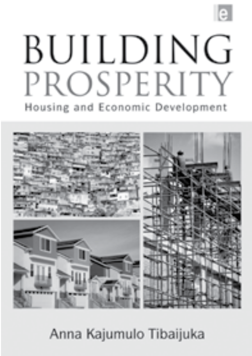

BUILDING PROSPERITY

HOUSING AND ECONOMIC DEVELOPMENT

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BACKGROUND

HOUSING FINANCE AND DEVELOPMENT

Nations still saddled with housing shortages are looking at innovative financing. This involves the organized mobilization of savings, credit and subsidies, or a combination of these.

Chile, for example, uses such a variety of finance mechanisms. One mechanism is for households to qualify for subsidies by providing a savings record. Savings and credit is another combination. Here, savings serve as a vital indication of the ability and willingness of households to save and make regular payments which then qualifies them for credit. There are also links between formal and informal financial bodies; in Bolivia PRODEM, which eventually became BancoSol, is one such example.

However, relatively little is known of the linkages between housing finance and economic development. Despite this dearth of information, research suggests a relationship. One study on the role of micro and small enterprises shows that the growth of this sector has resulted in the better distribution of income. It has also led to a reduction of poverty and unemployment, the building of the foundation for industrial growth, and the mobilization of savings. The increased access to money by low-income groups has thus helped them to start and sustain businesses, as well as improve their output.

In the developed world, housing has influenced financial markets and development. In 2001-2002, housing hauled the United States out of recession, although it also created financial volatility.

In contrast, in the developing world housing finance and development is generally weak. The reason is that many developing countries lack the financial muscle that could go to housing. In addition, public budgets may be in arrears, and may be further weighed down by debt servicing. Another problem in developing countries is that they lack the right match of housing finance to households needs. This means that most households cannot build wealth by increasing or releasing the equity held in their homes.

Despite the innovations in housing policies and housing finance, there is still scope to shift the focus from the supply to the demand side of housing. Housing finance must be provided to support urban livelihoods and asset formation rather than indebt people and thereby make them vulnerable

TYPES AND SOURCES OF HOUSING FINANCE

CONVENTIONAL MORTGAGE FINANCE

This is a large loan that is offered for 10 to 30 years to those who have a minimum and regular income, and to those with immovable tangible assets and registered title deeds as collateral. This is usually provided by the formal sector financial organizations and is for the purchase of completed housing units. Borrowers are required to demonstrate savings ranging from 10 per cent to 30 per cent of the unit's value and repayments should not exceed 25 per cent of household income. Repayments of loans are fixed, with regular periodic payments which consist of capital and interest. The availability of mortgage finance is important for individual wellbeing in these societies, usually in the developed world.

Conventional mortgage finance usually avoids servicing the poor because they fear they may not repay loans. Conversely, low-income households find mortgage finance unsuited to their needs, since the poor prefer to build incrementally. In addition, low-income groups prefer small loans for short periods of time, a form of lending in which mortgage financial houses are not interested because of the associated high administrative costs.

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HOUSING SUBSIDIES

There are different forms of such subsidies: direct interest rate reductions, capital grant subsidies, subsidies which support the issuance of mortgages and secondary mortgage market. Capital grant subsidies, also known as end-user subsidies, are targeted at the demand rather than the supply of housing, operate as up-front transparent grants, and are extended to lower income households, who utilize them to buy property developed by the private sector. This form of subsidy was pioneered in Chile in 1977 and has been used in housing programmes in Colombia, Costa Rica, Ecuador, Panama and South Africa.

HOUSING MICROFINANCE

This is small-scale lending typically aimed at housing consolidation and improvement, but may also be used for new builds. This lending aims to meet the shelter needs of households excluded from formal mortgage finance - due to low, irregular incomes - who may live in dwellings which fail to meet the standards required by formal organizations, and who lack secure or legal land tenure. Therefore, this kind of finance is suited to the needs of growing numbers of lower-middle-class households as well.

This facility has been successful in part due to the fact that it is particularly suited to incremental building as it is, in effect, incremental finance, flexible with considerable outreach. This kind of finance also enables poor households to build up savings and credit histories that, in turn, reduce the risks incurred by lenders, leading to lower interest rates in the long-term. In addition, this kind of financing can be critical in slum upgrading programmes, which frequently disregard housing and focus only on improving or extending basic urban infrastructure, land tenure and other services.

REMITTANCES

Remittances by migrants also represent another potential source of housing finance. Given that in 2005, people living outside their countries remitted USD165 billion, these rival overseas development assistance and direct foreign investment to some developing countries. Since migrants and people in the developing country highly value home or land ownership, most of these remittances are likely destined for such uses.

INFORMAL FINANCE

This has been defined as individual and group savings, windfalls, fabrication of their own building materials, sweat equity, small loans from neighbourhood lender, barter arrangements and communal self-help, and remittances from family living abroad.

Informal finance is prevalent in developing countries and is important to poorer households. This type of finance holds the potential of solving a range of development programmes. Female-dominated informal finance often bears the primary responsibility for saving, and accessing credit.

Despite its potential, informal finance can be unreliable and irregular, leading to a situation where housing consolidation takes a long time. Furthermore, informal credit is usually well below the scale of need.