PN-ACD-582

Next Steps toward Housing Finance in Tanzania

Final Report

Presented to

United States Agency for International Development
USAID/Tanzania
RUDO/Pretoria

and

National Housing Corporation of Tanzania

Presented by

PADCO, Inc.

Contract No PCE-1008-I-00-6008-00
September 1998

Funds for production of this report were provided by the United States Agency for International Development

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Table of Contents

Foreword

This report was carried out by Dr Douglas Diamond, PADCO consultant The assignment, with financing from USAID/Tanzania and RUDO/Pretoria, grew out of an invitation to Dr Diamond by the Government of Tunisia's National Housing Corporation to review and comment on a Shelter Afrique report recommending the development of a housing finance system Subsequently, Dr Diamond visited Tanzania and, following two weeks of intensive discussions, provided suggestions as to possible next steps in creating a sustainable housing finance system The views expressed in this report are solely those of the author and do not necessarily reflect the views of the United States Agency for International Development or the National Housing Corporation (NHC) The author wishes to convey special thanks to Hermes C Mutagwaba of NHC for his assistance with logistics and analysis

List of Acronyms/Abbreviations

BFIA	Banking and Financial Institutions Act (1991)
BOT	Bank of Tanzania
CBD	Central Business District
CD	Certificate of Deposit
CDC	Commonwealth Development Corporation
ESAF	Enhanced Structural Adjustment Facility
GDP	Gross Domestic Product
GOT	Government of Tunisia
HDFC	Housing Development and Finance Company
IFC	International Finance Corporation
LAPF	Local Authorities Pension Fund
LTV	Loan to Value
ML&HS	Ministry of Lands and Human Settlements
NHC	National Housing Corporation
NIC	National Insurance Corporation
NPF	National Provident Fund
NSSF	National Social Security Fund, formerly National Provident Fund
PB	Postal Bank
PPF	Parastatal Pension Fund
PTI	Payment to Income
SA	Shelter Afrique, the Company for Habitat & Housing in Africa
TBL	Tanzania Breweries Ltd
THB	Tanzania Housing Bank
TMB	Tanzania Mortgage Bank, the proposed institution
TSh	Tanzania Shilling, the unit of currency exchanging at US$1 = TSh 620

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Executive Summary

Tanzania has been without long-term finance for housing since the Tanzania Housing Bank (THB) closed in 1995 It is commonly stated that THB was completely misconceived and mis-managed and that better design and management could ensure viability for a new institution What is not always appreciated is how difficult it is to provide long-term financing for housing, even in the most-developed countries There are a variety of special risks involved, primarily because of the relatively long-term desirability of such a loan The challenges are much greater in the legal, economic, and financial environment of a developing country, simultaneously, the importance of not squandering resources is also greater The THB never seriously attempted to address these challenges, and thus Tanzania is essentially starting the process from the beginning

This report considers the challenges of sustainable housing finance in Tanzania and attempts to provide relevant suggestions as to how to meet them in the near future

The first challenge is to effectively turn houses into reliable collateral for long-term loans In Tanzania, this involves reaching a conclusion to the long-running debate over reforms to the land laws and enacting a law that is supportive of clear and strong titles and long terms on transferable leases The outcome must be such that private lenders will be convinced that housing can be good collateral Substantial improvements are also necessary in properly recording land titles and liens Another essential step is obtaining efficient and effective enforcement of mortgages The expectation of glacial judicial action and judicial concern for the debtor must be eliminated

Having built a strong foundation on a bedrock of housing collateral, housing lenders do not want to overburden their borrowers and have to routinely fall back on the collateral The key to doing so is **the underwriting process, an assessment of the ability and will of the borrower to repay** It would be very useful to be able to pool records of credit repayment and outstanding loan balances from financial institutions and to confirm earnings from all sources This will permit more widespread lending on more liberal terms Initial steps should be taken toward organizing such capacities

Another major challenge, especially in developing countries, is **to design a mortgage that has repayments that are both affordable and that protect the interests of the lender and the provider of funds against economic shocks** It may be useful to explore the potential for the loan and the funding to have a provision deferring a part of the inflation-related premium This can be done by setting a maximum interest rate that is applicable to calculating what is due currently (the payment rate) and putting the difference between this payment and the full market rate (the accrual rate) back into the loan amount

Making loans for long periods of time sharply increases the scope for the all the risks of mortgage lending The economic circumstances of both individuals and nations can change radically over the course of 10-15 years **Another challenge of creating a housing finance system is building it so that it can best withstand the unknown, but likely, twists and turns of future events** One such approach is to channel funding from long-tem investors, such as pension funds and insurance companies, to banks or other lenders Sometimes arrangements whereby mortgages are used as security for long-term loans to lenders, called "secondary market" facilities, are set up to reduce the risks to the investors Other requirements for a resilient system include substantial capitalization for all lenders (with a minimum of the Basle standards) and a regulatory and supervisory system that can monitor the risks being taken by lenders

Lastly, experience has shown that housing is a political issue This has meant that governments around the world take an active interest in the development of the market in housing finance However, there is a point beyond which governments cannot act, where **only dispassionate judgments and incentivized behavior of the private sector can ensure proper administration** This cannot be achieved if the Parastatal Pension Fund (PPF), the National Housing Corporation (NHC), the Ministry of Lands and Human Settlements (ML&HS), or any other government-related body is the one actually operating or appointing management of a housing finance institution

Possible Next Steps

It is premature to restart housing lending, since a new land law has not been enacted and there has not been a breakthrough that would ensure lenders that foreclosure and recovery will be swift and sure However, it is a good time to start a dialogue among all parties involved One approach would be for the PPF to invite all of the banks for a discussion about the terms under which they might be willing to make housing loans The focus of the discussion could be simple variable rate loans, funded by the PPF through the banks, with maturities only to 7-10 years initially [1] The banks must shoulder all risks and only completely healthy banks can participate The PPF's funds could carry a rate based on a spread over the 1-year T-bill rate and reset annually

An attractive alternative arrangement is for the funding and the loans to accrue interest at the full market rate, but to defer payment by the borrower of part of the inflation-related portion of the interest rate This approach could permit the reduction in the repayment burden and expansion in the amount to be borrowed

What would be the role of the government? Purely political bodies, such as the ML&HS, should not be involved in the primary discussions, so that the parties do not feel pressured to compromise commercial principles Ultimately, housing finance must be a business deal, not a social policy function But the government should stand ready to listen and respond to the concerns of the parties immediately involved

Preferably, this discussion would not focus on the creation of a new specialized lender, but rather on increasing the participation of the banks Ultimately, however, it may not be possible to get enough attention to housing finance without couching the discussion in the context of starting up a new specialized institution The big advantage of doing so is that the likely can-

[1] Lengthening maturities when interest rates are over 20 percent makes little difference for affordability For example extending the term from 10 years to 15 years decreases the monthly payment by less than 10 percent

didates for managing the institution have an interest in pushing for resolution of the various issues **Any new entity must still be created in collaboration with the private sector and the control must be in private hands or it will grow up misshapen**

Another possible direction for government efforts could be in the creation of some kind of secondary mortgage facility Such an institution would not make loans itself, but would instead reduce the risks faced by long-term institutional investors funding private "primary" lenders Such a step makes sense only if this will induce the private sector financial institutions to create a "primary" market, i e , to actively lend

Another way of developing the potential market for housing finance a bit further without going as far as trying to create a real lending system would be for the NHC to sell residential and commercial real estate on a medium-term installment basis The installments could be structured in various ways mimicking a medium-term mortgage For example, the installments could be for 5-7 years and indexed for inflation The title to the property would remain in the name of the NHC, and the purchaser would gain no legal claim other than as a tenant until completion of the payments

The only households likely to be borrowing to buy a complete house are from the upper-income groups While such a development is still needed and should be pursued, there are also several possibilities that should be explored for making useful finance available to other income groups One simple approach is to encourage lending on relatively short term for completing, upgrading, or expanding houses Another is to explore the potential for pension entitlements to be used as collateral against repayment on loans for improving squatter housing, for which no proper mortgage can be executed Pension entitlements can also serve as additional collateral in cases where households do not have sufficient cash for a required down payment

Next Steps Toward Housing Finance in Tanzania

Introduction

Tanzania is without long-term finance for housing This has been the case formally for 3 years, since the Tanzania Housing Bank (THB) was closed for insolvency in 1995 Even before that final act, the amount of financing available was very limited and the cost unaffordable to most Tanzanians This situation means that most households seeking to build a house, for self-occupancy or for rental to others, must do so either through a laborious process of incremental construction or through an equally painful process of payment of installments over a short period covering 2-3 years at maximum

Many Tanzanians recognize the great value of having better access to housing finance It makes far more sense to put up a house and live in it while paying for it than to have half-finished structures sit empty and open to the sun and rains Moreover, the most efficient way of building housing is to develop whole communities on a larger scale, complete with infrastructure and community facilities This can only occur when there are large numbers of ready buyers armed with long-term financing

What is not always so appreciated is how difficult it is to provide long-term financing for housing Even in the most developed countries, there have been major financial disasters associated with housing finance and there continue to be important system refinements even today The challenges are much greater in the legal, economic, and financial environment of a developing country and simultaneously the importance of not squandering resources is also greater [2] The THB never seriously attempted to address these challenges and thus Tanzania is essentially starting the process at the beginning

This report begins with the premise that Tanzania wants housing finance as soon as possible but only if it can be done in an efficient and sustainable manner In general, Tanzania is attempting to build a foundation for sustainable economic progress, one that requires the maximum efficiency in the investment process, including investments in housing and financial institutions Tanzania has had too much experience already with approaches that meet short-run goals but stumble and fail in the longer run

This report considers the challenge of sustainable housing finance in some detail and attempts to provide relevant suggestions as to how to meet them in the near future It does not offer a judgment as to whether conditions presently exist for the restarting of housing finance, nor does the report prescribe a single approach that will be viable and resilient in the long term It does indicate the major requirements of such a system, based on experiences in many other countries, including some in Africa It points the way toward such a system and makes clear the elements that must be in place before the system can start The various interested and involved parties,

[2] For example developing countries are more likely to experience major swings in economic conditions are less likely to have a judiciary independent of political and social interference will have a larger portion of income coming from the informal sector and so on At the same time, the importance of wise investments is critical for accelerating growth

in both the private and public sectors, will need to pursue this road in the coming months and years

The Challenge

The job of a housing finance system is to intermediate funds between those who are saving in the economy and those who wish to invest in housing In general, there are a lot of difficulties involved in intermediating funds between savers and borrowers Some of these are the mechanics of the business collecting the funds, keeping track of all aspects of the transactions, verifying all claims, operating the offices involved, communicating with all parties, and so on As has been so well illustrated in the case of the THB, these tasks are critical to the long-term success of a financial institution Not only must they be performed competently, but there should be competitive pressures to ensure that they are performed efficiently

Basically, these tasks do not differ substantially from those involved in other types of service industries What makes finance different from selling ice cream or petrol is the major role of certain risks, the risks inherent in gathering funds from unrelated parties and granting use of the funds to other unrelated parties These risks can be generally classified into six categories

1) **Credit risk** the risk that the money will not be returned by the borrower, with whatever interest or other charges are due, on a timely basis,
2) **Liquidity risk** the risk that the money will be needed by the lender before it is due,
3) **Cash flow risk** the risk that changes in market conditions will alter the scheduled cash flows (real or nominal) among any of the parties involved in the whole process of financial intermediation, e g , savers, investors, borrowers, this includes interest rate risk, prepayment risk, and exchange rate risk[3],
4) **Agency risk** the risk that an intermediary between the saver and borrower will misuse the funds,
5) **System risk** the risk that a crisis at one institution or in one part of the system will spread to the rest of the system, and
6) **Political risk** the risk that the legal and political framework within which the lending takes place will change or distort it

In light of all these risks, it is surprising that any financial intermediation takes place In fact, finance has been one of the late bloomers on the world economic scene While goods and even services have been traded over thousands of miles for centuries, money has only relatively recently freely flowed to and from all areas of the globe Even within the most developed countries, any finance for housing has only been available for at most 150 years and more broadly only for a few decades

[3] Interest rate risk is the risk borne by the lender that market forces might cause its costs of funds to diverge from its return on loans, thus jeopardizing its profit spread One sort of interest rate risk is prepayment risk, which occurs when borrowers pay off their loans earlier than planned (often because market rates have fallen) and the lender cannot use the funds for a loan or other investment at an equally high rate

It must be emphasized and appreciated by all concerned that housing finance is a tricky business, in many ways more difficult than most other types of finance **The extra difficulties arise from the size and term of the housing investment** Housing is one of the very longest-lived assets, not only because it is a durable physical commodity, but also, in contrast to many commercial types of investments, it does not become obsolete rapidly Since a house may last a lifetime or beyond, it is possible to finance the repayment of the cost of the house over a lifetime or at least over a substantially longer period than for most other investments

Making loans for long periods of time sharply increases the scope for the all of the risks noted above The economic circumstances of both individuals and nations can change radically over the course of 10-15 years, for the better or the worse, affecting the repayment capacity (credit risk), the cash-flow situation of the lender, and the reliability and stability of the financial institution, the entire financial system, and the nation itself **One part of the challenge of creating a housing finance system is building it so that it can best withstand the unknown, but likely, twists and turns of future events**

On the other hand, the extreme durability of housing and stability in its real economic value (relative to almost any other kind of asset) can, and ultimately must, serve as the underpinning of the system Housing is one of the best collaterals (something of value pledged as a guarantee of loan repayment) known to modern finance **Another part of the challenge of creating sustainable finance is to effectively build on houses as a collateral for long-term loans**

Having built a strong foundation on a bedrock of housing collateral, housing lenders do not want to overburden their borrowers and have to routinely fall back on the collateral The key to doing so is **the underwriting process, an assessment of the ability and will of the borrower to repay, gauged against levels of burden and expectations of "unexpected" shocks**

Another major challenge, especially in developing countries, is to **design a mortgage that has repayments that ~~are~~ both affordable and that protect the interests of the lender and the provider of funds** The problem is that inflation and economic crises can cause interest rates to be very high and in general very volatile The investor wants to be protected from all of these shocks, but the borrower cannot bear them easily without defaulting

Lastly, experience has shown that housing is a political issue This has meant that governments around the world take an active interest in the development of the market in housing finance However, there is a point beyond which governments cannot act, where **only dispassionate judgments and incentivized behavior of the private sector can ensure proper administration** In fact, the private sector must be assured that government (or the courts) will not act in a politically motivated way to undermine the contractual arrangements they have made with their borrowers

The issues facing Tanzania in these regards are not unusual They exist to varying degrees in all countries, and there is a wide range of ways that countries have dealt with them, reflecting the local political and economic circumstances and history In fact, no two countries have exactly the same systems But all successful systems have found solutions, more or less efficient and effective, to these issues

I shall consider each of these issues in turn, exploring the nature of the issue, indicating some solutions used in developing or developed countries, and suggesting one or more approaches for Tanzania

The Foundation Solid Collateral

As noted, the rock on which housing finance must be built is a low risk of non-repayment In most cases, repayment is firmly tied to easy and reliable access to the house itself as collateral [4] In theory, foreclosure and attachment of the house should be straightforward Usually, there is no uncertainty as to the lawfulness of the debt and the agreement of the borrower to forfeit the house if he or she does not repay the debt Moreover, there is a large degree of common sense in the proposition that someone forfeits his or her right to remain in a house if he or she does not continue paying for it There is even more common sense, and recognition of human nature, that borrowers will go to extraordinary lengths to repay loans, including ultimately selling the house themselves, if and only if they know that they can and will be forced to [5]

In practice, however, relatively few countries pursue totally strict enforcement of mortgages [6] Other countries have tended to practice greater degrees of patience and forbearance In some cases, such as Germany, lenders can afford to be relatively slow to force the issue because there is no prospect of the borrower evading the entire debt owed, even if it exceeds the value of the house and even if it falls to the heirs to pay On the other hand, in France, borrowers have a variety of judicial means to force delays in foreclosure (the taking over of a collateral in case of loan default) for up to 3 years Notably, default rates and losses in France are much higher than in Germany In other countries where foreclosure is hard to enforce, lenders are extra careful about whom they will make loans to In general, the greater the chance that borrowers can avoid full repayment on a timely basis, the more that lenders charge and the pickier they are in their lending

Easy access to housing collateral is not always sufficient protection in cases where the borrower wants to obtain a loan for much more than half its value The lender must still ask at what price it can actually sell the house on short notice This amount can be very different from what the house cost the borrower For example, houses that are specifically built to the designs of the

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[4] This is not always the case The most famous example is that of India where the private Housing Development and Finance Company (HDFC) has managed to attain reliable recoveries for over 20 years in a judicial environment that is even less supportive than that in Tanzania The key has been the presence of a number of other tools to press recovery (including jailing for bad debts) and the well established readiness of the company to use them Another approach that is being pioneered in South Africa is to rely on pension accumulations for all or part of the collateral

[5] Several countries have observed the inevitable downward spiral in borrower performance once it becomes clear that the consequences of non-payment are nil or relatively small or delayed

[6] The U S Canada, and the U K are the best-known examples of places where defaulting borrowers will be dis possessed of their houses quickly and surely if they fail to repay on a timely basis

buyer are rarely worth to anyone else what they cost to build Other problems are that (1) there may be relatively few people interested in that kind of house in that location, (2) the people in the area are mostly friends or relatives of the borrower (e g , in a village or small town), (3) there is a potential for house values to swing from high to low levels according to market conditions, and (4) there may be some degree of fraud in the actual construction of the house This potential for losses is then further magnified by the fact that there are significant costs to selling houses (including transfer taxes) and, in cases where the borrower can also force any substantial delay in foreclosure, with accumulation of interest and penalties

Even if the foreclosure is straightforward and the lender avoids lending more than what it can recover from a forced sale, recovering on a defaulted loan often faces an even more basic hurdle in developing countries It may not be possible to establish for certain who owns the land on which the house is located or if there are other loans secured by the house The systems that keep track of the ownership (registration of title), liens (financial claims against the property), and sales or transfers of all real property often do not exist or are in very poor condition in developing countries Ownership may be substantively quite unclear, because of a history of unrecorded allocations by traditional rulers or because of splintered ownership over many heirs In these cases, even more basic work needs to be done before real estate can serve as the bed-rock collateral of the housing finance system

When there are no really good ways of minimizing credit risk, there may be few or no private financial institutions willing to lend If there are lenders, they will have to factor the greater risk into their charges and limitations Thus, a society that does not provide clear land titles or significantly limits the ability of lenders to effectively manage the credit risk on the relatively few borrowers that default significantly raises the costs of loans or limits the access for the great majority of borrowers who would repay on a timely basis On the other hand, if residential lending is established as a very safe and reliable activity, cheaper ways of raising funds (e g , secondary markets) and underwriting and originating loans (e g , using agents) can be pursued

Underwriting Whom Do You Trust and How Much?

It is possible to build a housing finance system entirely around the value of the housing collateral [7] But as noted above, few societies are in favor of allowing individuals to be routinely dispossessed of their home, despite their voluntarily bearing that risk by having taken out the loan Moreover, lenders know from experience that they do not usually end up taking losses on a loan *simply* because the value of the house falls to an amount lower than the loan [8] This

[7] The most famous case of this is mortgage finance in Denmark Until recently the Danish system reflected its roots in a rural society in which farmers did not want lenders investigating their financial situation and lenders wanted absolute assurance of repayment The result was that borrowers would agree that they would lose their property if they did not repay and also that all of the other borrowers from that lender would compensate the lender for any shortfall it experienced after sale of the property Everyone benefited (except the few defaulters) since this arrangement permitted lenders to raise funds cheaply by offering bonds backed by these very safe mortgages

[8] Of course if the house value is more than the loan the borrower will generally not default but rather will probably try to sell the house and repay the loan out of the proceeds However even then if interest, penalties, and expenses accumulate for too long the loan amount may grow to be larger than the realizable value net of selling costs

situation usually must be compounded by the fact that the borrower suddenly finds it to be unexpectedly difficult to repay the loan

Thus, it matters to the lender not just how much the collateral is worth and that the title (evidence of exclusive ownership) is clear and strong and that the judicial system is supportive of the lender's claims, but also that it be a reasonably sure that the borrower will not run into difficulty repaying the loan to begin with or, in that eventuality, the borrower will try very hard to remedy the situation In other words, not only must the property be evaluated, but so must the ability and intent of the borrower to repay

This is all part of a process called "underwriting" the loan This goes beyond confirmation of borrower employment and income to include discovery of other outstanding debts and past history of debt repayment, assessment of stability of employment and prospects for retrenchment, willingness of employers to deduct repayments at payroll, any criminal record, and so on **A principle of underwriting is that the borrowers must prove themselves to be creditworthy, not that the lender must make the loan unless there is proof of dishonesty** No member of the public is entitled to a loan

Proper underwriting is especially critical in developing countries, where records are few and much income is "off the books " Even borrowers with substantial positions in the formal sector may rely on income from other jobs and informal sector activities to support themselves Many potential borrowers have no formal sector income and may not be "bankable," but sometimes ways can be found to develop evidence of income or confidence in repayment capacity and intent

Lenders in more developed countries often have access to organized pools of information on the credit history of would-be borrowers These usually contain data on any loans or credits taken previously, even if not currently outstanding, and on any defaults or episodes of arrears on those loans Not only does this data confirm the existence of additional debts, but it has been found that there is a very high correlation between the experience of arrears in earlier loans and default on housing loans This apparently reflects the fact that people of solid "character" go to great lengths to avoid arrears, and weaker character is revealed by past arrears and defaults

Sophisticated private lenders will use all of this information to assess whether to lend anything to the applicant and how much They will apply many "rules of thumb" based on experience, but will also use some judgment when the strictest standards are not met Most lenders have certain limitations that are applied in most cases, including a ratio of the required repayment to available income (payment to income [PTI] ratio) and also of the loan amount to the indicated value of the house (loan to value [LTV] ratio) In both cases, these limitations set up a buffer zone to protect the borrower and the lender from the unexpected but likely sorts of "bad news " If a two-worker household takes on a PTI ratio of 40 percent and one spouse loses his or her job, the PTI ratio may jump to 50 percent or more, but this still usually leaves enough income to survive and make payments until a new source of income is found If the PTI ratio is allowed to start at 40 percent (which is the case in some countries with great economic stability), then loss of one income could raise it to 80 percent or more, guaranteeing default Similarly, the lower the LTV ratio, the longer can interest pile up and the lower can house prices fall before the lender will take a loss

These underwriting standards should be set according to the type of loan being taken and also the economic circumstances For example, making a loan at 22 percent in an environment of 15 percent (and declining) inflation means that the payment burden will probably go down in a year or so, as nominal earnings rise (see section below) Thus, a higher payment-to-income burden can be approved But if inflation is low but rising, so that a floating rate on a loan may soon be rising, a lower initial payment burden is indicated Similarly, payment burdens can vary according to the reliability of the income and the payment history of the borrower The ratio of the loan to the appraised value can also be higher if foreclosure can be executed quickly, before a large build-up in arrears, but should be low in legal systems where foreclosure is long and costly Clearly, though, none of these kinds of decisions can be made properly when the lender is subject to political influence

Making Loans More Affordable

Most people think of the cost of a loan as being the interest rate And they know that at higher levels of interest rates, the payments are higher and the amount that they can "afford" to borrow (i e , can afford the repayments on) is lower

But economists make an important distinction between the part of the interest rate that is associated with the presence of inflation and the rest of the interest payment Even the general public intuitively knows the difference When inflation is running 30 percent, they are painfully aware that their savings are declining in purchasing power if they are not getting over 30 percent in interest If inflation falls by 10 percent, so will savers expectations as to a fair return on their savings They also know that only to the extent that they are earning an interest payment over the inflation rate are they getting a "real" return on their savings

The same distinctions apply on the other side of the savings/loan transaction When an interest rate of 22 percent is being charged, and inflation is 15 percent, only 7 percent is the "real" cost and 15 percent is the compensation for the inflation When the inflation is simultaneously boosting the borrowers income and the value of their houses, the inflation component is to some extent not a real cost

However, no matter what, the expectation of a steady depreciation in the value of the currency in an inflationary period can impose a real burden on the borrower, because it means that effectively the borrower is having to pay back the loan more quickly than otherwise To take a simple case, first think of a two-year loan of TSh 1 million when there is no inflation and the "real" interest rate is 10 percent After one year, the borrower makes a single payment of half of the principal and 10 percent on the full amount or TSh 600,000 At the end of the second year, he repays the second half, plus 10 percent more on just that half, or TSh 550,000

Now consider the same loan when there is an inflation of 10 percent, and the borrower pays the lender an interest rate of 20 percent a year At the end of the first year, the borrower pays TSh 700,000, i e , half of the original principal plus the 10 percent real interest rate, plus the

10 percent extra to compensate for the 10 percent loss in purchasing power on the full amount Now the 10 percent inflation means that the TSh 700,000 is only worth TSh 636,000, but this is still more than the real value of the first year payment with no inflation On the other hand, the borrower will pay TSh 600,000 at the end of the second year, but that amount is worth 20 percent less than originally, or really only about TSh 500,000

The net effect of the inflation is to raise the real value of the payment in the first year (to TSh 636,000) and reduce it in the second (to TSh 500,000) or about the same total of TSh 1,150,000 This is because the compensation for the loss in purchasing power on the whole loan amount is being paid immediately, not as the loan is actually repaid On longer-term loans, this makes a huge difference If this were a 10-year loan with 10 percent inflation, the principle being repaid in the last year is worth only 39 percent of what it would have been with no inflation, and the amount paid in the first year is almost twice as much

Paying such an inflation compensation is fair and does not raise the "real" interest rate on the loan, but does dramatically accelerate the repayment of the loan, when those repayments are viewed in inflation-adjusted terms In the extreme, anyone who has taken a 10-year loan at 50 percent interest rate in a 40 percent inflation environment knows that the repayment in the first year is over half of the nominal amount of *the whole loan* and about a third of the real amount and the payments after 2-3 years are negligible Even if advertised as a 10-year loan, it is really more equivalent to a 3-4 year loan when there is no inflation The purchasing power of the last payment in the tenth year will be only 3 percent of the real value of the first month's payment, instead of the constant amount applicable when there is no inflation

In summary, the major reason why interest rates are 20 percent or more in some countries and 10 percent or less in others is the rate of inflation Lenders need to be compensated for the loss in purchasing power of the currency, but the net effect is that borrowers can borrow less and have to effectively repay the loan faster

Countries with long traditions of high inflation know this well and have made arrangements to adjust for it The most common adjustment is to pay only the inflation compensation for the principal due currently and to add the inflation compensation for the remaining principle back into the principal This is what is meant by "indexing" the loan to inflation Just like indexing salaries for inflation, the lender automatically gets a "cost of living" adjustment in the loan amount, but is not immediately paid the whole amount, instead spreading it over the full term of the loan The effect is to have the real burden of the repayments approximately track the levels that they would have if there was no inflation In other words, this "indexation" of the loan balances for inflation and neutralizes the effect of inflation on the repayments

The impact on the initial loan repayment can be significant If the 15 percent inflation part of a 22 percent loan rate is removed, so that only the real interest rate of 7 percent is paid each year and the rest deferred, the initial repayment on a 20-year loan falls by more than half In many cases, this means that the borrower can afford twice the amount of loan Even if only 10 percent of the 15 percent inflation premium is deferred until that part of the real principal is repaid, the loan amount is boosted by 67 percent

In addition to such financial engineering to smooth out the repayment burden, a housing finance system that encourages lenders to offer low "real" interest rates (net of inflation) is simply cheaper for borrowers As noted above, this real rate will be lower if credit risk and other risks are lower It will also be lower if there is more competition in the sector, partly because profits will be lower, but also because competition forces lenders to constantly look for ways of doing their job cheaper and better

Building a Resilient System

Just as an architect must design buildings to shrug off such threats as hurricanes, relentless sun, sometimes earthquakes, and always fire, so must the housing finance system be designed for much worse than the picture-perfect financial day Following the engineering analogy, we have already noted the necessity of a "foundation" down to a bedrock of housing collateral, as well as reliance on private incentives to properly underwrite borrowers and administer the system However, beyond these things, there are profound questions of how to design the flow of funds from savers through intermediaries to borrowers and back to savers in such a way that the stormy economic circumstances do not derail the whole process

There is a common refrain that it takes long-term funding to finance long-term loans Certainly the strongest system will be that where such funding is forthcoming The first step in that direction is to develop savings mechanisms that are in fact oriented toward the long term, not just for buying a refrigerator or paying school tuition in six months' time, but for precaution against such events as death or disability of a family breadwinner (life insurance) or against just the opposite, a long retirement (pension funding) Many developing countries have invested considerable effort in developing pension systems and may also have significant insurance sectors

Having such pools of long-term savings is a first step for a long-term housing finance system A necessary next step is to have a system of financial institutions that are capable of competently borrowing those funds, lending them out as housing loans, and recovering them These institutions must be private and must have enough equity capital to help ensure that they can absorb any losses without jeopardizing the repayment of the funding sources They must also be adequately regulated and supervised so that the pension funds and other funders can be confident of the management of the institutions, without having to constantly monitor them directly

A third necessary step is for there to be contractual relationships among savers, lenders, and borrowers that are synchronized and that meet the most important needs of the three parties Matching the term to maturity of funding with that of housing loans is only half the battle In addition, the terms of repayment and interest charges on the funding and the loans must also be matched or the financial institution may end up with having to pay more for its funding than it is receiving on its loans In general, there needs to be a congruence between the way that financial market forces affect the liabilities of the lender and its assets [9]

[9] The classic example of this sort of problem is the experience of savings and loan institutions in the U S who were being required by the U S government to issue loans at a promised fixed interest rate while paying a floating variable rate on their funds In theory the government would prevent interest rates on deposits from going up so high as to cause a loss on the loans But this proposition was eventually insupportable and when it failed so did many of the institutions

Public Versus Private Roles

One of the ways that some countries have tried to handle all of these issues is to make housing finance an activity of a government-owned body It seems evident that infusing government funds solves the problem of building a resilient system, since they are long term and do not involve any need to synchronize interest rates with the loans being made and, in some ways, the government has the most power to make sure that the loans are repaid In some cases, the model has had significant success For example, the government of Hungary under socialism offered low-rate loans to all citizens (but only a relatively small amount) and was able to enforce collections through the simple fact that it employed almost everyone in the country Disaster struck only when socialism ended and the government could no longer garnish wages to obtain repayment and moreover had to pay much higher interest rates on the funds it was using (drawn from the national savings bank) while continuing to get a very low return on the loans

However, more generally, it has been shown again and again that publicly appointed officials cannot respond appropriately to financial risks, both because of political pressures and because ultimately it is not their money at risk Moreover, borrowers generally perceive this and tend to assume that, if the government is behind their loan, it must be partly a social policy action and not really subject to serious efforts to repay (or possibly even foreclosure and eviction) To the public, voluntarily repaying loans to government-owned entities is only one step above voluntarily paying taxes While everyone wants the government to be well funded, they individually have more important things to do with their funds

Even aside from the fact that management's "backbone" will be weakened by political interference and that borrowers will expect such weakness, there is the further burden on any parastatal housing lender that it is in fact a government-owned entity, missing the key incentives to operate efficiently and also largely protected from failure due to bad management As Tanzania's experience confirms, there is no substitute for a commercial corporate culture that emphasizes profits, from which derives great pressure toward accountability, efficiency, and repayment

The result is that, as discussed below, there is only a limited role that the government of Tanzania can play in restarting housing finance It can encourage and support, and even partly fund, but all lenders must have a substantial amount of private money at risk in every loan and must be completely free to decide on the terms and amount of any loan according to their perception of the risks and rewards Richer countries can afford to subsidize the loans for certain purposes or borrowers But no country can afford to throw away public resources, gathered from all the citizens, to finance the houses of defaulting borrowers, who usually have above-average incomes to begin with This is what happened in the case of many borrowers from the THB and will happen again if publicly appointed officials have any say about who gets what in the way of a loan and what is done to recover from defaulters [10]

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[10] It is important to recognize that this statement applies to all entities for which the management is appointed by the government Thus a lender owned by the PPF the National Insurance Corporation (NIC), and the National Bank of Commerce could not at all be considered to be a private entity

Despite this universal experience, it has been found that there may be a role for government-sponsored entities in encouraging or facilitating the private provision of housing finance There are few countries that do not encourage housing finance through some method or another As discussed below, the key is to provide key support without undermining or distorting the right private incentives

Application to Tanzania[11]

All of these issues pose major questions about how to restart housing finance in Tanzania Foreclosure and sale is nearly impossible, credit histories do not exist, inflation and nominal interest rates are high, the potential for various economic and political shocks are high, and there is a deep tradition of political intervention in housing lending for pursuit of social goals Nearly every aspect of an effective and sustainable lending system is absent or only partially present

On the other hand, Tanzania is in a mode of rebuilding its economic structures to sustain steady growth into the future A system for long-term financing of housing is definitely one of the economic structures that the country ultimately needs It is the ideal candidate for a steady step-by-step process of foundation building, not indulging in large-scale but unsustainable activity, but instead investing in developing the legal, institutional, and financial infrastructure to provide market-based housing finance in an efficient manner as the real incomes of Tanzanians improve over time The process will take several years at a minimum, but, if done correctly, will pay dividends in the form of better housing and a better financial system for many years into the future

There are steps that can be taken now and into the near future to build this system in Tanzania These are discussed below

Strengthening the Collateral and Limiting Default Losses This is a "must-do" issue The long-running debate over reforms of the land laws must be resolved and the new law must be supportive of clear title and, in the case of leased land, of long terms on leases and straightforward renewal of leases Whatever the outcome of the political process, the ultimate judge of the success in this matter will be the private lenders, who must rely on strong and clear titles to properly secure the repayment of their funds If would-be lenders remain unconvinced that strong land rights will prevail, it will be necessary to delay significant investment in housing finance until the issue is resolved further

Beyond the political issues of land control there is the more mundane but just as essential issue of properly recording land ownership It is reputed that the current system for registration of title and liens against real estate is slow, erratic, and unreliable This must also be addressed, possibly by privatizing the function and setting a fee schedule that will support an efficient system

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[11] This discussion of the barriers to housing finance in Tanzania draws on two earlier reports, the first by Pamela Hussey for USAID May 1997 and the second by Shelter Afrique for the Government of Tunisia (GOT) in December 1997 (see Appendix)

Establishing and perfecting title and liens is the first step The next step, obtaining efficient and effective enforcement of mortgages, appears to be a quagmire awaiting draining It has been proposed to have special courts for such commercial matters, presumably funded by fees that could support rapid and fair disposal of cases It is the author's impression that such an approach has been tried elsewhere and not been as successful as hoped [12] The judicial culture of glacial action and social concern for the debtor is hard to break

It is strongly recommended that consideration be given to strengthening the procedure allowed under current law for waiving any rights to judicial consideration in cases of non-payment Apparently, debtors are still successful in obtaining injunctions against execution even in these cases A solution may be to impose significant fees for the injunction or to somehow eliminate or time-delimit this practice As noted above, many places provide for foreclosure without judicial recourse, because the range for complaint is very narrow, limited just to the facts as to whether payment was made or not Given the history here, it will probably take such serious medicine to convince lenders and borrowers that mortgage bonds are inviolable and straightforward

Finally, it must be recognized (even if not publicized) that there is no prospect in the near future of houses in villages or even small cities being used as loan collateral There must be a market for the collateral, and there is no market among the friends and neighbors of the defaulter Even in developed countries, lenders appraise houses in small rural communities very conservatively, because of the small resale market In developing countries, the situation is made even worse by the even less secure title in most of these circumstances **Visions of nationwide lending for all citizens have to given up in favor of pragmatic and gradual constructive action on each building block of a sustainable system**

Underwriting This is an area that can be improved progressively over time, not necessarily before the first loan is made Ultimately, it will be very useful to be able to compile credit histories and outstanding loan balances and to confirm earnings from all sources It will permit more widespread lending on more liberal terms However, until these improvements are made, lending can proceed if there is strong enough recourse to conservatively underwritten collateral and a focus on verifiable earnings from formal sector employment In addition, underwriting standards will need to be relatively conservative [13]

[12] The author understands that this was the case in Ghana However Ghana did eliminate all judicial recourse for mortgage borrowers in 1993 and since then not a single loan has gone to actual forced sale with defaulters coming up with the funds when it becomes clear that they have no alternative

[13] An implication of this is that in the near term the natural market for lending is a relatively small group of urban professionals with verifiable incomes from formal-sector employment that are sufficient to afford a mortgage on the smallest houses generally acceptable This statement can be confirmed by doing the arithmetic The very minimum interest rate on a loan might be 7 percent even with full deferral of the inflation compensation The very minimum acceptable house appears to cost about US$12 000 Even with a loan term of 20 years (the maximum possible before retirement for a 35-year old worker) and a down payment of 25 percent the monthly payment would be US$70, requiring a verifiable income of at least US$280 a month (if the PTI is limited to 25 percent as is appropriate for such a loan) or roughly TSh 190,000 at current exchange rates

One of those underwriting standards is the LTV ratio Given the uncertainty as to house values and reliance on the house value for security, it would be expected that the maximum LTV ratio will be limited initially A calculation will need to be made as to that amount for which typical collateral can be sold in a forced sale on short notice, and accounting made of all costs of the sale and for the potential for arrears to accumulate before disposition In well-developed systems, the standard LTV limit is 80 percent, with a potential to go higher if a risk premium is paid However, it is generally recognized that a limit of 50-60 percent of the house price is more appropriate in housing markets where resale is not straightforward [14] In any case, it is a parameter that will be set by private lenders and cannot be forced by the government

Loan Affordability The simplest approach to making long-term housing loans would be to have the interest rate set at about the current bank lending rate and then have it change on a regular basis in the future, either based on bank lending rates or on 1-year T-bill rates This approach is easy for all to understand, but it does mean that the inflation premium is fully paid currently and that the repayment could rise sharply at some time in the future if inflation were to rise again

As noted above, in countries that have suffered chronic high inflation rates, all loans are "indexed" for inflation, with the outstanding principal amount being adjusted each month for inflation and only the "real" interest rate being paid currently [15] Such indexation may be extreme for Tanzania, where there is a very promising downward trend in inflation But an alternative that may be attractive is to defer a part of the inflation-related premium This can be done by setting a maximum interest rate that is applicable to calculating what is due currently (the payment rate) and putting the difference between this payment and the full market rate (the accrual rate) back into the loan amount

Such a loan is used in Hungary, where the payment rate is set at 15 percent and the accrual rate (the rate at which interest is charged) is currently 25 percent, implying that about 10 percent is being added back into the loan and deferred Inflation is about 15 percent, so that about two-thirds of the inflation component is being deferred The advantage is that a 15 percent payment rate calls for an initial monthly payment that is 35 percent lower than at 25 percent (for a term of 15 years), allowing borrowers to take out 50 percent more in loan amount

The other advantage of such a loan design is that it automatically adjusts for trends in interest rates If rates continue to come down, then the amount of deferral shrinks also, so that if rates reach 15 percent, it becomes a regular loan But if rates go back to the range of 40 percent, then the repayment does not immediately go up by over 50 percent, but rather rises over several years The loan continues to mature in the same period of time as originally set

[14] In some countries a requirement that up to half the cost of the house be available in advance is considered untenable However in other countries it is viewed that the ability to borrow even half the price is of great benefit

[15] Countries with chronic but moderate inflation often try to avoid indexing loans wages and other economic elements partly in order to keep inflation on people's minds and encourage its reduction

This smoothing helps protect the lender from the borrower defaulting due to inability to make the new higher payment On the other hand, the loan principal will rise in nominal terms and the LTV ratio will not decline as quickly as when nominal principal is going down while inflation is pushing house prices up Use of this deferral-type loan places even greater weight on being able to foreclose on defaulters quickly

The design of the loan terms is something that public officials can encourage discussion on and, through an installment sale program of the NHC, possibly set an example for But once again, only the private sector can properly balance the risks involved and the rewards from being able to offer more attractive loan terms

Building a Resilient System As noted above, many countries have tried different approaches to building a housing finance system that is resilient to the economic shocks that inevitably occur In some cases, they have succeeded in harnessing savings deposits in commercial banks or savings banks (e g , building societies) as the main source of funds, sometimes with special access to government-sponsored funding or guarantees in case of financial crisis But such an approach assumes a strong and stable banking sector

A viable alternative to such an approach is to channel funding from long-term investors, such as pension funds and insurance companies, to the banks or other lenders Sometimes such investors are uncomfortable with placing too much trust in any given bank and want some kind of specific collateral, such as residential mortgages, before committing funds on a long-term basis Arrangements whereby mortgages secure long-term loans to lenders are often included in what are called "secondary market" funding

Normally, a secondary market is not needed until lenders have become well established and need funding beyond their base of short-term deposits However, it is possible to start with a secondary market arrangement if it is viewed as being very imprudent to lend at all for more than 5 years based on short-term deposits

Such an arrangement is also very desirable if there is to be any provision for deferring part of the inflation premium Banks are concerned when the cash flow from their loans is very different from the cash flow that they are committed to provide their depositors In such circumstances, funding from long-term sources allows greater flexibility in designating at what rate borrowers must make their repayments

Other requirements for a resilient system include substantial capitalization for all lenders (with a minimum of the international standards for capital adequacy) and a regulatory and supervisory system that can monitor the risks being taken by lenders In general, housing lending should be subject to similar rules as commercial banking, but it is appropriate for the risk-weighting applied to residential mortgages to be reduced to 50 percent once their reliability as security is established

The Government's Role In an ideal world, private financial institutions would design and implement the best system to provide housing finance and proceed accordingly However, few, if any, housing finance systems have developed very far without some degree of government interest or support or outright intervention Several have developed with government involvement only to later shed most or all of that involvement Many have paid a large price for that involvement, usually through imposing large losses on the government, other times simply creating inefficiencies or distortions in the overall financial sector

So far, Tanzania has been among the countries that has suffered large losses by intervening in housing finance **Because of that history and because of the more general pattern of non-repayment of debts throughout the economy, it is essential that the government's role, direct or indirect, be kept to a minimum** Yet the government must be involved in resolving many of the challenges remaining, including upgrading the access to the housing collateral, clearing titles and strengthening registration, and perhaps assisting negotiations between government-related funding sources, such as the PPF, and potential private lenders As noted below, one approach is for government to set up a working group or task force to facilitate dialogue among the relevant parties But ultimately the risks must be assessed and managed from a truly private perspective or it is unlikely that any kind of "professional" management will keep political considerations from undermining the new housing finance system

Alternative Next Steps

In some ways, it is premature to pursue any next steps toward restarting housing lending, since there is no solid evidence that a new land law and improved registration will be implemented soon enough to provide a foundation of reliable land titles Nor are there signs of a breakthrough that would assure lenders that foreclosure and recovery will be swift and sure However, an argument can be made that it is a good time to start a dialogue among all parties involved, so as to improve the chances that the land law, registration system, and foreclosure issue remain a priority and move toward potentially supporting renewed lending [16]

One approach to that would be for the PPF to ask all of the banks in for a discussion about the terms under which they might be willing to make housing loans The system around which discussion could focus could involve simple variable rate loans, funded by the PPF through the banks, with maturities only to 7-10 years initially [17] The banks must shoulder all risks and only fully healthy banks can participate The PPF's funds would carry a rate based on a spread over the 1-year T-bill rate and reset periodically

An attractive alternative arrangement is for the funding and the loans to accrue interest at the full market rate, but to defer payment by the borrower of part of the inflation-related portion of the interest rate As explained above, this approach could permit the reduction in the repayment burden (to as little as a 10-15 percent interest rate) and expansion in the amount to be borrowed

[16] This conclusion is in sharp contrast with that of Shelter Afrique s study As noted earlier in the comments by this author on the SA report (see Appendix) the report did not require solutions to the issues that caused the demise of the THB but rather assumed a leap of faith based on a presumption that some housing finance should exist even if organized by the government

[17] Lengthening maturities when interest rates are over 20 percent makes little difference for affordability For example, extending the term from 10 years to 15 years increases the amount afforded by less than 10 percent

What would be the role of the government? It would have a large role already in urging the PPF to become involved But purely political bodies, such as the ML&HS, should not be involved in the primary discussions, so that the parties do not feel any pressure to compromise commercial principles Ultimately, housing finance must be a business deal, not a social function But the government must stand ready to listen and respond to the concerns of the parties immediately involved

This process would probably bring into focus the credit risk issues and possibly the difficulties involved in proper underwriting, as noted above It should also clarify the potential for crafting an arrangement, using pension and insurance funds, that minimizes the financial risks faced by lenders while protecting the funders

Preferably, this discussion would not focus on the creation of a new specialized lender On the contrary, it is unlikely that the volume of business achievable in the first several years, given the level of interest rates and incomes, will support the overheads of a significant financial institution (as is evident in the analysis in the Shelter Afrique report) Moreover, there are advantages to having housing lending being done by diversified lending institutions, at least until the risks of housing lending become clearer and competition emerges

The private bankers that this author spoke with expressed interest in lending for housing, particularly if the problems of long-term funding and foreclosure could be solved However, there still may not be sufficient interest initially to move ahead on an agenda of preparing the groundwork In that case, the government-related parties, including the NHC, the ML&HS, and the PPF, could proceed among themselves to seek solutions to the issues raised by the private sector In no case should any government entity engage in direct lending There is no way that any private entity can compete with government in this arena, and thus the evolution of the housing finance market will come to a standstill

Ultimately, it may not be possible to get the relevant people to focus on housing finance without couching the discussion in the context of starting up a new specialized institution The big advantage of doing so is that there can be a number of people identified who would be likely candidates for managing the institution and thus would have a interest in pushing for resolution of the various issues It is hard to overestimate the power of self-interest and, if the individual bankers do not see enough reward for themselves in pursuing the resolution of issues, it may be necessary to create a group of people who do

In that case, the new entity must still be created in collaboration with the private sector and the majority of shares be in private hands, or it will grow up misshapen The government could have a minority interest (including all government-related shareholders), but it could receive special focus and favor from the government, including special foreclosure powers, the longer-term funding from the PPF and the National Social Security Fund (formerly the National Provident Fund [NPF]), and exemption on such funding from the statutory minimum reserve set by the Bank of Tanzania (BOT) As noted, though, the effective market for unsubsidized housing loans is in fact pretty small, making it difficult to make a profit and also creating political pressure to weaken the commercial operation of the entity [18]

Another possible direction for government efforts could be in the creation of some kind of secondary mortgage facility Such an institution would not make loans itself, but would instead facilitate the flow of funds from long-term institutional investors to private "primary" lenders Its value lies in creating a process involving securing the funding from the pension funds through using the mortgages as collateral This could address the legitimate concerns of the pension funds about lending funds to the banks for a relatively long term [19]

Another way of developing the potential market for housing finance a bit further without going as far as trying to create a complete lending system would be for the NHC to sell its existing residential and commercial real estate on a medium-term installment basis The NHC is not properly equipped to service such installment loans, but this portfolio of loans could be serviced by a bank or any new housing lender being created or it could be bought at some discount, thereby bringing the NHC substantial cash The installments could be structured in various ways, as proposed in an earlier memorandum [20]

It is possible that housing lenders from nearby countries have a greater interest in lending for housing in Tanzania than do the local banks This could reflect the fact that they already have greater experience and proven management systems in this area than do the local financial institutions Any such interest should be welcomed, the goal is to make such a service available to Tanzanians and at the lowest cost, regardless of who is willing to provide it Such successful housing lenders exist in Kenya, Malawi, Zimbabwe, and South Africa Any of them could also be a very useful partner in a joint venture However, it should be noted that their participation may be predicated on the ability of foreigners to own land

As noted above, the only households likely to be borrowing to buy a complete house are from the upper-income groups There are several possibilities that should also be explored for making useful finance available to other income groups One simple approach is to encourage lending on relatively short term for completing, upgrading, or expanding houses This can be done through relatively small loans for roofing or finishing kitchens and baths, repayable over a relatively short period, such as less than 1 year It must be recognized, though, that lenders would need to charge significant fees and interest for such loans, because of their significant

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[18] It may be reasonable in this case for the government to provide an indirect subsidy in the form of a long-term loan that does not earn interest for the first five years or so helping the institution get on its feet without distorting the lending rate or other aspects of its operations

[19] It is not really necessary for an institution to be set up to implement such an arrangement For example in Barbados the pension funds and insurance companies directly fund most of the housing lending by banks but take pledges of mortgages as collateral to their loans

[20] See Phillip Mayfield Memorandum on Proposed Financing Options for the NHC dated 4 December 1995 One further attractive approach would be for the buyer to spread the payments out over 5 years with the sale price expressed in U S dollars with an equal U S dollar payment due each month at the average exchange rate of the previous six months

fixed costs of making and servicing the loans and the risks that exist for recovery One key is for a major employer to bear the cost of setting up a payroll deduction arrangement that then allows the employees to access such short-term financing on a relatively simple and cheap basis

Another important alternative worth exploring is the potential for pension entitlements to be used as collateral against repayment on loans for improving squatter housing, for which no proper mortgage can possibly be executed (This latter type of lending is an important innovation in South Africa) Pension entitlements can also serve as additional collateral in cases where households do not have sufficient cash for a required down payment

In the past, it may have been possible to involve a major donor in the provision of technical assistance and even long-term funding in this area In the last few years, donors have shifted away from such efforts, hoping that private financial institutions will develop an interest and expertise on their own (The one exception known to the author is the International Finance Corporation [IFC], which has expanded its involvement in housing finance) This situation further highlights the attraction of involving one or more foreign lenders in the market here Even if such lenders are not interested, their expertise can be tapped through consultancies or joint training opportunities

Summary and Conclusions

More than people realize, housing finance is a luxury, not a necessity, in a developing country To be done right, it requires an advanced combination of legal, financial, and socio-political infrastructure to be in place There are methods to cope without any housing finance and few developing countries have had truly proper systems in place at low levels of gross domestic product (GDP) per capita

Most of these difficulties arise from the size and term of the housing investment This makes it more likely that a loan made today will experience economic conditions, for good or bad, quite different from current ones The funding, loan design, value and access to the collateral, and loan approval process must all incorporate this high degree of uncertainty about the twists and turns of future events

The foundation of any system must be a very high reliability of recovery Lenders can only make loans at affordable terms if they face a reasonable and limited potential for default losses It is a "must" that land and housing become a reliable collateral in Tanzania

Another key is to have a conservative but informed underwriting process, the assessment of the ability and will of the borrower to repay, gauged against levels of burden and expectations of "unexpected" shocks A principle of underwriting is that borrowers must prove themselves to be creditworthy, not that lenders must make loans unless there is proof of dishonesty No member of the public nor any area of the country is entitled to a loan

Another major challenge, especially in developing countries, is to design a mortgage that has repayments that are both affordable and also protect the interests of the lender and the provider of funds The problem is that inflation and economic crises can cause interest rates to be very high and in general very volatile The major reason why interest rates are 20 percent or more in some countries and 10 percent or less in others is the rate of inflation Lenders need to be compensated for the loss in purchasing power of the currency, but the net effect is that borrowers can borrow less and have to effectively repay the loan faster There are some steps that can be taken to reduce this effect

Lastly, experience has shown that housing is a political issue This has meant that governments around the world take an active interest in the development of the market in housing finance However, there is a point beyond which governments cannot act, where only dispassionate judgments and incentivized behavior of the private sector can ensure proper administration It has been shown again and again that publicly appointed officials cannot respond appropriately to financial risks, both because of political pressures and because ultimately it is not their money at risk

Despite this universal experience, it has been found that there may be a role for public officials to encourage or facilitate the private provision of housing finance There are few countries that do not encourage housing finance through some method or another The government should be actively discussing with the private sector financial institutions what needs to be done to encourage their entry into this activity (of course, short of taking on the risks itself, which would defeat the purpose of having the private sector involved)

The important goal at the current stage of development in Tanzania is for the public and private sectors to cooperate in proceeding, step by step, toward the infrastructure needed to support truly private sector housing finance The shadow of past state interventions in the economy makes it even more important than usual for the sector to be imbued with private management and judgments as to risk-reward trade-offs This report has attempted to delineate such steps and to suggest ways that the government can facilitate the process and simultaneously encourage greater access to finance by a wider spectrum of income groups

UNITED REPUBLIC OF TANZANIA
MINISTRY OF LANDS AND HUMAN SETTLEMENTS
DAR ES SALAAM

FEASIBILITY STUDY FOR THE DEVELOPMENT OF A MARKET-ORIENTED HOUSING FINANCE SYSTEM IN TANZANIA

DRAFT REPORT PREPARED FOR·
THE GOVERNMENT OF TANZANIA

BY
SHELTER-AFRIQUE

DECEMBER 1997

24

Table of Contents

25

Charts

Appendices

Abbreviations

BFIA	Banking and Financial Institutions Act (1991)
BOT	Bank of Tanzania
CBD	Central Business District
CD	Certificate of Deposit
CDC	Commonwealth Development Corporation
ESAF	Enhanced Structural Adjustment Facility
GDP	Gross Domestic Product
GOT	Government of Tanzania
IFC	International Finance Corporation
LAPF	Local Authorities Pension Fund
LTV	Loan to Value ratio
ML&HS	Ministry of Lands and Human Settlements
NHC	National Housing Corporation
NIC	National Insurance Fund
NSSF	National Social Security Fund, formerly National Provident Fund
PPF	Parastatal Pension Fund
PB	Postal Bank
Shelter-Afrique	The Company for Habitat & Housing in Africa
TBL	Tanzania Breweries Ltd
THB	Tanzania Housing Bank
TMB	Tanzania Mortgage Bank, the proposed institution
TSh	Tanzania Shilling, the unit of currency exchanging at US$1=TSh 620

Tables

EXECUTIVE SUMMARY

1 At the request of government of the United Republic of Tanzania the Company for Habitat &Housing in Africa (Shelter-Afrique) investigated the feasibility of establishing a market-oriented housing finance system, involving the creation of a new institution A mission comprising Shelter-Afrique's Project Officer (Lamin Barrow) as mission leader, Housing Finance expert (Kihara Waithaka) and Economist (Dr Joe Oshomuvwe) as consultants, conducted field investigations in Tanzania during the period 29th June -7th July 1997

2 The study identifies some major constraints and proffers several policy recommendations for the emergence of a market-oriented housing finance system in Tanzania High population growth and rapid urbanization, at 3% and 6 5% per annum respectively, have contributed to the massive housing deficit in Tanzania and caused a strain on the provision of urban infrastructure and services Coupled with a poorly functioning land market, an institutional vacuum that prevents many individuals from acquiring the stock of housing units currently being liquidated by some of the parastatal entities, legislative and regulatory constraints, these constitute the main bottlenecks for sustainable shelter delivery in Tanzania

3 The mission noted that although there is excess liquidity in the banking system, banks and non-bank financial institutions have not ventured much into term lending activities, including for housing, partly because of the cumbersome procedures lenders face when enforcing their property rights

4 One major finding of the mission is that although reported incomes are generally low in Tanzania, there is no shortage of individuals developing housing units of fairly high standard The fact that many households augment their earnings through informal sector activities partly explains this phenomenon Nonetheless, the majority of the population cannot qualify for a mortgage under the proposed underwriting standards and prevailing construction costs, which translate to high house prices The report makes some suggestions on how government could assist the low income groups

5 Notwithstanding the constraints, there are compelling reasons for the establishment of a market-oriented housing finance institution, taking into account the potential effective demand arising to a large extent from the improved security of tenure to be provided by the New Land Act which is to be enacted The mission further proposes that the proposed housing finance institution be licensed as a bank under the BFIA (1991) Other findings and recommendations for establishing the proposed institution - Tanzania Mortgage Bank Ltd are highlighted below

6 **Project Description**

i) A **commercially- oriented** housing finance institution is proposed to mobilize funds and provide mortgages for the acquisition, construction and/or improvement of residential and commercial properties mainly within the urban areas of Tanzania

ii) It is recommended that the Head Office be located in Dar es Salaam s Central Business District, with branching to be dictated by growth of business

7 **Project Sponsor**

i) Although the Government of Tanzania is the promoter of this project, it is expected that majority shareholding in the new institution will be held by the pension and provident funds in the country, the insurance company, other corporate bodies and private individuals As a manifestation of its support to the project, the government could take a token 10% shareholding in the proposed housing bank

ii) It is highly recommended that at least one international/regional development institution be invited as technical partner in this venture, bringing in financial resources and technical expertise to assist in the proper take-off and growth of the institution

8 **Project Costs**

i) Total project cost is estimated at TSh. 1 515 billion (US$ 2 44 million) in order to establish a viable housing finance institution This includes TSh 1 14 billion for mortgage lending during the first year of operations, as it is envisaged that the institution would be self-sustaining using locally mobilized resources

ii) The breakdown of these costs is provided below

Item	Cost (TSh '000')
Office/house rentals	52,000
Furniture	14,500
Partitions etc	12,500
Motor Vehicles (2)	58,000
Computer equipment	160,000
Pre-Operational expenses	43,000
Capital Costs	340,000
Contingency	34,000
Mortgage advances (year 1 only)	1,141,000
Total	**1,515,000**

Proposed Financing Plan

Equity	Tsh'million'	%	%
Insurance	180	15	
Pensions/Provident Funds	480	40	
Banks	120	10	
Private Individuals/Companies	180	15	
[illegible]	[illegible]	[illegible]	[illegible]

Loans

Int/Regional dev institutions	315	20 79
Total	1,515	100 00

9 **Resource Mobilization Strategy**

i) The proposed financing plan relates to the raising of seed capital necessary for launching the new housing finance institution Thereafter, it is envisaged that the new housing finance institution will raise funds locally using a variety of financial instruments, which will include but not be limited to, housing bonds, bearer certificates of deposit, current, fixed and ordinary deposit accounts

10 **Institutional Structure and Legal Framework**

i) It is recommended that the new institution be registered as a limited liability company and licensed as a bank under the BFIA A seven member Board of Directors is proposed, six representing investors in cumulative subscriptions of Tsh 20 million, representing 16 66% of the authorized and called capital, in addition to a Managing Director It may, however, be necessary to allocate seats to the international/regional shareholders on the basis of their subscriptions

ii) The day-to-day management of the institution should be delegated to a team headed by a Managing Director who may be seconded by the technical partner in the formative stages of the institution The team should include a Tanzanian counterpart designated as Executive Director

11 **Project Implementation**

i) The project may be implemented in accordance with the plan appended to this report, which sets July 1998 as the project's inauguration date

12 **Conclusion**

i) The project is considered both a feasible and viable proposition as it will fill an existing institutional gap in the country's financial sector, contribute in the expansion of the rate of capital formation and the realization of development objectives set for the housing sector

ii) However, the success of the project will be dependent upon the following factors -

a) establishment of well defined property rights, in particular expediting the procedure for enforcement of foreclosure laws by establishing commercial courts,

b) legislative and policy reforms such as enactment of the proposed Land Act repeal of the Rent Restriction Act articulation of a policy for the provision off-site infrastructures and the introduction of modern systems of registering land titles and charges created over land,

c) GOT agreeing to grant tax exemptions for interest earned on housing bonds and similar saving instruments to be introduced by the new institution,

d) loans from international/regional institutions guaranteed by the Government or made available in Tanzania shillings to avoid adverse foreign exchange risks to the project,

e) the institution adopting a variable mortgage rate system, and

f) efficient and dynamic management can be provided to run the new institution

1 COUNTRY BACKGROUND

1 1 The United Republic of Tanzania, which lies between the great lakes Victoria, Tanganyika and Nyasa on one side and the Indian Ocean on the other, covers 945,500 square kilometers including approximately 60,000 square kilometers of inland water The country is endowed with ecological diversity that can form the basis for a diversified agricultural and tourism economy Tanzania consists of mainland Tanganyika, the islands of Zanzibar and Pemba, which formed a political union and became the United Republic of Tanzania on 26 April, 1964 After more than 30 years of single party socialist rule, the country adopted multiparty democracy in 1995

1 2 Tanzania is divided into 20 regions on the mainland and five regions in Zanzibar There is only one level of local government in the country made up of urban and district (rural) authorities At the national level, there are both the Union and Zanzibar governments, with the seat of the Union Government to be transferred to Dodoma upon completion of construction works

1 3 Although more than 75% of the country's 31 9 million population (1997) still live in rural areas, the urban population has been growing rapidly since independence Dar es Salaam, the capital city and economic nerve center, has a population of 2 2 million which is projected to increase to 3 96 million by 2015 Other major urban centers include Mwanza, Mbeya, Bukoba, Arusha and Dodoma Approximately 46% of the population is less than 15 years of age with life expectancy at birth being 57 years

2 ECONOMIC OVERVIEW

2 1 With per capita income estimated at US$130 (1995), although household surveys reveal average expenditure closer to US$210, Tanzania belongs in the category of least developed countries The country has undergone significant political and economic transformation, performing relatively well in meeting basic human needs and economic growth targets until 1967 when the "Arusha Declaration" was adopted which put the country on the path of socialism Economic policies pursued by the government thereafter were based on nationalization, restrictions and pervasive state intervention in all sectors of the economy

2 2 Although some impressive gains were made in the social front, for example a literacy rate of 76% and improved access to health services a combination of factors such as inappropriate policies, declining terms of trade, poorly performing parastatals and successive droughts plunged the country into economic crisis This was manifested in the decline of GDP growth from an average rate of 5 1% per annum between 1970-76 to less than 2% between 1977 and 1986 A decline in real per capital income by more than 15% between 1965-86 was accompanied by a rise in the annual inflation rate from 5% in 1966-70 to 34% in 1995 as the overall budget deficit reached 11 5% of GDP The balance of payments position equally deteriorated, with the current account deficit (before official transfers) increasing from US$321 million in 1975 to US$644 million in 1995

2 3 Under the aegis of the International Monetary Fund and World Bank inspired Structural Adjustment Programme, a three-year reform programme was initiated in 1982 followed in 1986 by an Economic Recovery Programme with main objectives as follows

i) increase domestic production of food and exports

ii) restore efficiency in the mobilization and utilization of domestic resources

iii) reduce the rate of inflation from 30% in 1986 to 5% by 1998/89

iv) restore internal and external balances by pursuing prudent fiscal, monetary and exchange rate policies

v) rehabilitate the infrastructure, in particular transport and communications, to support directly productive activities, and

vi) revamp the industrial sector using appropriate trade and industrial policies

2 4 The government has made significant progress in reforming the incentive system and in laying the foundations for greater private sector role in the economy Restrictions on trade, foreign exchange, interest rates and private banking were lifted while privatization is in full gear, with 141 out of 300 parastatals privatized by June 1997 Industrial activities have also expanded as several companies are now prospecting for diamonds, gold and gemstones The mining industry registered growth rates averaging 6% in the past three years and is expected to be a major source of employment and income in the medium term While tourism sector activity has also expanded, the country's potential remains underutilized The informal sector continues to play a significant role, accounting for 22% of the labor force

2 5 Economic performance over the reform period (1986 - 1995) has been mixed As can be gleaned from Table I, GDP growth exceeded the population growth rate of 3% per annum during this period, reversing the decline of per capita income from -0 6% in 1986-90 to a growth rate of 1 7% in 1995 Robust export growth contributed to an improvement in the current account deficit but inflation has remained high, peaking at 36% in 1994 before declining to 18% in 1996 Macroeconomic management therefore remains a major concern as critical areas such as public expenditure programming and management, banking and civil service reform require urgent attention

Table I Selected Macro-Economic Indicators (1986 - 95)

	'86-'90	'91-'93	'94 estimates	'95
GDP growth at factor cost	3 9	4 5	3 6	4 7
GDP per capita at factor cost	0 6	1 4	0 7	1 7
Export (growth)	4 4	4 9	12 8	20 3
Import (growth)	2 3	-0 3	22 6	6 6
Current Account deficit/GDP/1	15 7	22 0	22 6	12 1
Fiscal Deficit/GDP	7 6	5 4	10 2	n/a
Total Expenditure/GDP	23 2	20 2	23 0	n/a
Revenue/GDP	15 8	15 2	15 0	n/a
Terms of Trade (rate of exchange)	-5 0	-4 5	-1 9	0 1
Domestic Inflation Rate (%)	28 6	22 0	36 0	30 5
GDI/GDP/2*	27 7	32 8	31 3	24 0
DS/GDP/3	7 6	4 7	3 3	4 6

Sources Tanzania Challenge of Reform, World Bank, 1996 and Economic Bulletin, BOT 1997

2 7 The widening gap between savings and investment has been financed mainly by external inflows, with Official Development Assistance averaging 20% of the GDP in 1986-94 This made it possible for investment to expand in spite of the sharp decline in national savings While investment share in GDP peaked at 37 9% in 1990 before declining to 22% in 1995, savings behavior has been erratic, reaching a low of 1 4% of GDP in 1987, rising to 17 1% in 1994, declined sharply to 2 2% between 1991 and 1992 before increasing again to 4 6% in 1995

2 8 Performance of the construction industry has been equally volatile, its share in GDP rising from 2 8% in 1985 to 4 8% in 1987 After declining marginally to 4 6% in 1988, it rose to 5 3% in 1990 before declining again to 4 3% in 1991 There was an upward trend from 1992, reaching 4 9% in 1994 Activity in this sector reflects the general economic problems of the period and the increase from 1992 is associated with the resumption of growth in the economy

3 MONETARY POLICY AND FINANCIAL SECTOR REFORM

3 1 The objectives for the macroeconomic policies supported by the ESAF reforms initiated in 1996 are to achieve real GDP growth of 4 5% in 1997/98, a budget surplus at 0 5% of GDP in 1996/97, reduction in the rate of inflation to 5% by 1998/99 and closing in on the current account deficit Tight monetary policy adopted during the period, reflected in the sharp decline of M3 growth to 16 3% in 1995/96 from 36 2% in 1994/95, led to a reduction in domestic credit, especially bank credit to the private sector

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* 1 GDP = Gross Domestic Product, 2 GDI = Gross Domestic Investment, 3 DS = Domestic Savings

37

3 2 Interest rates liberalization, a key component of the financial sector reforms, have spawned higher spreads between deposit and lending rates While deposit rates are on a declining trend, with savings rates moving from 26% in 1989 to 10 25% as at end June 1996, short term lending rates remained at 20% between 1989 and 1991, declined to 18% in 1992 but have risen to 30 5% in 1997 Similarly, medium and long term lending rates declined to 28 5% in 1996, but rose to 34% in 1997 Mortgage interest rates have not changed, remaining at 29% from 1989 until the demise of THB in 1995

3 3 The regulation of the financial sector has undergone significant changes since the Banking Ordinance (Cap 430) was enacted in 1960 This legislation subjected banks to inspection by the Registrar, stipulated their minimum paid up capital and required banks/financial institutions to invest 25% of their annual income in government stocks and bonds

3 4 In 1967, the Ordinance was superseded by the "Arusha Declaration," which brought about the nationalization of all private banks Specific Acts were enacted that defined the objectives and powers of individual state owned banks and non-bank financial institutions Nonetheless, by effectively removing the control and supervisory functions of the BOT, these regulations had the effect of plunging the banking sector into a crisis

3 5 The enactment of the Banking and Financial Institutions Act (BFIA) in 1991 constituted a milestone in Tanzania's financial system as it paved the way for entry of private foreign and domestic banks As at September 1997, the country had eleven banks, seven non-bank financial institutions and eighty-five operating bureaux de change Although BOT was vested with the power to license, supervise and regulate bank and non-bank financial institutions, it had no powers to deal with erring banks A case in point is the National Bank of Commerce, the largest commercial bank, whose accumulated losses reached TSh 100 billion by June 1994 with most of its loans irrecoverable loans as many borrowers were politically connected Government has recently issued a policy statement to the effect that NBC will be split into two separate banks pursuant to its privatization

3 6 In addition to the BFIA and related regulations issued by the BOT, the following statutes were enacted,

i) Loans and Advances Realization Trust Act (1991) to facilitate the collection of bad debts transferred from banks and financial institutions,

ii) Capital Markets and Securities Act (1994) setting the framework for the establishment and regulation of capital market institutions, including the stock exchange

3 7 The introduction of indirect controls within the context of financial sector reforms in the 1990s, have contributed to improvements in the capital position of banks and financial institutions The ratio of non-earning assets in their portfolios declined from 71 53% in 1995 to 56 61% in 1996 while liquidity ratios (see Table II) increased from 48 1 % in 1995 to 65 1% This performance is largely on account of increases in Treasury Bill investments, which grew from TSh 32 23 billion to TSh 93 44 billion (189 9%), and holdings of foreign assets which shot up by 46 7% from TSh 146 23 billion to TSh 214 52 billion during the period

35

3 8 Changes in the composition of assets and liabilities of the banking system presented in the pie-charts below for 1995 and 1996 reveal that on the liabilities side, local deposits grew from 36% to 56% in 1996 while foreign deposits increased by 20% in 1996 Capital and Reserves increased by 12% in 1996 compared with zero growth in 1995 while other liabilities decreased substantially from 63% in 1995 to 12% in 1996

Table II Liquidity Analysis of Banks and Non-bank Financial Institutions (Figures in TSh million)

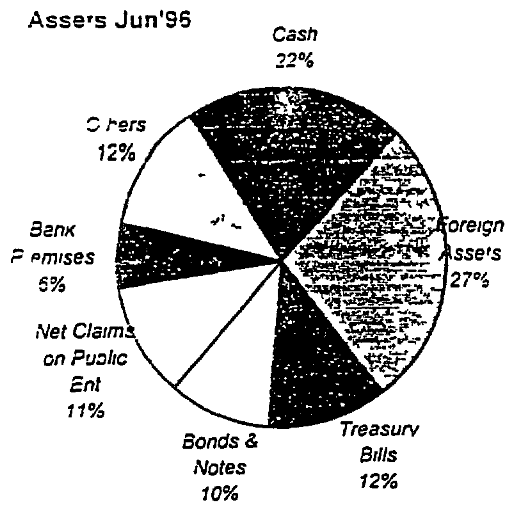
Liquid Assets	June 1995	June 1996
Cash	74,077	74,835
Foreign Assets	146,238	214,523
Treasury Bills	32,233	93,447
Total	**252,548**	**382,805**
Liquid Liabilities		
Deposits	524,572	593,178
Liquid Assets/ Liquid Liabilities Ratio	48 1%	65 1%

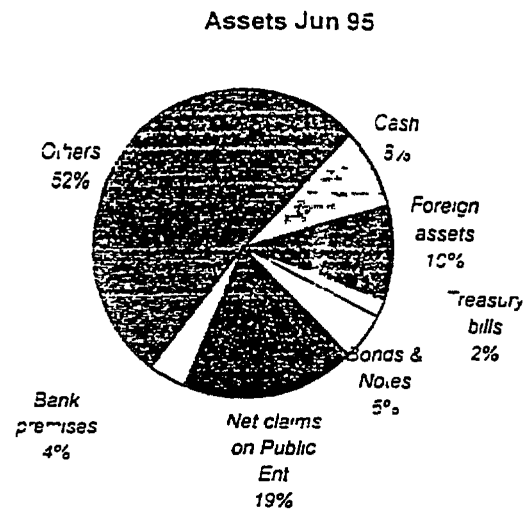
Source BOT Directorate of Banking Supervision, Annual Report 1996

CHART I

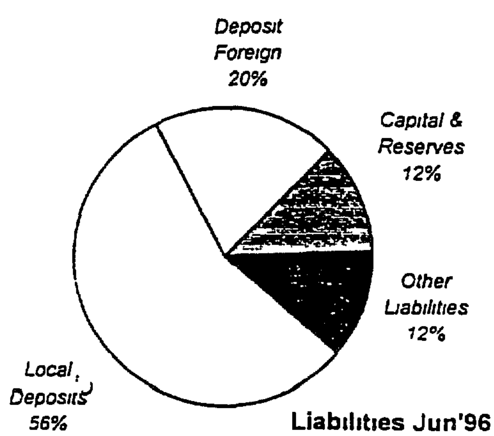
ASSETS

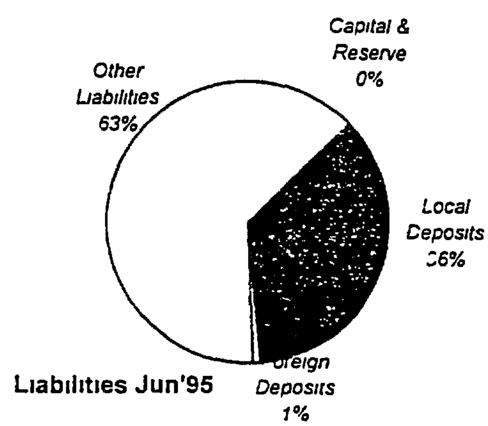
Assets and Liabilities of the Banking System





LIABILITIES





Source BOT. Directorate of Banking Supervision, Annual Report 1996

4 DEMOGRAPHY AND URBANIZATION

4 1 Tanzania's population is projected to increase to 55 8 million by the year 2017, assuming a growth rate of 3% per annum With an urbanization rate of 6 5%, the share of the urban population which grew from 6 4% in 1967 to 24 4% (7 7 million) in 1997, is projected to increase to 43% of the total population by 2017 Population density reached 33 7 persons per square kilometer in 1997, up from 26 1 in 1989 Urban population growth is largely attributable to natural growth, as borne out by the findings of the 1988 population Census that nearly half (48%) of the inhabitants of Dar es Salaam were actually born in the city

4 2 Against this backdrop, pressure has increased on the already overextended urban infrastructure and services Failure on the part of the government to provide, expand or invest in infrastructure to cater for the rapidly expanding urban population has led to the emergence of unplanned settlements, with as many as 70% of Dar es Salaam's population accommodated in these areas

5 LAND DELIVERY SYSTEM

5 1 The Land Ordinance (1923) vests ownership and control of all land in the state Land is allocated by way of a Right of Occupancy which is granted expressly or deemed in case of land held under customary tenure The general approach toward making land available in the urban areas is by way of declaring a planning area. Planned land is granted for tenures of between one and five years and for long term of 33 and 99 years

5 2 Since land in Tanzania is considered to be publicly owned, the transfer of undeveloped land is prohibited and there is officially no market in undeveloped land, which removes the basis on which land values can be calculated In practice, however, there is a thriving market in land, both official and unofficial (Kironde,1997) It is instructive to note from Table III that 50% and 69 4% of land in the urban areas and Dar es Salaam respectively was purchased

Table III Percentage of Land Tenure by Area

Land Tenure	ALL	URBAN	DAR
Inheritance	0 3	0 4	0 6
Public Authority	21 3	13 6	7 3
Clearing	19 8	11 7	11 9
Purchased	45 5	50 0	69 4
Other Sources	5 6	10 0	4 6
Reason not given	7 4	14 3	6 0
Total	**100 0**	**100 0**	**100 0**

Source Tanzania Challenge of Reforms Vol II World Bank 1996

5 3 **While the supply of serviced land is extremely limited, modern administrative and legal systems for surveying, recording and transferring title are poorly developed** These constitute a major constraint for the establishment of a market-oriented housing finance system Among the reasons adduced for this situation include the lack of

38

resources to acquire, plan and survey land in time to meet demand Others include poor conceptualization of the land market which ignores the role of the private sector and the informal land delivery system where the bulk of urban plots are exchanged

5 4 To address these shortcomings, a new National Land Policy was adopted by the government in May 1995 A new Land Act which is expected to be enacted shortly specifically recognizes the monetary value of land, thereby making it tradable Clear land ownership rights will be spelt out so that property rights are enforceable

5 5 **It should be emphasized that these legislative changes will be necessary to give impetus to the take off of dynamic mortgage and land markets If enacted, the new Land Act will enhance security of tenure, revolutionize the land delivery system and create a robust source of revenue for government through the property tax system**

6 OVERVIEW OF THE HOUSING SECTOR

6 1 Institutional Framework

6 1 1 The main objective of Tanzania's National Housing Policy (1981) is to ensure that citizens have access to adequate shelter and basic services The Ministry of Lands and Human Settlements (ML&HS) has the responsibility of implementing this policy while its Housing Development Division coordinates the activities of various actors in the sector Department of Lands performs valuations, registrations and settles land disputes, Surveys and Mapping department handles cadastral surveys and mapping functions while Human Settlements prepares urban layouts and plot demarcations

6 1 2 Although the policy recognizes the socio-economic importance of the shelter sector, **government has not been providing adequate budgetary resources for the effective functioning of the Ministry and its technical Departments** Hence investment in housing related activities averaged 4 9% of GDP between 1964-1984 and has been on a declining trend

6 1 3 **The weaknesses of the National Housing Policy emanate from the fact that implementation strategies and action plans were not embarked upon to follow-up on the policy statements Furthermore, the lack of clearly defined institutional arrangements has resulted in the inability of the Housing Department to effectively carry out its responsibilities Therefore, there in a need for the policy to be updated to incorporate developments in the sector, articulate the proper role of the private sector in shelter delivery and the specific strategies to be pursued by government in facilitating access to land by developers and in providing off- site infrastructure and services**

6 1 4 Tanzania Housing Bank (THB), which was established by an Act of Parliament in 1972 to finance housing and real estate development, ceased operations in August 1995 as a result of insolvency Other institutions such as NIC, PPF and NPF develop houses for rental and sale, including multi-storey buildings for rental There is also a revolving loan scheme for civil servants to finance the renovation, construction or purchase of houses However, its funding base is limited and it has only succeeded in providing loans for few civil servants

6 1 5 National Housing Corporation (NHC) is the largest formal sector property developer in Tanzania It was established by an Act of Parliament No 45 (1962) and reconstituted in its present form by the Act of Parliament No 2 (1990) after the dissolution of the Registrar of Buildings Under the revised Act the Corporation is charged with the responsibility of providing and facilitating the provision of residential houses and other buildings for business and other purposes in Tanzania

6 1 6 During the first decade of its existence, the performance of the NHC was very impressive in terms of the number of housing units completed (15,964 housing units between 1962 and 1990) and the construction cost for these units was considerably lower than the industry average in East Africa However, in the wake of the economic crisis of the mid 1980s, the Corporation began to experience financial constraints which has affected its performance According to NHC's corporate plan, it targeted building 798 housing units between 1985/86 and 1989/90 but the actual number of units completed was only 222 Of the 1,000 housing units targeted from 1991/92 to 1995/96, only 168 units were developed NHC owns 6,000 properties with 20,000 units, 70% of which are residential and 30% commercial Some 2,000 of these properties are located in Dar es Salaam

6 1 7 In the face of dwindling government subventions, NHC resorted to borrowing from commercial banks at market rates Although the Corporation had to rely increasingly on rental income and proceeds from the sale of incomplete houses, 30% of total rents due to NHC are currently in arrears and current rentals for NHC properties are estimated to be at least 300% less than those charged for private housing units of similar standard Computerization of the billing function will make record keeping and retrieval systems more efficient, hence improve NHC's financial performance

6 1 8 **Furthermore, the Rent Restriction Act currently in force constitutes a serious impediment to the Corporation's financial performance and its scrapping will eliminate a major disincentive to private investment in rental housing** At a time of economic crisis, NHC cannot adjust rents upwards and it appears that the Corporation has little or no recourse in the eviction of nonpaying tenants as the judicial system is known to be protective of such tenants Besides, bureaucratic delays in prosecuting cases leads to appeals being tied up in the courts for up to three years

6 1 9 To generate funds for its real estate development activities, a phased program of asset privatization should be undertaken by NHC starting with the sale of high cost housing units which may be the most unjustifiable and a more politically feasible strategy

6 2 Housing Conditions

6 2 1 In 1991, Tanzania had a stock of 3 6 million shelter units with an average of 2 5 rooms per unit Assuming an average of 1 9 rooms per shelter, the shelter deficit was estimated at 1 7 million units (Continental Shelter Atlas 1996) The situation has not improved and contribute to the poor housing conditions in Tanzania as shown in Table IV

40

Table IV Basic Housing Amenities (Percentage of Households)

	TANZANIA Poorest	TANZANIA Better off	ALL	RURAL Poor	RURAL ALL	URBAN	DAR ES SALAAM
Houses with non-earth floor	5 5	54 9	27 1	4 3	11 2	55 9	91 6
Houses with iron roof	20 1	71 9	45 0	17 5	29 9	75 0	94 2
Houses with no windows	25 5	7 4	14 8	27 8	19 3	5 5	0 8
Houses with glass windows	1 1	3 4	2 3	1 2	2 0	3 2	1 8
Electricity supply (Households with)	1 7	30 8	11 2	0 5	0 8	30 3	51 8
Kerosene as the main source of lighting fuel	94 4	70 5	88 0	96 4	97 1	72 1	48 8
Wood as the main source of cooking fuel	96 8	53 2	79 6	99 0	96 6	50 0	5 0
Households without toilet facilities	10 2	2 4	5 3	10 9	6 6	2 6	1 3

Source Tanzania Challenge of Reforms Vol II World Bank, 1996

6 2 2 As shown in the Table, housing conditions are generally poor although households in urban areas, particularly those in Dar es Salaam, tend to have better access to services Only 49% of households in Tanzania, and 10% of households in the urban areas, have access to safe water About 56% of households in the urban areas live in houses with non-earth floors While 75% have iron roofs, only 30% of households in the urban areas, compared with 51% of households in Dar es Salaam, have access to electricity More than 72% and 50% of the households in the urban areas use kerosene and wood as the main source of lighting and cooking fuels respectively With regard to toilet facilities in all Tanzania, only 2% of households have flush toilets, the bulk (92%) using pit latrines

6 3 Sources of Finance

6 3 1 In the absence of formal sources of finance for housing, most individuals secure loans from relatives, employers and money lenders to supplement their savings and current incomes for purposes of financing their house construction activities The main source of housing finance in the formal sector was the Tanzania Housing Bank until its collapse in 1995 and, to a lesser extent NIC, PPF and NSSF For instance, NIC invested TSh 4 4 billion on building projects, representing 27 5% of its investible funds while PPF commits 11% of its income for real estate investment

6 3 2 Commercial bank lending to the building and construction sector has dropped consistently since 1993 to reach TSh 3 11 billion, representing 2 3% of the total lending volume, in June 1996 after peaking at TSh 6 60 billion in 1993

7 HOUSING MARKET

7 1 Demand and Supply

7 1 1 Among the factors which influence housing demand include income, land tenure systems as they affect property rights, house prices, the availability of housing finance and in some cases, taxes and subsidies The demand for housing increases as household incomes grow Many people aspire to own houses as a consumer durable, a cultural status symbol and as a hedge against inflation

7 1 2 The administrative apparatus for registering land ownership and issuing titles does not function well in Tanzania Under the proposed Land Act security of tenure will be enhanced, as clear land ownership rights will be spelt out so that leaseholds can be freely exchanged and utilized as collateral

7 1 3 Housing supply is influenced by factors such as the availability and cost of housing inputs infrastructural services as well as the legal and regulatory framework within which suppliers operate In Tanzania, most building materials are imported and depreciation of the local currency in the recent past has translated into higher prices Government's capacity to provide infrastructure and services is limited by the budgetary situation, as is the enforcement of building standards and regulations **The practice of stringent rent control has also contributed to the deterioration in the quality of housing services and perpetuates an inefficient hidden system of subsidies at great cost to the economy**

7 1 4 The private sector supplies almost 98% of all new houses in a year and there is an emerging class of private developers who provide residential and commercial units for sale or rental In a few instances, some of them have undertaken joint ventures with the NHC which supplies only 2% of all new houses NHC s new houses are sold only to cash buyers prepared to provide 25% down payment and the remaining 75% of the house price paid within one year after handover of the property

7 1 5 The informal sector plays a significant role in the housing market, in terms of the goods and services they offer, which include the production of building materials such as bricks, metal fabrications, carpentry products, in supplying casual labor, and with auto-construction as the dominant mode of production However, the incremental nature of these activities ensures that housing development takes a very long time to complete because households have to match their investment to their variable income streams Since most houses are built by private individuals who take a long time to complete their construction, the existence of a housing finance institution could be advantageous in reducing inefficiencies associated with tying capital resources that remain underutilized for long periods

7 2 Assessment of Housing Needs

7 2 1 The requirement for housing arises from newly formed households as well as the need to upgrade and replace the existing stock Apart from population growth, the trend of rural-urban migration adds to the growth of urban households while overcrowded conditions in the existing stock also necessitate the production of new units On the assumption that an occupancy rate of more than two persons per room constitutes overcrowding, it is obvious that there is an element of overcrowding especially in the urban areas, with average household size of 5 48 persons and average 2 5 rooms per house On account of the poor housing conditions noted even in the urban areas, it is conservatively estimated that at least 8% of the existing stock, representing 288,000 of the 3 6 million stock of housing units, need to be upgraded and 5% representing 180,000 units, need to be replaced

7 2 2 In 1993, Tanzania had about 5 243 million households (Continental Shelter Atlas, 1996) Given an average urban household size of 5 48, the total number of households in 1997 is estimated at 5 8 million and projected to increase to 10 2 million by the year 2017 (see Table V below)

42

Table V Population Growth and Household Formation

COUNTRY	1997	2002	2007	2012	2017
Population	31 914 400	36 701 560	42 206 794	48 537 813	55 818 485
Annual growth rate(%)	0 0	3 0	3 0	3 0	3 0
Average Household size	5 48	5 48	5 48	5 48	5 48
Total Households	5 823 795	6 697 364	7 701 969	8 857 265	10 185 854
New Households per year	0 0	194 126 5	223 245 4	256 732 3	295 242 0

URBAN AREA	1997	2002	2007	2012	2017
Population	7 787 114	10 317 926	13 671 251	18 114 409	24 001 592
Annual growth rate	0 0	6 5	6 5	6 5	6 5
Average Household size	5 48	5 48	5 48	5 48	5 48
Total Households	1 421 006 2	1 882 833 2	2 494 754 0	3 305 549 0	4 379 852 5
New Households per year	0 0	54 574 8	72 311 7	95 813 0	126 952 0

7 3 Affordability Analysis

7 3 1 The asset value of housing that households can afford is the capitalized amount of the investment they may make It is determined by the amount households devote to monthly housing payments and the terms of the mortgage loan they are able to take

7 3 2 Housing expense is, in turn, a function of income and the share of that income devoted to other expenditures such as food, clothing and other services Based on the expenditure patterns highlighted in World Bank's Country Survey (1996), average annual household incomes in Tanzania range from TSh 255, 847 for the poorest households to TSh 1 13 million for the better-off In Dar es Salaam, the average income for the better-off household is estimated at TSh 1 18 million per annum The survey reports that the poorest households in Tanzania devote TSh 13, 982 or 5 4% of their income to housing, while the better-off devote TSh 66, 570 or 5 8% for same In most cases, however, between 25% to 30% is a safe rule of thumb for allowable housing expenditure

7 3 3 Presently in Tanzania, mortgage loans could only be affordable to the top two quintiles of the income distribution bracket. Based on the average annual income of the better-off in Dar es Salaam, and assuming a loan term of 20 years nominal interest rate of 22%, 25% down payment for a standard house with total floor area of 54 12 sq meter and costing TSh 8 million, affordability analysis is presented below based on a typical borrower profile

Borrower Profile for Mortgage Facility

LTV = 75% Term= 20 years Interest= 22%p a

Borrower's annual salary	=	TSh 1 18 million
Total Monthly income	=	**TSh 98,470**
Allowable housing expenditure (30% of monthly income)	=	TSh 29,541
Standard House price	=	TSh 8 million
Down payment	=	TSh 2 million
Required mortgage loan amount	=	TSh 6 million
Required monthly installment	=	**TSh 111,400**

7 3 4 With a poverty index of 50%, and on the basis of the foregoing analysis, it would appear that the majority of Tanzanians would not be in a position to afford the standard house because the TSh 111 400 required for the monthly mortgage repayment is more than 300% of the allowable monthly housing expenditure

7 3 5 However it must be mentioned that there is no shortage of individuals buying building and renting houses at these and higher prices **Although incomes are reportedly low in Tanzania, the fact that many households augment their earnings through informal sector activities partly explains why they seem to be paying a significant share of their incomes to acquire houses, apart from the growing cultural premium placed on house ownership** In the urban areas, more than 75% of households have two to four sources of income (see Table VIII below)

Table VI Income Diversification In Tanzania (Percentage of Households)

	TANZANIA Poorest	TANZANIA Better-off	ALL	RURAL Poorest	RURAL ALL	URBAN ALL	DAR ES SALAAM ALL
Number of different origins for sources of incomes							
One source of income	20 7	27 4	22 1	20 9	19 0	23 0	55 0
Two sources of income	41 2	34 05	38 0	38 9	38 0	39 4	31 9
Three sources of income	26 2	24 9	26 9	26 9	29.2	24 9	8 4
Four sources of income	11 9	13 2	13 0	13.2	13 9	12 7	4 4
TOTAL	100	100	100	100	100	100	100

Source Challenge of Reforms Vol II, World Bank 1996

7 3 7 The above scenario indicates that informal sector activities generate supplementary incomes, and have been estimated to be as high as 45% of G D P Another interesting aspect about house affordability in Tanzania is the fact that for the 168 housing units recently developed by NHC under the Tabata Housing Scheme, there were 375 applications, all of them cash buyers, a ratio of 2 2 applicants per house NHC and other developers are confident that many more applicants could come forward if mortgage financing facilities become available in the country

8 ESTABLISHING A HOUSING FINANCE INSTITUTION

8 1 Background

8 1 1 Like other East African states, Tanzania had a housing finance institution before independence in 1961 The First Permanent Building Society operated in the three East African states, Nyasaland, Northern and Southern Rhodesia providing savings and mortgage facilities mainly to Europeans and to a lesser extent, Asians However, as agitations for independence heightened in the region uncertainties about the future among these groups caused a run on the Society, leading to its eventual collapse

8 1 2 The measures instituted by the Colonial (now Commonwealth) Development Corporation (CDC) on behalf of the British government to rescue the Society resulted in the creation of a housing finance company in each of the East African countries Thus the Housing Finance Company of Tanzania (HFCT) came into being, with CDC and the government of Tanzania as equal shareholders in the new company As part of the ongoing nationalizations, the Tanzania Housing Bank (THB) was established in 1972 as successor to HFCT with objectives as follows

44

(ı) to mobılıze local savıngs and external resources for housıng development,
(ıı) operate savıngs, tıme and term deposıt accounts,
(ııı) promote housıng development,
(ıv) make loans, and guarantee loans made by others for the constructıon and development of commercıal and ındustrıal premıses,
(v) ensure the ımplementatıon of Government polıcy on housıng and buıldıng

8 1 3 The three shareholders ın THB were

		TSh (mıllıon)	%
(ı)	Government of Tanzanıa	186 0	46 5
(ıı)	Natıonal Insurance Corporatıon	120 8	30 2
(ııı)	Natıonal Provıdent Fund	93 2	23 3
		400 0	100 0

8 1 4 THB was placed under lıquıdatıon ın 1995 as a result of a myrıad of problems vız

(ı) a weak capıtal base - at the tıme of the collapse the share capıtal was TSh. 400 mıllıon,

(ıı) the tendency to depend on short-term borrowıng to finance long-term assets, thus creatıng an asset - lıabılıty mısmatch,

(ııı) hıgh commercıal lendıng rates due to hıgh cost of borrowıng and very hıgh proportıon of nonperformıng loans, more than 50% of THB's outstandıng loans beıng ın arrears,

(ıv) poor record keepıng, makıng the follow up of defaulters extremely dıfficult,

(v) lendıng agaınst unsurveyed land wıthout extra securıty and sometımes dısbursıng loan funds agaınst nonexıstent propertıes,

(vı) operatıng ın a legal envıronment that ıs ınefficıent and at tımes outrıghtly corrupt whıch made loan recovery long and cumbersome

8 2 **Case For**

8 2 1 The most obvıous reason for establıshıng a new housıng finance ınstıtutıon ıs that Tanzanıa had, even before ındependence Tanzanıans have utılızed housıng finance servıces and mortgage facılıtıes There ıs, therefore, an ınstıtutıonal gap to be filled as ıs the general perceptıon

8 2 2 However, the most compellıng reason ıs **the many housıng unıts on offer for sale by the NHC and other parastatals that have eıther been or are beıng prıvatızed/restructured There are few buyers ready and able to acquıre these houses ın the absence of a mortgage financıng facılıty or ınstıtutıon** In the case of NHC, thıs lack of mortgage finance ıs sıngled out as the bıggest ımpedıment to mıddle and lower-ıncome Tanzanıans' abılıty to purchase the 4,000 NHC housıng unıts approved for sale by the government between 1994 and 1997 It ıs also the cause of government's apparent unwıllıngness to approve the sale of another 2,000 propertıes belongıng to the Corporatıon Other parastatals e g Natıonal Insurance Corporatıon Postal Bank and the

45

recently privatized Tanzania Breweries Ltd (TBL) are being compelled to sell their residential properties so that they can concentrate on their core businesses For this exercise to succeed, there is definite need for a mortgage financing facility/ institution in the country An advertisement for sale of 21 properties by TBL was viewed with great skepticism in the absence of such an institution

8 2 3 In addition to these ready-to-take business opportunity for the proposed housing finance institution, NHC and other developers have plans for real estate development, especially for the low and middle income segments of the population Some of these schemes involve the provision of serviced plots while others entail making available for sale housing units at different stages of completion For these housing projects aimed at meeting the demand of a rapidly expanding urban population to be successfully implemented, the availability of mortgage financing is a necessary condition

8 2 4 As Tanzania moves toward a market economy, the forces of demand and supply will become the main determinants of resource allocation It is, therefore, to be expected that a market- oriented housing finance institution could stimulate the emergence of private developers with beneficial effects for aspiring homeowners

8 2 5 On the supply side, there is a further incentive for establishing a housing finance institution as some of the institutions, specifically NIC, NSSF, PPF, LAPF and the Postal Bank (PB) are involved in businesses that generate a lot of medium to long-term funds Investing in real estate continues to be the main investment opportunity that is available to these institutions and some of them have set aside specific amounts of their investible funds that should go into housing For these institutions, a commercially-oriented housing finance institution could serve as a right conduit to channel their funds When established, the housing finance institution could shift the burden of managing housing loans from these institutions while providing them with viable investment opportunities The new institution will, therefore, benefit from having dependable sources of deposits with which to fund its mortgage origination business

8 2 6 Finally, it should be noted that when the development of a capital market is completed, the stock exchange could serve as an excellent platform for wholesale funds mobilization by the proposed institution This can be done through the issuance of commercial paper, housing bonds or similar asset backed debt instruments, thereby contributing to the deepening of the capital market

8 3 Case Against

8 3 1 From the review of information available to the Consultants, and discussions held with officials of GOT and other interested organizations, there are some major factors that militate against establishing such an institution These are constraints that, if not addressed at an early stage, might affect the future solvency of the institution

- First is the stigma of associating the new institution with the recently collapsed THB This perception will disappear if the new institution is fully autonomous, with a professional management team that is apolitical in the conduct of its business This kind of management team could create confidence in the marketplace, especially to the depositing public and those seeking mortgage loans Actions already taken by the Government to ensure that no depositor with the defunct THB loses his deposit and the creation of a Deposit Insurance Fund already have gone a long way in creating depositor confidence

- Secondly, is the "culture of nonpayment tolerance" which is said to have been fostered for decades in Tanzania by the socialist orientation In the new capitalist era and with the requisite legal framework in place changes in attitudes toward borrowing and loan repayment will occur

- Related to the above is the general perception of the court system in Tanzania Tenants or borrowers threatened with eviction or foreclosure take their cases to court where it takes up to three years to resolve, which is obviously very frustrating to landlords and lenders as the case may be NHC, the biggest landlord in Tanzania and hence the main culprit, has already initiated discussions for speeding up the judicial reform process **More serious consideration should therefore be given to the idea of creating commercial courts to deal with cases more expeditiously** This will certainly constitute a significant development not only for the establishment of a market-oriented housing finance system, but for other lenders in the economy as a whole

- Fourthly, **the process of land allocation, titling and registration is fraught with bureaucratic delays and identified as a major constraint to the development of vibrant housing and land markets in Tanzania** Government is, however, addressing this issue beginning with a National Land Policy which was adopted in March 1995, to be followed with a Land Act which is soon to be submitted for Parliamentary approval and enactment The most important provision of the new land law is that land will have monetary value and therefore tradable

- The process of land allocation, registration and issuing of titles need to be streamlined and modernized, as these actions will ensure that leaseholds can be freely exchanged and usable as collateral for mortgages

- Finally, **inadequate urban infrastructure and services, particularly access roads, constitute serious impediments to housing development** For instance, NHC is currently undertaking two housing projects in Dar es Salaam and although the houses are nearing completion, there are no access roads Water reticulation and lack of waste disposal systems also impose constraints to housing development

8 3 2 It is encouraging that the government is aware that provision of urban infrastructure and services remains its responsibility It is, however, recommended that government intensifies its provision of urban infrastructure and services to facilitate an investment from developers, with spillover effects on access to housing

9 INSTITUTIONAL FRAMEWORK

9 1 Considerations

9 1 1 Having regard to the arguments advanced for and against a housing finance institution in Tanzania, the logical conclusion is that it should be established The new institution should be based in Dar es Salaam's CBD for at least the first five years Thereafter the decision to establish a branch network in other major towns within the country should be informed by business potential

47

9 1 2 In considering the type of housing finance institution to establish, the alternatives considered include a bank, broadly defined as "a financial institution authorized to receive money on current account subject to withdrawal by cheque" a financial institution which is like a bank but does not operate current accounts and a building society

9 1 3 The trend worldwide is a convergence towards universal banking, with banks providing all types of financial services, including housing finance, under one roof For instance, in the United Kingdom, building societies have been converting into banks and operating within an integrated financial system Although the financial sector is not highly developed in the Tanzania, the situation should not be any different Besides the fact that there are no major differences between a bank and a financial institution as far as licensing and supervision considerations are concerned, operating as a bank offers more flexibility in terms of the scope for resource mobilization and providing a diverse range of financial products While the eight newly licensed commercial banks are busy establishing themselves and providing short-term credits, the proposed institution could develop a niche in offering mainly housing finance products The National Bank of Commerce, with branches all over the country is undergoing a restructuring and therefore is not in a position to provide housing finance

9 1 4 As regards a building society, it should be noted that although the first housing finance institution in Tanzania was a building society, in the last three decades no building society has operated in the country, and there is no sperate legal regime governing the operation of such institutions in Tanzania In addition, most of the population has little idea how a building society operates This conclusion is supported by the Kenyan experience where the business of housing finance is carried out by both financial institutions such as HFCK and building societies **It is therefore recommended that the proposed institution be registered as a bank although its core function will be mortgage financing activities**

9 1 5 The new institution should be registered as a limited liability company under the Companies Ordinance and licensed under the Banking and Financial Institutions Act (1991) However, two amendments to this Act 1991 call for special note

(i) Section 13, (2) (a) as amended by "Written Laws" (Miscellaneous Amendments (No 2)1994 "Every financial institution shall commence operations with a minimum core capital of not less than TSh 500, 000,000 or such higher amount as the Minister may, by order published in the Gazette, prescribe, and shall maintain this minimum amount at all times

(ii) Section 13 (3) also amended by "Written Laws" as above, "Notwithstanding subsections (1) and (2), no one individual body corporate owned or controlled directly or indirectly or otherwise shall have a beneficial interest in more than twenty percent of the share capital of any bank or financial institution,"

9 1 6 The implications of the above are that a financial institution's minimum share capital is TSh 500 million while the minimum number of shareholders cannot be less than five

48

9 2 **Capital Structure**

9 2 1 It is expected that the majority shareholding in the proposed Tanzania Mortgage Bank Ltd will be held by Tanzanians, both corporate and individuals While the pension funds and NIC may be the most desirable investors government could have a token presence as a sign of its support, subscribing to 10% of the shareholding It is also proposed that at least two international and/or regional development institutions be invited to invest as technical partners and/or long-term lenders in the venture The share capital proposed for TMB is TSh 1 2 billion (US$1 9 million), divided into 1,200,000 shares each at a nominal value of TSh 1000

9 2 2 It is also proposed that a long-term loan of TSh 315 million (US $500,000) be sought from the international/regional institutional shareholders and lending agencies Distribution of the TSh 1 515 billion capital structure could be as follows

Type of Investor	%	TSh	%
Equity			
Pensions Funds	40	480	
Insurance Companies	15	180	
Banks	10	120	
Private Individuals/ Companies	15	180	
Int /Regional devt Institutions	20	240	
	100	1,200	79 21
Loans			
Int /Regional devt institutions		315	20 79
Total		1,515	100 00

9 2 3 This will result in a debt ratio/equity of 1 4 While it is recommended that the equity be contributed in full during the first year of operation, the loan should be disbursed only when the institution is ready to utilize the proceeds for lending operations Concerning representation at the Board of Directors it is proposed that shareholders be allocated seats in blocks of subscriptions up to TSh 20 million of the authorized and paid in capital In addition to a seat for the Managing Director, the number of seats would be seven

9 3 **Office Premises**

9 3 1 Having concluded that establishing a housing finance institution is justified, it is logical to consider its location and the space requirements for its operations Ideally, the new bank should be housed in its own building and be prominently located in Dar es Salaam s Central Business District (CBD) The desire to operate from own building must, however, be balanced against the need to utilize all the funds available for the purpose of mortgage underwriting during the first few years of operation It may therefore be appropriate to

rented premises for the new institution until such time as its funds position allow for the purchase or construction of its own headquarters building The following space would be required initially

Use	Area
Offices	$400m^2$
Banking Hall/Computer Room	$200m^2$

10 RESOURCE MOBILIZATION STRATEGY

10 1 The proposed housing bank will depend on shareholders'funds, loans, public and institutional deposits for its operations Current, time and savings deposits will be encouraged As the new institution will have to compete with the existing commercial banks, seven non bank financial institutions and any new entrants it must, therefore, devise resource mobilization strategies that will make it competitive by offering market rates **It should also be noted that there is currently a very high spread between deposit and lending rates in the banking** system In July 1997, savings rates ranged from 2% to 10% while the prime rate stood at 24% and 25% at Standard Chartered and First Adili banks respectively As at 31 December 1995, time and saving deposits with commercial banks stood at TSh 188 14 billion while the PB had TSh 22 29 billion in savings accounts These increased by 27 8% and 7 5% to reach TSh 240 40 billion and TSh 23 96 billion respectively as at the end of December 1996 At the end of March 1997, time and savings deposits with commercial banks increased further to TSh 254 40 billion while savings with the PB stood at TSh 24 60 billion

]2 Per the proposed Implementation Plan (Appendix III), the first step is for the project promoters, ML&HS, possibly with the assistance of the Consultant (Shelter Afrique) to bring together the prospective local investors (PPF, NPF& NIC) to confirm their investment interest in the proposed housing bank The consultations should also agree on a capital structure and implementation programme International/regional development institutions such as IFC, CDC and Shelter Afrique should also be sounded out as to whether they could participate in this venture

3 Once agreement is reached on the shareholding structure implementation programme and financing plan, an Interim Committee of Shareholders should be constituted to coordinate project implementation, including the recruitment of key staff, until a formal Board of Directors is appointed to supervise the operations of the housing bank

4 When it opens its doors for business, the bank can launch the following resource mobilization strategies

(i) encourage members of the public to open current, savings and time deposit accounts For this purpose, the institution should have custom- built banking hall with full computerization of its operations,

(ii) encourage employers, including government institutions, to pay salaries through the institution,

50

(iii) introduce savings products like "Contractual Saving for Housing for potential clients

(iv) introduce a programme through which employers wishing to provide housing loans for their employees can do so without having the burden of managing the loan portfolio themselves Participating employers will be required to deposit funds with the bank to on-lend as mortgage loans to their employees The employer may determine the applicable mortgage rate while a margin of 3 or 4% points will be sufficient to cover the administrative cost of the programme and provide the bank with returns

(v) enter into specific arrangements with the institutions that generate long term funds with a view to channeling these funds to housing through the bank This will involve agreement on interest rate and other terms for their deposits The institutions to be approached include some of the potential shareholders The housing finance institution can structure housing bonds, commercial paper or similar asset-backed debt instruments either on private placement or through the stock exchange when it is operational

(vi) seek GOT and Bank of Tanzania permission to issue tax free housing bonds and bearer certificates of deposits that are negotiable

11. ADMINISTRATIVE AND MANAGEMENT STRUCTURE

11 1 It is proposed that TMB be supervised by a seven man Board of Directors to be appointed by and representing the shareholders The Board will be expected to delegate the implementation of its policy to an executive management team headed by a Managing Director, who may be seconded by one of the technical partners

11 2 The Managing Director, who should be professionally qualified with an excellent track record in managing similar institutions, will help develop the necessary confidence in the new institution from both the depositing and borrowing public Having regard to their experience with the recently collapsed THB, depositors in particular will need to be convinced that the new housing finance institution will operate on sound commercial principles, be able to operate by the rules and resist any political or other undue pressures

11 3 The precise number and categories of other staff to be hired initially will be determined by the Board of Directors on the advice of the Managing Director However, some of the key staff must be there early to establish the operating norms of the bank

11 4 Once the institution is fully operational it is expected to have the following staff

Job Title	No.
Managing Director	1
Executive Director (ED)	1
Mortgage Manager	1
Finance Manager	1

51

Computer Supervisor	1
Mortgage Officers	2
Accounting Assistant	1
Operators	2
Secretaries/Clerical Staff	11
Messengers\Drivers	4
	25

11 5 An organigram is proposed in Chart II with the estimated costs for the full staff complement provided as Appendix I Salaries proposed for the top management are comparable with those obtaining in the banking industry of Tanzania Five key officers will constitute the company's top management as shown below

Job Title	Qualifications
1 Managing Director	A university graduate with extensive experience in housing finance and/or banking at senior managerial level
2 Executive Director	As for Managing Director above but with a legal background He/she will handle all the legal aspects of transactions
3 Mortgage Manager	A university graduate with relevant and practical experience in banking, preferably lending and administration at a managerial level for at least four years
4 Finance Manager	A university degree plus professional qualification in accounting coupled with practical experience in housing finance, investment and/or banking at managerial level for not less than four years
5 Computer Supervisor	A diploma in computer science/information technology plus practical experience in managing computer operations of a medium to large organization especially in the financial sector

11 6 Other staff to be engaged should have relevant experience in their respective areas of competence Staff involved in mortgage lending and administration will be given short term training while external training could be limited to short- term attachments at successful housing finance institutions in countries within the region such as Kenya, Zimbabwe and South Africa Suppliers of the computers and the software will also be expected to provide in- house training as part of their sales packages

12 SUPPORTING ACTIONS AND POLICIES BY GOVERNMENT

12 1 The proposed housing finance institution will be a a profit- oriented institution Although the government may not have a direct role in the institution it will nevertheless, **be expected to provide the enabling environment in terms of the macroeconomic, legal and regulatory framework, and in the provision of the physical infrastructure** In particular GOT will be expected to put in place credible macroeconomic policies, entailing low budget deficits for maintaining low levels of inflation Coupled with the reinforcement property rights, foreclosure laws and procedures, these will be vital ingredients for the emergence of a sustainable housing finance system by reducing both credit and systemic risks

12 2 It should also be acknowledged that housing has a major social welfare component which helps create political and social stability in a nation By assisting the new institution in its role of promoting housing delivery, the government will also be achieving its goals for maintaining economic, social and political stability

12 3 Government could also **facilitate the mobilization of funds by such fiscal measures as making interest on residential mortgages tax- deductible and exempting interest on housing bonds and other deposit raising instruments issued by the new housing bank from taxation** Should the new company's external lenders insist on a government guarantee, the same may be considered on its own merit

12 4 As regards investment incentives and the enabling environment in general, external investors will look to the government policy on remittance of profits, dividends and capital The investors will also want speedy approval and licensing of the new institutions as the approval and licensing process for new investments is currently fraught with bureaucratic delays

12 5 It is also recommended that the new institution makes it mandatory for every borrower's life to be insured for an amount equivalent to the loan taken and for the entire duration of the loan Modalities for the payment of insurance policy premiums regarding mortgage protection and fire hazard can be worked out with interested insurance companies

12 6 The last, but not the least important issue to consider relates to the question of subsidies for the low income groups It is noted that many housing subsidy programmes have not succeeded in helping the target group as the benefits tend to leak to higher income groups Furthermore, lumpsum subsidies are more transparent and effective for housing subsidy programmes

12 7 For Tanzania, it is would not be prudent to burden the proposed housing finance institution with the management of subsidies for the low income groups In any case, it is very unlikely that the government will provide housing subsidies to its low income people from the central budget Rather, government should assist the low income groups by providing serviced plots to encourage the allotees to mobilize financial and other resources to acquire their own dwellings With an improved budgetary position the government can consider financing the provision of cash grants and other forms of direct support for low income housing

53

In addition to providing serviced plots to low income groups, the government can give incentives to private developers to build houses that are affordable by these groups, one such example being land allocation free of charge or at minimal prices In this instance the government would allocate serviced land to developers on the express condition that houses to be constructed on the land will be sold for prices which do not exceed an agreed figure, which should be adequate to generate normal profits to the developers The Buru Buru and Koma Rock estates in Nairobi were developed on the basis of this principle

OPERATIONS

Introduction

The structure of the financial sector in Tanzania is fairly rudimentary and has no secondary markets or credit reporting agencies Consequently, the new institution will have to administer mortgages from origination to the time when they are fully repaid This involves receiving loan applications and processing them to the point where first charges on the properties being purchased, constructed or improved are registered and funds disbursed, and then servicing the loans until they are fully repaid The institution will have to operate in a manner that will protect investors and create confidence with depositors and borrowers alike

Business Line

TMB will offer various financial services, although it will concentrate on housing finance business which basically entails

(i) mobilizing savings and other deposits, and

(ii) utilizing the funds for the provision of mortgage loans for purchase, construction and improvement of residential, commercial and industrial buildings

The bank may diversify its portfolio by offering other financial services such as leasing and hire purchase, loans for consumer durables like motor vehicles, household goods

Underwriting Standards

TMB must establish stringent underwriting criteria to be met by every borrower, and which may include the following

(i)	loan to value ratio	-	most mortgage lenders require between 15 and 25% of the property value to be financed from borrowers' own resources,
(ii)	verification of income	-	for employed applicants, a letter from the employer is sufficient,
		-	for self-employed applicants, tax returns for the preceding three years or bank reference are required,

54

(iii)	housing expense ratio	- between 25 and 30% of the total monthly income ratio income of the household is allowable,
(iv)	loan servicing	- check off system, i e , direct deduction from salary and remittance by the employer of the borrower, - bank standing orders and/or internal transfer orders from savings accounts maintained with the housing finance company (especially for the self-employed)
(v)	security/collateral for the loans	- first charge on the property against which the loan is made and/or credit enhancements such as institutional guarantees or co-mortgagees
(vi)	type of property to be financed	- if existing, the soundness of the structure and materials used must be verified, - if the loan is for construction of new dwelling/buildings architects plans approved by the appropriate authority plus specifications by a registered quantity survey or architect must accompany the application
(vii)	tenure of the property	- if leasehold its unexpired term should not be less than 2 times the term of the loan
(viii)	loan disbursement	- for purchase of an existing property, funds will be disbursed on fulfillment of all preconditions including registration of the first charge on the property - if the loan is for construction, stage disbursements will be made on fulfillment of all preconditions plus certification/ verification by a registered valuer that the borrower has used the respectively agreed amount on construction
(ix)	term of the loan	- between 15 and 20 years depending on the income and age of the borrower and the type of the property being financed
(x)	insurance	- the subject property must be insured against fire and other hazards while the borrower's life will be insured for the amount and the term of the loan

4 **Fixed vs Adjustable Interest Rates**

4 1 In an inflationary economy, the application of fixed interest rates result in diminution of the real value of the repayments to the detriment of the lender Because of this, the use of adjustable interest rates for long-term lending instruments such as mortgage loans are common The rate of interest is usually indexed or pegged to a benchmark instrument in the economy such as inflation rate, treasury bills rate, central bank's discount rate or simply the average cost of funds for the particular institution or a reference group of institutions

4 2 **For the proposed housing bank, the application of an adjustable rate of interest is highly recommended, with the interest rate pegged to the commercial banks' average base lending rate** The basis for this recommendation is that currently in Tanzania, banks apply fixed rates because they lend mainly for short term Rate setting for long term lending should, however, be done in such a way that the institution's average mortgage rate is at least 200 basis points above the average base lending rate This rate, currently 24% p a. in Tanzania, is likely to go down as government efforts to bring down the inflation rate bears fruit The margin will provide the institution with a sufficient return on its funds while borrowers will accept this rate for the privilege of securing mortgage loans

5 **Operational Benchmarks· Volume of Lending**

5 1 As stated in this report, the new institution has readily available pool of properties to provide mortgage loans to their purchasers The number of mortgages to be concluded during the first year of operation will, however, depend on the availability of funds and the ability of the management team to process mortgage applications to their conclusion

2 It is, nonetheless, suggested that the new institution should be able to process at least 60 mortgages during the first year of operations Loans can be spread out to cover different price ranges and different income groups An indicative spread is set out below -

Maximum loan amount	No	%	Total (TSh."000")
TSh 9,556,000	20	33 2	191,120
TSh 15,000,000	10	16 7	150,000
TSh 20,000,000	10	16 7	200,000
TSh 25,000,000	10	16 7	250,000
TSh 35,000,000	10	16.7	350,000
Total	60	100.0	1,141,120

5 3 During the first three years of operation, the number of mortgage loans advanced may be modest starting with 60 loans in the first year increasing to 75 and 95 in the second and third years respectively As the staff become better trained and experienced, they will be able to handle more loans per year It is thus projected that between the fourth and sixth years, the number of mortgage loans concluded will increase at the rate of approximately 35%

› 4 From the seventh year onwards, the number of loans is expected to increase at a rate of 10% per annum For the first ten years, therefore, the projected mortgage lending in both the number of mortgages and the amount is as follows

Year	No of Mortgages	Amount in TSh 000
1	60	1,141 120 0
2	75	1 369,344 0
3	95	1,780,147 2
4	125	2,403,198 7
5	170	3,244,318 2
6	230	4,379,829 5
7	255	4,817,812 4
8	280	5,299,593 6
9	305	5,829,552 9
10	335	6,412,508 1

13 5 5 Having regard to the number of NHC's housing units already approved for sale and those awaiting approval, it is safe to conclude that shortage of housing units is not likely to be the limiting factor **However, one factor that will determine the number of eligible borrowers will be the mortgage rate charged by the new institution** It has already been suggested that such a rate should, at most, be two percentage points above the banks' average base lending rate At the time of the Consultants' visit to Dar es Salaam, the average base lending rate was about 24% p a with the rate of inflation at 16 5% BOT and many players seem to agree that the inflation rate is coming down, hence average base lending rates will follow a similar pattern

13 5 6 Besides inflation, the benchmark for banks' base lending rates is the yield on Treasury Bills Up to 1992, the rate of Treasury Bills was fairly steady at around 13-14% However, in 1993 the rate rose sharply to between 28 9% and 75 7% and continued into the first quarter of 1995 Thereafter, a marked drop in the rate occurred between June 1995 and June 1996 as the weighted average yield of Treasury Bills fell from 46 7% to 18 3% By the end of December 1996, the yield had decreased further to 13 5% and at the end of March 1997, it stood at 8 1% Interest rates on both deposits and lending have also followed more or less similar trends during the last five years Given that the inflation rate and the yield on Treasury Bills are falling, it is to be expected that the banks average base lending rates will also fall

13 5 7 It is, therefore, expected that the average base lending rate will be in the region of 20-22 % in the near future This would suggest that it should be possible for the new housing finance company to lend at between 23 - 25% Its average borrowing rate, having regard to the need to give long-term depositors an attractive and positive rate of interest, will be around 15 - 17% p a giving a margin of approximately 7% which is considered adequate to meet all operational costs and give a reasonable return to the shareholders' funds

14 COMPUTERIZATION

14 1 One of the major problems that caused the collapse of THB was poor record keeping which led to massive defaults by the borrowers To avoid a repetition of this problem, it is proposed that all aspects of the new bank's operations be computerized from the very beginning It is therefore suggested that the project implementation team identify and install a suitable and cost-effective computerized banking package

14 2 Although most banks and financial institutions prefer to have custom-made software, usually developed in-house or by commissioned consultants proper record keeping is considered so crucial that the new institution cannot afford to wait for software to be developed In any case, off-the-shelf packages suitable for mortgage operations are available in the market

14 3 ' BANKPLUS"software is currently being used satisfactorily by HFCK in Kenya Apart from being easy to install and operate, it is an integrated package suitable for banking and mortgage lending operations, as well as the preparation of accounts including the general ledger With regard to maintenance, a contract is typically entered between the user and the supplier, in addition to the usual warranty period Because of its versatility, 'BANKPLUS may be utilized and its cost has been included in the investment estimates

14 4 Regarding computer hardware, it is noted that there are many PCs suitable for big operations such as a mortgage bank's For instance, the versatility of IBM AS/400 makes it suitable for a mortgage company with only one office or a network of branches Both the IBM AS/400 and "BANKPLUS" software can also be modified to accommodate expanding operations

14 6 There should be workstations at seven different points in the company one each for the Chief Executive, Executive Director, Mortgage, Finance and Administration managers Computer Supervisor and two for the tellers

Appendix I Estimated Staff Costs

Salaries			TSh '000"
Managing Director			2 500
Executive Director			1,200
Managers	800 x 2	=	1,600
Computer Supervisor & Other Senior Officers	600 x 4	=	2,400
Operators/Senior Secretaries	300 x 4	=	1,200
Clerical Staff	250 x 9	=	2,250
Junior Staff	200 x 4	=	800
			11,950
Add Pension/medical benefits (10%)			1,195
Training element ($2^{1}/_{2}$%)			299
Monthly Staff Cost			13,444
Annual Staff Cost			161,325
Add Board of Directors Fees			6,000
Initial Training expenses			5,000
Grand Total			**172,325**

58

Appendix II Estimated Cost of Furniture, Motor Vehicles and Equipment

Office furniture and Office Supplies for

		TSh "000"
MD and ED	TSh 4,000	
Managers	TSh 4,500	
Others	TSh 6,000	14,500
Partitions		6,000
Banking Hall		5,000
Motor Vehicles		58,000
Computers (Hardware) with 7 workstations		60,000
Software - 'BANKPLUS'		100,000
		243,000
Add Contingency 10%		24,300
Total Cost		276,300

59

Appendix III :Proposed Implementation Programme For The Establishment of Tanzania Mortgage Bank Ltd. (1998)

ACTIVITY	JANUARY		FEBRUARY		MARCH		APRIL		MAY		JUNE	
1 Forum for Potential Investors												
2 Call for Shares Subscription & Allotment												
3 Company Formation, Appointment of Board of Directors & Application for Banking License												
4 Rental of Head Office												
5 Confirmation of Board Members												
6 Procurement of Goods & Services												
7 Establish Departments & Recruitment of Staff												
8 Installations & Training												
9 Finalize Resource Mobilization Strategy												
10 Inauguration Ceremony												

Appendix IV Duties and Responsibilities of Senior Managers

(A) Managing Director.

The Managing Director will have the overall responsibility for the bank s operations on a day to day basis In this role, he/she will be responsible for implementing Board policies and decisions with a view to ensuring continued growth and profitability of the bank

(B) Executive Director

The Executive Director will be responsible for all legal matters of the bank's operations He/ she shall undertake such tasks and responsibilities as will be assigned to him by the Managing Director and will deputize for the latter during his/her absence In addition, he/ she will have specific responsibilities over the company's public relations and business development activities

© Mortgage Manager

The Mortgage Manager will, under the direction of the Managing Director, be responsible for the operation of an effective system of mortgage lending and administration He/ She will be required to

1 Organize and supervise the work flow in respect of lending operations from the receipt of an application to the eventual disbursement of the funds,

2 Maintain and operate a mortgage administration system that ensures that

- repayments are regularly received and credited to the respective mortgage accounts,
- any default in repayments is detected quickly and follow up action taken,
- the fire and the mortgage protection policies are always in force during the currency of the mortgage,
- the mortgaged properties are well maintained

3 Train, deploy and evaluate staff of the Department and ensure there is industrial peace,

4 Undertake such other tasks and responsibilities as may be assigned to him by the Company

(D) Finance and Administration Manager

The Finance and Administration Manager will, under the direction of the Managing Director, be responsible for directing and supervising resource mobilization, accounting functions and administrative aspects of the bank such as office accommodation, cleaning and security, stores and purchases, etc

The manager will be required to

1. Ensure that cash receipts, custodv and banking are handled with due diligence and efficiency,

2. Spearhead mobilization of funds, initiate programmes for attracting pensions, provident and trust funds accounts,

3. Undertake investments and management of short-term funds, that is, management of the organizations' liquidity,

4. Maintain proper and adequate records of all transactions and ensure that proper accounting system is in place at all times

5. Ensure careful use, handling and maintenance of the company's property

6. Undertake such other tasks and responsibilities as may be assigned to him by the Managing and Executive Directors

(E) Computer Supervisor

The Computer Supervisor will, under the direction of the Managing Director, be responsible for the installation, development and effective utilization of the bank's management information system

Appendix V TANZANIA MORTGAGE BANK Ltd.
SUMMARY OF PROJECTED MORTGAGE ADVANCES (TSh "000")

Year	1	2	3	4	5
Mortgage Advances	1,141,120	1,369,344	1,780,147	2,403,199	3 244,318
Cumulative Mortgage Advances	1,141,120	2,510,464	4,290,611	6,693,810	9,938,128
Interest Received (24%)	273 869	602,511	1,029,747	1,606,514	2,385,151
Mortgage Report (5%)	57,056	125,523	214,531	334,691	496,906
	330,925	728,034	1,244,278	1,941,205	2,882,057
Cumulative Mortgage Repayments	57,056	182,579	397,110	731,800	1,228,707
Mortgage Advances O/S	1,084,064	2,327,885	3,893,501	5,962,010	8,709,421

FINANCING PLAN (TSh."000")

Planned Business Volume	1,141,120	1,369,344	1,780,147	2,403,199	3,244,318
Share Capital 'A' Shares	960,000				
'B' Shares	240,000				
Forex Loans	315,000				
Housing Bonds/Debentures	-	200,000	250,000	300,000	300,000
Deposit/PF/Savings	300,000	1,000,000	1,500,000	2,000,000	2,800,000
	1,815,000	1,200,000	1,750,000	2,300,000	3,100,000
Self-generated Funds	-	169,344	30,147	103,199	144,318
Total Financing	**1,815,000**	**1,369,344**	**1,780,147**	**2,403,199**	**3,244,318**
Cumulative H B/Debentures	-	200,000	450,000	750,000	1,050,000
Cumulative Deposits/PF/ Savings	300,000	1,300,000	2,800,000	4,800,000	7,600,000

63

Appendix VI TANZANIA MORTGAGE BANK Ltd.
PROJECTED INCOME STATEMENTS (TSh "000")

Year	1	2	3	4	5
INCOME					
Interest Received (24%)	273,869	602,511	1,029,747	1,606,514	2,385 151
Application fees (1%)	11,411	13,693	17,802	24,032	32,443
Investment income (8 5%)	34,000	34,000	34,000	34,000	34,000
Other income	1,000	1,000	1,000	1,000	1,000
Total Income	320,280	651,204	1,082,549	1,665,546	2,452,594
COST OF FUNDS					
Interest on Forex Loan (9 5%)	29,925	26,184	22,444	18,703	14,963
Interest on Debentures (15%)	-	30,000	67,500	112,500	157,500
Interest on Deposits (15%)	45,000	195,000	420,000	720,000	1,140,000
Total Cost of Funds	74,925	251,184	509,944	851,203	1,312,463
Gross Profit/ (Loss)	245,355	400,020	572,605	814,343	1,140,131
Operating Expenses					
Staff Costs	161,325	177,458	195,203	204,963	215,212
Administration & General Expense	53,775	59,153	65,068	68,321	71,737
Depreciation	29,000	29,000	29,000	29,000	29,000
Amortization	5,410	5,410	5,410	5,410	5,410
Directors' fees	6,000	6,000	6,000	6,000	6,000
Audit fees	2,000	2,000	2,000	2,500	2,500
Rent	46,800	46,800	51,480	51,480	56,628
Marketing	12,000	12,000	12,000	12,000	12,000
Total Expenses	**316,310**	**337,821**	**360,751**	**379,674**	**398,487**
Net Profit/(Loss) Before Tax	**(70,955)**	**62,199**	**211,854**	**434,669**	**741,644**
Tax (37 5%)	-	-	76,162	163,001	278,117
Net Profit /(Loss) After Tax	**(70,955)**	**62,199**	**135,692**	**271,668**	**463,527**

64

Appendix VII TANZANIA MORTGAGE BANK Ltd
APPROPRIATION ACCOUNT (TSh "000")

Year	1	2	3	4	5
Net Profit after Tax	(70,955)	62,199	135,692	271,668	463,527
Provision for Bad Debts (2%)	-	(1,244)	(2,714)	(5,433)	(9,271)
Distribution Profit/(Loss)	(70,955)	60,955	132,978	266,235	454,256
Dividend 'B' shares (17%)	-	-	20,906	45,260	77,224
Net Profit for 'A' shares	(70,955)	60,955	112,072	220,975	377,032
Dividend 'A' shares (75%)	-	-	76,554	165,731	282,775
Retained Profit	(70,955)	60,955	35,518	55,244	94,257

65

Appendix VIII TANZANIA MORTGAGE BANK Ltd PROJECTED BALANCE SHEETS (TSh "000")

Year	1	2	3	4	5
Fixed Assets	235,000	235,000	235,000	235,000	235 000
Less Depreciation	29,000	58,000	87,000	116,000	145,000
Net Book Value	206,000	177,000	148,000	119,000	90,000
Pre-operating expenses	21,640	16,230	10,820	5,410	0
Mortgage Advances	1,084,064	2,327,885	3,893,501	5,962,010	8,709,421
Less Prov for Bad debts	0	(1244)	(3958)	(9391)	(18662)
Cash and Investments	432,341	445,754	837,027	1,324,601	2,039,876
	1,744,045	2,965,625	4,885,390	7,401,630	10,820,635
Financed by -					
Equity	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000
Retained Profits	(70,955)	(10,000)	25,518	80,763	175,019
Shareholders' funds	1,129,045	1,190,000	1,225,518	1,280,763	1,375,019
Provision for Tax			76,162	163,001	278,117
Provision for Dividend			97,460	210,991	359,999
Forex Loans	315,000	275,625	236,250	196,875	157 500
Housing Bonds/Debentures	-	200 000	450,000	750,000	1,050,000
Deposits/PF/Savings	300,000	1,300,000	2,800,000	4,800,000	7,600,000
	1,744,045	2,965,625	4,885,390	7,401,630	10,820,635

Appendix IX TANZANIA MORTGAGE BANK LTD
SOURCE AND APPLICATION OF FUNDS STATEMENT (TSh "000")

Year	1	2	3	4	5
SOURCES OF FUNDS					
Net Profit before Tax	(70,955)	62,199	211,854	434,669	741,644
Add back Depreciation	29,000	29,000	29 000	29,000	29 000
Amortization	5,410	5,410	5,410	5,410	5,410
	(36,545)	96,609	246,264	469,079	776,054
Mortgage Repayments	57,056	125,523	214,531	334,691	496,906
Self - generated funds	20,511	222,132	460 795	803,770	1,272,960
Equity	1,200,000				
Forex Loans	315,000				
Housing Bonds/Debentures	-	200,000	250,000	300,000	300,000
Deposits/PF/Savings	300,000	1,000,000	1,500,000	2,000,000	2,800,000
Total Source of Funds	**1,835,511**	**1,422,132**	**2,210,795**	**3,103,770**	**4,372,960**
APPLICATION OF FUNDS					
Furniture & Fixtures		20,000			
Motor Vehicles		55,000			
Computer		60,000			
Software		100,000			
Pre-operating Expenses		27,050			
Mortgage Advances	1,141,120	1,369,344	1,780 147	2,403,199	3,244,318
Tax Paid	-	-	-	76,162	163,001
Dividend 'B' shares	-	-	-	20,906	45,260
'A' shares	-	-	-	76,554	165,731
Forex Loan Repayment	-	39,375	39,375	39,375	39,375
Total Application of Funds	**1,403,170**	**1,408,719**	**1,819,522**	**2,616,196**	**3,657,685**
Increase /Decrease in Cash	432,341	13,413	391 273	487,574	715,275
Opening Cash Balance	-	432,341	445,754	837,027	1,324,601
Closing Cash Balance	432,341	445,754	837,027	1,324,601	2,039,876

Appendix X LIST OF PERSONS INTERVIEWED

1 **Ministry of Lands & Human Settlement**

D M S Mari	-	Principal Secretary
J Mghweno	-	Director of Housing
	-	Deputy Director of Housing

2 **Ministry of Finance**

W L Nyachia	-	Treasury Registrar
G M K Msella	-	Ag Assistant Treasury Registrar

3 **Ministry of Economic Planning/Planning Commission**

	-	Ag Director

4 **National Housing Corporation**

H M Sanga'nya	-	Ag Managing Director
N K S Malisa	-	Research and Planning Manager
H C Mutagwaba	-	Principal Economist

5 **Parastatal Pension Fund**

D E Mattaka	-	Director General

6 **National Insurance Corporation**

P M Kapalata	-	Ag Managing Director
H Mgude	-	Director, Human Resources and Administration
Mwako Rubo Asumevsye	-	Investments Manager
R Ngai (Mrs)	-	Manager, Estates Management
H A Nohum	-	Civil Engineer

7 **USAID (Tanzania)**

H Mrema	-	Development Specialist
D Ngoloy	-	Economist
R Mpazi	-	Secretary

8 **Presidential Parastatal Sector Reform Commission**

N N P Shimwela	-	Co-ordinator
D P Mwanyika	-	Senior Legal Counsel

9 **Tanzania Investment Bank**

A W Mosille	-	Director of Projects Appraisal
L J Magoma	-	Manager Advisory Service Department

10 **Bank of Tanzania**

Dr J L Masawe	-	Deputy Director, Economic Research & Policy Department
M J Gasabile	-	Bank Examiner

11 **Standard Chartered Bank**

T Bowen	-	Executive Director, Corporate and Institutional Banking

12 **National Bank of Commerce**

A N J Karashani	-	Special Assistant to Managing Director

13 **Sustainable Dar Es Salaam Project**

B B K Majani	-	Project Manager

14 **Tanzania Telecommunitcation Co Ltd.**

G Kibola (Mrs)	-	Principal Legal Officer

15 **University College of Lands and Architecture**

Dr J M Kironde	-	Registrar

16 **Private Sector**

A T H Mwakyus	-	Director General, National Engineering and Design Company (NEDCO)
M IQbal Haji Mohammed	-	Director, Baghdad Tower Ltd

Comments on
"Feasibility Study for the Development of a Market-Oriented Housing Finance System in Tanzania"
Douglas B. Diamond
Final, March 13, 1998

On 16 December 1997, Shelter Afrique (SA) provided the Government of Tanzania (GOT) an evaluation of the feasibility of creating a market-oriented housing finance system, involving the creation of a new institution The present document provides a brief review and evaluation of that report The SA report was based on research and interviews conducted in Tanzania in mid-1997 This evaluation is based solely on the contents of the final report and has not benefited from personal research in Tanzania

In summary, the report reaches the conclusion that a Tanzania Mortgage Bank (TMB) should be established as a new institution, chartered as a bank This author's primary concern with the report is that this conclusion seems to have been preordained and not subject to enough critical analysis and consideration of alternatives From the information available, it appears that there may be sufficient potential for mortgage lending operations to support continued evaluation, but not necessarily the creation of a housing bank and certainly not the rapid action plan proposed in the SA report

The discussion here will follow that in the SA report and highlight concerns on issues as they appear there At the end, there is a more general discussion of the prospects for housing finance in Tanzania

Background Sections (1-5)

The SA report notes the very low per capita income levels in Tanzania and the long period of experimentation with socialist economic structures, and very briefly mentions the periods of stabilization and structural reform Unfortunately, there is not sufficient information and analysis to form an opinion about the likelihood of future periods of economic instability, including analysis of the reasons for continuing high inflation despite the IMF program and some historical accounting of what has happened over time to the real value of formal sector salaries during periods of inflation These are two important considerations in evaluating the stability of a housing finance system

Similarly, much more analysis is needed with respect to the financial sector in general and recent trends in interest rates (nominal and real) and banking margins If the proposed TMB is to be operated as a bank, the state of the banking sector must be more thoroughly examined It seems to be in the process of being privatized and restructured What are the sizes and ownerships of the important banks and their financial health at this point? Are there large deposits in the banks by the NPF and other government agencies?

From the information provided, it appears that the banking sector remains in disarray, with the largest bank, the NBC, thoroughly bankrupt and awaiting restructuring Little more can be told about the extent of private sector control and competition in the sector The information on trends in interest rates is also very fragmentary and inconsistent Paragraph 3 2 needs to be expanded to an entire section including tables and indications as to sources (such as for the long-term lending rate) Table II is not helpful as it stands Also, if the NBC is a dominant bank, and is subject to special consideration, the data should be desegregated for it separately

The strength in the demand for housing (and perhaps market-rate housing finance) is clear Rapid urbanization appears to be underway Unfortunately, not enough is stated about how the land market is working at the moment Paragraph 5 2 states that all the land is considered publicly owned and leased, but notes that there is a thriving official and unofficial land market Does this mean that the problems posed by competing claimants to tribal land is not a problem in Tanzania? Is the administrative functioning of the land title process the only major impediment to developing a strong collateral interest through a mortgage or are there other legal issues? Are leases usually for 33 years or 99 years and what is the legal standing of the lease at time of expiry? Does the pending Land Act address all important issues in this area?

Overview of the Housing Sector

It is difficult to infer from the discussion here how the housing sector really works Obviously it is working somewhat, providing housing to thousands of new urban residents each year Presumably, it is working in a manner similar to that in many other developing countries, with higher income households paying cash for large completed or custom houses, lower-income households either renting (probably from an informal sector effectively outside the ambit of the Rent Restriction Act) or building in illegal informal settlements, and middle-class households that struggle to buy a piece of land and gradually complete a structure over a period of 5-10 years, with no formal sector finance

It would be interesting to know more about the housing activities of the NIC, PPF, and NPF Are they significant in number and impact? Are they intended to be profit-making or are they delivering subventions (either explicitly or implicitly)? How do they deal with rent restrictions? Do they provide for installment sales over five years or so? If so, at what interest rate and other terms?

The housing affordability analysis does not reconcile the apparent contradiction between the usual finding that housing is unaffordable and the fact that people seem to have cash to buy it when it is offered It appears that it is believed that a middle-class income (mid-level official?) is about TSh 1 2 million a year in Dar, or about US$1,900. In many developing countries, households routinely afford, somehow, a house price of about six times their (stated) income or US$11-12,000 in this case, or almost the cost of the standard small house in Dar The important question here is not if a middle-class household can afford to borrow 80 percent of the house cost, but whether the amount they can afford to borrow under a proposed scheme will substantially accelerate access to housing that is currently being achieved in more inefficient or costly ways The rule of thumb in this regard, from experience in other countries, is that if loans of 30-50 percent of the cost of the standard house are made affordable by the scheme, it will be useful

71

Evaluation of a New Institution

It was useful to start the evaluation of establishing a new housing finance institution by reviewing the fate of the previous one, the THB Unfortunately, this review has two major weaknesses First, it gives no qualitative or quantitative idea of how much each of the six "problems" listed in 8 1 4 contributed to the demise of the THB Second, it does not carefully assess how each of these factors would be avoided by a new institution

The analysis of the appropriateness of a new institution becomes increasingly disconnected after this [1] It is stated that the "most compelling reason" is the need for financing the sale of houses owned by parastatals But no analysis is done as to whether the proposed TMB would help in this and the business plan below refers to only a relatively few loans being made on generally larger properties (Nor is the earlier statement that many people have cash to buy houses reconciled with the skepticism that TBL can sell 21 properties) No analysis is done to show that a TMB could facilitate the plans of NHC and others to sell houses to low and middle-income populations

Para 8 2 5 implies that various parastatal financial institutions currently developing housing should be glad to channel funds through the TMB But the TMB would basically be offering them rates similar to what they can get now on bank deposits or Treasury bills Why should they shift their funds if they can earn more in other ways? Or are they pursuing housing schemes for non-financial purposes, purposes that could be met by funding TMB instead?

Is the TMB meant to be dependent on small savers or big investors? It is hard to tell, but it would matter greatly for the size, stability, and cost of its deposit base

How will the problems that plagued the THB really be avoided by the TMB? As long as the pension funds, banks, and insurance companies are publicly owned, the basic potential for political interference will be there, even if explicit government ownership is missing Essentially, of the six problems faced by the THB, only #4, the weak record keeping, can be addressed assuredly The capital base will start off strong, but could deteriorate quickly if defaults are high or financial risks are not properly managed Reducing the term mismatch is not discussed here, but it appears to be unlikely, since it is assumed that deposits will provide most of the funding High nominal interest rates are not dealt with in the proposed mortgage design The land registration and loan recovery situations do not appear to have been remedied

There are internal inconsistencies It is noted (9 1 3) that the trend is towards universal banking, with commercial banks handling housing finance as well However, creating a TMB goes in the opposite direction, creating an undiversified specialist institution (making long-term loans on housing) within the guise of a commercial bank The usual solution to that problem is to diversify the "housing" bank into commercial lending, thus creating one more weak bank very prone to getting into bad lending policies

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[1] This reader infers that the report authors started with a concept in mind for the institution and have backed into an analysis that seems to support that notion An indication of this is the statement in 9 1 1 that the logical conclusion is that it should be established without having created any logical analysis

12

Neither are the financial projections very encouraging [2] It is presumed that the TMB would open a "custom-built banking hall" and start offering all retail banking services, such as checking and savings accounts, payroll depositing (all out of one branch), and so on, all with a staff of 25 people Even at that staff level, operational costs are about 10 percent of projected outstanding loan balances after two-three years, effectively swallowing up profits Projections beyond that are more promising, but rely on (1) practically no default losses at all (provisions are 2 percent of profits, not loans), (2) no prepayments of loans, and (3) maintenance of a 9 percent gross spread in the face of intensifying banking competition If default losses are 2 percent of outstanding loans (likely if Tanzanian banks are expected to meet GAAP accounting of delinquent loans) and gross spreads are 2 percent less, then the projected profit in year five is cut in half

The proposal does not get beyond the superficial level to consider how the bank will really do its basic business Is it realistic to assume that it is safe to use short-term deposits to make variable rate loans at 24 percent interest when there is a significant chance that the rates will go back up to 30-40 percent or higher? How many people can borrow safely under such terms?

According to the report, the answer seems to be that only a relatively few are expected to and they are the relatively rich households Despite the discussion of middle-income households earning TSh 1 2 million per year and of NHC tenants using TMB loans to buy their units, the projections assume that only 100-200 loans a year will be made and the average loan size would be TSh 19 million, about US$31,000, presumably to buy a house costing US$50,000 or more At 24 percent interest rates, such loans require an income of at least TSh 14 million a year, 10 times higher than mentioned earlier

This may in fact be the relevant market for mortgage loans under current circumstances But setting up a TMB to serve this market should not be confused with the earlier discussion of other compelling reasons to do so

Considering Alternatives

This reviewer was also disappointed to find that the SA report considers only the potential for a housing bank and not what is needed in general for developing housing finance in Tanzania The latter question is, of course, more difficult but also more open to critical assessment than when there is only one option (a housing bank) on the table

From what can be gathered from the report, and based on the author's experience elsewhere, it appears that Tanzania is at a difficult stage for creating a whole new system of housing finance that would be resilient against all of the potential economic and financial shocks which may arise That makes it inopportune to invest heavily in a new institution that is fully exposed to market forces But it may be a good opportunity to take some useful steps

[2] The financial projections have a significant number of discrepancies in assumptions and calculations and have to be carefully worked over again if the analysis is to be pursued further For example the "interest received' line is based on the "cumulative mortgage advances line, not the "mortgage advances outstanding" line

If, as it appears, there is a perceptual problem created by past practices, then no further market-based finance should be undertaken until this can be cleanly dealt with For example, if the defaulted borrowers at the THB are escaping any consequences, or for other reasons, it is widely believed that foreclosure and eviction will not be carried out, then it is the author's view that half-measures will only further undermine the long-run development of the market Only when the message can be clearly given that a loan must always be repaid one way or another and sooner or later can this perception be dealt with [3]

The pressures created by the absence of any finance should be channeled into action to ensure that housing can serve as excellent collateral In some form or another, the right of a lender to easily but fairly take over the property in case of default has to be clearly established Various protections should be provided for, but the basic "open and shut" nature of the legal situation has to be recognized (i e , there are no valid excuses for not paying, only prescribed notifications and chances to remedy the situation) and the foreclosure process removed from the slow process of most civil court matters

Also, it appears that the administrative basis for securing the mortgage at the registrar of deeds needs to be perfected It is not critical that this be completed before proceeding, but at least on track

A second area of work is in thinking how the funds in the provident funds or other long-term, large-scale investors can be tapped The proposition is not that they are to be forced to channel funds into housing, but how their financial needs can be met by doing so

The third area is thinking of how borrowers can be protected from major changes in interest rates or real income levels over time This analysis has to match that of protecting the investors

A fourth line of thinking is about how banks or other institutions that have a retail financial presence, such as insurance companies, can be made to feel that housing finance can be a profitable line of business In particular, fears about recoveries and liquidity issues have to be addressed

Once this thinking and actions have been taken, there will be a number of possible directions to go in Ideally, private commercial banks themselves may find it attractive to make mortgages They can be encouraged by some degree of government-sponsored liquidity or refinance, or possibly even default insurance (but only when there are no business risks, only political risks)

Different types of loan designs can be encouraged or innovated, depending on likely funding sources Different collateral arrangements can be tried But basically, after the experience of the THB, it is more important that a new approach be resilient and market-driven than that just some

[3] It may be possible that there are other ways of effectuating this Perhaps a claim can be registered against an employees provident fund Or wages of guarantors can be garnished The important thing is that the whole issue of default will be much more rare and manageable if borrowers know from the beginning that repayment is inevitable

14

sort of lending be provided The proposition that there simply should be some housing lender available is the least reason for creating one

There is some potential, however, to move ahead with initiatives to sell off housing assets at parastatals separately from this effort, but in congruence The parastatals can take more risks and bear certain costs that a market-driven lender can not, simply because they have no liabilities to worry about on the other side of their balance sheet Thus, some kinds of installment systems for repayment, coupled with retention of the deed in their name, may be able to meet their needs, as well as allow the tenants to gain ownership (that assumes that under some circumstances, the tenants will want to buy their unit)

In this regard, it should be noted that there is a common misperception that, for a loan to be affordable, it has to be for a very long-term, longer than a parastatal may want to be involved However, the financial arithmetic is such that at high interest rates, the term becomes of much less importance For example, a TSh 1 million loan at 25 percent over 15 years requires a payment of TSh 21,300 a month, while the same loan over only seven years has a payment that is only 19 percent higher (TSh 25,300) Moreover, when borrowers (or tenants on installments) know that they are paying a high interest rate on their outstanding balance, experience has shown a remarkable degree of early repayment

15