more Commercial Banks	Studies of Privatization of Public Housing Development Companies	

- Supply constraints such as excessive standards, building materials production, and rent control;
- Surveys and data collection.

The first step is development of a long-term strategy for CNEP consistent with the emerging market system. Other recommendations include technical assistance to commercial banks; a survey of household income to assist policy development by CNEP and the commercial banks; development of a rediscount facility at CNEP; establishment of a Housing Construction Loan Guarantee Fund to support the growth of construction lending at the commercial banks; development of housing cooperatives to facilitate the sale of public housing; and studies of unsold public housing, hoarded housing, and rent control. Several recommendations are further described in Chapter 5.0.

Technical Areas that Need to be Addressed in CNEP

- **Revision of CNEP mortgage lending procedures with regard to interest rates and targeting of subsidies in order to establish market-based procedures and invite competition by the commercial banks;**
- **Development of a long-term financial strategy for CNEP which takes account of market interest rate strategies and competition;**
- **CNEP could assume a leading role by establishing itself as a market-based lender and at the same time, nurturing mortgage lending at the commercial banks. This role has been very effectively managed by the Government Housing Bank in Thailand, for example.**
- **Housing and construction finance could benefit greatly if some way were developed to utilize the liquidity offered by CNEP's favorable financial position. CNEP could provide a rediscount facility to the commercial banks and/or purchase the bonds of banks or newly established housing finance companies.**
- **Consideration of alternative mortgage instruments to help further the long-term strategy of both CNEP and the commercial banks;**

Steps That Need to be Taken to Develop a Housing Sector Data Base

- Data on income and the housing sector (and in general) are very scarce. A household survey should be undertaken in order to better understand the distribution of income, affordability and saving; this will assist CNEP and the commercial banks as well as the Ministry of Finance and the Central Bank;
- Utilizing these data in assisting CNEP to **target subsidies** to low-income households; ultimately, subsidies should be extended to only the neediest segments of the population, procedures should be developed to help maintain a good "credit culture," and clear separation should be made of the grant and loan portions of the lending policy;
- Undertaking surveys of **public housing units and vacant/hoarded units** to assist in analyses of unsold units, partially finished units, and, ultimately, in development of a private rental sector.

Recommended Technical Assistance to Commercial Banks

- Assisting commercial banks in the mobilization of resources and the development of construction and mortgage lending; the proposed Housing Construction Loan Guarantee Fund, which is one aspect of this effort, is discussed below;
- Undertaking studies to examine the feasibility of privatization of one or more commercial banks;
- Undertaking studies to investigate the possibility of establishing new private or joint public/private banks or non-bank financial institutions, including those that might specialize in housing finance;

Development of Housing Construction Loan Guarantee Fund

- Creating a Construction Loan Guarantee Fund to encourage construction lending by the commercial banks, and the development of a private sector construction industry;
- The Fund could be utilized only by private sector companies and only for building housing affordable to low and moderate income households.
- The Fund could be managed by the Central Bank and would bring together the commercial banks, private sector developers and builders, and CNEP, which could provide take out financing and/or rediscount construction loans made by the commercial banks;

Assistance to Facilitate the Sale of Public Housing Units Include:

- Undertaking a survey of the unsold inventory of public housing in order to assess rehabilitation needs, saleability, and the characteristics of households now being served;
- Assisting the development of private **Housing Cooperatives** in order to facilitate the sale and maintenance of the remaining public housing stock;

Other Technical Assistance to Housing Supply

- Providing technical assistance to private contractors and developers for construction techniques, management, and project preparation;
- Studying the access of private companies to the means of production and financing on a competitive basis;
- Studying the possibilities of privatization of public development companies;
- Studying the so-called "hoarded" or "latent" housing supply and determine what policies, including revisions (and eventual removal) of rent control, might make more of this stock available for rental;
- Coordinating this technical assistance with studies being undertaken by the World Bank of building costs standards, and techniques and the building supply industry.

2.0 HOUSING FINANCE AND THE REFORM OF THE FINANCIAL SECTOR IN ALGERIA

2.1 The Past Role of CNEP in Housing Finance

Most public investments in Algeria, including the supply of public housing, have been based on fiscal resources derived from oil and gas production and from monetary creation. As discussed below, until recently, the State Treasury has automatically met the funding needs of the entities producing public housing, via the CNEP (Caisse Nationale d'Épargne et de Prévoyance, or National Savings and Loan Institution), regardless of the cost of capital and the economic viability of the use of the project.

The State Treasury's role as unique financial intermediary until 1986 was a major reason for the absence of money and financial markets, the lack of "bankability", the absence of policy relating to credit, and, as a consequence, the lack of mechanisms to allocate capital based on credit costs and economic return.

The absence of the allocative function of interest rates has been particularly evident in the housing finance sector because:

- The funding provided by the Treasury to the public sector housing sector has been at negative real interest rates (1% per annum) for very long amortization periods (40 years)
- Savings mobilization and lending to households, has taken place within a closed circuit through the CNEP network. This protected network is based on the mobilization of household liquidity by means of savings accounts (bearing a 5% interest rate) and on the granting of mortgage loans at heavily subsidized rates.

The CNEP since 1964 has been the principal household savings institution, and since 1971 it has been the only entity offering home savings accounts ("livrets d'épargne logement") giving privileged access to mortgage loans. The CNEP is omnipresent in Algeria: more than 90% of Algerian households have an account at the CNEP. These accounts are managed by 120 regional branches, supplemented by 2,597 post offices which accept deposits into CNEP home savings accounts as well as into postal checking accounts (CCP's). The CNEP pays the post offices 2.65% of the interest earned on the home savings accounts.

The CNEP has aspired to become a specialized "housing bank", but this step has been opposed and is not provided for in the 1990 banking reforms.

Initially the CNEP and the State Treasury shared the financing of social housing construction. The pre-1979 financing shares and terms were:

1970-73: Treasury: 50% share at 1% per annum for 30 years
CNEP: 50% share at 4.75% per annum for 20 years

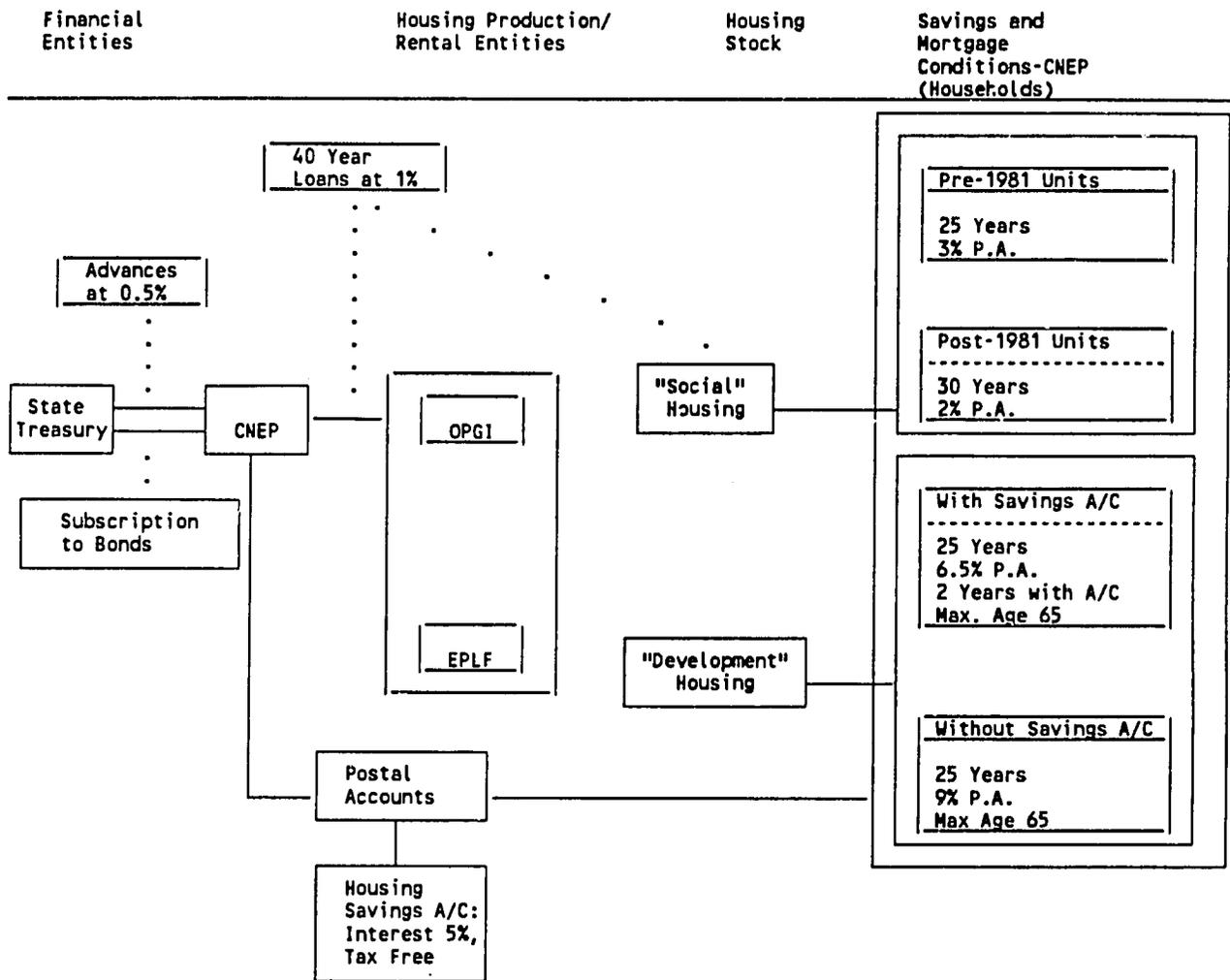
1974-78: Treasury: 75% share at 1% per annum for 30 years
CNEP: 25% share at 4.75% per year for 20 years

Since 1979 the Treasury has provided 100% of financing extended by the CNEP for the purchase of housing units from the OPGI: the Treasury has financed the CNEP at 0.5% per annum, and the CNEP has on-lent to the OPGI at 1% per annum for 40 years with a 4-year grace period. The CNEP in its turn has placed its excess liquidity with the Treasury by subscribing to Treasury bonds at 7% per annum (in an amount of Dinars 50 billion in 1989). This circuit is illustrated in Figure 2.1.

This transfer of public funds to the OPGI via the CNEP ceased in 1990, with the removal of the State Treasury from the housing finance circuit. Previous projects remain funded as before, but the CNEP is no longer obligated to subscribe to Treasury bonds. The loans from the CNEP to the OPGI will now be converted into bonds and remunerated at market rates. This new debt obligation will place a burden on the OPGI, whose rate of rent collection is insufficient to service such debt. It is likely that this situation will accelerate the movement toward selling off the remaining rental units. The OPGI debt to the CNEP is Dinars 76 billion, of a total CNEP loan portfolio of Dinars 140 billion; the burden of this level of OPGI debt weakens the CNEP financially.

The CNEP's protected home savings system is based on sight deposit accounts remunerated at 5% (and free of taxes). Savings accumulated over a two year period give the saver access to a mortgage loan at an interest rate of 6.5% per annum, with interest subsidies paid directly by the Treasury since January 1990 according to the following scale:

Figure 2.1
The Circuit of Housing Finance



	<u>Amount of loan</u> (Dinars)	<u>Interest subsidy</u> (subtracted from rate of 6.5%)
CNEP home savings account holders (2 years)	< 300,000	4% per annum
	300,000 - < 500,000	2% per annum
	> 500,000	0%
Non-Savers	< 300,000	1.5%

Other conditions for access to a mortgage loan include: 20% minimum down payment, and 25-year amortization provided maximum age 65 at final maturity.

The CNEP also offers term savings accounts at rates of 6% for three-year deposits, and 6.5% for five-year deposits. However, only Dinars 106 million have been placed in term deposits with the CNEP (1988), compared to Dinars 58.6 billion in sight savings deposits in the same year.

From 1980 to 1990 about 6,000 development housing units, and about 13,000 "social" rental units sold by the OPGI, were financed by the CNEP with savings account holders. This relatively small number of loans granted would not appear to discourage savers, since total savings balances at the CNEP rose to Dinars 65 billion in 1989. Despite the general increase in interest rate levels (the Central Bank base rate went to 10% in April 1990), the CNEP as of late May 1990 had not yet decided to increase its own rate structure.

2.2 Reform of the Financial Sector

Central Bank Reform and CNEP Policies

In April 1990, the Algerian Popular Assembly passed the Money and Credit Law granting the Central Bank greater autonomy, particularly concerning monetary, credit, and foreign exchange policy. This law, along with a variety of other reforms aimed at banks and public enterprises should assist Algeria in creating a more dynamic and efficient financial and monetary system.

Under the new law, a Council of Money and Credit is in the process of being formed. The Council will consist of a Governor, three Vice-Governors, the Directory of Treasury, a representative from the Ministry of Planning, and eventually the President of the Stock Exchange,¹ all appointed by the President of Algeria. While this law continues to give the government considerable influence over money and credit policy, the majority of the Council's representatives will be officials from the Central Bank. The Council will bear the responsibility of setting monetary policy, establishing regulation governing the banking system, and overseeing foreign investment activities in Algeria.

One significant goal of the Central Bank reform program is the achievement of positive real interest rates by 1992. To facilitate this goal, the Central Bank announced in April 1990 that the rediscount rate would be raised from 7 to 10 percent, encouraging banks to raise their interest rates on demand deposits from 5 to 8 percent. Given the government's estimates for 1990 inflation, about

¹ Until the Stock Exchange is established, the representative will be the Director of Prices.

13 percent, however, this increase in nominal interest rates basically leaves real interest rates negative. Even the short-term borrowing rates are extremely low at 14 percent, one percentage point above inflation.

The Central Bank interest rate target on 3-year deposits, at 7 percentage points above demand deposits, underscores, however, the Central Bank goal of improving the term structure of interest rates, encouraging savers to place funds in longer-term instruments. The importance of the Central Bank raising interest rates may, at this point, more signal its willingness to undertake an active role in interest rate management and improve the structure of interest rates, rather than to take major steps to achieve positive real rates by 1992.

Of particular interest for the financing of housing and construction, the new provisions under the April 1990 law should strengthen banks and their balance sheets. Banks will no longer be required to conduct business in government-determined sectors (the policy of "domiciliation"). Rather, banks are presently being encouraged by the Central Bank to diversify their interests, to participate and compete in all savings and lending activities in the economy. Banks will also have greater autonomy in establishing their own saving and lending interest rate, although the Central Bank will use its rediscount rate to guide commercial bank rates. To assist banks in obtaining their funds, the Central Bank is promoting the development of financial and interbank markets. Central Bank regulatory provisions, including the establishment of a variety of reserve, liquidity, and capital requirements should strengthen weaker banks' balance sheets over the next few years, improving both confidence in and the functioning of the banking system.

Other key aspects of the Reforms include the following:

- The Central Bank of Algeria (B.C.A.) is entirely separated from the State Treasury and operates as an independent agency of monetary emission, regulation of the banking system and oversight of foreign exchange transactions;
- The Central Bank regulates the banking sector by means of the rediscount rate (increased to 10% in April 1990), the establishment of minimum reserves and ratios (still to be set), and the selective use of a rediscount window for bank loan refinancing;
- The Central Bank can now authorize the establishment of foreign banks in Algeria based on reciprocity;
- The commercial banks become autonomous and responsible for their own funding and profitability. The previous system of specialization by sector and activity, and of obligatory domiciliation of special borrowers with specific banks, is terminated: all commercial banks can now in principle perform any banking transaction with

enterprises in all sectors, and enterprises in all sectors can now work with any commercial banks.²

- Insurance companies (5 companies - SAA, CAAT, CAAR, CNMA, Les Mutuelles, plus the reinsurance entity C.C.R.) are also despecialized under the 1990 reforms, and are authorized to offer all insurance products in a competitive manner. They will also be encouraged to place their reserves in the emerging money and financial (bond) markets. Insurance companies can therefore become important long-term funding sources for banks lending to the housing construction industry and to household home purchasers. It remains to be seen how this role will materialize in the framework of the current institutional reforms.
- The various social security and pension funds will also need to take charge of the management of their excess liquidity. It is not clear how the reforms will impact these institutions' activities, but one can imagine that they will become providers of long-term funds to the housing and mortgage markets, possibly directly but more likely via the CNEP or by funding the commercial banks by subscribing to long-term bonds issued by the banks.

2.3 The Position of CNEP Under Financial Sector Reform

CNEP remains a specialized savings and housing finance institution and is not able to engage in other areas of activity. CNEP no longer has a monopoly in this area, since the commercial banks may now develop savings instruments and extend housing-related credit. As has been discussed, however, the present framework for CNEPs activities presents problems for the evolution of a market based system and the future role of the existing commercial banks or future housing finance institutions.

² In the previous system of specialization and domiciliation, the roles of the commercial banks were:

- B.N.A. (Banque Nationale d'Algérie): manufacturing industry, transportation and distribution;
- B.E.A. (Banque Extérieure d'Algérie): energy, chemicals and maritime transport;
- C.P.A. (Crédit Populaire d'Algérie): light industry, tourism, light and artisan industry, fishing, and retail trade;
- B.A.D.R. (Banque Algérienne de Développement Rural): Agriculture and rural construction.

Under the 1990 reform, CNEP does not fall under Central Bank Authority. Thus, CNEP is not being encouraged to raise its rates and does not now plan to do so. Furthermore, CNEP does not appear to fall under Government efforts to limit subsidies to low income households.

Continuation of these policies will have the following major, problematic effects on the shelter system:

- subsidizing the more well-off households encourages over-consumption and does not reflect true cost of capital;
- subsidizing borrowing rates is a "demand" subsidy; since no immediate stimulation of housing supply exists to offset the demand effect, the net result is pressure on housing prices;
- elevated housing prices make it even more difficult for poor households to obtain needed housing;
- existing commercial banks whose borrowing and lending rates are being moved toward market levels cannot (and should not) compete with CNEPs subsidized interest rate policies; there is thus little incentive for commercial banks to develop mortgage lending;
- similarly, little incentive exists for the future establishment of private or public/private sector financial institutions for lending in housing.

3.0 HOUSING SUPPLY AND HOUSING NEED

This chapter describes the existing housing stock, problems with current efforts to sell public housing, and the factors underlying hoarded housing. In addition, a rough estimate has been made of the current annual need for housing, which far exceeds production in the formal sector. No estimates exist for production in the informal sector. Despite the lack of data, however, it is strongly felt that formal housing production lags far behind both need, and behind the ability to finance purchase of such housing.

3.1 The Existing Housing Stock

Table 3.1 summarizes data collected during the 1987 census. Apartments are primarily occupied by tenants, while two-thirds of the single family units are occupied by their owners. Given the large-scale sale of public rental units that has been taking place, one may expect that the proportion of owner-occupancy has increased in these two main housing types. Overall, apartments form only 14 percent of the total housing stock, and single-family houses about 75 percent. It is noteworthy that precarious housing types, including units in urban shanty towns, so far do not seem to have developed to a great extent.

Table 3.1
Housing stock according to tenancy and type.
(Number and % of column/row totals)

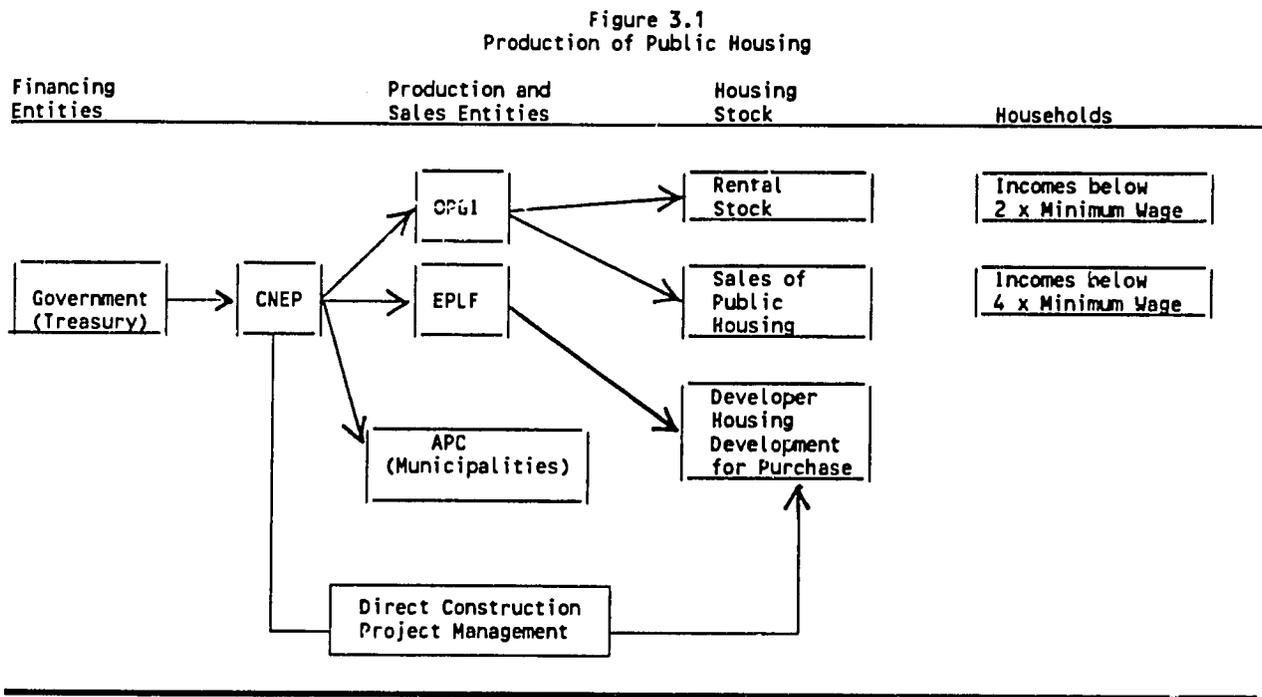
Tenancy Type Housing type	(Co)Ownership	Rental	Housed Free	Total
Apartments	84,739 4.5%	301,903 45%	28,529 7.5%	417,433 14%
Single-Family Dwellings	1,037,926 54%	218,622 33%	172,951 45%	1,434,594 48%
Traditional Houses	642,881 33.5%	102,437 15%	126,491 33%	974,520 29%
Precarious Dwellings	141,006 7.5%	6,768 1%	43,902 11.5%	192,568 6.5%
Total	1,919,709 100%	674,157 100%	385,974 100%	2,991,972 100%

Source: Données statistiques No.85, Recensement 1987, ONS

3.1.1 Current Policies with Regard to Public Housing

The public housing stock represents at present only about one-fourth of the total housing stock. However, public housing has constituted the bulk of new (formal) housing production over the

past 20 years. The principal sectors and entities involved in the process are described below in Figure 3.1. This figure will be commented upon below with particular emphasis on recent developments and the concepts and conclusions that can be drawn from this analysis.



The "O.P.G.I." (Office de Promotion et de Gestion Immobiliere, or Real Estate Development and Management Offices of the Government of Algeria) were created in 1976. These regional entities (one for each of the 53 "Wilayas", plus 5 in the Wilaya of Algiers) manage the residential and commercial real estate stock inherited in 1962, plus the stock put into place since then. These 58 OPGI's manage about 700,000 units, representing nearly 60% of Algeria's rental housing stock and about 20% of total real estate in the country. The OPGI's employ a total of 12,000 people. The average age of OPGI-managed units is fairly high: one-third are over 40 years old, and another 20% are between 20 and 40 years old.

Since 1981 a significant effort has been made to sell State-owned rental units to their residential and commercial tenants. In the past, these sales have taken place at extremely low prices and favorable financing terms which have had no relation to the marginal cost of construction of public housing, and even less with the cost of purchasing similar units sold in the private market.

The sale prices of these units vary with the building date of construction (before or after 1981) and with a complex set of rent and structural parameters. Sale prices for residential units have varied from 1,500 Dinars per square meter (for purchases before June 30, 1989) to 3,500 Dinars per square meter at present. Recent price levels are beginning to approach current construction cost levels, but do not take into account the cost of land or infrastructure. Discounts from these prices occur for cash purchases; for short financing terms (under 5 years); and for a variety of other reasons (such as a 40% price reduction for war veterans, their families and descendants). Sources have indicated that such units have been re-sold privately for between 3 and 10 times the purchase price (though this could not be verified). Sales financed with long-term mortgages have carried interest rates of 1% per annum for 30 years for units built before 1981, and 2% for 25 years for units constructed thereafter.

Despite these advantageous terms, and a major marketing effort, many of these residential units remain unsold. This can be explained by several factors: poor condition; inability to locate the legitimate tenant of a unit; or preference of a tenant to continue to pay (extremely low) rent and wait for a better unit to become available for rent or purchase. This residue of unsold units poses a difficult problem for the OPGI's: they must continue to own and manage - at a loss - the unsold rental units, and they must continue to maintain buildings in which they only own a fraction of the units.³ This situation and image of the OPGI's as providers of housing units and services at little or no cost to tenants or to building co-owners is perhaps the OPGI's greatest and most costly problem.

The situation of rents in public housing buildings accentuated the OPGI's image problems, since existing rents do not even cover current costs of managing the apartment units (averaging Dinars 100 to 350) and commercial units; furthermore, the rent collection rates from tenants are extremely low in some areas (under 50% in the Algiers OPGI's - but over 85% in Tizi Ouzdu; overall statistics are not available).

Sales of publicly owned housing units to their occupants have progressively increased since 1981 and at the present time, 34 percent have been sold. (See Table 3.2.) Judging from the number of applications received, one can assume that about 50 to 60 percent of the units will eventually be sold, leaving the OPGI's, who are responsible for management of public housing, in charge of

³ As long as only one unit in a building remains unsold, the owners of the other units leave these responsibilities and costs to the OPGI.

200,000 to 300,000 dilapidated dwellings, mostly apartments occupied by low-income tenants. The authorities are envisioning the rehabilitation of the buildings in order to encourage their purchase by the tenants. This however will be very costly and there is no hope of recovering the cost through either rental or sale prices. An example illustrates the situation; the OPGI in Sidi Mohamed (Algiers) is in charge of 732 elevators of which 495 have not been functioning for several years, although the building may have up to 17 floors. The cost of repairs for only 71 of these elevators is estimated at DA 37 millions.

Table 3.2: Status of sales of public housing on December 31, 1989

	built before 1981		built after 1981		Total	
	Number	%	Number	%	Number	%
Total stock	444,902	100	263,765	100	708,667	100
Applications received	325,366	73	37,819	14	363,185	51
sales approved	279,177	63	18,204	7	279,381	42
titles given	237,488	53	3,057	1	240,545	34

Source: Ministry of Equipment

An additional problem is that those who have recently purchased their dwellings continue to count on the OPGI's for maintenance and repairs; the OPGI in Sidi Mohamed has among its personnel 210 garbage men and 190 cleaners for cleaning staircases and common spaces. Finally, the management resources of the OPGI's are, at least in Algiers, inadequate to deal with the maintenance and rent recovery problems.

The rent structure was increased in 1989, with the increases based on the physical parameters of each unit. Rent assistance is available to lowest-income households based on a percent of household income. The intentions of these new rent increase measures are evident. Less clear is the ultimate success of such measures in an environment where expulsion for non-payment of rent or illegitimate occupancy is virtually impossible, and where any intervention in the public housing area is a politically charged issue. The following conclusions can be drawn:

- The Government (through the OPGI's), despite positive measures taken, will continue for some time to bear the financial burden of the unsold housing residual, until new approaches to sale are available;
- Good intentions to facilitate the "right to housing for all" run up against obstacles and expectations that have not yet been overcome.
- The current rules aggravate the housing crisis. Various forms of assistance, subsidies, and under-priced rents, only serve to exacerbate demand for a good (housing) whose price does not reflect its extremely short supply.

3.2 Housing Supply

Actual housing supply is known only approximately. The National Plan for 1990 predicts for this year the completion of 86,000 new units, including 56,000 apartments by public and private developers and 30,000 owner-built units. In 1988, 84,000 building permits were issued out of 124,500 applications and in 1989 about 100,000 applications for permits were received. Given the various constraints that hamper the housing market and the construction industry, however, it is hard to predict the number of units that might actually come on the market during the next few years. Also, an unknown number of dwellings are built without permit; 300,000 were counted in 1988, of which 114,500 were regularized.

3.2.1 Production of Housing Developments for Sale

The role of developer of "social" housing for resale is filled by several institutions, including: the O.P.G.I.; the "E.P.L.F." (or Household Residential Development Companies, see description below), individual municipalities (via the Popular Municipal Assemblies or A.P.C.'s), and directly by the C.N.E.P. These entities contract out the construction of their projects among approximately 1,200 public sector contractors and private subcontractors.

The E.P.L.F. (Entreprises de Promotion et de Logement Familial), which in 1984 replaced the former O.N.L.F., are regional public sector housing development entities established by Wilaya councils and responsible for developing "social" housing. Only 23 E.P.L.F. have been established to date, with development activity beginning in 1986 having led to the initiation of construction of 100,000 new residential units, plus commercial space. The E.P.L.F. are autonomous enterprises which must operate on a commercially viable basis. The purchasers of E.P.L.F. units have access to subsidized 25-year C.N.E.P. mortgage financing (6.59% per annum for C.N.E.P. savings account

holders, and 9% for non-account holders). Financing of buyers is not seen as a problem: in addition to readily available C.N.E.P. mortgages, many buyers pay cash.).

In housing development, public sector entities can achieve financial viability because they are not burdened by the need to carry rental units at a loss. Due to the strong demand for new housing, units offered for sale by these entities quickly depart from the "social" category (E.P.L.F. units frequently sell for as much as 2 to 3 million Dinars, and are sold before construction begins). Covering full production costs is not a problem under such circumstances. In addition, these developers can cover production costs by constructing commercial units and selling them at auction.

3.2.2 Underutilized Housing Supply

There are many indications of a considerable latent, or "hoarded," housing supply, including three main types of plots or dwellings that for various reasons do not come on the market: partly completed infrastructure, vacant housing, and incomplete dwellings.

Partly completed and occupied subdivisions, and ZHUN (zone d'habitat urbain nouveau).

According to the annex to the Draft Law on Regional and Urban Planning, at the end of 1989 there were more than 4,000 subdivisions spread out over all the Wilayas (districts) with a total capacity of 470,000 plots. Only 56,000 of these plots had been serviced with infrastructure, but 63,000 units had been completed and another 95,400 were underway. In addition, there are 257 ZHUN with a total capacity of 660,000 dwellings, of which 180,000 had been completed, while another 180,000 were under construction. Infrastructure construction had commenced on only 136 of the ZHUN. Lacking more precise data, we estimate that some 700,000 plots or housing units remain available, but without service.

Vacant housing units. During the 1987 census, about 550,000 vacant dwellings were counted. According to our informants, there are three main reasons for these vacancies. First, Algerian families are in the habit of building or purchasing ahead of time dwellings intended for their children, that will be occupied only when they marry. **Second, there is strong fear, justified under the present rental legislation, that dwellings once rented cannot be repossessed.** Thirdly, the owners may be worker-emigrants who are retaining a unit in reserve. The low level of officially authorized rents is probably a factor as well. We estimate that at least 200,000 of these units could enter the market if the current rental legislation were liberalized.

Incomplete dwellings. Apart from those already taken into account under the first category, there also are a number of incomplete dwellings scattered around the country on private plots of land. Precise figures are not known, but judging from observation, the number must be large. We conservatively estimate the available capacity at 100,000 units.

Totalling these figures, one arrives at the surprising number of one million potential units (700,000 plots and 300,000 vacant or incomplete units). This could be 200,000 units per year if this potential were mobilized over a five-year period. This almost amounts to the estimate made below of annual housing need of 237,000 units.

Apart from these factors, there undoubtedly is also an element of speculation. Some owners have been able, due to various and sometimes illegal circumstances, to acquire several dwellings and await market conditions enabling them to profit from substantial increases. Speculation has been encouraged by a well-intentioned but counterproductive method of taxing capital gains on real estate, which works as follows:

<u>Period of ownership</u>	<u>Tax rates on capital gains</u>
3 years	50%
3 to 6 years	40%
6 years	30%
9 years	tax free

One might ask why the owners do not attempt to draw rental profits from their assets. Again, rent control may be at fault. Once tenants occupy a property, it is impossible to get them out. The owners would rather have an empty dwelling than a frozen one.

Thus, unavailability of building materials, high construction costs, lack of construction credit, absence of infrastructure, low rents, and large-scale sale of public housing units at low prices, account for this latent supply.

Most probably, this potential housing stock would be affordable only to the upper and upper-middle incomes, once completed. A comparison of this potential supply with the estimated needs of these income groups (48,000 units per year for income groups above DA 4,500 per month) tends to suggest that there could be an ample supply.

The reverse is the case in the lower-income segment of the market. While the need of these groups was assessed at some 190,000 units annually, the supply is largely limited to the public programs, and does not exceed 60,000 new dwelling units per year.

3.2.3 Private Sector

In 1987, there were 8,512 companies engaged in construction contracting or subcontracting, of which 7,464 were private, mainly sub-contractors. Despite the high number of private companies, they account for only 15% of the total number of employees in the sector, with the remaining 85% employed by the few large public contractors who dominate the industry. Prior to 1985, the government had a quasi-monopoly on housing construction, a situation which contributed to high costs and diminished quality of work. Currently, private contractors may either contract with the public sector, with private individuals, and since 1986 with private developers. When working for a public agency, a private contractor must have large capital reserves or lines-of-credit because of the need to deposit a 5% guarantee with a bank and to stockpile sufficient construction materials needed to start the job, while receiving only a 5-15% start up payment. Completion of the building may take years, due to lack of construction materials or delays in utility hook-ups. Private contractors are forced to buy materials on the black market at inflated prices in order to meet contractual deadlines, but final payments may only be received years after construction has commenced.

When working for private individuals, contractors, may also be required to furnish a completion guarantee, but the advance payment is 25% or more, with payments due as work progresses. Furthermore, the owner himself may take the responsibility of acquiring a stockpile of materials, the availability of which affects public and private contractors equally and causes delays in approvals.

In 1988, the GOA launched a new program to stimulate private investment in new construction materials industries. The package of incentives include access to land, tax credits, and most importantly, access to foreign currency for importing new equipment. In addition, a new joint venture law is currently being discussed and some form of law authorizing foreign private investment is expected this year.

Present factors inhibiting the emergence of a viable private sector include:

- Competition from a public sector whose rents do not reflect construction, maintenance, or management costs;
- Reportedly, still unfair access to materials and credit, despite recent reforms;
- The public taboos against challenging legally-protected tenants; and,
- Barriers to collateralization, because of problems with land titling, and foreclosure.

As with the public rental housing sector, the necessary modifications of the relationship between landlords and tenants will be difficult to obtain because of the stalemate in this area.

A vicious circle is at work here. The protection of tenant rights (rent control, respect of occupancy, moral protection against eviction, etc.) contributes to a housing shortage and inadequate services. Scarcity reinforces protection, and protection further discourages new supply. The example of 300,000 hoarded rental units is merely a symptom of the severe bottlenecks that exist.

Only massive new additions to the existing stock (upwards of 15%) will activate the market, reduce constraints, and modify behavior patterns. Such effort would, under present construction methods, seriously misdirect production and raw materials, involve significant inflationary surges, and put great pressure on hard currency reserves.

3.3 Assessment of Annual Housing Needs

A rough assessment of the annual need for new housing takes into account the following factors:

- **Population growth.** Using the hypothesis that the annual growth rate, which is 2.9% at present, will decrease to 2.8 during the period 1990-1995 and further to 2.7 during the period 1995-2000, then starting from a total population of about 23 million in 1987, population growth during the time span 1990-2000 would equal about eight million people, or 1.23 million new households at an average household size of 6.5 persons. This would translate into a yearly need of 123,000 new units over the ten-year period.
- **Reduction of overcrowding.** Using the standard that the number of people per unit, which stood at 7.55 according to the 1987 census, would be reduced to an average of 6.5 over the same ten-year period, 54,000 new housing units are required annually.
- **Replacement of old units.** At the rate of 2 percent per year, presuming an average life span of fifty years for dwelling units, adds another 60,000 units to the quota to be produced yearly.

On the basis of this approximate assessment, the yearly need for new dwellings is in the order of 237,000 units.

3.4 Affordability

Since almost no income distribution figures are available in Algeria, a hypothetical income distribution will be used in the following analysis. It is developed from figures provided by the Ministry of Labor in 1989, which give income deciles, as well as the approximate distribution of all public and private sector employees according to these deciles. The employee salaries were extrapolated to the total active population, 4.2 million in 1987. The public and private sector employees (2.4 million) represent about 57 percent of the work force. In order to take into account various bonuses received by employees, their salaries were uniformly augmented by 17.5 percent, equal to half the maximum bonus. Finally, to transform these individual incomes into household incomes, a factor of 1.3 was applied, representing the average number of income earners per household. It should be noted that this distribution does not take into account secondary sources of income. This hypothetical income distribution is admittedly a crude one, but it provides some useful clues to overall trends. The actual income distribution is undoubtedly flatter and more displaced to the right than the hypothetical one represented in Figure 3.2. The same data are presented in the form of deciles in Table 3.3.

At present, some fifteen to twenty private developers offer high-income housing (e.g., apartments from DA 500,000 and individual houses from DA 4 or 5 million and upwards). Presuming that the cost of an affordable house represents 3.5 times annual income, or 42 times monthly income under the prevailing financing conditions (20% downpayment from sources other than salary, 25-year credit at 6% interest, and monthly payments amounting to 25% of monthly income), these dwellings are accessible only to households with incomes above DA 12,000 per month, or less than 5 percent of the households in the hypothetical income distribution being used here.

The EPLF (Entreprise Publique de Logement Familial) and some of the OPGI (Office Public de Gestion Immobiliere) are proposing housing units for sale in the price range from DA 250,000 to DA 800,000. Under the same credit conditions as above, these are affordable for households with incomes above DA 4,800 per month. With a higher downpayment, say 30 percent, these units would become affordable for households with incomes above DA 4,200 per month. The average price of the units sold by these public developers is DA 400,000 to 500,000 accessible for incomes around DA 6,500 per month. Thus, the clients of the EPLF and the OPGI belong to groups with monthly income between DA 4,500 and 12,000 per month. This represents only about 20 percent of the total number of households.

Figure 3.2
Distribution of Household Revenues

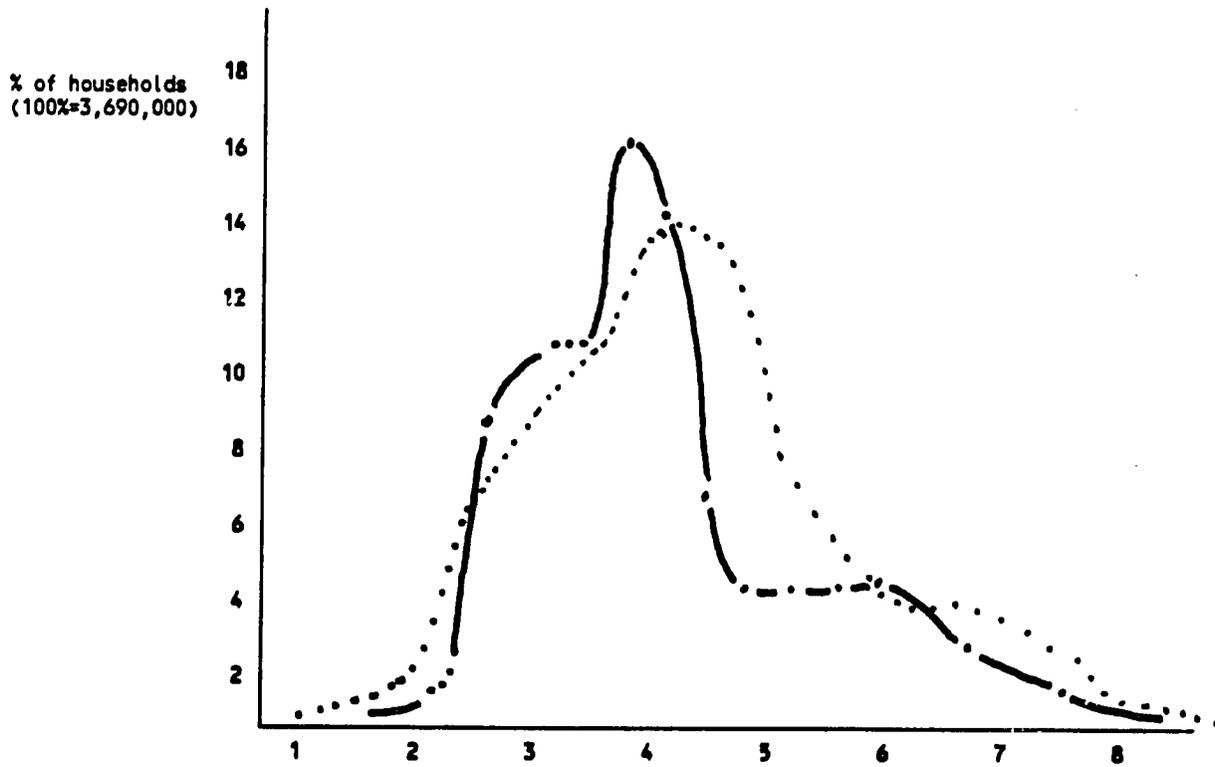


Table 3.3: Monthly Household Incomes in Deciles

Decile	%	Monthly household income in DA
1	0 - 10	2300 - 2700
2	10 - 20	2700 - 2800
3	20 - 30	2800 - 3200
4	30 - 40	3200 - 3500
5	40 - 50	3500 - 3700
6	50 - 60	3700 - 3900
7	60 - 70	3900 - 4200
8	70 - 80	4200 - 4800
9	80 - 90	4800 - 5800
10	90 - 100	5800 & more

Source: Ministry of Labor and mission estimates.

A 64 sqm apartment is presently considered by the authorities to be the minimum acceptable standard. Built with the current methods, its cost is DA 3,500 per sqm, including the cost of secondary and tertiary infrastructures, which brings its total cost to DA 224,000. Still applying the same credit conditions as above, this unit is affordable only to households with incomes above DA 4,200 per month, which still excludes the lower 70 percent of the households. On the other hand, if the minimum floor area standard were lowered from 64 to 45 sqm, and consequently the unit's cost to DA 160,000, under the same financing terms such a unit would become affordable for households with incomes between DA 3,000 and 4,200 per month, which includes about 45 percent of all households.

Under the present conditions however, effective demand ("la demande solvable") for public sector housing remains confined to the upper income groups above DA 4,200 per month, excluding the lower 70 percent of the population. Even if the standards and cost were lowered, the purchase of a turn-key dwelling unit would remain impossible for households below the DA 3,000 per month limit.

Distribution of Housing Needs by Income Group

The distribution of overall housing needs for the different income groups was estimated through an evaluation of specific needs according to the three parameters used to estimate need: population growth rate, overcrowding and need for replacement.

Table 3.4: Distribution of Annual Housing Needs Per Income Group

Income group DA/month	Source of Need							
	Population growth		Overcrowding		Replacement		Total	
	%	No.	%	No.	%	No.	%	No.
> 12,000	5	6,150	--	--	--	--	2	6,150
4,500-12,000	25	30,750	10	5,400	10	6,000	18	42,150
3,000-4,500	45	55,350	55	29,700	55	33,000	50	118,050
< 3,000	25	30,750	35	18,900	35	21,000	30	70,650
Total	100	123,000	100	54,000	100	60,000	100	237,000

Table 3.4 suggests that the housing need of the lower and middle income groups below DA 4,500 per month, who presently are not served by the public and private developers, could amount to nearly 200,000 units per year (118,500 plus 70,650).

3.5 Other Characteristics of the Algerian Housing Market

Housing Transactions: Formality and Reality. In principle, real estate transactions in Algeria are subject to the high degree of procedural formality. The transaction must be legalized by a Notary (Officer of the State) who must verify the validity of the property title and ensure the public notice of the transaction. The verification of title deals with the legitimacy of the seller as owner, and with the correctness of the recorded description of the property. Again in principle, no construction permit, mortgage loan or subsequent resale are possible in the absence of these official procedures. In practice, however, due to problems in property conveyance and to the absence of a valid land and building registry, it is a frequent occurrence for transactions to deviate sharply from the required procedures. It is very common for transactions to occur directly and privately between buyer and seller, without any notarized authentication, without registration and without public notice. These private acts provide *de facto* occupation rights for existing units, and normally suffice to allow recognition *ex-post-facto* of a new construction made without advance permits (regularization typically occurs with the payment of a small fine and property taxes to the Municipality).

This situation of land and building title uncertainty is a classic barrier to mortgage lenders. Commercial banks, applying orthodox banking practice and lending only with a solid lien on the property, can be expected to refuse to lend to property purchasers who cannot produce clear title documents. In fact, only the purchasers of public housing units sold by the OPGI, the EPLF or the municipalities can be certain of obtaining clarity from the seller as to legal title. Most private transactions are clouded by doubt as to the formal authenticity and validity of the seller's title to the property. The great bulk of such transactions must therefore be financed outside the formal mortgage lending circuit, either by cash payment or by informal financing. Clearly, potential buyers of modest means are excluded from formal mortgage financing circuits when they wish to purchase a unit from the existing privately-owned housing stock. The legal constraints preventing financing simply compound the problem of price levels.

Special Programs for Emigrant Workers

More than one-quarter of the salaried Algerian workforce is employed outside the country. This group contributes extensively to the unofficial savings of the country. An important share of this savings appears to be invested in new housing construction in Algeria, converting foreign currency to Dinars outside official channels at rates of up to 5 times the official rate. (The CNEP system of foreign currency savings accounts, convertible at official rates, has been notably unsuccessful, with negligible balances).

However, when these savings use "black market" channels for foreign exchange, building materials, and for land and building permits, the total cost of construction can become much higher than it would otherwise be. **It may be desirable to examine special "turnkey" construction programs financed in foreign currency by Algerian expatriates.** The success of such programs would obviously depend on the applicable exchange rate. Establishing such a mechanism would encourage the repatriation of a large quantity of external resources, as well as legalize the many "grey" housing transactions (bringing them into the tax system) and satisfy a portion of internal housing demand. This type of program could also benefit from the proposed guarantee fund program.

The Contribution of Enterprises. The employees of industrial enterprises had been granted a certain number of public (social) housing units ("logement d'accompagnement") constructed by the OPGI. This preferential housing allocation was ended in 1989; thus, certain enterprises are organizing construction programs for the benefit of their employees. Compagnie ENIE (electronics manufacturing), for example, is using a portion of its social welfare funds (FOS) as well as CNEP financing to construct accessible housing for its employees. Social welfare funds of companies are generated by withholding 3% of gross salaries. The funds are managed by the workers (the General Assembly of Employees). Until now these funds have above all been used to meet ordinary social needs (worker vacation sites, day care, cafeterias, etc.).

Previously, restraints on the sale of housing have limited their purchase to individuals and have excluded corporations which hold leases on the buildings. Since 1988, the sub-tenants (namely the employees inhabiting the units) have been able to acquire these units, and the enterprises have been authorized since 1989 to buy the apartments upon which they hold the leases. With the

disengagement of the State from the housing sector, one can expect that the social welfare funds of the enterprises will re-direct their priorities towards housing financing, either by acquiring the public units of which they hold the leases or by becoming developers of new housing.

4.0 ANALYSIS OF SAVINGS AND CREDIT

The Algerian savings rate is an important determinant of domestic resources available for financing the purchase, construction, and renovation of Algerian housing. While it is clear that Algeria has an abundance of savings, the question of who is saving, and how much, is far less well understood. This question is particularly important, because, inexplicably, government estimates show that total domestic savings as a share of GDP remained constant in 1989, and will continue to do so in the near future, while two major components, household and enterprise savings, are plummeting. The Central Bank of Algeria is presently researching these issues.

4.1 The Outlook on Domestic Savings

Historically, Algeria has been fortunate in having a high rate of domestic savings. Generally, centrally planned economies tend to have high household savings rates because few goods are available in local markets, and most of those that are available tend to have low, fixed prices. Because people cannot spend as much of their income as they would like, they are "forced" to save, an outcome that often leads to excess liquidity and strong inflationary pressures, particularly in the informal economy.

Although Algeria's high rate of domestic saving has fallen over the course of the decade, at 30 percent of GDP, Table 4.1 shows that it remains high in comparison to other Maghreb countries.

Table 4.1
Algerian Domestic Savings
(in billions of dinar)

	<u>1980</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
Algeria	69.9	107.1	83.0	98.8	93.9	112.7

Domestic Savings as Percent of GDP

Algeria	43.0	37.7	29.5	33.3	30.5	(31.1)
Morocco	14.8	14.9	14.5	16.8	NA	
Tunisia	20.4	15.9	19.3	19.3	NA	

Sources: IMF, International Financial Statistics and Algerian Ministry of Planning.

The Outlook for Household Savings. Much of Algeria's savings is done by households, although estimates vary considerably since so much of the savings never enter official channels. According to

the Ministry of Planning, household savings climbed dramatically in 1987 and 1988, but has subsequently been falling sharply, as Table 4.2 illustrates.

Table 4.2
Household Savings
(in billions of dinars)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
Disposable Household Income	147.7	166.6	172.3	180.9	202.0	243.0
Household Consumption	135.1	155.1	150.1	161.5	191.4	236.5
Household Savings	12.6	11.5	22.2	19.4	10.6	6.5

Source: Ministry of Planning.

The sharp rise in household savings in 1987 and 1988 occurred despite the fall in petroleum revenues and stagnation of the economy. One explanation may be that, with the intensification of government restrictions on imports and the overall compression of the economy, there were simply too few goods in the economy to buy. This could have stagnated household consumption and resulted in a "forced" household savings rate of over 10 percent of income. While household savings grew as a percent of total household income, Table 4.3 indicates that it became an increasingly large portion of total domestic savings during the latter half of the decade, prior to falling in 1989.

Table 4.3
Household Savings
(in percent)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
Household Savings as percent of:						
Household Disposable Income	8.5	6.9	12.9	10.7	5.2	2.7 (est.)
Total Domestic Savings	11.8	13.9	22.5	20.7	9.4	N.A.

This growth in household savings as a percent of total domestic savings developed not only because of higher levels of household savings, but probably also because of reduced levels of savings from public enterprises, and the hydrocarbon sector in particular. However, it should be underscored

again that the composition of savings is not well understood. Many government officials believe that household savings may account for a far greater share of total savings than estimated here, held as cash or other forms of wealth outside the banking system.

With economic recovery in 1989, bolstered by a government policy dedicated to the provision of consumer goods following the October 1988 riots, household consumption expanded rapidly, reducing savings rates to 5 percent of household income. The Ministry of Planning hopes to raise consumption levels even more in 1990, thereby reducing savings levels further. This fall in household savings may be offset in part with higher savings in other sectors, resulting from recovery in the rest of the economy, particularly the hydrocarbon sector.

The Outlook on Public and Private Enterprise Savings. Few data are available on the contribution of public and private enterprise savings to total domestic savings, although government officials emphasized its importance. An extremely rough estimate of enterprise savings may be found by taking changes in deposits held at commercial banks and assuming that the impact of household deposits is minor. This is likely to be the case since most household deposits are held at CNEP.

Table 4.4
Change in Time and Demand Deposits Held at the Commercial Banks
(in billions of dinars)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
Total Deposits	16.7	-7.8	19.9	18.5	7.8
Time Deposits	7.4	.9	12.0	6.8	10.9
Demand Deposits	9.3	-8.7	7.9	11.7	-3.1
Total Deposits as percent of Total Domestic Savings	15.6	7.3	20.1	19.7	6.9

Sources: Central Bank of Algeria; Ministry of the Economy, Plan National 1990.

Note: Banks include BEA, BNA, CPA, BADR, and BDL. 1989 bank demand deposit estimates are as of November.

The data appear to follow the same trend as household savings, with commercial bank deposits growing as a percent of total domestic savings in both 1987 and 1988. Total deposits fell

sharply in 1989 suggesting either that enterprises have chosen to save less, or that, with economic liberalization and increased autonomy, they are no longer choosing to place all their savings in banks.

Public enterprise savings have been the source of a considerable portion of Algeria's savings. Government policy throughout most of the 1980s limited the ability of these enterprises to retain earnings; enterprises were required by law to deposit their "surplus" into designated banks (Algeria's policy of "domiciliation"). The parastatals were not allowed to invest or lend these funds independently of the government. In 1988, the government began giving public enterprises greater autonomy, including granting them the right to use their own retained earnings and choose their own banks. While this change in policy has thus far had little impact (except, perhaps, to reduce savings deposited at banks), it intended to improve efficiency, the allocation of resources, and earnings. Over the long run the impact of these reforms on savings, and in particular savings channeled through banks, is uncertain. Competition among banks of public sector accounts may push up interest rates, increasing return on savings and thereby encouraging enterprises to place more funds in bank accounts. Greater efficiency and higher earnings may increase the amount of cash enterprises have on hand to place in banks. Enterprises, however, may well choose to reinvest their earnings or lend amongst themselves, reducing savings that actually enter into banking channels.

Private enterprises are the other significant source of deposits held in commercial banks. They account for one-fifth to one-fourth of bank demand deposits and over half of time deposits. Private sector enterprises have always had the privilege of being able to choose where they deposit their money. Should real interest rates rise over the next few years, more private enterprise savings could flow through the banking system. There is also the chance that bank reforms aimed at improving access of private companies to bank credit may improve relations between bank and private sector clients, encouraging private companies to place more funds in banks. The major determinant of overall private enterprise savings, however, will be the degree to which the government allows the private sector to flourish.

4.2 Savings and Inflation

Inflation can seriously affect savings rates in countries with rigidly controlled prices and interest rates. While Algeria has never suffered from the high rates of inflation found in many developing countries, it has been a chronic problem over the last few years. Officially, inflation reached double-digit levels in 1985 and 1986, falling in 1987 and 1988, but rising significantly since. As Table 4.5 shows, inflation is again expected to reach double digit levels in 1990. Official inflation

figures tend to underestimate price rises, however, because they do not capture price changes in the parallel market or the impact of devaluation. Unofficial estimates place inflation at 17 percent in 1989 and over 20 percent in 1990.

4.2.1 Inflation and its Impact on the Purchasing Power of Disposable Income

Inflation normally affects savings through two routes. First, higher prices normally mean that consumers (or businesses) must pay more to purchase the same number of goods and services, so that the purchasing power of disposable income may fall. If individuals believe that inflation is going to accelerate in the future, they will also be inclined to stock up. However, if wages and disposable income rise at the same pace as inflation, then inflation should have little impact on savings. In Algeria's case, the growth in disposable income appears to have kept pace with changes in the official consumer price index. Yet, as Table 4.5 shows, households chose to save less of their income during periods of high inflation and more when inflation moderated.

Table 4.5
Inflation, Income Growth and Savings
(in percent)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
Change in Official Consumer Price Index	10.5	12.4	7.4	6.0	9.3	13.0
Growth in Disposable Household Income	16.9	12.7	3.4	4.9	11.6	20.3
Household Savings as percent of Household Disposable Income	8.5	6.9	12.9	10.7	5.2	2.7

Source: IMF, International Financial Statistics, Office Nationale de Statistics, and Ministry of Planning.

Note: 1990 change in the official consumer price index is the government's projection.

Double-digit inflation in 1985 and 1986 coincided with relatively lower rates of household savings. The higher rates of savings that occurred in 1987 and 1988 can partially be attributed to lower inflation, although "forced" savings caused by lack of available goods during this period was

probably a more important determinant. **Savings are again dropping as inflation has begun to pick up again over the last year.**

The sensitivity of the rate of savings to inflation may be due to the fact that the government consumer price index does not capture price changes in the informal sector and the impact of devaluation on most imports. Actual inflation may have been greater than government estimates, as it was in 1989 when unofficial estimates placed inflation at twice the government's estimates. **Because actual inflation may have risen faster than disposable income, households may have had to spend more on consumption, having less left over to save.**

4.2.2 Savings and Negative Real Interest Rates

A second route through which inflation affects savings is interest rates. In an economy of fixed interest rates, inflation often results in negative real interest rates, discouraging savings held in banks. In Algeria's case, however, the impact of negative real interest rates on household savings was mitigated by other institutional factors.

Interest rates at the Caisse Nationale d'Epargne et de Prevoyance (CNEP) the major banking institution holding household deposits, have been kept constant at 5 percent, leading to varying but consistently negative real interest rates.

Table 4.6
Interest Rates on Demand Deposits Held at CNEP
(in percent)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
Nominal Interest Rates	5.0	5.0	5.0	5.0	5.0	5.0
Real Interest Rates	-4.9	-6.6	-2.2	-0.9	-3.9	-7.1

Source: Caisse Nationale d'Epargne et de Prevoyance

Note: Real interest rates calculated using official changes in consumer prices as the deflator. 1990 uses present CNEP interest rates and government projections for inflation.

Changes in real interest rates, reflecting changes in inflation, may have influenced to some degree the portion of disposable income households chose to save – providing another possible

explanation for the sensitivity of household savings to inflation. Given the negative return on savings, households may have decided to save less. However, as illustrated in Table 4.7, negative real interest rates appear to have had little influence on the stock of household savings accumulated in savings institutions. Despite the fact that negative interest rates were driving down the purchasing power of accumulated savings, Algerians chose to add to, rather than reduce, their savings balances.

The insensitivity of household demand deposits to changes in real interest rates can be explained by several factors. First, even though Algerian households had wished to spend more of their disposable income during the late 1980s, they were constrained by the limited number of goods they could purchase -- Algerian "forced" savings. Second, there were only a limited number of places that households could place their excess funds besides CNEP, and none that paid higher interest rates on demand deposits. Lastly, and perhaps most importantly, many households saved in order to obtain reduced interest rates on mortgages lent by CNEP. Indeed, savers understood that a savings account held at CNEP gave them a right to a reduced rate mortgage; consequently, and remarkably, CNEP estimates that 97 percent of households have savings accounts with it.⁴ From 1985 through 1989, the amount of household savings held in demand deposits at CNEP grew significantly every year regardless of movements in real interest rates.

⁴ This figure is a bit misleading in that some households hold more than one account, raising the average when CNEP divides total number of accounts by number of households.

Table 4.7
Demand Deposits Held in Banking Institutions
(in billions of dinars)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
Total Household Demand Deposits at CNEP (annual growth rate)	32.0 (19.3)	39.0 (21.9)	48.3 (23.8)	58.6 (21.3)	68.4 (16.7)
Total Demand Deposits of Commercial Banks (annual growth rate)	104.6 (9.8)	95.9 (-8.3)	103.8 (8.2)	115.5 (11.3)	112.4 (-2.7)

Sources: The Caisse National d'Epargne et de Prevoyance; Central Bank of Algeria; Ministry of the Economy, Plan National 1990.

Note: Demand deposits held at banks are as of November, 1989.

Although the impact of negative real interest rates is not evident in accumulated household savings, Table 4.7 clearly shows that they have had an impact on demand deposits held at commercial banks.⁵ While some households did place savings in commercial banks, the majority of depositors were Algerian public and private enterprises. As rates became more negative in 1986, these demand deposits fell, but rose through 1988 as rates became less negative. In 1989, total demand deposits fell again as real interest rates turned downward once more.

4.2.3 The Impact of Negative Real Interest Rates on Term Structure of Deposits

We can also see the impact of negative real interest rates on the term structure of deposits held in Algeria, although this relationship is far less clear. Most savings are held in demand deposits, where the dinars are more liquid, rather than tied up in time deposits. However, since 1985, time deposits have grown continually as a percentage of total deposits, as is illustrated in Table 4.8. This growth in time deposits can be attributed in part to larger spreads on interest rates given on longer term accounts beginning in October 1986.

⁵ Although nominal and real interest rates on demand deposits held at commercial banks differed from those at CNEP, real interest rates appear to have been more negative, with similar movements over the period.

Table 4.8
Time and Demand Deposits Held in Banking Institutions
(in billions of dinar)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
Time Deposits Held at Banks	21.1	22.0	34.0	40.8	51.7
Demand Deposits	157.6	154.4	175.3	201.0	209.4
Held at Banks	104.6	95.9	103.8	115.5	112.4
Held at CNEP	32.0	39.0	48.3	58.6	68.4
Held at the Treasury and CCP	21.0	19.5	23.2	26.9	28.6
Time Deposits as a percent of Total Deposits	(13.4)	(14.2)	(19.4)	(20.3)	(24.7)

Sources: Central Bank of Algeria; Ministry of the Economy, Plan National 1990; Caisse Nationale d'Epargne et de Prévoyance.

Notes: Banks include BEA, BNA, CPA, BADR, and BDL. This table does not include time deposits held at the CNEP. 1989 bank, Treasury, and CCP demand deposit estimates are as of November.

Unfortunately, data breaking down time deposits by holder or by period were not available. Time deposits held at commercial banks may be held for as short a period as 6 months or less, making them similar to demand deposits. It is clear from the data that most savers have chosen to place their money in readily available accounts, where money can be withdrawn quickly if inflation increases, lack of confidence in the banking system grows, or more remunerative opportunities arise.

This term structure, it should be mentioned, has important implications for the health of the banking system in general and the housing market in particular. **The banking system is highly vulnerable with so many funds in short-term and demand deposit accounts.** A major change in the environment, such as higher rates of inflation, lack of confidence in the banking system, or simply greater availability of goods on the market to buy, may cause households and businesses to reduce their savings. This in turn might cripple banks -- particularly those already struggling to improve their balance sheets -- with money lent in long-term instruments. **This possibility may make banks hesitant to make long-term loans to the construction industry, or to home purchasers, without some type of guarantee of repayment.**

4.2.4 Savings and Algeria's Liquidity Overhang

Over the past 5 years, the Algerian government has tended to accommodate shocks to Algeria's economy with a strong expansion in domestic credit and money/quasi money.

Table 4.9
Monetary Survey
(in billions of dinar)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
Net Foreign Assets (annual growth)	14.9 (59.7)	9.3 (-37.4)	9.1 (-1.9)	9.3 (1.4)	5.8 (-40.0)
Domestic Credit (annual growth)	251.2 (12.3)	278.0 (10.7)	303.8 (9.3)	339.2 (11.7)	375.0 (10.5)
Money and Quasi-Money (annual growth)	223.9 (15.0)	227.0 (1.4)	257.9 (13.6)	293.0 (13.6)	318.6 (8.8)
Liquidity/GDP	0.90	.95	1.03	1.15	1.07
<u>memorandum items:</u>					
GDP	283.9	281.2	297.0	307.0	361.9
Growth in real GDP	(5.2)	(1.0)	(-1.1)	(-1.8)	(2.8)
Liquidity/GDP					
Morocco	.46	.45	.48	.48	
Tunisia	.46	.47	.48	.52	

Sources: Central Bank of Algeria; IMF, International Financial Statistics; Ministry of Plan, Plan National 1990.

Notes: All monetary figures are provisional. Liquidity is defined as money, quasi-money, and demand deposits at CNEP. For Morocco and Tunisia, liquidity includes just money and quasi-money.

As Table 4.9 demonstrates, both domestic credit and money/quasi-money consistently exceeded the growth of real GDP throughout most of the last 1980's. Growth in money led to a major increase in liquidity, a "liquidity overhang" which will continue to place upward pressure on prices over the short-term. To give Algeria's liquidity ratio a context, it is more than double that of two Maghreb neighbors. The Central Bank of Algeria is presently hoping to absorb some of this liquidity through a variety of means including the creation of money markets, the sale of government bonds, and tight

monetary policy. In addition, it hopes that the continued sale of government-owned housing units will soak up liquidity.

4.3 The Outlook for Inflation and Savings in the Near Future

The outlook for inflation and savings over the short-term is not good. As noted above, the government has adopted a policy of trying to provide more consumer goods on the market in order to reduce political friction. This policy, according to the Ministry of Plan, is likely to result in a continued fall in household savings. In addition, the government is in the process of liberalizing the economy -- of reducing subsidies, removing price controls, lifting government restrictions on imports, and depreciating the dinar. This process may well, at least initially, raise prices of both domestic and imported goods, meaning that households and businesses will have to dedicate more of their disposable income to consumption. Higher rates of inflation are likely to discourage savings unless interest rates keep pace with inflation. While the Central Bank has recently moved to raise interest rates on deposits in light of Algeria's higher inflationary pressure, the CNEP has not.

Despite this pessimistic outlook, Algeria has an abundance of savings that can be used to finance the acquisition, promotion, and construction of housing. At the end of 1989, total accumulated savings in banking institutions exceeded 260 billion dinar with another 50 billion dinar in savings estimated by one government official to be available in the informal sector. Indeed, the high level of liquidity and savings is underscored by the fact that many home purchasers can, and do, pay with cash. The more difficult problem will be assuring that savings continue to flow into banking channels, and from there into the construction industry.

5.0 RECOMMENDATIONS

As has been discussed in Chapter 1, a number of studies, surveys and technical consultations are proposed to help facilitate the major efforts now underway in Algeria for financial sector development and formulation of public/private collaboration to foster market-oriented strategies.

Table 1.1, which summarized these recommendations, has also been included in this chapter for the reader's convenience. The major goals of the recommendations are to:

- formulate a role for CNEP, which helps ensure its own financial viability and allows competition from the commercial banks to take place on an "even playing field;"
- stimulate the banking sector toward activity in commercially based, market-rate lending in housing;
- study the role of CNEP as a leading institution in the development of housing finance, including providing liquidity through a rediscount facility; and
- target assistance to overcome key bottlenecks in housing supply including formation of a Housing Construction Loan Guarantee Fund, establishment of Housing Cooperatives for sale of public housing, examination of rent control, and provision of other types of technical assistance to make possible the development of a privately-owned, housing sector for development, construction, and rehabilitation.

5.1 Comprehensive Housing Sector Data Base

It is recommended that the first step in the process of technical assistance is to develop a comprehensive data base of both households and key segments of the housing stock. The sample design would be structured to obtain household income and expenditures information and dwelling unit information for samples and urban and rural households. The sampling plan must be structured such that adequate representation is made of informal sector households as well. Finally, public housing, both sold and unsold, should be represented, as well as so-called hoarded (unoccupied) units.

The need for more information with which to conduct policy analysis is quite pressing. Like many other countries, Algeria is in the process of developing additional data. Because of its recent emergence from a centrally managed system, however, the requirements in the past for micro-economic and private sector data were not strong. This is no longer the case. As mentioned above,

Table 1.1
Recommended Technical Assistance, Studies, and Surveys

Institution/ Sector Type of TA/Study	CNEP	Banking Sector/Financial Institutions	Construction Sector/ Developers	Public Housing/ Rent Control
Developing a Strategy for Housing Finance	Financial Strategies for Market Oriented Operations and Effective Subsidy Targeting		Technical Assistance to Existing Private Sector Companies	Studies on Strategies for Sale, Maintenance and Rehab of the Public Housing Stock
Surveys and Data Collection	Household Income/Expenditures Study for Use in Targeting and Planning by CNEP and the Commercial Banks			Study of the Hoarded Housing Stock/Standards/ Building Materials
Private/Joint Sector Institutional Development		Investigation of the Feasibility of Joint or Private Sector Financial Institutions in Housing Finance		Formulation of Housing Cooperatives for Sale and Management of Public Housing
Housing Finance Institution Building	Formation of Rediscount Facility for Housing Finance Lending	Housing Construction Loan Guarantee Fund (Central Bank/Ministry of Finance)		
New Financial Tools/Regulations	Studies of Alternative Mortgage Instruments			Studies of Rent Control Regulations and Impacts
Privatization		Studies of Feasibility of Privatizing one or more Commercial Banks	Studies of Privatization of Public Housing Development Companies	

for example, the Central Bank is undertaking a study of the composition of domestic savings, yet recent changes in the composition of savings are not well understood. Micro-economic data on household savings and consumption would assist in this effort. At the same time, the commercial banks, as well as CNEP can utilize savings information in their efforts for deposit mobilization. And, as discussed below, analysis of targeting CNEP (and other) subsidies to low income households will require careful assessment of affordability and "willingness-to-pay" by these households.

The necessary data do not now exist for these studies. For example, as discussed in the analysis of housing need and affordability in Chapter 3.0, household income data were derived from employee salaries provided by the Ministry of Labor and approximate estimates of income deciles, earners per household, and bonuses. Any number of deficiencies could affect the resultant estimates of income distribution. The most obvious, however, will be bias at both the lower and upper ends of the income scale. Most importantly, informal sector employment and earnings are not included, which primarily includes lower income households and individuals. In addition, non-salary private sector earnings, frequently higher incomes, will also be excluded. The savings and consumption patterns of both groups are important, especially since a major factor in increasing savings mobilization is to gradually incorporate informal sector savings and lending into formal sector institutions.

Analyses of supply-side issues face a similar dearth of information. An important area where micro-economic data can assist in macro-economic and policy analyses is in estimation of housing need and the level of investment required to fulfill that need. As described in Chapter 3.0, the requisite data are not currently available for undertaking a housing needs assessment. A rough estimate was made based on assumptions about population growth, crowding and replacement needs. What is required, however, are data disaggregated by income group, with subgroup calculations for the factors which determine need. Persons per room, condition, and household formation are all likely to vary by subgroup; furthermore, different assumptions about standards, crowding and upgrading can be made to assess the sensitivity of the needs estimate.

Another survey which is recommended at the present time is of the public housing stock, both sold and unsold units. This will assist in determining, for example, which units are selling, what the patterns of "resale" suggest about asking price and the target buyers, and the cost-effectiveness of rehabilitation of units in poor condition.

Finally, the information concerning the so-called "latent" housing stock would help understand the actual magnitude of housing supply and whether policy changes in rent control and

improvements in the availability of credit and/or building materials would actually bring some of the latent stock into active use. As discussed, the emergence of a private rental market is a long-run policy goal and a thorough study of rent control is suggested below in Section 5.6.4. If completed units are not rented because of fears that eviction is impossible, an estimate of the magnitude of this problem would assist in understanding rent control. In addition, the magnitude and cause of unfinished units is not known.

In summary, the following types of analyses will be greatly assisted by the provision of micro data for households and units, obtained from surveys based on carefully designed sampling plans in order to allow utilization of the data in macro-economic estimates:

- analysis of savings behavior, which will assist CNEP, the commercial banks, and the Central Bank. The analyses would help understand savings patterns; determine responses to the changes in the level and structure of interest rates (especially if a time series study was done); and help understanding of factors that impact mobilization of savings from the informal sector.
- analyses of expenditures and affordability to assist CNEP and the National Housing Fund target subsidies and develop housing and lending policies consistent with competition from the commercial banks and/or from new housing finance institutions.
- analyses of housing need, to better assess the investment requirements for fulfilling specific housing goals and what public and private resources are needed to meet these goals.
- analyses of several additional aspects of housing supply and the impact of the current regulatory environment for rent control and standards.

5.2 Reformulation of the Role of CNEP and the Banking Sector

As discussed in the Executive Summary, an opportune moment has arrived in the evolution of Algeria's financial sector reforms to establish a new role for CNEP. Fundamental issues are at stake regarding institutional leadership, introduction of competition, and the eventual introduction of the private sector, whether in the form of new financial institutions or privatization of existing ones.

A decision must be taken as to whether housing finance at CNEP is to remain isolated from market-oriented strategies and from the rest of the financial sector, or whether there will be competition and multiple lenders in construction and mortgage lending. In addition, a decision must be taken as to whether CNEP will adopt a leading institutional role in the housing finance system and adopt an active stance of public/private cooperation in order to provide incentives for the commercial

banks to develop the requisite skills. Although the contexts are quite different, the evolution of the Government Housing Bank (GHB) in Thailand has been mentioned as a role model. Like CNEP, the GHB successfully tapped the savings market; unlike CNEP, however, it did so with attractive deposit instruments. Following GHB's example that mortgage lending can be an attractive business, existing commercial banks and finance companies in Thailand followed suit. The result has been a significant increase in housing supply and a clear deepening of the formal market and importantly, public and private financial institutions are competing on an equal footing. CNEP has a strong savings mobilization network and the only housing finance management and technical expertise in Algeria. It is also currently very liquid. These factors, combined with increased understanding of the benefits of leading institutions in housing finance in a number of developing countries suggest the following actions by CNEP:

- CNEP should establish market-based rates for lending and borrowing at least as quickly as the Central Bank plans for positive real rates by 1992;
- CNEP should develop a long-run financial strategy based on market rate new lending instruments, as applicable;
- a study should be undertaken of the role of CNEP as a leading institution in a scheme of public/private cooperation in housing finance;
- CNEP should assess development of a rediscount facility to utilize its liquidity and to provide assistance to the commercial banks in developing housing finance lending;
- CNEP should effectively target its subsidies to those unable to pay without assistance, separating the loan and grant portion of the subsidy.

5.3 Facilitation of the Sale of Public Housing: Formation of Housing Cooperatives

Management of the state-owned housing stock is a complex issue which requires a specific study that would first assess the present situation with respect to the condition of the buildings, the status and financial capacity of the occupants or the rate of recovery of rents, which in many cases, is not well documented. Different options should then be worked out with regard to the rehabilitation of the buildings, the recovery of the costs, the future type of occupation (sale or rental), and the future methods of management and financing.

The OPGI's should continue their effort to sell the remaining rental units, easing the requirements for potential purchasers (occupants) to prove tenancy rights. They should avoid embarking on a process of rehabilitation for sale: it would be less expensive to give certain units away than to undertake extensive restorations. The OPGI's should seek to avoid remaining in co-proprietor situations in buildings where it only owns a few units and continues to bear full maintenance costs. This disengagement could be facilitated by the formation of cooperatives to manage and maintain a building on behalf of the owner-residents. These cooperatives (which would be private corporations) would:

- manage the un-sold rental units. The rent revenues can finance a portion of building maintenance costs. (One might expect a higher rate of tenants' rent payment to a cooperative owned by building residents than to a distant OPGI).
- take care of the sale of the unsold units, using the sale proceeds to contribute to a fund for the maintenance and rehabilitation of the building. These sale transactions would thereby be outside the public sector and within the domain of private transactions, with a different view of pricing and profitability considerations.
- establish ties among various cooperatives for the purpose of arranging for local services (cleaning, security, improvements) in collaboration with local authorities.

Ultimately, the State should fully disengage from its roles as housing-provider and building-manager. Thus, the State should remove itself entirely from its function as building-manager, placing this responsibility in the hands of owner-cooperatives. These cooperatives should be the recipients of the rental of unsold residential and commercial units, and of the proceeds of the sale of these units. The cooperatives would in turn be solely responsible for the rehabilitation, maintenance and management of their building. These cooperatives can also become private housing constructor/ developers, undertaking new housing projects including rental projects. They can thereby substitute themselves for the State and become private providers of rental units. Decentralized, without the constraints that hamper the OPGI's and without having to compete with state rental housing, these new private entities could more readily align rent levels with production costs. The cooperatives'

activity would fill an important gap by creating a private rental-housing sector, currently lacking in Algeria. The implementation of the concept of a real estate management cooperative sector is not difficult. There already exists legislation governing cooperatives which construct or purchase real estate, as well as detailed legislation on the management of co-proprietary (condominium) housing units. At present, cooperatives have been set up primarily for employees of one State enterprise (e.g. the railroad company) for the purpose of purchasing land for auto-construction of housing. It would certainly appear feasible to adapt this existing concept to the purpose of single-building owner cooperatives as outlined above.

This cooperative concept, which naturally requires further examination and refinement, should nevertheless be seriously considered as an interesting way to solve the difficult problem of state-owned rental housing. It would be preferable to take a pragmatic, empirical approach: to begin with a few pilot cooperatives in this area, followed by a flexible framework for continuing and expanding the concept based on early experience (as opposed to the frequent practice to date of promulgating detailed legislation and procedures which may in practice turn out to be unworkable).

5.4 Facilitation of Housing Supply: Technical Assistance to the Banking Sector and Development of a Housing Construction Guarantee Loan Fund

As a long-run goal, the supply of new housing should increasingly be provided by the private sector, and by a public sector industry which must operate as viable, autonomous business, no longer able to depend on direct state support.

The public housing development agencies (the "O.P.G.I." and the "E.P.L.F.") will continue to obtain housing project financing from the CNEP based on project viability criteria. However, the public housing development agencies, and the few private sector development companies should have, in addition, access to project financing through the commercial banks. Aside from some specific transactions, the Algerian commercial banking sector has little experience with financing housing construction projects. They lack a number of ingredients necessary to become active in this business: a network of relationships with private developers and construction companies, project control and follow-up systems; progressive disbursement and progress payment procedures, and effective loan collection and recovery procedures.

With the commercial banks' new autonomous status, they will need to raise their lending activities more than previously on credit risk assessment, and will have difficulty evaluating and lending against the risk of an affordable-housing construction project presented by a private-sector

developer. It is to mitigate these risks, and encourage all commercial banks to lend to such companies (including new ones) that we recommend **technical assistance** in construction lending and establishment of a Housing Construction Loan Guarantee Fund. The Fund could be financed by internal or external resources and by guarantee premiums paid by the commercial banks and the borrowers.

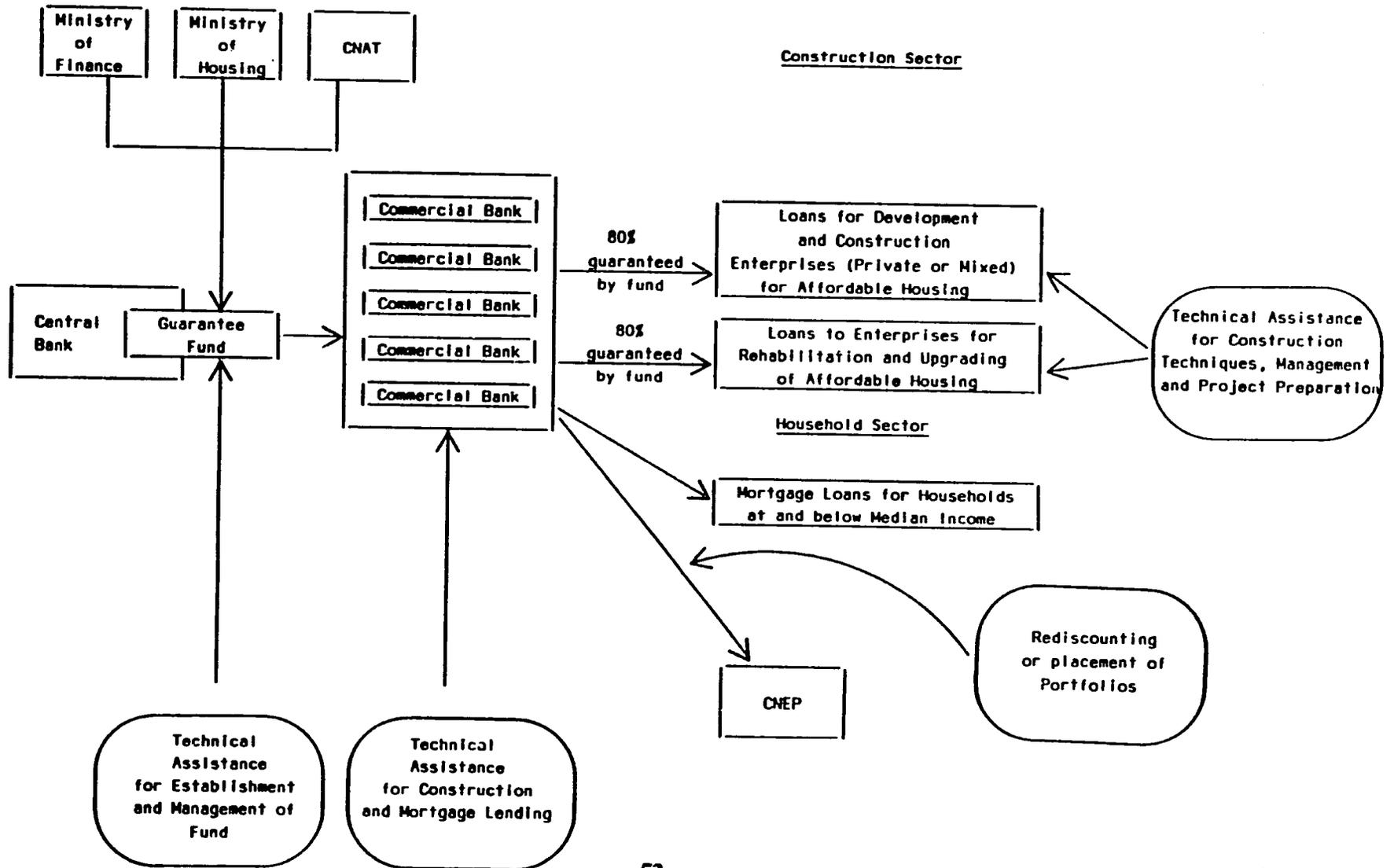
The very success of Algeria's savings and financing mechanisms (both formal and informal) has dramatized a key difficulty: high inelasticity of supply for housing. In Algeria, numerous bottlenecks to increased housing supply must be opened. The focus here, however, is on a specific goal: to encourage the construction and financing of new (affordable) housing units at commercial, market conditions. (A forthcoming World Bank study will focus on the Algerian construction and building materials industries.) The supply of new housing needs to be accelerated. To do so it is necessary to diversify the sources of financing this activity, and specifically to encourage the commercial banks to become active in this sector. For the moment, the best-financed housing construction segments are: (a) auto-construction (self-built housing, which in Algeria largely involves luxury housing), and (b) public sector construction of projects which have been given priority. This leaves a great number of unmet needs, especially in urban areas. It is clearly desirable to support the creation of financing mechanisms aimed at all sectors, but particularly at providing new affordable housing for modest-to-middle income levels. It is possible that the coverage of the Housing Construction Loan Guarantees Fund would be limited to the types and cost of housing accessible to modest household income levels. The exact delineation of the target revenue level and housing unit cost level should be the subject of further discussions in Algeria, however.

It is also possible to improve housing supply by making better use of the existing housing stock, notably by its rehabilitation. The deterioration of pre-1962 housing, and even of more recent buildings, means that there is a large number of units which do not meet habitable standards. The causes of this deterioration are numerous, but the process is not irreversible.

We therefore propose to use the **financial and technical assistance mechanisms to stimulate the development of private enterprises specializing in housing rehabilitation**. Such enterprises are virtually non-existent at present. Such companies could be relatively small enterprises and could benefit from the available incentives for employment of youth.

The recommended program is summarized in Figure 5.1 below, and in the one-page summary of the chart which follows.

Figure 5.1
Housing Construction Loan Guarantee Fund



SUMMARY OF FIGURE

- I. **Guarantee Fund**
 - A. **Managed through Central Bank (BCA), with direct supervision of Ministries of Housing (Equipment) and Finance, and the CNAT (exact institutional arrangements to be determined).**
 - B. **Funded through external sources, e.g.,**
 1. **Principal of fund**
 - Domestic sources
 - Bilateral/multilateral external sources
 2. **Revenues of Fund**
 - Interest earned on fund's principal
 - Guarantee premiums paid by beneficiaries (banks, borrowers)
 - C. **Technical/management assistance/risk evaluation:**
 - BCA/Ministries
 - CNAT
 - External (USAID) technical assistance for establishment and management of fund.
 - D. **Technical assistance available to the Fund during start-up**
- II. **Fund extends guarantee to commercial banks covering 80% of eligible loans (to be defined precisely). Generally, eligible loans are:**
 - A. **For purposes of developing/constructing new housing at unit prices affordable by modest income households. (Exact unit cost and income parameters to be determined.)**
 - B. **Borrower to be private sector developer/construction company (public or foreign shareholding permitted up to 50%), specifically including new enterprises. Borrowers have access to technical assistance (management/project development/affordable-housing construction techniques).**
 - C. **Commercial Banks must lend at market rates, must do proper project risk evaluation, and must help arrange that takeout mortgage financing (via CNEP or another financial institution) is available. Technical assistance is available to banks for construction lending activity.**
 - D. **Commercial banks have recourse to the Fund in event of borrower default and after loan collection and recovery procedures have been completed.**
- III. **Commercial bank-arranged development/construction loans (guaranteed by Fund) may be carried on the bank's portfolio, rediscounted (with CNEP or possibly BCA), or placed directly with CNEP.**

The Guarantee Fund would help cover the risks inherent in a start-up industry: financing housing construction and rehabilitation. This Guarantee Fund could be domiciled at the Central Bank. The management of the fund could be provided by the same unit that will manage risk control as provided by the new monetary and credit legislation. Loan Guarantees would cover 80% of the amount of loans granted by commercial banks to eligible borrowers. Commercial bank lenders would be responsible for putting into place all normal recovery procedures. Recourse to the guarantee of the fund would be subject to the banks' following proper procedures with regard to loan performance and efforts to recover the loan. These procedures remain to be defined. The Guarantee Fund will receive premiums paid by the borrowers, the levels of which must be determined.

The Guarantee Fund program would be limited to covering credit risks for commercial bank loans to enterprises whose nature and activity are as follows:

- housing development and construction enterprises as defined by the new law on housing development. These enterprises could be privately-owned, or mixed public-private ventures which could result from the possible restructuring of the public sector housing construction industry.
- private-sector companies engaged in the rehabilitation of existing housing. The objective here is to encourage the establishment, on a small capital base, of new small enterprises.

The Guarantee Fund program would be limited to covering credit risks of bank loans for the following activities:

- Housing Construction. Construction of residential projects. Completion of housing units developed by construction cooperatives.
- Housing Rehabilitation. Development of building rehabilitation programs for groups of housing owners (the nature of such projects and maximum amounts remain to be defined).

The commercial banks will be encouraged to ensure the availability (via the CNEP or the banks themselves) of takeout mortgage financing for households in housing projects financed under the Loan Guarantee Program. Technical assistance can be provided to the Guarantee Fund unit of the Central Bank with regard to the establishment and procedures of the Fund. This assistance would involve the definition of criteria and procedures for assumption of risks, financial evaluation of projects presented, handling of claims, and the like.

Technical assistance would also be provided to the commercial banks relating to housing development and construction lending (risk evaluation, project analysis and follow-up, recovery

procedures, etc.) Finally, technical assistance to eligible housing development and construction would relate to Construction techniques and methods successfully used elsewhere to produce affordable housing, and management of private housing development or construction companies.

5.5 Other Possible Assistance in Housing Supply

The Guarantee Fund concept allows limited resources to serve as a "lever" and catalyst to the necessary development of a private housing development industry focusing on affordable housing. It can also stimulate the entry of all Algeria's commercial banks as active participants in financing this activity at market rates of interest.

Selecting a specific, focused financing mechanism increases the chances of its successful implementation. This is especially true in the current environment of extensive reforms and changes in the roles and activities of many institutions in Algeria, from Government agencies to banks to enterprises. The Guarantee Fund mechanism may be workable regardless of the exact nature and impact of the many changes now underway, since its implementation can proceed within the framework of existing institutions.

It is possible, however, to envision a wide range of which can address the problems of Algeria's housing supply sector, and specifically the production of new housing units. Restructuring the public sector construction industry, and stimulating an expanded building materials industry, are areas where considerable effort -- and financial resources -- will be required. Other critical areas include construction standards, the legal status of land, tenant rights, and property conveyance. Comments on several of these areas follow.

5.5.1 Mobilization of the Private Sector Construction Industry

As has been discussed above, it is both necessary and desirable to mobilize a private sector development and construction industry. However, in spite of the sweeping legislative reforms that are underway, the public housing development agencies and the state enterprises continue to enjoy considerable privileges and competitive advantages that are denied to the private sector, for example where access to building materials, land and credit are concerned. This quasi-monopolistic situation creates a strong disincentive to private land and housing developers, contractors, and producers of building materials and is not conducive to increased housing production and lower construction costs.

It is therefore recommended that a study be conducted of issues facing the currently-existing private developer/construction industry and that technical assistance be offered in management, project design, affordable construction, and so forth.

5.5.2 The Role of Public Sector Developers

Public sector developers (especially the O.P.G.I. and the E.P.L.F.) can use the extensive expertise of their numerous personnel to pursue this activity by:

- continuing to undertake mixed (residential-commercial) projects;
- developing property for resale for auto-construction to households. (This activity is currently the responsibility of national and local land agencies, but they do not appear to be conducting it); and,
- entering into maintenance, management and rehabilitation contracts with the proposed housing cooperatives.

Also, a framework exists for the OPGI's and EPLF's to become profitable housing developers. This framework includes: new legislation on housing development, the experience of OPGI and EPLF's with construction companies and with the means of housing production generally, access to finance from the CNEP and (increasingly) the commercial banks, and access to land for development via the A.P.C.'s and the land agencies.

Thus, it is not difficult to envision these public-sector developers evolving from autonomous, profitable entities into mixed or private-sector enterprises. The management capabilities and profitability criteria used by the top managers of certain OPGI's and EPLF's make this evolution achievable in practice. **Thus, a study of the options for privatization should be undertaken.**

5.5.3 Revision of Town Planning and Housing Standards

Most of the standards that are in force today are too high and have effects contrary to the ones aimed at, for they imply housing types and costs that are unaffordable for the larger part of the population. Considerable reductions in land development and construction costs should be achieved through higher densities, smaller plots, less generous rights of way, row housing, more realistic building codes and possibly, through the search for cheaper alternatives to the current anti-seismic standards. **A study should be undertaken to assess the impact of changes to these standards.**

5.5.4 Revision of Rental Laws and Regulations

Algerian tenant households have become accustomed to very low rental rates and to an extreme degree of protection against landlords, to the extent that the private rental market has practically vanished. Yet it is a powerful source of housing supply, especially for the lower and middle income groups, and requires almost no assistance from the state. In order to revive it, rental rates will have to rise and the main disincentives to prospective investors in rental property will have to be removed from the legislation. Already, the rents of state-owned housing are being raised. **A study should also be undertaken to clarify the rent control regulations and propose liberalization of the system.**

5.5.5 Creation of Mechanisms for Land and Infrastructure Development

The present mechanisms are deficient because unable to ensure adequate financing. Large numbers of unserviced subdivisions are therefore being occupied in spite of the absence of infrastructures. The Local Authority Law and the Land Law are at present under revision, but could not be consulted during the mission. It is our understanding that the municipal land development agencies (AFU or Agence Fonciere Urbaine) will be dissociated from the municipal administration, but it is not clear whether adequate financing mechanisms are being introduced. Given the limited means of the central and local authorities, should be encouraged to enter the market; they would subdivide, service and sell land made available by the local authorities, without getting involved in housing development. Another constraint on land development is the land management system; e.g., the cadastre is not geared towards providing up to date information on availability of public and private land in the urban areas. **This problem is being addressed through a study financed by the World Bank.** A revised Town Planning Law was adopted recently, but it leaves so many issues to be settled by by-laws and regulations that it is difficult to judge its effects.

5.5.6 Mobilization of the Latent Housing Supply

There are strong indications of a considerable latent housing supply that could be mobilized, provided that a series of measures already mentioned are implemented. These include an increased availability of building materials for private builders, giving priority to the completion of infrastructure in the existing subdivisions and ZHUN, and the revision of rental laws to encourage rental of vacant dwellings. **The above-mentioned studies of private developers and rent control should include an assessment of the underutilized stock.**

APPENDIX 1: THE ALGERIAN ECONOMY – EVOLUTION AND PROSPECTS

1. Background

Algeria is a developing middle-income country subject to intense demographic and political pressures. It is an oil producer with limited reserves, and is currently emerging from a severe economic crisis, induced by the oil counter-shocks of 1986 and 1988. It is in the process of shedding its system of central planning, and is developing a sweeping program of economic reforms which involves a complete overhaul and liberalization of its economic system.

The following discussion of the Algerian economy -- past, present, and future -- is cast as a foundation for analyzing the central issue of this report: housing finance.

2. Main Characteristics of the Algerian Economy

With a population of 25 million, growing at an average annual rate of 3.1 percent, Algeria is one of the fastest growing countries in the world. The birth rate is in a period of decline (registering 34.6 per thousand in 1987), but the death rate, too, has been dropping (to 7.9 per thousand in 1987). As a result, the Algerian population is one of the youngest on earth, with 43.8 percent being less than 15 years old.

This explosive growth has enormous implications for the Algerian economy, in terms of educational and infrastructure costs, as well as the labor and the housing markets. The active population is growing at an annual rate of four percent, which requires the creation of 240,000 jobs per year. Likewise, the urban population is growing at a rate of six percent per annum, which imposes **unsustainable demands** on the housing and construction markets.

Since independence in 1962, Algeria's traditional development strategy was based on centralization and industrialization, financed by the exploitation of hydrocarbon resources and external debt.

Crude oil exploitation began in 1954, and intensive production eventually forced a recognition of ultimate depletion. Reliance then turned to secondary and tertiary recovery techniques and to the development of the production of condensates. Natural gas began to play a major role in the economy, as Algeria ranked fourth in the world for natural gas reserves. Overall, hydrocarbons combined the advantages of a cheap and flexible source of energy in the form of fuel or electricity, a source of raw materials for the petrochemical and metal industries (direct reduction process and electrolysis), a source of tax revenues and a source of foreign currency.

Today the hydrocarbon sector plays a prominent role in the Algerian economy, as main provider of foreign currency (97 percent of merchandise exports; 95 percent of exports of goods and services), as prime source of tax resources (one third of tax revenues), and as producer of one seventh of the total value-added of the economy.

3. Current Economic Reforms

Inspired by a militant nationalistic and socialist ideology, the Algerian Government assumed effective control of virtually all parts of the economy. Over time, the rigid system of central management of the economy had led to severe cumulative disequilibria, with the result being the development of a comprehensive program of economic reforms supported by the technical and financial backing of the IMF and the World Bank. These reforms can be broken into both macro- and microeconomic categories.

3.1 Macroeconomic Reforms

In addition to the monetary reforms discussed in this report, key elements relate to budget policy. The overall deficit of the Treasury, (due principally to the financing of public firms' operations) was seriously affected by the crisis of 1986-88, at which time it reached 44.4 billion dinars⁶ or 13 percent of GDP. Since a very large portion of this deficit was financed by money creation (22.9 billion dinars in 1988), it resulted over time in a massive amount of liquidities, which fuel inflation and illicit activities.

The response was a new budgetary policy which included: improved transparency of budgetary operations; the eradication over a period of three years of the overall Treasury deficit; and the elimination of the Treasury as direct intermediary for operating subsidies to parastatal corporations (with the exception of the financing by the Treasury of interest rate subsidies for priority investment programs).

As a result of these budgetary measures and the overall improvement in the economic environment, the overall deficit of the Treasury has decreased from 44.4 billion dinars in 1988 to 15.1 billion dinars in 1989. Even more significant is the decline in the (inflationary) contribution of the Central Bank to the deficit. This contribution decreased from 22.9 billion dinars to 7.0 billion dinars in 1989.

⁶ of dinar = .1176 USD

It must be noted, however, that the significant improvement in the budgetary situation in 1989 was mainly due to improved hydrocarbon tax proceeds, supported by the decline of the dinar. Tax reform is part of the process, and several measures were taken in 1989 to reduce the corporate tax rate and provide investment tax incentives, via accelerated depreciation and consolidation of subsidiaries' profits.

The tax reform currently envisaged includes a simplification of the obsolete and ponderous tax system, a widening of the tax base, further reduction of the overall Treasury deficit and the soaking of speculative rents. A Value Added Tax system is planned, within the framework of a complete overhaul of indirect taxes. The social security tax system is also being revamped. Additionally, the Tax Administration is being reorganized and computerized with the technical and financial help of the World Bank.

Another key element is exchange rate policy reform. It was determined that the Central Bank had been setting the official exchange rate of the dinar at an unrealistically high level, thereby negating any attempt to make non-hydrocarbon exports competitive and overly protecting Algerian industry from external competitive pressures. In response, over the last three years the official policy has been to reverse this trend by a decrease of the value of the dinar on the order of 30 percent in real terms. This has not been sufficient, however, as the official exchange rate and that prevailing on the parallel market varied by a factor of seven in May 1990. Official policy is to continue a moderately paced devaluation and to completely liberalize foreign exchange and international capital transfers.

The main ingredients of the foreign trade policy, until now monopolized by the State, are: the diversification of exports by promoting non-hydrocarbon exports of goods and services, freer trade with Maghreb countries, and the reform of the foreign exchange allocation system.

Until recently, foreign exchange was channelled through and allocated by the State via a complicated and bureaucratic multi-stage administrative process through the ministries and the national corporations. Allocations were earmarked to specific projects, with little flexibility for the firm to reallocate its limited foreign exchange resources. The system was exceedingly wasteful of scarce resources and invited circumventing practices. It was also a source of handicap for private firms, which were to obtain their allocations through the parastatals and had lowest priority.

In 1987, the government instituted the so-called "Importations sans paiements" (I.S.P.) system, whereby Algerian non-residents could finance their imports of products into Algeria, with their own foreign currencies, outside of the official foreign exchange channel. The success of this

innovation was outstanding and it has generated a flow of imports on the order of ten percent of total imports. While the system did contribute to overcoming the shortage of imported materials and equipment, it also fueled the thriving parallel economy.

In September 1988, the Government instituted a new and more efficient system of distribution of foreign currency, whereby firms are free to spend their allocation as they see fit within the confines of a multi-year budget (budget-devises). In addition, the new system is constantly upgraded to remove excess rigidities and grant equal access to private firms, based on the priority of their projects.

3.2 Microeconomic Reforms

The reform of public enterprises is a program begun in January 1988, and designed to return decisionmaking powers to public corporations. The new law creates eight "Fonds de participation," i.e., government-owned portfolio management agencies, which acquire shares in the capital of public corporations under fairly stringent rules. For example, a given fund may only own up to 40 percent of the capital of a given national corporation; likewise, the capital of a given public corporation must be spread among three funds. Otherwise, the funds are allowed to trade shares and are encouraged to create new financial instruments. (The real autonomy of the funds can be questioned, however, since their boards are still selected by the government.)

A second element of the reform is the "Committee for the Restructuring of Public Corporations," targeting those which have negative net worth or are otherwise viewed as non-viable (given the decision to eliminate direct Treasury operating subsidies). The Committee is to propose restructuring operations. A third element is the "Fonds de restructuration," designed to inject new capital to those parastatal corporations which will be judged worthy of being restructured. The money, however, will come largely from a one-time contribution from healthy, profitable corporations. Additionally, the Treasury will no longer be allowed to provide direct (seldom reimbursed) loans to cover the public corporations' operating deficits, and firms are now allowed to select their bank freely, a welcome departure from the previous system of domiciliation.

A second microeconomic reform comprises rehabilitation of the private sector, addressing historic practice in which the private sector was confined to a few strictly delimited activities regarded as not strategic. Private firms were subject to the strict control of numerous administrations and were discriminated against, in the allocation of raw materials, imports, and foreign currency and investment credits. Most sources of de jure discrimination are now eliminated.