THEME 2: EMERGING MARKETS IN THE RESALE OF EXISTING HOMES

MORE THAN SHELTER: HOUSING AS AN INSTRUMENT OF ECONOMIC AND SOCIAL DEVELOPMENT
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EXECUTIVE SUMMARY[1]

It is not enough to create new homes, nor even to provide financing to enable families to become homeowners for the first time -- instead, countries will have fully functioning housing ecosystems only when current homeowners who want to sell their homes can do so, at a market price, and realize meaningful cash equity that they can then use in another home or for personal use. Many urban development and housing finance initiatives in emerging markets stimulate or assist new production; few do the same for the resale home market.

Accordingly, in this paper we have sought to articulate:

1. What elements contribute to a functioning home resale market (using as an illustrative end state the US today).
2. What issues and challenges confront nations seeking to grow effective home resale markets. A key issue will be the perceived impact on resources for new construction.
3. What initiatives or experiments have been tried to stimulate home resale markets.

[1] Special thanks to David A. Smith and Tam Doan of the Affordable Housing Institute for preparing this paper for the Bellagio Housing Conference. Special thanks also to Peter Kimm for providing the initial outline and reviewing the final draft. The authors would like to acknowledge the generous contributions of Douglas Duncan (Mortgage Bankers Association), Lynn Fisher (MIT), Michael Lea (Cardiff Economic Consulting), Sally Merrill (Urban Institute), Mario Navarro (Lincoln Institute of Land and Policy), Kecia Rust, and Zhong Yi Tong (Fannie Mae Foundation).

Terminology

Home Resale, not 'Secondary' Market

Among housing policymakers and financiers, the term 'secondary market' is usually understood to mean the packaging and resale of mortgages, after their origination, so as to allow the originating lender to realize its profit, recapture its capital, and originate future loans. So as to avoid any confusion, we have elected to call the market we are studying 'home resale'. The same considerations will generally apply to home equity lending and refinancing.

"Effective home resale market"

For the purposes of this paper, an "effective home resale market" is a market area in which the following elements are present:

- Stakeholders buy and sell existing homes on a purely market basis, with an adequate supply of both buyers and sellers and a normal, fluid market.
- Buyers and sellers have adequate access to money capital and financial instruments appropriate to monetize and liquefy their investments.
- Property trades on an efficient equilibrium basis, that is, not at a deep discount to its intrinsic worth.

Inherent in this definition is the concept that 'market area' is a neighborhood large enough to be distinguishable by buyers, sellers, and capital providers, but not necessarily so large as to encompass an entire city, province, state or nation. It is a premise of this paper that in many nations, some of their market areas are effective home resale markets even as many are not; the paper thus seeks to identify barriers to effective home resale market formation.

INTRODUCTION

The buying and selling of existing homes is essential to fostering economic and social mobility. Equity-based financing allows homeowners to tap into their housing wealth to finance large purchases or invest in small enterprises or other income-generating activity. But while the resale, refinance, and home equity lending markets are major components of housing finance in the US, such markets are small or non-existent in the developing world.

South African Township: Example of an Under-functioning Home Resale Market

(Extracted from Appendix B)

The Shisaka report on formerly black South African township property markets undertook a thorough analysis of the primary and secondary property markets (the home resale market). Their findings support the following hypothesis:

“The secondary property market in formerly black townships in South Africa is ineffective and inefficient. This is due to the legal, institutional and procedural constraints that frame it, rather than the financial factors regularly identified by policy makers. Not only does this constrain the economic growth potential of these townships, it also undermines the asset creation potential of the state’s subsidised housing scheme.’’

Still, several emerging markets have begun developing component parts of a home resale market.

This paper explores the development of home resale markets in [middle-income] developing countries. We posit a set of synergistic systems and institutions that have worked well for developed country experiments, discuss potential challenges to building these systems in emerging markets and highlight experiments.

As a useful example, we look first at the US resale market where these systems now work well together.

ONE SUCCESSFUL EXPERIMENT: RESALE MARKETS IN THE US

The US has an extremely well developed, diversified, populated and interdependent resale market that has arisen over roughly two hundred years. It builds on the US's history (i.e. settlement, homesteading, and strong respect for property rights embedded in the US Constitution), as further stimulated and stressed by the two great demographic waves of the US's twentieth century:

1. The Great Depression (1932-39), with the collapse of credit and the need to protect homeowners and farmers.
2. The post-WW2 baby boom (1948-65) that accompanied a vast expansion of the American population and the growth of suburbs.

Most significantly, the current US system arrived not all at once, but was hard-won over many decades and with many false starts and setbacks. Capacity grew slowly, with time, and usually with government intervention either directly (subsidies, credit enhancement, risk sharing) or indirectly (bank depository support, legal and titling jurisprudence, homeownership facilitation products).

The US system should be looked at not as a model to be faithfully copied, but rather as a successful experiment: home resale markets will succeed when they deliver the same expectations and ecosystem interdependencies as now exist in the US. The particular participant entities will be specific to each country, as will the path each country takes to building the symbiotic interdependence that characterizes a successful system.

Today the US home resale financing ecosystem comprises the following elements (all of which we understand are replicated in other developed nations, although through varying mechanics and programs):

Table 1: Elements of the US Home Resale Financing Ecosystem

	Participants	Roles, features
1.	**Efficient titling**	Title to property in America transfer quickly, efficiently and reliably. There is a built-up network of title insurance companies who provide a financial guarantee of ownership for all transactions, at competitive low rates.
2.	**Transaction implementation agents**	A network of professionals -- real estate conveyancing attorneys, escrow agents, appraisers – is distributed throughout the country to enable rapid impartial reliable settlement of real property transfers. These specialists are typically registered with professional associations that have standards, society-based membership entrance criteria, and means of enforcing against non-complying members, as well as continuing education or professional recertification programs.
3.	**Standardized instruments and financial terms**	American mortgages – their business terms, covenants, security, and legal protections for all parties – are largely standardized at a national level. The standardization is further buttressed by consumer-lending laws (e.g. the Home Mortgage Disclosure Act and Real Estate Settlement Procedures Act), large-scale securitization or credit enhancement (e.g. FHA, Fannie Mae/ Ginnie Mae/ Freddie Mac)
4.	**Transaction transparency and reporting**	Home resale price information is public record (commonly published in local newspapers). A series of mandatory property condition assessments (e.g. lead-based paint, radon) are required to inform buyers of property condition. Consumers have access to comprehensive disclosure of financial terms of mortgage instruments.
5.	**Customer perception of equity value**	"Homeownership is the American Dream." Americans consistently rank their home as their largest investment and greatest source of family wealth. Americans strongly aspire to homeownership for financial security, financial freedom, and an equity source to be tapped for family use. Numerous consumer-education systems and programs exist to facilitate financial literacy among aspirant home buyers.
6.	**Ability to access built-up equity**	In the US, more than 70% of new business formation taps home equity as a source of startup capital. Home equity takeout loans are plentiful; refinancing is quick, easy, and statutorily protected (homeowners have a legal right to refinance after twelve months). Equity in the home is regarded as liquid, accessible, and the cheapest, safest source of ready cash for homeowners.
7.	**Robust home improvement market**	Owner improvement of properties, and financing for home improvements, characterize American homeownership. Numerous financial products, short-term consumer loans, or readily-refinanceable mortgages allow consumers to expand and upgrade their homes. Most home buyers anticipate making changes in the home promptly after their acquisition.

8.	**Mortgage originators**	Home mortgages are generated through a vast and highly competitive network of home originators (e.g. Countrywide Financial) whose role in the value chain is specifically to link borrowers with capital, to originate and place these loans, and then to on-sell them.
9.	**Secondary market of mortgages resold, via securitization or otherwise**	Once loans are originated, they are rapidly aggregated and resold, either through mortgage-backed securities (MBS), in large portfolios held by institutions (e.g. pension funds, insurance companies), or through securitized instruments (e.g. Ginnie Mae, Freddie Mac, Fannie Mae). (Large-scale resale of home mortgages predates securitization but has clearly been accelerated by securitization, to the customer's benefit.) As these larger capital markets are national in nature, in practice mortgage terms are highly standardized throughout the country.
10.	**Electronic transfer of funds and information**	Mortgage credit scoring information is routinely handled primarily electronically. Efficient electronic transfer of funds is commonplace. Mortgage servicing is routinely handled at a great distance from the original borrower or the property, all of it electronic.
11.	**Government risk absorption**	Under a variety of programs, including most significantly FmHA, VA and FHA single-family family mortgage insurance, the Federal government absorbs a substantial portion of the financing risk for certain types of acquisitions and certain categories of borrowers.
12.	**Bankability frontier innovations**	Beyond credit enhancement of specialized loan products, the Federal agencies (FmHA, FHA, VA) also provide higher-leverage homeownership loan products, down payment assistance, and other first-time homebuyer benefits. Additionally, many state housing finance agencies likewise provide customized first-time home buyer programs. While none of these are specifically targeted to existing rather than new property, few if any of them advantage new over existing, with the practical result that most are used predominantly for existing housing.
13.	**Low-income lending stimuli**	The Federal government incentivizes lending at the middle and lower income levels through a series of statutes such as the Community Reinvestment Act (1977) and GSE affordability goals. It is significant that these stimuli arrived only after development of government risk absorption and bankability frontier innovations.
14.	**Financial advantages for homeownership**	Homeowners benefit from various statutory advantages, including unlimited deductibility of mortgage interest on a primary residence, and unlimited deductibility of real estate taxes. These advantages, worth $80 billion annually, are among the benefits cited by home sellers and home buyers alike.

All of the above distinctive features are long-standing elements of the US home resale market system; nearly all of them interact positively with the others. Significantly, virtually all of these factors apply with equal effectiveness at all levels of the bankability pyramid: that is, there is no ‘lower bound’ below which property is not bankable simply because of its location or the low value of the inventory.

While it is always possible that a given ecosystem will mature with program participants who once served a need but no longer do (or do in a diminished capacity), the presence, pervasiveness, and robustness of these elements suggests that they are important contributors to a successful home resale market.

BUILDING BLOCKS & EMERGING MARKET CONCERNS

In the context of developing or 'fusion' countries, effective home resale markets generally emerge among upper income groups. However, this is not the case among other market segments.

For emerging market areas, effective home resale markets – meaning those with money transactions at intrinsic value rather than at significantly discounted prices resulting from financial blockages – generally arise later than markets for new-home sales.

Market Failure: South African Townships

(Extracted from Appendix C)

The Township Property Markets Research found that **properties were undervalued by as much as 44%** - where a homeowner thought (reasonably, the researchers determined) that they should be able to sell their home for about R178 000 (appx. $29,000 USD[2]), they were only able to achieve a sale price of R100 000[3]. This is where the very same house outside of the township would probably cost somewhere in the region of R250 000 – R500 000.

There are thus two levels of discount:

- ***Buyer value discount*** (say 29%[4]), because of a complex array of reasons undermining buyers' interest in buying *into* the township, including being afraid of township property rights and the limited availability of finance in township areas.
- ***Financial discount*** (44%), because sellers cannot realize the economically rational price through market impairments.

The two factors combined represent a 60% discount for equivalent property that is within the boundaries of a township.

In this market, the risk profile of the client – and just as important, the servicing approach of the lender – is critical, because the house itself does not offer realizable security.

Note: Currency Conversion

In part this is due to normal developmental economies – large-scale developments aggregate capital and have a professional developer that is often the principal credit behind the financing – and in part it is due to governmental emphasis on new production to the unintended detriment of resale of existing supply.

Because of this, effective home resale markets rely on the building blocks already in place for new home markets, plus additional elements. While robust legal, financial and regulatory

[2] 1 ZAR = 0.164198 USD
[3] R100 000 realizable price divided by R178 000 economic price.
[4] R178 000 economic price divided by R250 000 price for comparable property just outside the township.

institutions support both markets in general, a few systems particular to resale should be highlighted. In general, these building blocks diminish transaction costs, mitigate risk, increase the likelihood of return on investment and increase market access. We review these systems and challenges or opportunities for developing them.

Clear title, registration systems, enforceable property rights

De Soto's work has sparked a lively debate over whether the revival of "dead capital," owned by the poor in developing countries, could unleash development and make capitalism work for the poor (de Soto, 2000). Recently, international donors and policy advisors have become interested in advocating for formal tenure and property rights systems believing these would in general (Payne, 1997):

- Encourage investment in land and housing
- Improve access to formal credit
- Improve the property tax base
- Increase public sector influence over land and housing markets
- Improve the efficiency of land and housing markets
- Increase the equity of land and housing markets

Enforceable transfer of ownership through sales and the realization of equity therein are embedded in the outcomes mentioned above.

There are supporters on both sides. On the one hand, many researchers believe clearly defined property rights institutions increase economic efficiency (Malpezzi, 2000) by creating the right incentives, particularly when there is good information (Jaffe and Louziotis, 1996). And property rights work better when they are not only clarified but bundled as well (Heller, 1998). Other researchers, often drawing from experience in the field, question de Soto's propositions by calling out incongruities (Gilbert, 2001, Gravois, 2005) or countering that informal systems have their own efficiencies (Roylston, 2004). Also, titling and registration programs have received mixed reviews, though often the assessment is these programs alone are not enough – other components are also needed. [5]

Reforming tenure and rights systems means replacing a system that is working for some subset of people. For greenfields, development may proceed *ab initio* with municipal infrastructure, property rights, site and stand titling, and initial mortgage finance. Resale markets emerging out of existing communities will be defined by a different initial condition that will include any of the following, possibly in combinations:

- Formerly collectively owned (e.g. Russia) property transitioned to some private ownership.
- Formerly restricted or segregated spaces (e.g. black townships in South Africa) that may have experienced deliberate anti-investment policies.
- Formerly state owned (e.g. black townships) property transitioned to private ownership in which the new owners' engagement with their property rights is tentative and willingness to enter the property market (given the perceived risks) is limited.
- Undocumented, informal, illegal, or even quasi-transient property development.
- Tribal, customary, unwritten or communal ownership (e.g. much of Africa).

Each of these situations is characterized by an in-place infrastructure of homes, usually self-built or self-improved, and a hodgepodge of titling, tenure, ownership, utilities, and capital access.

This is not to say that in areas and among populations where access to title has been denied, people feel that their tenure is insecure. Rather, it is secured by a complex web of social and political linkages which in the transition to formalized rights often prove to be stronger than title deeds and deeds registers. This tenure is secure not just for the identifiable owner (i.e. the household head) but for the extended family, including unborn generations. The asset value is thus socially and not economically defined.

Informality is thus the incumbent, and replacing it with formality poses immense challenges. Roylston writes from experience in South Africa and makes the point that extra-legal systems

[5] The de Soto debate is much richer than what this paper includes at this time.

need to be better documented and understood because some aspects work well and should survive in the reformulation. Unfortunately, she has not seen this done successfully:

> Leap and Afra found that there are no stepping stones, no ways for the poor to begin to enter the world of the economy and bureaucratic planning and service delivery, without also entering a property system that [currently] does not work for them. You are in or you are out. The experience is clear on this and years have been spent trying to build a bridge. For access to the economy and for access to services, the poor at Ekutheleni must give up a functional tenure security that works for most of them, in exchange for a property system that does not. 'People are not asking for a replacement. They're asking that what works for them be incorporated into official systems.'

Surrendering the familiar and functional (even if at a low level) for the unfamiliar and unproven, especially if imposed from without, requires overcoming considerable resistance. Reversion back to informality is common (Roylston, 2004), especially when the new, formal system is less accessible, and consequently perceived as less efficient than the previous, informal system. Gough and Yankson (2000), who studied transitions between communal land systems, mixed communal and private systems, and state controlled systems in Ghana, found these issues and challenges:

- Cultural – the role of chiefs as mediators is inextricably linked to land management and people identify strongly with this system.
- Cost and bureaucracy in registering land transactions discourages use of system.
- Disputes and conflicts increased within indigenous communities.
- Inequity – migrant populations have greater difficulty accessing land.

It is also unclear whether formalization brings the desired benefits. Kenya's efforts at land registration have brought mixed results (about which Bellagio's Kenya delegation will doubtless speak); while this is in a rural context, the experiment and its lessons are likely valid in urban and urbanizing arenas (Smith, 2003, Cotula et al., 2004)

Market information and transaction support: Appraisal, credit bureaus, brokerage systems[6]

Markets flourish when buyers and sellers have swift access to reliable information. In the property arena, the number of variables that distinguish a commodity is large – among them, metropolitan area, neighborhood, land plot, property configuration, property construction, property condition, and current tenure/ occupancy. Each of these is specific, most are not intrinsically quantitative, and all are no better than the observer/ reporter who provides the information and warrants its reliability…or does not. Accordingly, the information infrastructure – its development, warranty, transmission and use – is complex and extensive.

Reliable information encourages buyers, sellers and intermediaries to participate in housing markets. Systems that support good information are appraisal systems, credit bureaus, and brokerage systems.

The importance of appraisal and information systems

Property transfer systems begin with appraisal, whose results are reliable if and only if both input and methodology are reliable. Recognizing this, we see global trends to strengthen market information and transaction support:

- To standardize and improve appraiser certification.
- To standardize and improve appraisal methodologies applicable to different property types.
- To develop better databases and information technology platforms.
- To establish credit bureaus.

Challenges to establishing an appraisal industry in emerging markets

1. ***Too few appraisers.*** Many appraisers get their start as engineers who focus on hard costs. While this is essential in construction, and meaningful in appraising first-user property, it is of secondary or even tertiary importance for existing home resale. Appraisers whose

[6] This section owes a great debt to the groundbreaking work of Dr. Sally Merrill.

experience base is in cost assessment need both training in comparable sales and income approaches, and on-the-job experience. The problem is particularly acute in countries emerging from state-run housing systems.

2. ***Not enough comparables.*** Inherent in our definition of ineffective resale markets is the absence of reliable true-market comparables. Indeed, a proper appraisal of an impaired market should yield an impaired value for the simple reason that such is the price a seller could in fact realize. So appraisers who are true to their profession will ratify impairment rather than contribute to its alleviation.
3. ***Shortage of comparable-sales information.*** Beyond pure comparability, appraisers classically reach to broader neighborhoods and then make location adjustments. For this to avail in emerging markets, appraisers must be able to tap large databases from abutting communities. In reality, data is often disaggregated (held by individual firms, realtors, and banks) rather than accessible as in the Multiple Listing Service (MLS) pervasive in the US and other developed markets. In such situations, data hoarding creates a competitive advantage, so broadly available databases are unlikely to come into being unless stimulated by government pressure or until a market reaches a tipping point of rising property scale and falling information costs. Alternatively, in segregated markets (e.g. South Africa) the development of information systems has focused specifically on the high income segment of the market, rather than on the low income segment. This undermines not only access to information, but also accurate risk pricing by lenders and market comparison by buyers.
4. ***Not enough real-time reporting.*** Markets that transact informally seldom record formally. Markets that penalize formal transactions (e.g. with high transfer taxes or recordation fees whose cost exceeds the value of formalizing) stimulate reporting avoidance. Such data as may be reported may be consciously skewed with buyer and seller conniving to report information other than the economic reality.
5. ***No appraisal 'industry' to professionalize.*** Appraisers often double as realtors, loan originators, loan officers, or investors. When appraisal is only one of several business lines, it seldom achieves proper professionalism, and is vulnerable to coercion and corruption. An appraisal association can create effective governance, standardized flatter fee schedules, appraiser independence from other participants, and professional standards for reports. Its emergence normally accompanies the rise of a large enough pool of capable appraisers who

make their principal income solely from appraisal and related independent professional services.

Developing an Appraisal Industry: Poland, Rumania, and India

Trade association model. The Polish Association of Property Appraisers and the Romanian Appraisers Association (ANEVAR) have each developed good appraisal industries in a limited time frame. They achieved this as follows:

- Good use of donor technical assistance and membership in international appraisal organizations such as IVSC and TEGOVA.
- Import of US and British standards for licensing requirements, which include a college degree, specialized education, and on-the-job training. Poland's appraisers are trained in both the MV and MLV methodologies, and thus their approaches are compatible with all US and European approaches.

Market leader imprint model. There is no formal association of appraisers in India. India's premier housing lender, HDFC, handles the appraisal process as an in-house function. HDFC has developed an extensive property master centralized database that can be tapped by any HDFC network offices. In certain cases, independent appraisers are consulted, but it has been a conscious decision not to outsource this critical function.[7]

[7] Discussions with ANEVAR, PBA, and Conrad de Souza, HDFC.

Credit bureau development

In emerging markets, developing a full-service credit bureau takes time. The banking system itself is among the many barriers. Participants often resist sharing information because they believe theirs gives competitive advantage and they doubt the reliability of others'. Bank privacy/secrecy laws are sometimes a blockage, as is the other challenge of uniquely identifying customers. Finally, credit bureau development is costly, with funds to be raised from among the participants who may doubt the benefits and see all too clearly the potential erosion of market advantage.

Yet the benefits are real, as India's history shows. In 2001, HDFC, India's ground breaking mortgage lender, set up India's first credit information bureau by partnering with State Bank of India (India's largest commercial bank), Trans Union International, and Dun & Bradstreet. The Credit Information Bureau India Limited (CIBIL) deals with both positive and negative information that is sold to its members. Currently there are 87 credit grantors. CIBIL launched the operations of its consumer credit information bureau in April 2004. While the process of populating the database is still underway, the bureau will be useful for HDFC to tap into a larger customer base without compromising on credit quality.[8]

Thailand's Government Housing Bank has also championed efforts at credit bureau formation for nearly a decade.

Finally, credit bureau development in emerging markets has generally been one step at a time, often beginning only with banks, and offering only basic information. Once the bureau is established and its utility demonstrated, its membership can expand and its products become more sophisticated; scaling and growth thus become essential elements of bureau design.

[8] Conrad de Souza, HDFC.

Credit bureau design questions

What features would a comprehensive credit information service exhibit? This has been widely discussed in countries where credit bureaus have been under development. The issues include:

- ***Participation.*** Banks only or a wide sweep of lenders?
- ***Reciprocity.*** Who can access data; contributors, members, or anyone?
- ***Entity ownership.*** Private or public or mixed?
- ***DNA.*** Home-grown or imported, and if imported, from where and with what adaptation?
- ***Building it.*** Internal do-it-yourself, internal-external consultancy?
- ***Data types.*** In addition to positive information (acceptances), will negative (rejects) also be compiled?
- ***Borrower subjects.*** Individuals, small businesses, companies and links between? Does individual performance impact corporate credit score, and vice versa?
- ***Data specification.*** What format, standardization, and volume: what scope is hoped for?
- ***Secrecy/ privacy.*** What are the rules and how might they limit scope and operations?
- ***Updating and accuracy.*** How frequently are the data updated?
- ***Consumer protection.*** Are legal safeguards in place enable correcting errors?
- ***Modeling/ scoring.*** Is credit *scoring* also a function of the bureau? If not, how do private competitor scorers access data and what do they report? If it is a function, how are methodologies developed and who controls their evolution?
- ***Competition and efficiency.*** Is the bureau a monopoly? If so, is it expected to remain one?

Issues in credit bureau establishment and growth

Development plans, however, should (and generally do) contemplate expanding membership to multiple credit providers and providing additional and more sophisticated products addressing credit risk, so that a full service structure is envisioned from the beginning.

Credit Bureau Development: Croatia

Now under development, the Croatian Credit Bureau (HROK) was championed by the Croatian Banks Association, which had to work diligently to overcome reluctance by major-market-share banks to become members (the data hoarding problem). A private company owned by its member banks (benefits of pooling membership), HROK was developed with assistance from Trans Union's internationally utilized systems, combined with European and CEE knowledge and support from CRIF, an international credit reporting service which operates EURISC, the main Italian credit bureau. HROK will collect positive and negative date, will begin with banks, with information on numerous types of installment loans, credit cards, credit lines, and factoring; it will later expand to include other credit providers.[9]

Placed against these issues, any credit information bureau, and especially newly formed ones in emerging markets, faces ongoing challenges. Comments gleaned from recent experiences in emerging markets -- and the authors' recommendations, where appropriate -- include the following:

1. ***Comprehensiveness.*** Information should be collected from all banks, especially the major lenders, and ultimately include all major credit sources: non-bank financial institutions (NBFIs), retail stores, finance and leasing companies, microlenders, utilities, and so on. However, obtaining reliable data is a challenge,, which leads to the next fundamental issue.
2. ***Subscription model: membership or mandate?*** To avoid selection bias, and to assure the database is comprehensive and robust, broad participation is essential. This can be obtained in either of two ways:
   a. ***Participant benefits via reciprocity.*** If the model is to be subscription/ fee-based, reciprocity is a cardinal principle: only those providing data are permitted to purchase it, and they must have a legitimate purpose in requesting information.
   b. ***Sovereign mandate.*** Either directly (by statute) or indirectly (by monopoly power based on access to a critical resource such as credit enhancement), the sovereign

[9] See Zoran Bohacek, Croatian Banks Association "Developing Credit Bureaus: the Croatian Experience", available on www.ceemortgagefinance.org

(typically government, but potentially as dominant participant) imposes a requirement that all participants accessing the resource must contribute *and warrant* their data.

3. ***Functions, and rollout.*** Should the bureau begin by covering all topics at some level, or some topics at a deep level? Staged development is important: begin with basic products, then expand into value-added services such as scoring and anti-fraud.
4. ***Regulation.*** Should participation by lenders be obligatory? If so, which lenders? Regulation alone not sufficient; user demand and user discipline are also necessary.
5. ***Ownership.*** Whether a credit bureau should be state-owned or private, a mix of the two, and the extent to which it is user-owned has been one of the most widely debated issues in emerging markets. Although there is no hard and fast rule, the majority of credit bureau experts and users worldwide opt in favor of full or majority private ownership. As with the financial sector overall, best practice is for the government to provide prudent regulation and a legal framework, but for the private sector to own and manage the credit bureau. With two notable exceptions (China, France), nearly all credit bureaus in the developed world are privately owned.
6. ***Management and development.*** Databases need to be collected; information needs to be delivered (and hence, electronically deliverable). Credit bureaus therefore imply information technology (IT) platforms and systems, and these have their own specialty disciplines. Should a country buy (a black box), modify (retool a black box), or build (do it yourself)? The issue is difficult: re-inventing the wheel can be as costly in the long-run as engaging a seasoned international firm. Cost figures in: the cost of establishing the credit bureau must be justified in terms of reduced risk and improved efficiency. Ongoing management poses similar issues, and emerging markets exhibit a wide range of solutions. As noted, the international credit bureau companies have affiliates in many countries where they do not own the bureaus, and most countries seek their help; they may be under contract to assist in development, and may or may not do ongoing management.
7. ***Data.*** Both negative and positive data should be collected – e.g. all loan and credit types and amounts, and payment histories. Without this, lenders cannot compute capacity to pay and willingness to pay, or consider various “warning signs”, such as obtaining many new credit cards. Other data may include public data, such as bankruptcies, pledges of real estate and existing databases such as those from the central banks. Development of credit scoring

capability, or providing banks with the information to do so, will go hand in had with increased sophistication of the data and the data standardization process.[10]

8. ***Consumer protection.*** Misinformation and mistakes have proved to be very serious issues in use of credit bureau information, as individuals and others may be wrongly denied loans or offered less advantageous terms than deserved. Individuals should have the right to access their data, to correct mistakes, to know the reason for rejection, and to know who has requested their information; the information must also be secure to fight against identity fraud. In the US, these issues are codified in the Fair Credit Reporting Act, but this is an often-overlooked area that emerging markets should attend to as an integral aspect of credit bureau design.

Credit Bureau Development: Thailand

Efforts to develop a credit bureau in the early 1990s, by the Thai Bankers Association, the Bank of Thailand, and Ministry of Finance and the Government Housing Bank (GHB), failed due to unwillingness to share information, perceived high cost, unclear legal framework, and the 1997 Asian financial crisis.

Subsequently, renewed efforts by GHB and the Ministry led to creation of the Thai Credit Bureau (TCB) in 1999, which focuses on consumer credit information. Strengthened by laws for credit bureau regulation, including consumer protection, the TCB now has 47 members – banks, non-bank financial institutions (NBFIs), and leasing and credit card companies – and operates a large database at a profit, providing 400,000 reports a month.[11]

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[10] See Palla for a discussion of introducing credit scoring.

[11] See the presentation by Chompunute Sumanaseni, Government Housing Bank of Thailand, "Credit Bureau: Thailand's Experience", presented at the IUHF 25th World Congress. Credit bureau policy efforts have not ended in Thailand. Another credit bureau was also formed - the CCIS (Central Credit Information Service - significantly smaller but also very active. The Government has recently ordered the merging of the two bureaus.

Brokerage Systems

Brokerage -- the matching of buyers and sellers – is in structural terms a curious mixture of salesmanship and professionalism. It is fundamentally similar to appraisal and credit bureau establishment at one level – namely, that it relies on knowledge of the same set of individual real estate transactions. But it is fundamentally different at another level – the broker's compensation structure and the broker's resulting financial motivations (and hence the system vulnerabilities).

Like appraisal, brokerage is professional in the sense that for any given transaction, the buyer and seller each hope to go through it once, each of them impaired by lack of information:

- *Buyers* are unaware of a property's history.
- *Sellers* are unaware of market values and buyer alternatives.

Buyers and sellers also need financing to gear (lever) the purchase, settlement agents to handle the passing of money and papers, and recordation mechanisms to document it. Each of these functions is professional in nature; in developed systems, each is populated by specialists for whom delivery of the professional service is their core means of livelihood.

Typically, it is the broker who links seller and buyer, and who therefore has a practical leadership in the transaction – yet unlike the professional parties, brokers are paid fees that are proportionate to the sales price. The potential for seller or buyers to be harmed by succumbing to the influence of an unscrupulous or incompetent broker is thus great.

In developed markets, brokers are plentiful and make their primary living solely as brokers. Further, because they rely on market knowledge, broker individuals tend to be geographically localized, where they can develop personal reputations, whereas brokerage firms tend to be metropolitan, regional, or national. The brokerage firm develops a brand that thus acts as a counterweight to the individual broker's temptation to freelance, and indeed in the US and other developed markets the brand and network value of a large-scale brokerage operation add material value to the brokering individual. This, coupled with capital and family mobility in developed nations, has created an industry where the push to scale and consolidation have given a competitive advantage to organizations that provide their own brand-level warranty of the performance of their individual brokers.

These scaling features are less present, if not wholly absent, in developing nations, ands especially so in fusion countries where a capable individual broker can migrate from a township or informal practice into a more profitable formal practice. One can thus expect that resale of existing homes in formalizing neighborhood markets will be facilitated by the establishment of external credibility enhancements such as these:

- ***Licensing*** of brokers by municipal, state, provincial, or national government.
- ***Registration***, educational certification (e.g. via standardized examinations), and continuing professional education.
- ***Disclosure requirements***, e.g. track record, compensation sources and structures, licensing/ registration status, delivery of requisite legal information. (Brokers can be tasked with providing buyers and sellers with notices mandated by law … but how is their performance enforced when these disclosures may reduce the chances of any given transaction closing?)

Beyond capacity criteria such as the above lies the question of conflicts of interest. Should brokers be allowed to double as appraisers, credit bureau operators, settlement agents, or loan originators? While this may be economically feasible in developed countries, in emerging countries, and especially in the low-income marketplaces on which we are focusing, it may be economically impossible to maintain a strict isolation of function. So if the choice is between more qualified individuals playing multiple roles, or single-role individuals who are less qualified, which is better? And how are these standards and professional requirements to be dynamically managed across multiple metropolitan areas and changing demographies?

Reduce the cost of housing: From incremental construction to formal private developer model

One of the most crucial ways to make home purchases more affordable is to keep construction costs low. Unfortunately, the construction industry in many developing countries faces difficulties that can keep costs high (Nordberg). Construction costs can be higher than anticipated due to poor estimates, inappropriate technology and design, inappropriate tendering and contractual procedures, inefficient on-site supervision and construction management. Other constraining factors include the high import content of construction activity, the shortage of skilled local labor, and non-compliance with building and planning standards.

Conversely, in informal settlements, spontaneous communities, and formalizing markets, the dominant form of construction (at least, measured by square meters of new building) is clearly incremental housing – adding space, structures, and features to existing properties. Most of this incremental housing is self-build, although most such neighborhoods have a thriving market in both home-improvement do-it-yourself materials purchases and small-scale home improvement contracting (ranging from the individual laborer to mini-crews).

In developed markets, traditional forms of home improvement staple a formal contract to a formal loan instrument (e.g. a home improvement loan, a mortgage increase). This linkage works so well in developed nations, where property is already a liquid asset (because the home resale market is robust and fully transparent) and where home improvement contracting, like other construction disciplines, is subject to normal consumer-protection laws. But the linkage also contains its own trap – lenders become used to associating home improvement with particular forms of finance, so if that form of finance cannot attach (because, for example, there is no formal construction contractor, or no transparent and reliable record of the home resale prices), then financing is not extended to that borrower.

Enter the microlender and its counterparty, the informal-market informal lender. (However expensive microlending may seem in the abstract, it is cheap in the extreme compared with the informal lending that is many of these customers' only alternative.)

Logically, there is a huge market gap that banks and non-bank financial institutions (NBFI's) could fill – namely, providing small-scale finance to property owners who wish to improve their homes through incremental housing or otherwise. To some degree, the formal financial sector has provided this, but typically as a consumer lending tied to a payroll deduction or limited access to an employer or payroll-funded pension scheme. Yet these schemes are often use-restricted, or treated as classical consumer finance (i.e. spent on things that do not yield a mortgageable fixed asset) so they do not expand the bankability frontier nor provide cheaper credit to the target customers.

A further problem arises when the homeowner of the incrementally built home wishes to sell. Research conducted in South Africa found that no appropriate loan products exist to service resale transactions in an incremental housing market. So, the equity growth expected of incrementally improving housing is not realizable. This acts as a disincentive to home improvements.

Chile's experience, documented in Appendix A, demonstrates that incremental housing and home resale can both be cost-effectively stimulated with broader use of subsidies that have traditionally been targeted predominantly if not exclusively to production of new homes.

In short, incremental housing invites a financial solution that in turn depends on a combination of new financial products and new delivery channels to make loans available and collect payments therefrom.

Comprehensive vs. Incremental

These systems are interdependent and thrive in an ecosystem. The temptation to have a master plan is great, as are the arguments if it can be implemented (Galal and Razazz, 2001), even if implementation is phased over time.

Conversely, of course, markets are more complex than we can document, and the race to urbanization outstrips any government attempts to control it. Neighborhoods are self-organizing systems that *will* organize once they reach a certain mass. If we do not like the way they self-organize, we cannot will them out of existence: most slum clearance or informal settlement forcible relocation schemes have failed, usually after great struggle, leaving people worse off.

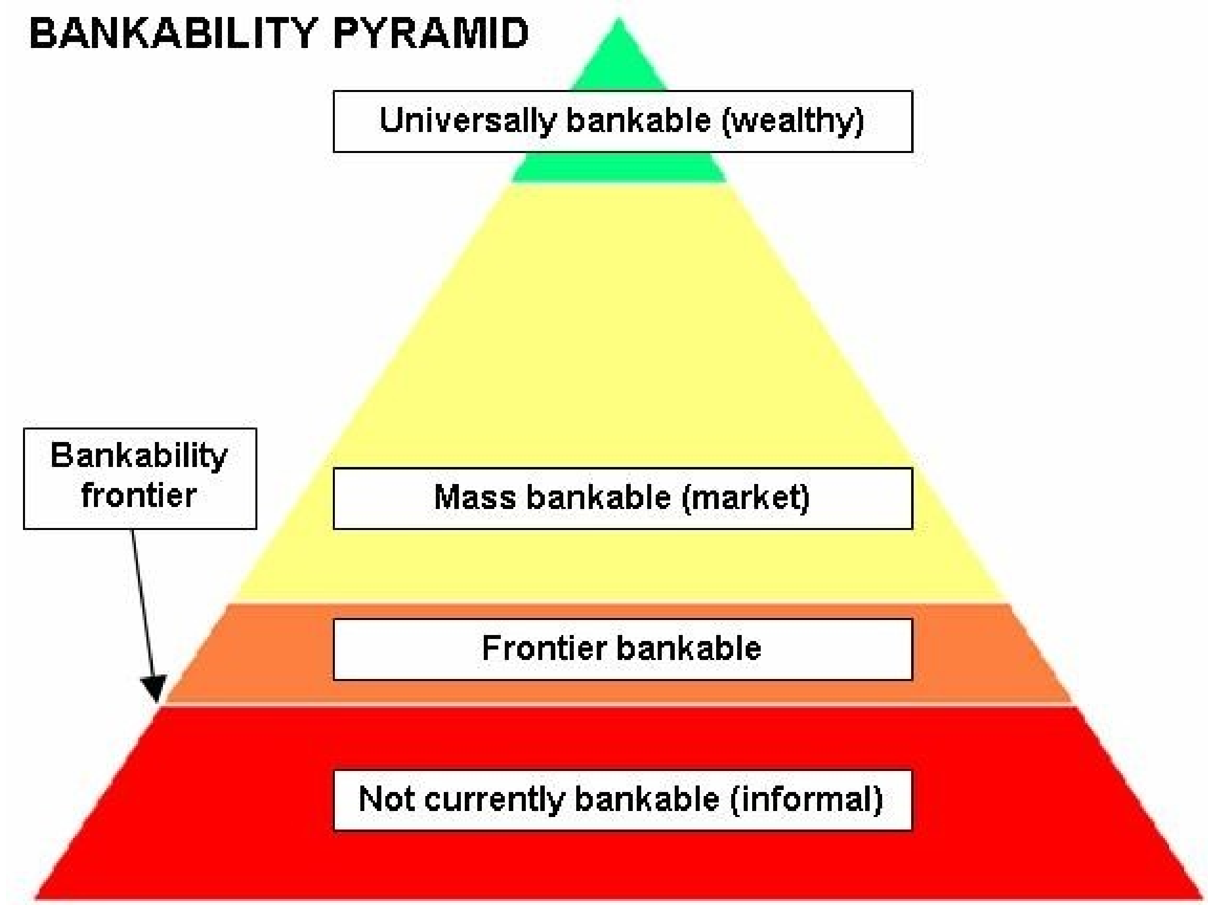
Moreover, since informal communities have a scale – whether measured by people, homes, hectares, or even total investment – far beyond the public sector resources devoted to their growth, is it not more reasonable to seek to catalyze or channel nascent indigenous neighborhood forces? Should we not be seeking to learn from informal markets and their incrementalism (Berner, 2001)? For instance, both the Philippines (Community Mortgage Program, CMP) and Pakistan (Hyderabad's incremental development scheme) show promising experiments to lower costs and processes by facilitating self-help.

We note here the need for a larger discussion of the fit between incremental construction, which is close to universal in the operations of the informal sector, and microlending. Microlenders have addressed some of the underlying issues, such as collateral without mortgages and an increasing percentage of microloans are for housing related purposes.

Expanding the bankability frontier

This issue was discussed at length in the first paper so we need not repeat it here. We simply note that every effort to deliver capital into the low-income marketplaces will likely have spillover benefits that directly enhance the ability to resell existing homes.

Extending the bankability frontier downward into low-income markets necessarily means providing additional capital to existing homeowners who want to sell, improve, refinance and buy existing homes. The activities are complementary.



We expect a key issue will be the perception or anticipation that providing financing and/or subsidies for the resale or home equity market will reduce the capital available for new construction, particularly for the lower and lowest income groups.

The alternative point of view is, in properly functioning markets, capital will flow to investments with predictable risks and reasonable returns. Subsidies should reflect national priorities and balance competing demands. Unfortunately, the history of housing subsidies includes many examples of disproportionate resource allocations to privileged groups.

Each of the countries represented at the conference needs to examine their specific situations to decide on the appropriate course of action given its goals. A well-designed system should be able to provide financing for a resale market without unduly disrupting low income housing efforts. However, each context has its own special features, quirks and imperfections, requiring country by country solutions.

Leveling the incentives between new and existing housing

Subsidy programs that target only new-build and ignore existing property have the effect of moving families into homes they cannot resell. Conversely, where money flows, building will follow, so how one chooses to direct subsidy powerfully influences, if not dictates, which neighborhoods and tenure types will blossom.

Chile's case study (Appendix A) demonstrates conclusively how neutralizing subsidy delivery can change market behavior.

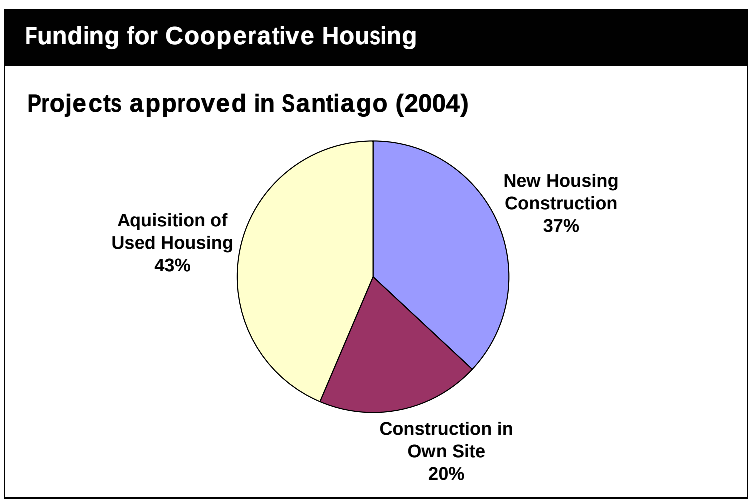
Leveling the Playing Field: Subsidy for Existing Homes (Chile)

(Extracted from Appendix A)

Five years ago, Chile broadened use of subsidies, then available only for purchase of new homes, to be neutral as to new versus existing homes. The subsidy was further broadened to allow housing bought with subsidy to be rented.

In part, this was a response to a new document elaborated by Profiv, an NGO associated with the Chilean Chamber of Construction (CChC). Profiv encouraged the Ministry of Housing to stop building small houses for poor people and create a new voucher solely for the purchase of used housing (Corporación para la Promoción del Financiamiento para la Vivienda, 2000). The CChC has continued to be an active promoter of stimulating the market for used housing, as shown by two recent documents they produced (Cámara Chilena de la Construcción, 2004; Doña, Larrañaga et al., 2004).

The policy change has led to an immediate boost in home resale and incremental housing:



If government wishes to use subsidy to lift or thicken markets for the resale of existing homes, it should consider expanding subsidy flexibility with initiatives or features such as these:

1. ***User neutrality.*** Allowing capital subsidies to flow not just to new homes but also purchase of existing homes.
2. ***Use flexibility.*** Allowing capital subsidies for not just home purchase but also for home improvement, home expansion, or incremental housing. (This must be managed so as to flow into actual capital improvement, otherwise it simply becomes a social welfare program/ wealth transfer that will rapidly monetize in a secondary market, with no benefit to the housing ecosystem.)
3. ***Tenure neutrality.*** Allowing capital subsidies to flow not just for purchases of homes but also for (say) security deposits for rental apartments, co-operatives, or shared ownership schemes.
4. ***Trade-in value.*** Enabling customers who use a portion of their subsidy on a first property transaction to bank the residue, for later use in another purchase, a home improvement/ incremental housing, or otherwise. In effect, such an approach makes the subsidy birthright into a limited-use, fully vested savings account to be drawn for approved purposes.
5. ***Annuitization.*** Allowing an up-front subsidy to be confronted, via a money instrument or otherwise, into a series of periodic (monthly) payments used to support debt service on a loan or otherwise.

Customer confidence in equity buildup and ability to access equity buildup

Beyond the obvious – that consumer confidence follows successful trading of homes – there are several initiatives that strengthen consumer confidence:

1. ***Property insurance against catastrophe.*** Catastrophe – fire, flood, natural disaster – wipes out homeowner equity. Small stakeholders lack the capital to absorb this risk, nor the market power to take out insurance against it. Available inexpensive insurance (possibly supported by a government participation, pooling, or even some inherent government subsidy) both strengthens consumer confidence and eliminates a large class of non-

commercial risks that inhibits lenders from providing capital into existing property markets. (Note that this intervention also applies more broadly to low-income markets, not just existing home resales.)

2. ***Transaction transparency.*** The more information recorded and available regarding movement in market prices, the better. Markets are smarter than individuals, so the best road to active markets is a surfeit of reliable accessible information.
3. ***Fair credit reporting*** (as in credit bureaus). Discussed at length above.

INTERVENTIONS/ INITIATIVES TO CONSIDER

Without endorsing any of the following, we list below various interventions and initiatives suggested by the country experience chronicled in the preceding narrative and in the appendices.

1. Access to title. Render greater transparency in title records available to all interested parties.

2. Reduce the administrative and legal limitations to the secondary transfer process. Costs and difficulty must scale down as property prices scale down.

3. Improved market information and transactional support. Credit bureaus are one visible and important example, probably the largest single intervention in the information space.

4. Access to credit/financing. Both in financial terms (i.e., who qualifies and who can afford) and in practical delivery terms (i.e. where one can access a loan/ make payments on it).

5. Local authority investment and management. Largely unexplored in this paper as it verges into municipal finance and infrastructure development.

6. Educational/ promotional programs (to promote participation in the market). Customer lack of financial literacy is itself a significant barrier to capital.

7. Licensing standards for intermediaries such as brokers, appraisers, settlement agents, recordation agents, and so on.

8. Branch presence in township and formalizing markets. This needs to avoid replicating the brick-bank high-infrastructure-cost approach of the twentieth century and embracing electronic, mobile, and web-based point-of-purchase capacity. The field is ripe for technological innovation to create new business models.

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APPENDIX A: CHILE CASE

Subsidy Programs to Support Resale of Existing Homes

Mario Navarro
Loeb Fellow, Graduate School of Design, Harvard University
Lincoln Fellow, Lincoln Institute of Land Policy
April 13, 2005

For the first 10 years, up-front subsidies in Chile were only available for first-time (new) housing purchases. Problems emerged, however, as home-owners needing or wanting to sell their houses in the low-moderate sector faced insufficient demand. In Chile, vouchers to purchase a house expired after a 21-month period. Many voucher holders were unable to use their vouchers because they could not find new homes meeting their expectations (price, size, location) for the capital they had (combining savings, loans and the voucher).

So the Ministry of Housing introduced flexibility into the programs and allowed families to use the subsidy to buy used houses in the last 12 months of the voucher's validity. Many people began using vouchers to buy used houses. The government and Chilean Chamber of Construction came to understand most sellers wanted to buy more expensive homes, which would induce new construction.

As Housing Policy Director, Mario Navarro proposed to the Minister that vouchers be neutral to used and new purchases. He also proposed the Minister eliminate an impediment to rent the houses bought with a subsidy not only because he thought they should stimulate the market of social housing but also because it was impossible to prevent people from renting their houses. Both proposals where approved.

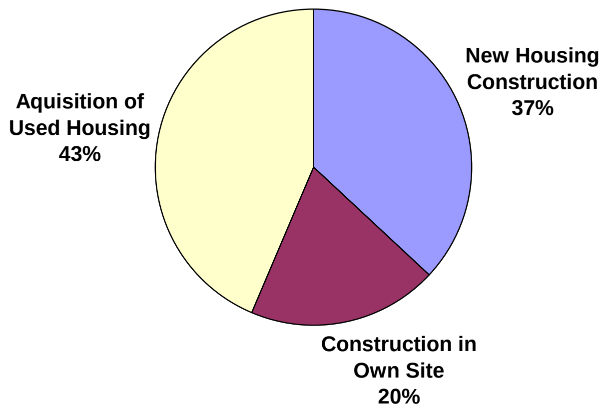
In part, this was a response to a new document elaborated by Profiv, an NGO associated with the Chilean Chamber of Construction (CChC). Profiv encouraged the Ministry of Housing to stop building small houses for poor people and create a new voucher solely for the purchase of used housing (Corporación para la Promoción del Financiamiento para la Vivienda, 2000). The CChC has continued to be an active promoter of stimulating the market for used housing, as shown by two recent documents they produced (Cámara Chilena de la Construcción, 2004; Doña, Larrañaga et al., 2004).

In the New Housing Policy, Mr. Navarro actively participated in the design and implementation of three different housing programs targeting different income level households and created or adapted from the former policy.

For the poorest, we created a Subsidy Program called Fondo Solidario de Vivienda (Funding for Cooperative Housing) with an up-front subsidy of US$8,200. People need US$300 of savings in order to apply and start a project (for new construction on a site where they already live in a non-permanent house or new land) or buy a used house (with a formal letter where buyer and seller agree on price). The selection mechanism favors those who buy used houses over people who build new houses. The idea was to open a new market in the very low-income sector, where houses constructed by the government in the last 30 years could be sold. This was also viewed as a solution to the traditional problems of sending families to new housing projects in the periphery of cities (e.g. separation from social and work networks, increased expense and time in commuting to work, etc.). The program targets people living below the poverty line (632,000 households in Chile, or 19% of the population). Between 25 to 30 thousand subsidies have been distributed each year. Promoting the use of this subsidy to buy used housing has been more successful in Santiago, as the next graph shows.

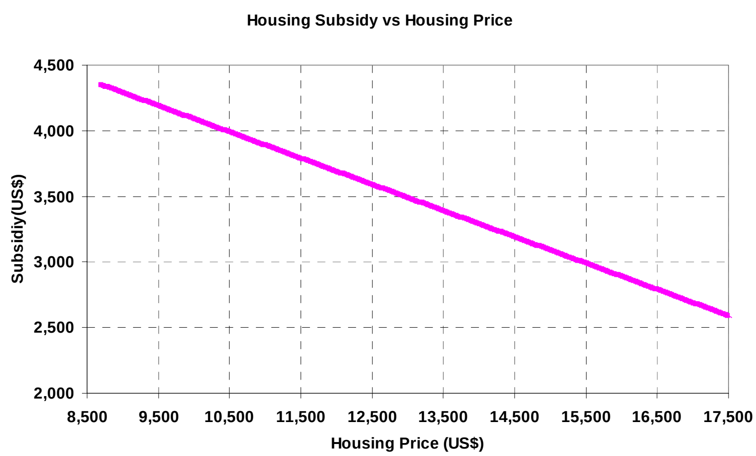
Funding for Cooperative Housing

Projects approved in Santiago (2004)



The second subsidy program was designed for low-income people above the poverty line. The vouchers can be used to buy houses priced up to US$17,500, with the subsidy decreasing as the price of the house increases.

New Basic Housing



[21]

These households were the main consumers of former housing projects developed by the Ministry of Housing up until 2001. Therefore, they used to be served by government mortgage loans (with arrears of 70%). To entice private banks to finance these houses we signed an agreement with the following terms:

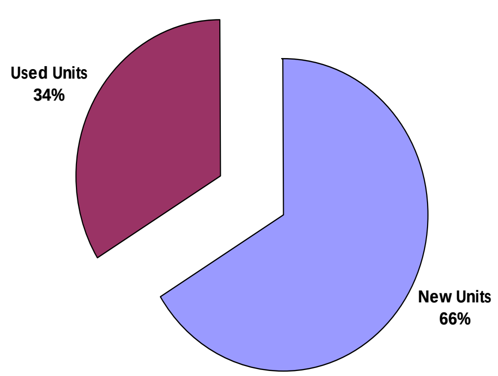
Agreement with Private Banks

Subsidies and Incentives

1. **Origination Subsidy**: A fixed amount between $100 and $300 is given to the bank for each loan to finance a subsidized house of less than $17,500
2. **Implicit Subsidy**: Ministry guaranties the loan is sold at the secondary market at 100% of it value (if not it pays the difference)
3. **Default Insurance**: In case of foreclosure, the Ministry guaranties that the bank recovers the debt balance and the cost of legal proceedings.

With this agreement, the government could cease giving mortgage loans. The subsidies in this program are also for new or used houses, but the program is much more simple than the first program described. People apply individually or in groups to the subsidies and they can buy directly in the private sector as long as the house complies with characteristics defined in the program. Close to 40,000 vouchers were distributed annually.

New Basic Housing Subsidies paid 2002-2003



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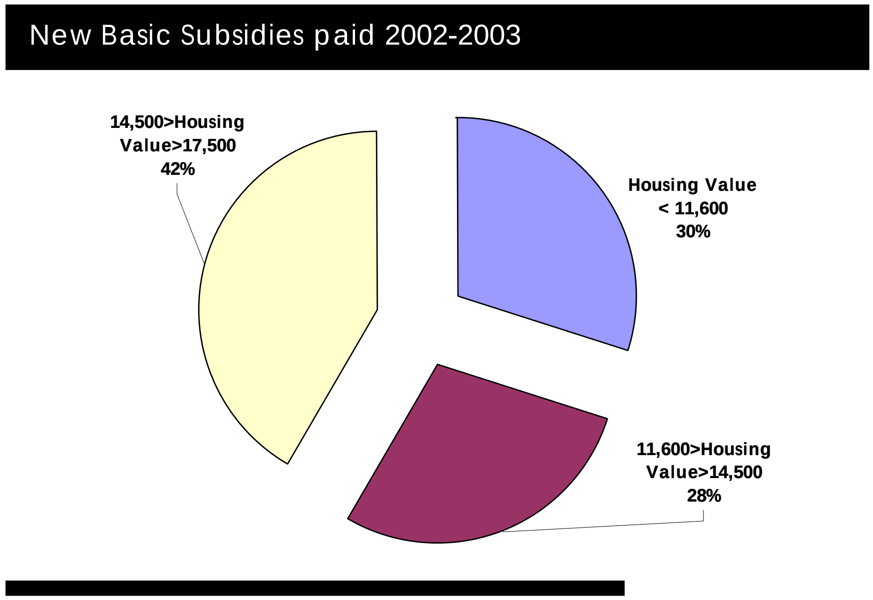
Notably, many people were afraid the majority of subsidies would be used on housing at the upper end of the price allowed and the market would provide neither an adequate supply of housing nor credit for houses under US$ 11,600. The following chart shows the progressiveness of the subsidies was enough to stimulate the market at all levels of interest:



[5]

Finally, there is a subsidy for houses between US$ 17,500 and US$ 29,000. Only 6,500 of these subsidies have been granted each year. The main reason for it is to promote mixed income housing in private projects. The only subsidy is up-front capital of US$ 2,600. The government eliminated any subsidies or guarantees from banks that they would have qualified for prior to the reform. In this program, more than 50% of vouchers are used to buy used houses.

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APPENDIX B: SOUTH AFRICA CASE

Township Property Markets and Market Renewal Programs

The Shisaka report on South African township property markets undertook a thorough analysis of the primary and secondary property markets (the resale market). Their findings support the following hypothesis:

> "The secondary property market in Black townships in South Africa is ineffective and inefficient. This is due to the legal, institutional and procedural constraints that frame it, rather than the financial factors regularly identified by policy makers. Not only does this constrain the economic growth potential of these townships, it also undermines the asset creation potential of the state's subsidised housing scheme'.

The Shisaka report breaks down the townships into submarkets for their analysis, shows the interdependence of the primary and secondary markets, and examines the enabling or disabling structures in the secondary market. The following include excerpts from their final report:

Residential property markets are made up of **primary and secondary markets** which are **interrelated** and **dependent** on each other… [They] both require key inputs and processes.

The number of households living in Black Townships is significant, representing one fifth of South Africa's population (estimated to be 2,28 million households in 2002). The majority of households fall into the lowest income category (average household incomes are R3546 per month). The economic circumstances of these households [have] worsened since 1995, implying reliance on baseline survival strategies and reducing effective demand for housing in the secondary property market.

Black Townships in South Africa have a distinct history, which has had a direct impact on the nature of residential property markets that exists in these areas. During the apartheid era these areas operated as a closed market, reflecting state intervention and received poor social infrastructure and services. This has directly influenced the way in which housing is delivered and property is valued and traded.

Based on the research undertaken the following key findings are evident:

1. The residential property market in Black Townships is not uniform, but comprises four sub-markets, namely:

- **Informal Settlement**: comprising informal dwellings erected by the occupants using non-conventional building materials, often on land without the permission of the owner.

- **Incremental housing**: comprising a subsidised formal freestanding housing unit (RDP) and site and service schemes where a subsidised site is provided and in some cases funding for the development of a dwelling.

- **Old Township**: comprising formal housing units built as rental accommodation by Government mainly between 1948 and 1960 as rental accommodation for Africans.

- **Privately developed**: comprising formal housing developed by private sector developers, usually sold using a mortgage bond from a financial institution.

Each of these sub-markets displays different characteristics which influence the way in which the secondary residential property market operates within the sub-market.

2. The extent of the secondary residential property market in Black Townships, both overall and in terms of all of the four sub-markets, is extremely limited with very few formal transactions occurring.

In terms of an analysis of Deeds Registry data for 12 survey sites, only 7,5% of all proclaimed properties were registered [with] a secondary market transaction in the last five years. This is substantiated by the Household Survey where, of the 2004 households interviewed, only **12% have transacted in the secondary market in the past 5 years**.

This is very low when compared to a 'normal' suburb. A **comparison with similar suburbs outside the townships** indicates levels of secondary market transactions in the region of **26% to 51%.** This reflects the depressed nature of the secondary market in Black Townships and indicates that the particular circumstances of such Townships are undermining the secondary market in these areas.

There is evidence of transactions occurring informally particularly in the informal, Incremental and Old Township sub-markets. The implications of this are that the Deeds Registry is losing relevance and the lack of formal title undermines security of tenure for the new owner. Even when transacting informally households demonstrate a desire to have proof of the sale.

The **'housing ladder'**, where a household sells one property in order to purchase a better quality property, is not effective and there appears to be very limited movement of households between the sub-markets…

3. The secondary residential property market in all of the four sub-markets identified is dysfunctional. This relates to almost all of the dimensions required in order for these property markets to work effectively. Critical factors in this regard are:

- There is a **limited supply of housing stock** in all sub-markets.
- There is an **extremely limited supply of end user finance** to purchase existing housing stock. This is particularly problematic in respect of the Incremental and Old Township Stock sub-markets where micro loans are not sufficient to purchase a property and mortgage loans are not available.
- There are significant **constraints in respect of the process of transferring property** including:

    - In respect of the **Informal** sub-market, the **lack of legal title** and the illegality of informal settlements undermine the ability of households to trade formally in these areas.

- In respect of the **Incremental** sub-market, the **provision prohibiting the sale of property which had the benefit of a government-housing subsidy** as specified in the Housing Act, 1997 is fundamentally undermining the sale of housing in this sub-market and is resulting in informal transactions occurring.
- **Land title** is not available to a significant number of households in the **Incremental** and **Old Township** sub-markets. The reasons for this are as follows:

  - The slow administrative processes in respect of opening township registers.
  - The transfer of housing in respect of Old Township Stock
  - The requirement for a municipal property valuation and Clearance Certificate prior to transfer of ownership.

- There is a **lack of service providers** (including estate agents and conveyancers) operating in Black Townships.
- The **cost of transferring properties** is problematic for low-income households, especially given that housing in this market is generally not financed.

- The residential property secondary market in all of the sub-markets appears to be thin, with limited willing buyers and sellers and transactions. Evidence for this is as follows…
- Extremely limited information on the processes and goods available exists in respect of the sub-markets….

The underperformance of the secondary market in Black Townships undermines the ability of the primary market to operate effectively. This is because without an effective secondary market housing financiers are insecure as to the property-backed security provided via mortgage bonds and consequently are reluctant to provide mortgage finance on new housing stock. The lack of supply of new housing stock limits choice and availability of housing in the secondary market.

4. The estimated value of residential properties in Black Townships is R 68,3 billion. Nevertheless **the use of these properties for wealth creation and / or income generation is extremely limited**. Households are unable to leverage capital using their property as an asset and are not making use of such a property to generate income, either through rental or the use of the property for business purposes."

The six interventions Shisaka recommends based on their findings are:

1. Access to Title
2. Reduce the Administrative & Legal Limitations to the Secondary Transfer Process
3. Improved Market Information and Transactional Support
4. Access to Credit/Financing
5. Local Authority Investment and Management
6. Educational/Promotional Programs (to promote participation in the market)

APPENDIX C: GETTING TO KNOW LOW INCOME NEIGHBORHOODS, A CHARGE FOR BANKS

The following comes from an article by Kecia Rust, Consultant, titled: "Even in the high income market, mortgage bond disputes top the list for ombudsman," written April 21, 2005. http://www.affordablehousinginstitute.org/blogs/za/2005/04/even_in_the_hig.html.

A significant body of additional posts on South Africa may be found at Ms. Rust's site, http://www.affordablehousinginstitute.org/blogs/za/.

One of the most common explanations for why banks haven't engaged with low income consumers in South Africa, has been that banks don't understand them. It's not usually published in those words, but the gist is the same – banks are accustomed to dealing with higher income, formally employed persons with straightforward incomes and importantly, who operate in markets where the security of their assets is virtually assured. So in a neighbourhood like the one I live in, which enjoyed property price increases last year of 32%, it doesn't really matter if the client is risky: the market isn't.

Translate this approach to low income property markets and things become much more difficult. **The Township Property Markets Research found that properties were undervalued by as much as 44% - where a homeowner thought (reasonably, the researchers determined) that they should be able to sell their home for about R178 000, they were only able to achieve a sale price of R100 000.** This is where the very same house outside of the township (and closer to my neighbourhood) would probably cost somewhere in the region of R250 000 – R500 000. So, in this market, the risk profile of the client – and just as important, the servicing approach of the lender – is critical, because the house itself does not offer realizable security.

Last year, the FinMark Trust sponsored research that looked into the servicing capacity of six South African lenders, including the big four banks. The research had four main findings:

1. Institutions universally believed that they "know their customer base well." However, **few, if any, institutions maintain a branch presence** targeted at low-income housing loan borrowers or dedicated customer service representatives in the areas where low-income

borrowers live. Furthermore, few of the decision makers supporting this customer base come from the same community.

2. Interviewed institutions frequently attempt to **contact borrowers via methods** which have proven effective for the middle and upper-end of the market, but which are **ineffective for reaching low-income borrowers**.

3. Interviewed institutions universally rely on **automatic payroll deduction**, in applicable cases, as a primary method of payment collection. While automatic payroll deduction is an effective and efficient method for collecting mortgage payments, this **method is not available to all borrowers** and an **over reliance on direct payroll deductions allows institutions to continue with inadequate collections services**.

4. In most cases, **interviewed institutions were not able to provide robust information on servicing costs**, and certainly no organization claims to have an understanding of the cost differential between servicing a performing versus non-performing loan. Furthermore, institutions were unable to provide information regarding the cost differential between servicing a low-income versus middle-to-upper income loan. It is imperative that institutions track these costs to understand the economics of lending to different market segments, determine cost savings associated with building economies of scale, and comparing costs across organizations.

This research has offered the banking industry a warning flag, especially in the context of their current Financial Sector Charter plans to extend access to housing finance for low income earners (classified as households within monthly incomes of between R1500 – R7500) dramatically.

Business Day recently reported that “mortgage bond disputes top list for ombudsman”, replacing ATM complaints as the dominant category. Complaints were related to interest rates being charged in excess of what was agreed by the banks, as well as accounts falling into arrears and repossession of properties. Speaking on the radio, the banking ombudsman Neville Melville, explained, “I think that is, as you suggested, with the vibrant economy - more transfers of property, and more scope for something to go wrong!” The Manager of Complaints Administration at the ombudsman, Mr Logan Balakrishna, suggests that another reason for an increase in complaints is that more people are aware of the service – and acknowledges that 80% of these are within the higher income groups. The ombudsman’s information campaign is therefore now targeting lower income groups.

It is estimated that new lending to low income earners in terms of the Financial Sector Charter could mean 250 000 more mortgages annually. Put this together with the problems relating to banks’ servicing of low income earners, and the ombudsman’s intention to publicise the complaints service to low income earners, and it looks like the complaints regarding mortgage bond disputes will stay on top of the list for some time.

This is clearly a warning to the banks to address issues of servicing and arrears management specifically in relation to the low income target market, and to develop appropriate consumer (and banker) education programmes to avert big problems.