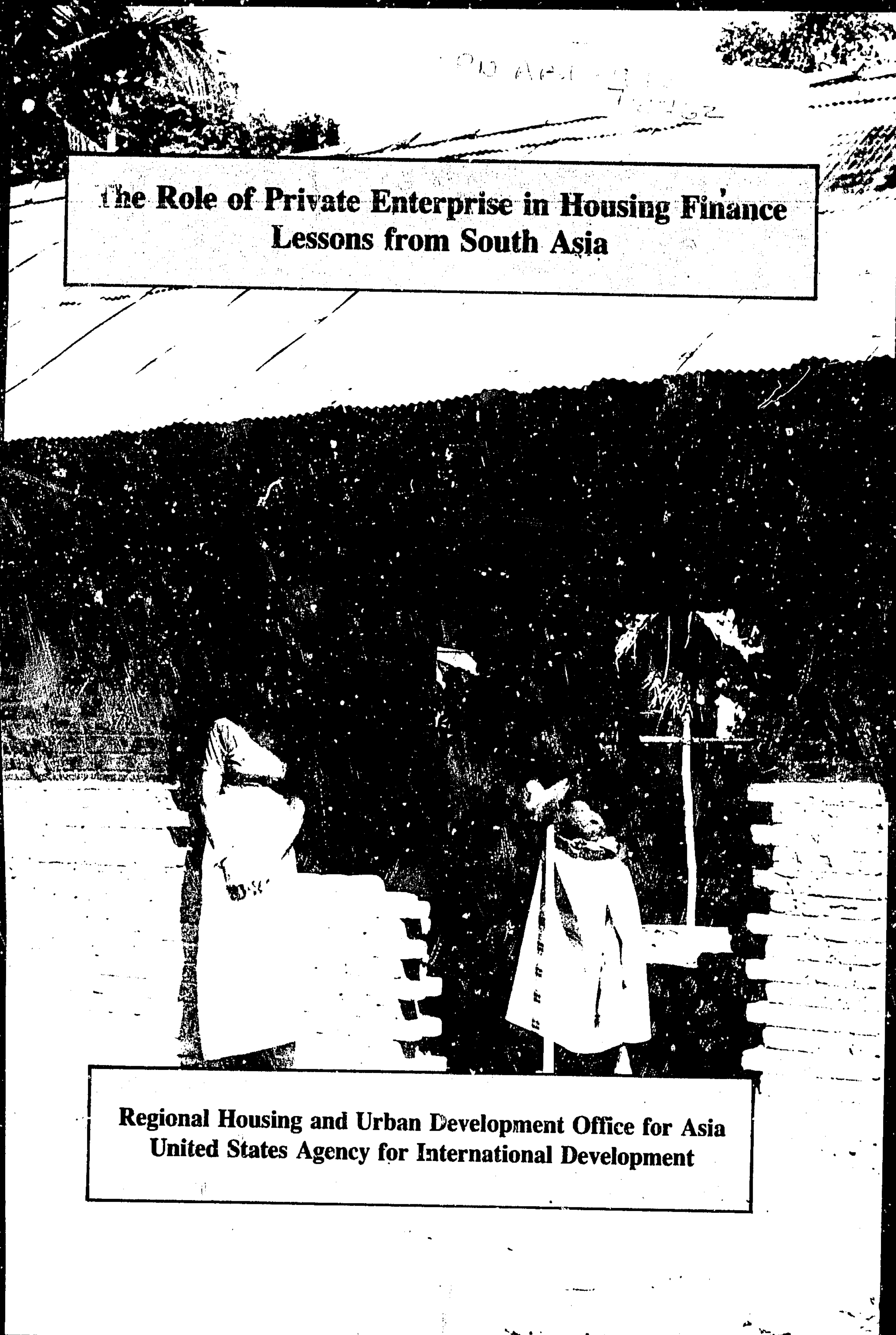
The Role of Private Enterprise in Housing Finance
Lessons from South Asia



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1. INTRODUCTION

This paper outlines the development of housing finance systems in South Asia--India, Pakistan, Sri Lanka and Nepal. These countries have experienced or are presently undergoing a transformation of their housing finance systems. Housing finance had previously been the domain of the public and informal sectors, with a standard of performance which did not and perhaps could not meet political expectations. The entry of private formal institutions into the sector is helping to raise large volumes of lending resources, to improve access to housing finance for middle and lower income households, and to widen consumer choice for both savings and loan instruments.

The paper starts by describing the financial context in which housing finance is provided in South Asia, and discusses how privatization of the sector is occurring. There is then a country-by-country description of how formal housing finance systems are evolving. A final section draws up a check-list of the advantages and disadvantages of private sector involvement in housing finance. It finds that there are overwhelming reasons for promoting competition in the sector and for governments to facilitate the participation of private enterprise in lending for housing. It also notes that there are several clear continuing roles for government, not the least important of which is to supervise and regulate sectoral development.

It is in this geographical region that the United States Agency for International Development (USAID) has had the most experience--within Asia--of working in the housing finance sector. An annex outlines USAID's current programs in the four countries of the region where we have an active shelter program.

INFORMAL SECTOR LENDERS

The paper describes the involvement of the formal private sector in the provision of housing finance, but gives no more than passing mention to the informal sector as an alternative source of loans for housing. This is not because of the unimportance of

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[1] It is conventionally estimated that, in South Asia, the formal financial sector typically provides about 20 percent of the total value of housing construction. Logic is then stretched to conclude that "therefore" the informal sector provides the remaining 80 percent of the finance. In practice, however, much of the construction is financed from family savings or inter-family transfers. Capital from these sources is informal only in the sense that it is often not deposited in formal sector institutions; it is, however, not borrowed from informal sector markets. In OECD countries, about 60 percent of the value of housing activity derives from formal sector loans.

the latter. Indeed, depending on definitions, the informal sector currently provides 80 percent or more of the volume of housing finance in South Asian countries today . The informal sector, however, with few exceptions, provides only short term loans, generally at high interest rates. Its main advantage is that it has low barriers to access: that is, in contrast to most formal sector loans, informal loans are relatively easy for households to obtain. The informal sector financial market offers a valuable service to households working in the formal and informal sectors: financing land purchase, house improvement and construction for both formal and informal shelter. Nevertheless, its characteristics are such that the informal market can easily finance only short term, small loans. It is necessary to look to the formal sector to meet the greater part of the potential demand for housing finance.

The case studies of this paper describe privatization approaches which have been adopted by the four countries, which are proving to be effective and which can be replicated in other countries and, doubtless, in other sectors. The approaches primarily have their foundations in formal sector models of development: collateral requirements are based on formal documentation of property ownership, the principal lending instruments are similar to those found in more highly developed housing finance systems, and funds are mobilized in competition with other formal sector lenders and on-lent on sustainable terms.

Such formal housing finance systems favor borrowers who work in the formal sector and construct formal sector houses. Conversely, they tend to discriminate against informal sector families. Because of the importance, often predominance, of the informal sector as employer in much of urban Asia, there has been some considerable discussion about ways of integrating informal sector needs into formal housing finance systems.

South Asia has several instances of existing institutions which have a formal sector structure, but serve informal sector borrowers. The best known, and probably the largest and most effective of these is the Grameen Bank, which is briefly described in Annex II. Other examples are known of institutions that lend mainly or exclusively to people living and working in the informal sector, although it is not yet clear the extent to which their operations are sustainable or are unique to particular circumstances, and hence can or cannot be replicated elsewhere. Many of the institutions mentioned in the body of this paper also have programs to extend access to housing finance to people who presently do not use formal financial outlets, by the application of techniques and instruments that are not yet in conventional use.

Finally, Annex III describes the work of the Asia-Pacific Housing Finance Coalition, which, among other things, is preparing a pilot project which will demonstrate the feasibility of using formal institutions to lend to the informal sector on a sustainable basis.

2. HOUSING FINANCE IN THE ECONOMY

The importance of housing to national economies and in national development strategies is acknowledged and well understood by the participants to this conference, and therefore does not need to be restated. However, it may not be so clear why stress is being placed on the development of housing finance systems. In brief, the reasons are as follows.

The development of a viable system of housing finance is an essential prerequisite for the sustained growth of investment in housing. A viable system comprises a set of lending institutions, often specialized in housing finance, that operate in a competitive environment and according to market principles, within a supportive legal framework. Sustained resource mobilization and efficient intermediation are the key attributes of an effective housing financial system. Over the course of time, the primary lending institutions can be complemented by specialized services and facilities such as mortgage insurance and secondary mortgage markets, and maybe also by a national housing bank.

Benefits of a functioning housing finance system, as so defined, include the following elements :

- A good housing finance system helps in the achievement of shelter policy objectives: it will improve the efficiency and stability of housing and urban infrastructure investments. The availability of housing finance stimulates the construction and maintenance of housing, in turn contributing significantly to local and national economic prosperity.

- Housing finance also brings social benefits: use of market-based systems for those who **can** pay helps to free up resources for those who **cannot** pay. (Subsidies are an inefficient way of transferring income to the poor, often forcing a greater consumption of housing than the poor themselves would prefer.) Results include better housing, improved health and lower costs of living--especially for poorer households.

- Experience has shown that once specialized housing finance institutions are created, new financial resources are generated that would otherwise have been idle, held unproductively, for instance as gold or jewelry.

- Financial systems become more stable if financial institutions are allowed to diversify their asset portfolios into housing.

- Housing finance is central to the development of the overall financial system, by encouraging the accumulation of financial savings. (In the United States, for instance, one third of personal savings are held with savings and loan associations, which specialize in making housing loans.) This adds to financial deepening and promotes a more efficient allocation of savings in the economy as a whole.

- Use of a market-based housing finance system should eliminate the need for directing credit to the sector, with the potential fiscal benefits that this implies.

With the recent exception of India, these conditions do not yet hold in South Asia.

3. THE FINANCIAL CONTEXT FOR THE PRIVATIZATION OF HOUSING FINANCE

Financial systems in South Asia have long been characterized by central control over directed credit. They have been dominated by government ownership of the commercial banks and of many of the specialized development finance institutions. The central banks, together with the Ministries of Finance, are responsible for much of the sectoral distribution of credit among government entities, public enterprises and the private sector. Typically, there is an extremely constrained role of private sector institutions: there is a limited competitive environment; there are gross inadequacies in licensing and supervision; and there are low rates of savings in financial institutions. Legal restrictions have inhibited the entry and expansion of private sector financial institutions, especially those specializing in housing finance.

All in all, the institutional structure has discouraged competition and the efficient operation of the financial system. The price to the national economy of stringent controls on credit has been inefficient allocation of credit and discouragement of financial sector mobilization of resources.

Because of these government controls and directives, financial systems in South Asia have been unable to transfer adequate resources to the housing sector: formal sector sources have been able to supply only one third of the potential demand for long term credit for housing.

The provision of housing finance in South Asia has been dominated by public sector lending institutions. They have not necessarily been the only lenders for housing ; but their policies have had a very strong influence on the structure of the sector[2]. Flows of formal sector finance for housing have been dominated by government transfers for housing, but these have been neither reliable, nor, given the overall levels of need, of any great magnitude.

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[2] Until recently, there have been no specialized non-government housing finance institutions in South Asia. The only exception was provided by the housing finance cooperative societies in India. Other institutions lending for housing have had a highly circumscribed clientele, and it is nearly impossible for lower income households and informal sector workers to obtain a housing loan from most of them. In most countries; it is theoretically possible for salary-earners to obtain loans from commercial banks. But because of banks' reluctance to make long term loans, they have tended to restrict the availability of housing loans just to their most favored customers. Certain employers--notably the commercial banks themselves--also provide loans to their staff members.

Many government actions, although well-intentioned, have had the opposite effect to what was intended. For instance, most countries have seen the establishment of some form of government housing banks to serve the poor and underprivileged. This goal, however, has often been interpreted as a mandate to relax financial discipline: the operating policies of these institutions were characterized by subsidized interest rates, lax underwriting criteria and poor attention to loan servicing.

DISINCENTIVES FOR PRIVATE SECTOR INVOLVEMENT IN HOUSING FINANCE

Affordability Concerns It has been a prime objective of governments to make housing affordable to the poorer parts of the population. Government actions, however, have had the effect of hurting the middle class. Government housing finance programs focused on the poorer groups; the private sector concentrated on serving the richest. Middle income households without access to inherited wealth, largely excluded from both systems, had to choose between foregoing the advantages of decent housing, building incrementally, and raising resources on disadvantageous terms,

By rationing credit, government policies have also often had the effect of depriving most of the poor of access to decent, affordable housing. As we now appreciate, there are many ways of improving affordability[3], including the facilitation and encouragement of longer-term and more efficient lending for housing, and the promotion of appropriate lending instruments. One of the easiest ways, however, for a government to hold down the price of housing to selected consumers is to decree that the rate of interest payable on housing loans be kept low. This has been a widespread practice in South Asia and elsewhere. But it has not been clear to policy-makers, at least until recently, that insistence on below-market interest rates places very severe constraints on the supply of finance.

Subsidized Interest Rates From the standpoint of managers of government housing finance institutions, below-market interest rates on government loans incur only deferred, marginal costs, but give immediate political benefits. The financial benefits of cheap loans go to the clients of the public sector lenders.These are assumed--often incorrectly--to be low income families. In the political climate of many South Asian countries, there is still much political mileage to be made from **being seen** to provide financial assistance to the poor, even though the actual number of recipients may be relatively small.

[3] Other, and better, means that may be used by governments to reduce housing prices include the following: stabilization of land prices by reform of land delivery policies and practices; adjustment of minimum acceptable physical standards for infrastructure, site layout and house construction; use of more appropriate building technologies for housing and infrastructure; use of less time-consuming institutional procedures; the encouragement of incremental construction, including self-help.

The costs of such generosity are borne over an extended period of time, unrelated to short-term political gain. The cost of subsidizing the loans is very rarely calculated; and because its magnitude is not known, it is usually not recognized as a cost. Even that part of the subsidy which is attributable to poor repayments may not be reflected in the budget of the housing finance institution itself.

The practice of subsidizing interest rates for housing loans could be sustainable only if either

(a) a country has sufficient government resources to meet all its housing needs, so that provision of housing finance can be a public sector monopoly; or

(b) involvement by the private sector in lending for housing is accepted by the government as necessary, but private firms can be required to give loans at less than market interest rates.

Neither of these conditions is true: governments cannot provide sufficient funds to meet even a fraction of the needs; and private financial firms cannot operate at below-market rates.

The arithmetic logic for holding to market interest rates is simple. Financial enterprises need to be able to lend their funds at a price somewhat above the cost of these funds. If only limited funds are available at privileged rates, then most funds must be raised from open financial markets, at standard rates of interest. It is the cost of these funds, plus a return on investment in proportion to the risks, that should determine lending rates, not short term political gain. Conversely, if rates are kept artificially low, the private sector will be unable to operate, except in a fairly insignificant way.

(Low interest rates also often fail to improve affordability to the low income families to which they are supposdly targeted, simply because many of the loans are taken over by higher income households, which have better access to government mechanisms for dispensing favors.)

It follows that maintaining interest rates below market levels severely limits access by most households to housing finance.

Poor Loan Recovery Another disincentive to entry of the private sector has been the high level of delinquency in government housing finance programs. This often was a matter of little concern to public sector program managers, who may even have seen a high default rate as an indication that their programs were reaching the most disadvantaged groups. There were neither penalties for high levels of default, nor incentives to increase the rate of repayment.

Private finance companies find it difficult to operate in a climate where default is condoned by their major competitors. (But experience has shown that it is not impossible: it seems to be the case that borrowers have considerably greater respect for and understanding of the culture of private finance enterprises than of public financial undertakings.)

Legal and Regulatory Factors Legal and other factors inhibiting the entry of the private sector into housing finance in South Asian countries include the following factors:

- The absence of laws or regulations which would allow them to foreclose mortgages in the event of default;
- the absence of a clear legal code which explicitly permits the establishment of specialist housing finance companies ; and
- a lack of public confidence in private finance institutions, especially when superficially similar organizations have proved themselves to be imprudent trustees of household savings.

NEW ATTITUDES

These practices--low interest rates and poor loan recovery, in particular--together with a weak regulatory framework and an ideological stance which saw housing as the prime responsibility of the public sector, served to inhibit the entry of private enterprise into the sector, other than for the service of upper income groups.

In recent years, however, propelled by national financial crises, stimulated by dialogue on "enabling strategies" for shelter and urban development, and with the internationally growing respectability of dealing with the private sector, South Asian governments have begun to re-examine their objectives with regard to housing policy, and to housing finance policy in particular. They found that thair housing finance systems, as they stood, were unresponsive to need, served only a small number of privileged consumers, and were a strain on tight public budgets. It needed only a slight leap of imagination to conclude that the solution lay in opening the sector to competition by the private sector. Privatization of housing finance in South Asia is about raising new capital and changing styles of management.

Several modes of privatization could have been used to expand access to the system and improve the level of service, including outright sale of state housing finance companies or engagement of private sector companies to manage specific activities. But South Asian countries have chosen the approach that is the most pragmatic and probably the most effective:

permitting and encouraging the entry of private enterprise into a system previously dominated by public undertakings.

The lead was taken by the private sector itself: by the Housing Finance Development Corporation (HDFC), of India. As will be seen in the following pages, this company has demonstrated that it is possible for a well-managed private company to operate and prosper in an environment that initially was largely hositle (competition from the public sector, an inadequate legal framework, mistrust by government of the private sector). The creation of HDFC was an entrepreneurial response to the failure of existing public and non-specialist institutions to meet sectoral needs for housing lending.

Risks to HDFC were high in the early years, since there was then no proof that a private company could operate in such an environment. There was neither effective supervision of housing lenders, nor even an efficient financial industry to support development of the infant company.

The new enterprise provided management expertise that was otherwise lacking, in a sector that had its own unique requirements. By demonstrating to the government and public that it was a responsible company implementing stated public policies, and by demonstrating to the private sector that it was possible to make a profit, HDFC consciously opened the gates to competition. Many new housing finance institutions have subsequently been created in India. Most are in the private sector but others, competing effectively, are in the public or "joint" sectors (owned by both private and public sectors). Indeed, by twinning with several other institutions--providing some equity capital, giving short term technical assistance, formatting of procedures, and, above all, lending its name as co-sponsor--HDFC itself has stimulated the growth of lenders that, over time, have developed into its competitors.

4. CASE STUDIES

India[4]

The Indian Financial System and Housing Credit

The Indian financial system is large and sophisticated, but monolithic. Only a few institutions have access to most of the country's financial resources, and most of these are government-controlled. These institutions are highly regulated and tend not to compete with one another. They act as instruments of government policy in that they allocate resources according to government directives rather than in response to market incentives. Government has tended to control interest rates, and to direct the allocation of much of the investment of financial institutions. Many of these investments are made at prescribed interest rates, implying varying degrees of subsidy. Low rates of loan recovery confer an additional, often very large, subsidy.

Until the late 1970s, the financial system provided relatively little credit for housing. Commercial banks typically provided mortgage loans valued at less than half of one percent of their total lending; even by 1982, mortgages accounted for little more than two percent of the total loans of banks and other financial institutions. Cooperative housing finance societies were active, but they, too, provided relatively small volumes of funds for housing. For the first years of the 1970s, other than these societies, the only specialist housing finance institution was the Housing and Urban Development Corporation (HUDCO). HUDCO had been established by the Government of India in 1970 with the principal objective of providing finance for the housing and urban development schemes of state governments and state housing boards. HUDCO was then, and remains, a wholesaler of housing finance and does not engage in any direct lending to households[5].

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[4] This section draws upon several sources, including unpublished work for USAID by Raymond Struyk, Robert Buckley and others (The Urban Institute), and from HDFC and National Housing Bank publications.

[5] HUDCO is still the largest government housing finance institution in India. Through loans to client institutions, it sanctions loan approvals for over half a million houses a year, with a current cumulative total of about 4.5 million units for which loans have been approved. HUDCO finances loans for new house construction, repairs and additions, and for settlement upgrading, and supports training and skill improvement programs. It also provides institutional finance for urban infrastructure programs in India.

With the paucity of institutions lending to individual households for house purchase, construction or improvement, as urbanization increased the commercialization of the housing process and thus limited the options for informal sector construction, and as budgetary constraints reduced the level of public investment in direct house construction, so levels of national investment in housing steadily declined in the 1970s.

The Housing Development Finance Corporation

It was in such an environment that the Housing Development Finance Corporation (HDFC) started operations in 1977, as the only institution in India then to provide retail housing finance to middle income households. The company was the brainchild of Mr. H.T. Parekh, one of India's outstanding figures in finance. His vision was backed by the Industrial Credit and Investment Corporation of India. Together, they found that conditions in India then were such that:

- there was a major need for housing finance, by households throughout the country;
- the imperatives of resource mobilization required an institutional structure that would command the confidence of investors;
- the domestic regulatory environment favored the creation of a mortgage bank, which would mobilize wholesale resources for retail lending (as distinct from a savings-and-loan type of operation, raising its resources direct from individual household savings);
- managerial input would be critical to the success of the new institution; recruitment of young talent would be necessary to be able to take on operating practices not normally found in development banks;
- success would require a lean and efficient organization;; strong customer orientation would be needed;
- the institution would be market-oriented, seeking funds and designing products that met with market preferences. Success would depend on attention to both sides of the balance sheet: resource mobilization and mortgage lending.[6]

Although the paradigm that the founders were aspiring to was a private sector model, it was not considered realistic, in the prevailing environment in India at that time, to expect to gain approval to form a purely private company to operate

[6] Nasser M. Munjee. "India: The Evolving Structure for Housing Finance". HDFC, August 1990.

nationally. The initial shareholding structure thus incorporated both public and private sector; the company had an autonomous board of directors, and appointed a professional management team. Involvement of the International Finance Corporation and of the Aga Khan Foundation as shareholders lent further credibility to the new company. Other equity contributions were made by the Indian business community and the Indian public. The participation of respected Indian parastatal finance companies identified HDFC institutionally and legally as a Development Finance Institution.

As time passed, HDFC widened its shareholding to embrace more private sector companies and members of the public. At present, some 53 percent of the company's shares is held by individuals; some 23 percent is held by companies, mainly in the private sectors; and the remaining 24 percent is held by banks and other financial institutions, mainly in the public sector.

From the beginning, HDFC attempted to develop a market-oriented housing finance operation: the cost of credit was directly related to the cost of resources mobilized from the market. HDFC was able to access a flow of resources both obtained on normal market terms and derived from the directed credit system: it was able to exploit the high interest rates charged to non-favored lenders by commercial banks, and provide profitable intermediation for the unserved urban household sector. Unlike other Development Finance Institutions, however, HDFC did not receive authority to issue government-guaranteed debt instruments. It has tapped into a wide variety of domestic and international funding sources, including USAID's Housing Guaranty Program (see Annex I). HDFC's domestic resource mobilization strategy has essentially consisted of identifying niches in the highly regulated market, and designing appropriate instruments to satisfy the needs of a diverse group of lenders and investors.

This strategy has preserved a dynamism for HDFC that is not characteristic of many other Indian financial institutions.

Nasser Munjee of HDFC points out that

> "this approach - a market orientation within a constrained system depends heavily on the managerial practices within an organization, and the ability of the organization to be adaptable to the external environment as well as to envisage methods by which a constrained system - through its own logic - could be made to work for the organization. The incentive to do this depends heavily on **not** possessing a predetermined source of funds which can be depended upon for financing future operations. It is precisely the uncertainty of the market that keeps internal systems alive and antennae tuned to market developments."

HDFC is also very proud, with justification, of the variety of lending instruments that it has developed in response to market demand.

The company has grown quickly and steadily over the years. It now employs over 700 people in 26 offices located throughout India. It has financed housing for over 500,000 households in more than 2,100 towns and cities throughout the country, and disbursed loans of Rs. 6,700 million ($ 270 million) in the year 1990/91.

HDFC has amply demonstrated that housing finance can be a profitable and self-sustaining business.

Sectoral Change in the 1980s

Since the mid-1980s, the structure of the Indian financial system has been undergoing change, through a gradual and piecemeal liberalization. There has been a progressive dismantling of financial structures, and the country is moving towards a system of market rates of interest, allowing greater freedom and giving more opportunities for institutions to raise capital. Rates have been increasing and, simultaneously, the competition for funds has been growing. New institutions have been created to serve the increasingly sophisticated financial needs of trade and commerce. India is experiencing greater consistency in economic policy than hitherto.

There have also been changes in policy towards institutional roles for the delivery of housing services. By 1985, the Government -- in the Seventh Five Year Plan -- stated, for instance, that "the Government's role in the field of urban housing has perforce to be promotional. The major effort will have to come from the private sector." The Government's role was "the encouragement and support of housing finance institutions that promote the channelling of private resources into housing in a constructive way". Policy statements increasingly began to stress the need for partnership between public and private sectors, and to de-emphasize the traditional role of the state as provider of housing services; the National Housing Policy assigns a dominant role to the private sector.

In this environment, HDFC remains the leader in the provision of market-oriented housing finance, but is rapidly being joined by new housing finance institutions and by the subsidiaries of government-controlled financial institutions. Both public and private institutions seem to be won over by the twin attractions of HDFC's healthy profits and its success in meeting the housing finance needs of low and middle income households. Indeed, there are now over 30 market-oriented housing finance companies serving India, and very many more companies registered but not (yet) operational.

The National Housing Bank

It was in response to the emergence of housing finance as a major sectoral force that a new housing finance regulatory institution, the National Housing Bank (NHB), was established in July 1988.

The NHB was created to foster development of a high volume housing finance system to serve households throughout most of the income range. As a wholly-owned subsidiary of the Reserve Bank of India, the central bank, the NHB enjoys considerable independence from the government. As an apex institution, it does not lend directly to households or developers, but rather operates through existing financial institutions, including commercial banks, housing finance companies and housing finance cooperatives. Broadly speaking, the NHB has three missions:

(a) to promote expansion of a market-oriented housing finance system;

(b) to mobilize additional funds for lending for housing, and for associated land and infrastructure projects; and

(c) to supervise and regulate housing finance institutions so as to ensure the financial health and stability of the housing finance system.

Consistent with a shift in the approach to the housing sector by the Government of India, the NHB is trying to implement a new vision of the housing finance system, with the government acting more as a facilitator of resource mobilization and less as a direct participant. Its view is that local housing authorities, traditionally responsible for the construction and financing of housing for lower income groups, should restrict themselves to the preparation and allocation of serviced sites. Construction and financing of housing should be left to the more efficient practices of the private sector, including households, employers and developers.

Since its foundation, the NHB has moved with alacrity in a number of areas to expand and strengthen the housing finance system :

- In terms of promoting housing finance companies, the NHB quickly issued guidelines setting out the requirements for a company to be registered with the NHB -- an essential step to becoming qualified to participate in the NHB refinance program, and a facilitating step for obtaining the various tax advantages associated with being a recognized housing finance company. In 1990, the NHB began -- with the support of USAID (see Annex I) -- to refinance small and medium loans originated by qualified housing finance companies, banks and housing finance cooperatives.

- As for mobilization of funds for the housing sector, the NHB has moved on two fronts. First, it launched a contract savings scheme, under which participants save regularly for five years and then obtain a mortgage loan for two to four times their savings. Secondly, NHB has tapped into various sources of funds to support its loan refinancing operations. To this end, it has been issuing Capital Gains Bonds, availing itself of other government-guaranteed and directed credit, and drawing on foreign sources. In addition, the NHB has recently been given new powers by the central bank to mobilize resources by marketing its own mutual and pension funds.

- With regard to supervision and regulation of the housing finance system, the NHB has taken over supervisory functions from the central bank and sets qualifying standards for housing finance companies. Among other things, it has issued directions concerning the acceptance of deposits and has established maximum loan-to-value ratios for mortgage loans.

Achievements

Considerable advances have been achieved in the development of India's housing finance system over the course of a relatively short space of time. Among others:

- The number of branches of recognized housing finance companies has been growing in recent years at 60 percent a year. Most of these companies are privately owned. The total volume of housing loans increased from Rs. 300 million in 1980/81 to Rs. 7,100 million in 1989/90.
- An increasing number of the clients of housing finance companies are lower income households; the share of the loan volume going to below-median income households increased from 27.9 percent in 1985/86 to 33.5 percent in 1990/91.
- Housing finance, having grown from a negligible percentage a decade ago contributed mainly from public sector sources, now contributes over 15 percent of total housing investment in India, predominantly raised by the private sector.

Case Study : Pakistan

The Financial Environment

Historically, the financial and institutional environment of Pakistan has not been conducive to the growth of housing finance nor, consequently, to the development of the housing sector.

Pakistan faces a serious resource mobilization problem: the private savings rate is low, at a time when the Government's budgetary capacity to fund economic development is overstretched and the need for domestic resources in growing rapidly. To encourage better domestic resource mobilization and to improve allocative mechanisms, the Government is committed to the development of market oriented financial institutions.

Housing finance has not performed well in Pakistan. Housing investment contributes 2.7 percent to GNP, well below the average for low income countries, and the proportion has been falling. Housing production as a proportion of gross capital formation is only 9 percent, less than half the figure in comparable developing countries. There is little savings mobilization by formal sector financial institutions directly from households.

Like other elements of the financial sector in Pakistan, housing finance has been dominated by government entities. The House Building Finance Corporation (HBFC) is the principal government institution in the sector, supplying about 80 percent of the small amount of formal housing credit available. Its charges for housing loans are below cost, and HBFC has a large volume of delinquent loans, on which it accrues interest. As a result, its real rate of return is very low. Such subsidization of interest rates is highly inefficient: it produces distortions in the money market, contributes to poor loan recovery and, most importantly, inhibits private sector investment.

Observers have noted the following problems to be critical for the sector :

1. Under the past system of directed credit, housing has always had a low priority. The supply of credit has not kept pace with demand. However, the Government did not seek credit for the sector elsewhere. There were no licensing provisions for market-oriented housing finance companies.

2. There was a lack of confidence on the part of investors in private housing finance institutions. The private sector feared competition from subsidized lending associated with government programs; and lengthy foreclosure procedures have made loan collection a difficult process.

3. Equally, there has been a lack of confidence in private sector financial institutions as a whole: people, rich and poor, have lost their savings to ineffectively regulated private finance companies.

4. Access to credit by the private sector has been restricted by the Government's need to borrow locally, as a result of the growing budget deficit.

5. The private sector has played almost no role in financial intermediation, since private banking is prohibited.

Development of a Market Oriented Housing Finance System

In recent years, the Government of Pakistan has taken a number of steps to liberalize the economy. Plans include deepening financial markets and expanding private investment and savings. Reforms are designed to support domestic resource mobilization for shelter, and to put mortgage and home improvement lending on a market-oriented basis. In the shelter sector, reforms are intended to create an enabling environment in which a market-based, private sector finance system would mobilize resources for shelter and provide mortgage and construction credit.

By proposing the establishment of a regulatory framework for a market oriented housing finance system, the strategy addresses the issue of public confidence, crucial to domestic resource mobilization, and of the mitigation of risk which is necessary for private capital to be attracted to long-term mortgage lending. Its objectives are:

- to protect the public from the consequences of fraudulent bankruptcies
- to foster growth and diversification
- to ensure the financial integrity of housing finance institutions
- to restrict conflicts of interest
- to ensure the proper management of risks.

Achievements in last twelve months include the issuance of Statutory Regulation Orders which provide a legal framework for private sector housing finance companies, and the establishment of a licensing process. The private sector responded vigorously and positively to the opportunity to set up housing finance companies: 24 firms, mainly in the private sector, applied for licenses, and several of these firms anticipate being able to open for business this year. The applicants include Citibank, which has extensive housing finance experience in the region; the Pakistan Industrial Credit and Investment Corporation, with backing from the IFC, the Aga Khan Foundation and the Commonwealth Development Corporation; the National Investment Trust; and Jaffer Brothers, a well-respected trading firm with widespread branch operations.

Case Study : Sri Lanka[7]

Some 80 percent of Sri Lankans live in rural areas. Their houses are generally built with locally-available materials, but cash is required for the purchase of roofing sheets or tiles, doors and window frames, and for payment of the master craftsman.

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[7] The first part of this section uses material from an article by Babar Mumtaz, "How Sri Lanka is tackling its housing finance problems", in **Housing Finance International**, May 1987.

Many households have been prevented from even considering building a house by difficulties in accessing even the small amount of cash that would be needed. Housing finance is as necessary in a rural as in an urban economy.

Housing has been a high priority for the Government of Sri Lanka: in order to assist these households, it made small loans available for a variety of housing needs, through its Million (now 1.5 Million) Houses Programme. Finance was made available for anything from house construction or improvement, through installation of a well or toilet, to the payment of survey fees. The loans were made available by the public sector National Housing Development Authority (NHDA), and funded from the NHDA's annual budget allocation. In the early 1980s, processing of the loans was the responsibility of village-level societies, Gramodaya Manadalas: loan disbursements and supervision of construction were generally well managed, but relatively little attention was paid to loan recovery procedures. Mumtaz reports, for instance, that at the end of 1984 large numbers of families had been helped to build their homes. However, loan recoveries at that time averaged only 43 percent; in some districts, less than 10 percent of the amounts due had been recovered.

In recognition of this problem, the Government decided to use the Thrift and Credit Cooperative Societies, local non-specialist savings and loan associations, to administer the program as agents for the NHDA on an experimental basis - the "Kandy Model". (The Thrift movement was founded in 1906 ; it presently comprises some 6,000 primary societies, with over half a million members throughout the country.) The Thrifts assumed responsibility both for the normal credit review, disbursing the housing loans on behalf of the NHDA, and for recovering repayments from the borrowers. With the advantage of the decentralized operations of these community-based organizations, repayment rates for the NHDA loans rapidly and dramatically increased. Utilization of the Thrifts also had the effect of reducing the cost of financial intermediation by utilizing informal financial techniques (and volunteer labor).

The pilot experiment was acknowledged to be successful, and much of the NHDA's rural lending was soon being channelled through the Thrifts. The expanded program was politically popular, and continued to be successful, especially insofar as recovery rates remained high. Demand for loans under this program was strong. However, as its funding was provided by the Ministry of Finance through the NHDA's annual budgetary allocation, it was difficult to increase the volume of funds available for lending. Other channels for housing finance, did exist, to be sure: the State Mortgage and Investment Bank, and the Housing Development Finance Corporation, both public entities, were doing a some what limited amount of lending, primarily to middle income urban households. Some other housing loans were available through the banking system, predominantly to higher income households and usually for terms of only a few years.

With the pre-eminence of the directed credit system in Sri Lanka and the rationing that this implied, most housing finance was still being provided by the informal sector. The formal housing finance system was able to serve only a small and thereby privileged segment of the population. A study for USAID estimated that, in 1988, formal sector finance provided some 21 percent of total investment in housing, but only about 13 percent of the calculated need.

The housing finance system, such as it was, received a severe set-back in 1988 when, as a poverty relief measure, the poorest households borrowing from the Thrifts/NHDA program were forgiven repayment of their loans. The problems arose when other, higher income, households borrowing under the same program did not understand that their own housing loans were not cancelled simultaneously. It soon became impossible for the Thrifts to make any recoveries, or to meet their own repayment obligations to the NHDA.

This event merely served to complicate the already-vexed question of how to increase the flow of resources for shelter lending. At the heart of the problem was the persistence of subsidized interest rates for housing: existing organizations became decapitalized, and were unable to raise new funds for on-lending other than through the Government budget or the directed credit system. The public sector lending institutions were allocated a finite and decreasing volume of funds for housing. The problem was exacerbated by weak credit discipline among low income borrowers, and segmentation of the market into public and private responsibilities, with the public sector being seen as taking care of the housing needs of the poor, and the private sector providing market rate housing finance for a tiny upper income group.

The availability of lending capital at concessionary interest rates had inherent weaknesses that crippled the financial system which was intended to serve the poor. No matter how carefully the government sought to conceal its contributions, cheap money was perceived by recipients as "government money", which carries low repayment obligations. With that burden, such a program could not but damage the integrity of a self-sustaining housing finance system.

Propelled by a deteriorating financial situation, in 1989 the Government announced the three principles that were to guide the formulation and implementation of its policies in the financial sector in subsequent years:

1. The private sector should have primary responsibility in generating growth;

2. The role of the public sector should be reduced and its efficiency increased; and

3. The Government should take prime responsibility in ensuring that the benefits of growth are equitably distributed among the population.

With respect to housing finance, this translated into the principle that housing loans should be made at market rates of interest, supplemented where necessary by explicit government grants to the poorest households. It became accepted that a grant should be a grant, and a loan should be a loan on commercial terms.

The central concept of the new government program, then, is to provide intended subsidies for low income housing, now not as below-market loans, but as outright grants. The poorest beneficiaries will receive unconditional grants earmarked for housing. For other financially disadvantaged households, provision will be made for the disbursement of "bridging grants", supplementary to and conditional on utilization of market-rate loans. Poor households that qualify to receive bridging grants would then be able to borrow additional funds, as needed, on standard terms in the market. The grant may serve to reduce the risk to lenders by establishing some up-front equity, thereby helping to collateralize the loan (provided the lender can in fact take possession in case of default). Affordability criteria are respected since monthly debt service obligations of borrowers are determined on the basis of a smaller loan at market rates. Subsidies, previously incorporated into the reduced interest rate and of uncalculated magnitude, now become transparent, as a line item within the regular government budget.

All housing loans, by all financial institutions, are now to be made at market rates of interest. The policy will thus allow fund mobilizers and loan retailers to set terms based on market conditions, not social criteria: financial resources flowing into the housing sector will offer a competitive return for private lenders. It is expected that the volume of lending, especially by the private sector, will increase significantly; that it will be distributed to households in income groups lower than hitherto; and that loan terms will increase in length.

The institutional structure is notably different from that planned in other South Asian countries, in that most of the lending is expected to be made by non-specialist financial institutions, particularly by cooperatives and local associations. The two specialist housing finance companies -- which are due to be privatized -- will continue to play an important, but not a formative, role. Where specialist housing finance institutions are set up in other countries because of their strengths in mobilizing resources and in the delivery of housing loans, it is intended that parallel efficiencies can be achieved in Sri Lanka through the integration of community-based organizations within the overall housing finance system.

Case Study : Nepal[8]

The only formal institutional source of finance for housing in Nepal is the network of commercial banks, whose collateralized personal and business loans may be used for housing purposes. It is possible to obtain loans for housing from the informal sector, but at interest rates that are typically double those of the commercial banks. Employees of banks and a few industrial enterprises are privileged to be able to get cheap loans for housing.

There is no formal housing finance system in Nepal, and relatively little institutional credit is available for housing. Yet there is a good deal of construction being undertaken in Nepal. However, largely because it is virtually impossible to borrow substantial sums of capital, housing construction is generally undertaken incrementally. First, land is procured: for urban dwellers, the process of identification and purchase of land may take several years. Then, the foundations and ground floor are built, usually taking about one year to complete. Houses are then completed over a period of several more years, addingrooms and floors as resources are obtained.

Much of this construction is financed from personal savings. Other sources of funds include family gifts, often through marriage; family loans, usually interest-free; or withdrawals from the Provident Fund.

Despite the access that some people have to informal capital, this system excludes many families from being able to borrow loans, and raises the cost of loans to others: many people are effectively required to choose between a new home and other equally important necessities of life.

In recognition of this, the Ministry of Housing and Physical Planning recently set in motion the development of a new specialized housing finance company. This is to be owned jointly by public and private sector entities, and is to be managed according to market principles. The company, the Nepal Housing Development Finance Company (NHDFC), was created in 1990, its charter prepared, and a Board of Directors nominated. Over the following months, seven institutional investors provided start-up and operating capital through the purchase of shares.

The company was established under an Act that requires 60 percent of shares to be held by private sector investors. However, because the company is breaking new ground (no company of any significance has been registered under the Finance Companies Act, and no precedents have been established), this condition has been waived for the time being : most of the shares are presently held by public and parastatal institutions, a minority by a private sector bank. It is intended to raise additional

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[8] This section draws heavily on unpublished work for USAID by Daniel S. Coleman, PADCO.

capital by a public offering once the company has established an operating record, to achieve a private sector majority shareholding, thus to comply with the letter of the law.

The company has not yet started operating and, at the time of writing, had not approved a business plan. It remains to be seen the extent to which the NHDFC will be free of central government directives, and to which it will be able to operate according to market principles and to utilize sound financial management techniques. However, the signs are favorable. The Articles of Association, for instance, state that the company will not lend below market interest rates. Observers note that the Central Bank does not normally impose rules and regulations that significantly impede commercial banks from operating effectively and profitably.

5. LESSONS LEARNED

In South Asia, India is leading the way with private sector involvement in housing finance, without having abdicated government responsibility for supervision and regulation of the sector. Other countries of the region, noting the political cost of restricting access to housing finance, and seeing the successes of India, are systematically starting to follow a similar path, tailored to their specific national circumstances.

In the light of a decade of experience in India, what are the benefits that have been gained from private sector involvement, and what have been the costs?

The usual objectives of privatization[9] include the lowering of costs and increasing of efficiency, increasing access to new capital, satisfaction of consumer preferences, innovation, and improved decision making. Arguments against privatization include raising of prices to some consumers, the deprivation of service to remote and unprofitable areas, greater corruption of politicians, and the concentration of economic power in a few hands. These arguments will be evaluated in turn, against India's own experiences.

LOWERING COSTS AND INCREASING EFFICIENCY

No studies have compared the costs of originating and servicing housing loans made by public and private agencies in South Asia. Two conclusions can, however, be drawn from the observation that, in their desire to minimize costs, HDFC and its competitor housing finance companies have succeeded in keeping spreads down to around 2 percentage points. (But note also that housing finance companies in India also charge origination fees, typically 1.5 percent of the value of the loan; the spread does not, therefore, represent the whole cost of overheads, profits and risk.)

First, this spread is probably as low as has been achieved anywhere else in the world. It indicates that Indian companies have achieved a much lower cost of doing business than companies in most other countries of the world. (HUDCO, the government-owned wholesaler of housing loans in India, also has overheads which are extremely low.)

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[9] This list is taken from a paper by Jim McMaster, 1987, quoting Dr. Madsen Pirie, **Privatisation : The Facts and Fallacies**, Centre 2000 Ltd., Sydney, 1985.

Second, note that all housing finance companies in India--in the private sector, and in the joint and public sectors--are successfully doing business on similar terms. In the absence of information to the contrary, it must be assumed that HDFC has set the price standard. For all practical purposes, HDFC's precedent has induced other housing finance institutions to match its level of efficiency of operation, and to pass on the benefits of this efficiency to their customers.

At the same time, it is true that the entry of the private sector, necessarily operating on market terms, has increased the supply of funds for housing, but has also raised the price of loans above the subsidized rates previously on offer from the public sector. This has been the inevitable consequence of the decision to expand the system to serve the whole population, not merely a privileged few.

INCREASED ACCESS TO NEW CAPITAL

One of the main reasons for governments to encourage private sector participation in the sector is to relieve the financial burden on them to meet the bulk of sectoral needs. Throughout South Asia over the last two decades, there has been a tendency for governments to cut back the amount of capital earmarked for housing from the Treasury. India has found that the availability of capital for the sector has increased dramatically as new private companies start operations. New savings instruments have been introduced. More resources have been accessed on a wholesale basis from the capital markets, at competitive prices. And doubtless as an indirect result of increased demand and higher political visibility, more funds have also been obtained from directed credit sources. In sum, lending resources for housing finance companies in India have increased at a remarkable rate: averaging 39 percent a year over the last decade.

SATISFACTION OF CONSUMER PREFERENCES

Monopolies, whether of the public or private sector, naturally tend to restrict consumer choice. Housing finance monopolies or oligopolies in South Asia are no exception: there is no compulsion to efficiency or excellence on the part of the public sector lenders. (But, in fairness, it must be acknowledged that a few of Asia's public sector housing finance institutions have been headed by people with absolute dedication to quality, and commitment to service to their clientele.) The public sector lenders use limited means of mobilizing funds (generally relying exclusively on established, inelastic sources of directed credit), and rarely offer any savings instruments to individual or corporate members of the public. The monopolies promote only one kind of mortgage loan. Worse, it tended to be extremely difficult for consumers actually to borrow these loans, requiring either months of their patience as well as familiarity with government bureaucracies, or else special access to politicians or officials who had the power to approve the grant of loans. (There were, of course, honorable exceptions to these generalizations, but they tend to prove the general point.)

Opening the sector to private sector competition has indisputably widened consumer choice. Borrowers can select the type of loan that most suits their income profile, and can choose the institution that is most convenient for their needs. Savers' choice has also been widened, with a variety of schemes on offer from various housing finance institutions.

Residual central controls over housing finance institutions in India have, however, dampened price competition. This is because institutions obtaining refinance from the National Housing Bank are required to offer small and medium loans to members of the public at identical interest rates. The institutions are permitted to charge different levels of front-end fees, but most have elected to charge similar fee rates--the highest permitted by the National Housing Bank.

In consequence, real competition has developed between housing lenders with regard to product (savings and loan instruments) and service. The finance institutions now have a long menu of different types of loan on offer, tailored to borrowers' preferences and circumstances. HDFC's challenge has eagerly been taken up by its competitor organizations in both the public and private sectors. Simultaneously, organizations are working to improve their image, making their offices and procedures more customer-friendly, and competing to reduce the time taken to process applications and originate loans.

INNOVATION

One particularly interesting form of innovation has been developed by the joint sector company, the Gujarat Rural Housing Finance Corporation, known as GRUH. GRUH lends exclusively to households in villages and small towns. This is a group of borrowers barely reached by other housing finance agencies, because of the presumed risk and high cost of doing business in isolated settlements and with non-salaried people (private sector concerns), and because of the physical and institutional difficulties of reaching this scattered population (public sector agency concerns). GRUH makes a large number of loans for home improvement and extension: "character loans", rather than mortgage loans. And it makes a significant proportion of its loans to individuals in the informal and agricultural sectors, on the security of work-based cooperative-type guarantees.

GRUH, after only a few years in business, makes a profit. It has just declared its first dividend to shareholders. Groups in other parts of India are seeking to emulate GRUH's example.

Other housing finance institutions, throughout the region, are exploring ways of doing business with NGOs as a conduit of funds to informal sector borrowers--see Annex III.

Private sector lenders have also introduced technological innovations, particularly by computerizing their operating functions. A number of Indian companies have now automated their loan accounting and processing procedures. This directly benefits consumers by reducing the delay between a company receiving a completed loan application and approval of the application, from several weeks to a few days.

IMPROVED DECISION MAKING

Jim McMaster points out that decision making in the private sector is driven by economic factors which reflect consumer demand for products and services, and consumers' willingness to pay for them. Public sector decisions, on the other hand, are made more according to political criteria, based on factors related to short-term political advantage.

He writes that "the impact of decisions [by public sector organizations] on marginal electorates, on government popularity with [undecided] voters and special interest groups is often more important than the realities of supply and demand and the need for cost recovery pricing policies for public goods and service. Political decision making can lead to the misallocation of public funds to secure political ends rather than provide efficient public service." This is as true of South Asian housing finance as of other sectors.

RAISING OF PRICES TO SOME CONSUMERS

It is a real fear that privatization--in any sector, and of any service--will hurt the poor. In the context of housing finance, the involvement of private enterprise necessarily involves an upward restructuring of interest rates, to a level which has been described by public sector advocates as "exploitative". The adjective "exorbitant", too, is often seen in the press and popular literature to describe interest rates for housing, which, in other sectors, are considered normal.

High interest rates are commonly believed to be unaffordable to the poor. This is in contrast to the evidence that many poor people, excluded from the formal housing market by inappropriate government policies, turn to use the informal credit market, especially for home improvements and extensions. There, they elect to pay rates considerably **higher** than those charged by formal sector financial institutions.

The informal sector generally charges interest rates that are higher than those of the formal sector. Sometimes these high rates do reflect monopoly conditions, but more often they accurately reflect the greater costs and risks assumed by informal lenders. If market rates in the formal financial sector are lower than in the informal sector, this is because of economies of scale enjoyed by the formal sector, its easier access to wholesale finance, a more risk-averse approach to credit finance, etc.

It also needs to be pointed out that the principle of utilizing market forces, relying on lending at market interest rates, is not inconsistent with the provision of subsidies for that part of the population in real need. As a case in point, the USAID-supported program of the Government of Sri Lanka demonstrates the compatibility and mutual supportiveness of market financing and well-targeted subsidies (Annex I). Note also that private firms in India have chosen to provide smaller loans at lower prices so as to cross-subsidize their poorer borrowers.

It is true that companies borrowing at market rates of interest cannot profitably reach the poorest of the poor, but experience in India has shown that it is possible and profitable for private companies to serve low income groups. Indian data suggest that, in recent years, housing finance companies have increased their lending to below median income households somewhat faster than total lending has grown. As total lending by the surveyed group of companies has grown by 44 percent a year, this is a not inconsiderable achievement. It explodes the myth that private companies deal only with the rich.

DEPRIVATION OF SERVICE TO REMOTE AND UNPROFITABLE AREAS

It has long been argued that the private sector, motivated by the expectation of profits, will locate its activities only in lucrative, high income centers of population, leaving the remoter areas unserved. If the private sector **supplanted** the public, this would presumably be a real disbenefit of privatization. However, the mode of privatization of housing finance in South Asia has been for the private sector to **complement** public sector activities.

It is true that housing lenders--as other private companies--naturally concentrate their early activities in the large urban centers, since this is where most business may easily be generated. However--to revert again to the case of India--experience has shown two relevant effects which should tend to dispel fears about the impact of privatization on geographic access.

Firstly, as India's metropolitan centers have become adequately served, in the sense of having a choice of housing lender, so private housing finance companies have begun to open branches in small towns. In 1980, there were only 6 branches of housing finance companies in India, all located in the largest cities. By 1990, there were 136 branches. As housing finance companies grow, they have expanded extensively across regions rather than intensively in a given city. The general pattern has been for companies initially to establish a branch in one or a few large cities, and then to expand their outlet network into the medium-sized settlements surrounding the metropolitan centers. As individual companies mature, their largest growth occurs in less dense areas.

The second effect is that the private companies have seen it as their responsibility to provide service to remoter areas--providing extension officers, in vans or on motorcycles, to visit rural areas on a periodic basis. It may be, in some cases, that this is done to fulfill societal obligations. It may be that this service offers good publicity and PR to the companies. But it is probable, too, that marginal profits are to be made from this low cost service. HDFC's own publicity material quotes that it provides loans to borrowers in 2,100 towns and villages: no small achievement from a base of 26 branch offices.

CORRUPTION

It is said that privatization gives opportunities to politicians to set themselves up in businesses protected from competition, or to give political favors by licensing the establishment of oligopolistic profit-making activities. This may be a real risk ; South Asia is not immune from charges of this nature, although the risk is probably higher in sectors other than housing finance.

However, opening the housing finance sector to competition does, at the same time, diminish the opportunities for politicians and government officials to use their patronage by giving low cost housing loans to favored individuals or groups. Political control of public sector housing finance institutions is not a guarantee of incorruptibility. On the contrary, the case could be made that politicians direct much of the activity of these institutions and thereby corrupt the system of beneficial distribution.

CONCENTRATION OF ECONOMIC POWER

Privatization can result in a concentration of economic power in the hands of big business with no interest in the social welfare aspects of public service. This has not been the experience in India, particularly as private sector competition has encouraged the emergence of public sector corporations which have elected to engage in housing finance both as a profit-making activity and to help fulfill their social mandates. The risk of concentration of economic power might have existed only if true competition were not encouraged, and if government did not retain its proper function of supporting the neediest part of the population.

IN CONCLUSION

The case has been made for the promotion of competition in the sector, and for the facilitation of the entry of private enterprise to the business of housing lending. However, one final note of caution should be added. That involvement of the private sector so clearly brings benefits does not mean that there is no role for government. On the contrary, government will remain responsible for important aspects of sectoral control and development, including the following:

- ensuring the neutrality of the interest rate and fiscal environments (the maintenance of a "level playing field") ;
- supervision and regulation of entry to and exit from the sector, and of its operations ;
- the provision of well-targeted and transparent grants for housing, since a housing finance system financed exclusively at market rates cannot reach the poorest of the poor: these people will always need government support and assistance;
- the provision of technical assistance and training for the sector, where it is not otherwise provided, such as by trade associations ; and
- addressing supply-side constraints to the provision of affordable housing for their people.

It has conclusively been demonstrated that allowing and encouraging the private sector to complement and compete with the public sector in housing finance has greatly expanded the number of households with access to housing loans. Individual welfare has been improved, and economic development enhanced. Experience has shown that national social goals are not inconsistent with financial goals of the private sector. Both can, and have been achieved.

ANNEX I : USAID'S HOUSING PROGRAMS IN SOUTH ASIA

Capital assistance from USAID for shelter programs is provided in the form of Housing Guaranty (HG) loans. With this mechanism, the United States government provides guarantees for loans from private American investors to institutional borrowers in other countries. The term of a typical HG loan is up to 30 years, with a 10 year grace period on repayment of the principal. An important condition of every loan is that its benefits must be affordable to households below the median income. In order to enhance the developmental benefits of HG loans, they are customarily supplemented by government-to-government grants for training, seminars, information, advisory services and research studies.

Within Asia, USAID places emphasis on expanding the access of low income families to services and housing finance, and on improving the quality of the urban environment.

The housing finance programs in South Asia are summarized below.

In addition to undertaking country programs of capital and technical assistance, training and research, USAID carries out a number of regional activities relating to shelter and urban services. These include the coordination of collaborative environmental activities, and provision of advice on disaster mitigation and preparedness. The Regional Housing and Urban Development Office for Asia (RHUDO/Asia) uses workshops and publications as an important tool in developing awareness of important shelter and urban issues, and for the sharing of success stories.

RHUDO/ Asia works with institutions throughout the region to develop and strengthen local training capacities in housing finance and urban development. For instance, a course on Effective Housing Finance was held in Bangkok in January 1991, co-sponsored with the Government Housing Bank, Thailand and the Fels Center of Government, University of Pennsylvania. Intended, among other things, to increase participants' appreciation of alternative ways of delivering housing finance, it was attended by 50 officials of public and private housing finance institutions in Asia. Other seminars in the region have included those on market towns, municipal finance and management, and land issues. Some of these activities are co-sponsored with other donors or national intitutions. RHUDO/Asia also holds an annual policy seminar in the region; in 1991, the theme of the seminar was Improving Urban Management Through Decentralization.

In addition to supporting training events in Asia, policy-makers and staff in the sector's public and private implementing agencies and organizations are sponsored for a variety of courses and study tours in the United States.

RHUDO actively supports several activities jointly with UN agencies. Prominent among these is the Asia-Pacific Coalition of Housing Finance Institutions. This is a grouping of leading housing finance institutions, which has the aims of developing ties among public and private sector institutions in the region, to help build capacity in housing finance by sharing experiences, approaches, technologies and success/failures in housing finance. The Coalition is described in some more detail in Annex III. RHUDO's information exchange includes the publication of a periodic newsletter, "Asia Perspective". Issues focus on specific subjects of topical concern, which in 1991 included housing finance and the urban environment.

INDIA

The housing finance system in India has been substantially transformed over the course of only a few years. In the early 1980s, it was characterized by extensive government control and a high degree of segmentation; formal housing finance reached only a small proportion of urban households. With the beginning of the 1990s, the essence of a structured system is in place. Directed credit is gradually being supplanted by reliance on market forces for mobilizing domestic resources. Housing finance has benefited from the creation of the National Housing Bank (NHB) to regulate and promote the sector. In the last few years, too, India has witnessed the birth and infancy of a large number of outlets for housing loans. Simultaneously, affordable housing finance is becoming accessible to an ever-larger number of households throughout the country.

USAID is proud to have been associated with this transformation. USAID's intent continues to be to assist with the development of a market-oriented housing finance system which is capable of raising capital from donestic sources and which provides long-term shelter finance to a wide range of families, particularly to lower income households.

Our program in India started formally in 1981, with the first of several projects which gave assistance to the Housing Development Finance Corporation (HDFC). This private sector mortgage bank has since grown into a multi-billion dollar housing finance operation and is a model for housing finance companies in India and the region. HDFC no longer needs capital assistance from USAID, but has become a partner with USAID in providing training to other institutions in the region.

Currently, USAID's principal counterpart institution in the shelter sector is the National Housing Bank (NHB), which was created in 1988 as India's apex housing finance institution. An agreement has been signed with the NHB to continue this program, which provides financial support to emerging housing finance companies. The "Housing Finance System Program" is designed to assist the NHB to increase the availability of formal housing finance to lower income households nationwide. The program seeks to develop a system of market-oriented housing finance companies ; capital assistance is provided through the refinancing by the NHB of loans made by private and joint sector companies. This scheme provides an incentive for these companies to make small loans that are affordable to families below the median income.

USAID has guaranteed loans of $ 125 million to HDFC and, more recently, has approved $ 100 million Housing Guaranty program agreements with the NHB. This latter program is complemented with some $ 7 million in grants for technical assistance and training.

PAKISTAN

There are currently very limited opportunities for Pakistanis to borrow for buying or building their own homes. The opportunities which do exist are often for subsidized loans, which are in short supply. A USAID project seeks to help the Government of Pakistan to overcome these constraints through the creation and promotion of private sector housing finance companies. These companies will mobilize savings and investments for all types of housing. To create these institutions, however, the policy environment must change in certain significant areas in order to permit the companies to provide effective financial intermediation services.

The USAID project therefore focuses on a set of policy reforms to create an "enabling environment", in which a market-based, private sector finance system will mobilize resources for shelter, and provide mortgage and construction credit. Among other activities financed by this program, U.S. experts have provided advice on revising current mortgage loan foreclosure procedures and on the policy framework needed for the licensing, supervision and regulation of housing finance companies.

The Shelter Resource Mobilization Project has an approved level of $ 40 million in Housing Guaranty loans, plus $ 4 million in grants for funding related technical assistance and training.

SRI LANKA

The current USAID Low Income Shelter Program is designed to assist the government of Sri Lanka implement its 1.5 Million Houses Program. After years of heavily subsidized interest rates and low loan recoveries, the Government of Sri Lanka, with USAID, has formulated a program which replaces subsidized interest rates for housing loans with a combination of grants and loans, so enabling more effective use to be made of government budgetary resources. The grant portion of the package will reduce monthly payments to affordable levels for beneficiaries who cannot afford market-rate loans of the size needed to meet minimal housing needs.

- Pure grants will go to a very limited number of households who do not have the capacity to take out a loan for home construction of improvement.

- Bridging grants will go to households who can bear the repayment of some loan, but whose basic housing needs require a larger loan than they can afford. The grant will reduce the loan size so that the monthly payment is affordable.

- All loans will be at full market rates, which, in Sri Lanka, are estimated to be at least 20 percent per annum.

The redesigned program will expand the resources of private credit unions, commercial banks and other market-oriented suppliers of housing loans, and will extend access to the housing finance system by lower income households.

In late 1991, U.S. experts provided assistance to the Government of Sri Lanka for the preparation of a detailed action plan for the implementation of this program.

This scheme is a continuation of a long-standing program in Sri Lanka, by which USAID supported the government's former Million Houses Program, and provided capital assistance for the reconstruction of war-damaged housing in the northern and eastern regions of the country. Since 1981, USAID has provided guarantees for $ 60 million of loans to the Government of Sri Lanka for housing programs.

NEPAL

Since the mid-1981's, USAID has been working on small, highly-focused urban sector activities in Nepal, responding to specific requests for assistance from Government or private sector institutions. Recent areas of collaboration have been on market town development and privatization of the shelter credit system. In 1991, for instance, USAID financed technical assistance by a housing finance expert to work with the head of the Ncpal Housing Finance Development Company (NHDFC) to develop a business plan for the company. NHDFC is described in the Nepal Country Case Study.

ANNEX II : THE GRAMEEN BANK, BANGLADESH

In 1976, an experiment was started in Bangladesh to bring banking to people who were landless, who had no assets and who could not prove that they can repay--breaking all the rules of conventional banking. This experiment was the beginning of the Grameen ("Rural") Bank, which has since helped about a million impoverished families to break out of the vicious cycle of "low income, low savings, low investment, low income". Its founder, Professor Mohammed Yunus, believes that, to reach the poor, an institution must be designed for them from the outset. The Grameen Bank is an experiment that has proved that poor people are bankable, and can even be better customers than the rich.

In its early years the Grameen Bank mainly loaned small amounts of money for income-generating projects. Housing loans were started in a minor way only in 1984, but their volume has expanded rapidly since the floods of 1987. To date, the Bank has made about 100,000 housing loans through its 900 branches. As in their other lending programs, loanees are landless men and women who form themselves into groups of five, in order to receive the loans for which no collateral is required. Several groups combine to appoint representatives who validate loan proposals and supervise activities.

The most popular type of housing loan has an upper limit of about $ 350, but there are also "moderate housing loans" available for up to about $ 600. They can be used for new construction, or for the improvement of old dwellings. Loans are to be repaid on a weekly basis, the period of loan depending on its size, for a maximum term of 10 years. Housing loans are generally made only to people who have previously borrowed for income-generation projects, and who have a perfect record of repayment. Priority is given to women and to those poorest members who do not have their own homes. Experience has shown that repayments of the housing loans are mainly made from sources of income which have been created by earlier loans.

By June 1990, a total amount equivalent to $ 14 million had been disbursed in housing loans. The rate of loan repayment is stated to be 98 percent, although the Bank's figures cannot be compared directly with those of conventional financial institutions. Nevertheless, by the standards of most non-government institutions, Grameen's collection rate is excellent.

ANNEX III : THE HOUSING FINANCE COALITION

A United Nations project[10] provides support to a coalition of leading public and private sector housing finance institutions in the Asia-Pacific region, to serve as a focus of expertise in the sector. The first meeting of the coalition was held in Bangkok in May 1991.

Participating institutions comprise the Government Housing Bank of Thailand, the Korean Research Institute for Human Settlements, the National Home Mortgage Finance Corporation of the Philippines, and the Housing Development Finance Corporation of India. The four were selected for the pioneering work they have done in their own domain. They represent leading public and private institutions, with considerable accumulated experience in the particular fields in which they have been involved : primary lenders with a proven record of success serving formal and informal borrowers, and an organization with strong research capabilities.

The coalition will seek to share the institutions' experience, knowledge, technologies and, perhaps most importantly, methodologies for implementation of their own programs, with each other and with other housing finance institutions in this region.

The coalition will be used to help create :

- more effective housing finance institutions in the region ;
- a self-sustaining regional technical cooperation program, particularly to strengthen and establish new credit mechanisms for lower income groups ;
- a knowledge base about key constraints in the sector ; and
- permanent links between formal and informal sector institutions, in terms of both credit dissemination and savings mobilization.

Through research, dissemination of experience and projects, the coalition will explore two important but neglected ingredients of a comprehensive housing finance strategy: the link between financial savings and housing, and methods of improving the accessibility of housing finance to low income households.

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[10] "Public-Private Partnerships in Expanding Access to Housing Finance"

Among a number of discrete activities to be undertaken in the first year of the coalition, one of the more important is the development of a regional project which will exhibit the efficacy and impact of different forms of informal-formal sector linkages in shelter finance. The project will have been initiated by a series of national meetings--in the Philippines, Thailand and India--between housing finance institutions and NGOs. These meetings will identify a number of possible demonstration projects involving lending from the primary housing finance institutions themselves, through different NGOs, to informal sector beneficiaries. Criteria for selecting the projects will be (a) that the housing finance institutions see it as in their interests to participate; (b) NGOs also see it as in their interest, in order to meet beneficiary demand; and (c) the projects are replicable/sustainable.

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