SUSTAINABLE HOUSING FINANCE

Growing Housing Opportunities in Africa

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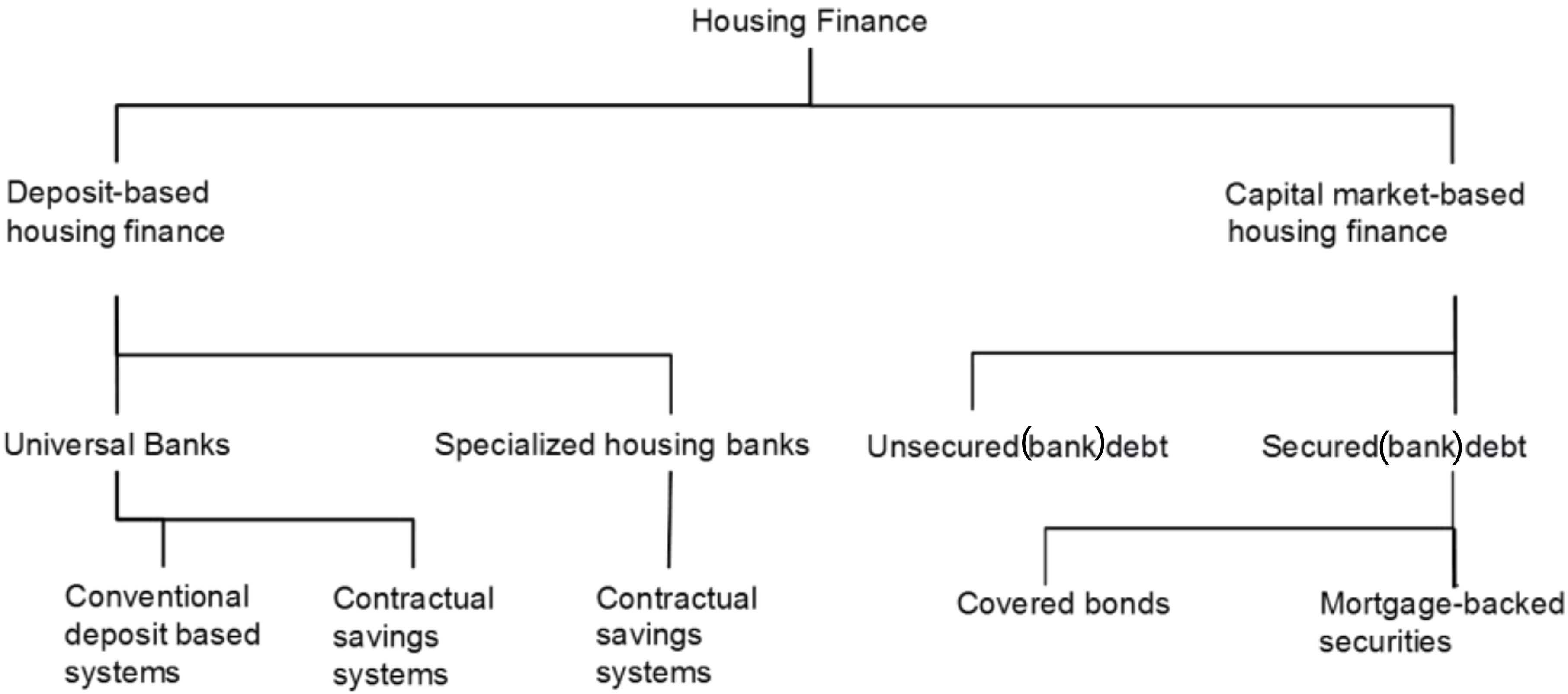
1. Dimensions of sustainable housing finance

Ecological Sustainability	Does the source of housing funding contribute to the reduction of greenhouse emissions and does it enhance resource efficiency?
Economic Sustainability	Is the system of housing finance able to persist over the long term?
	Is it resilient to external shocks? Does the system contribute to economic stability?
Social Sustainability	Does the system of housing finance allow a high proportion of people from all social backgrounds to become home-owners?
	Is the design of housing finance likely to avoid overstraining the home-owner's financial resources?
Fiscal Sustainability	Is government support of home-ownership efficient in the long-run?
	Does the government's policy contribute to a reduction of bubbles?
	And does it help to avoid the socialisation of private losses?
	Is the set of rules for housing finance adequate to promote the aforementioned goals?

Housing finance is sustainable if it enables a large share of the population to fund residential property within an adequate period of time on transparent terms and predictable as well as affordable cash flows, thus creating stable housing markets with a minimum risk of private/corporate failure and public involvement, while slashing the emission of greenhouse gases.

2. Typology of housing finance instruments



3. Typology and sustainability of housing finance instruments

Conventional deposit based systems:

-Traditional and long-standing way to finance housing
-Usually relatively cheap and available source for funding
-Claim on bank's balance sheet as a whole; protection by deposit insurance

<u>Economic and social sustainability mediocre:</u>

-Maturity transformation problematic: liquidity and interest rate risk for lender and/or borrower
-Banks often reduce credit risk by offering only moderate/ low price-to-income and loan-to-value (LTV) ratios; usually more variable rate loans
-Deposits not always a cheap and available source for housing finance

<u>Fiscal sustainability questionable:</u>

-Deposit insurance that enjoys implicit or explicit government guarantee might be in times of crisis a very high burden for taxpayer

<u>Ecological sustainability neutral:</u>

-Small loan amounts without high surcharge should be available

3. Typology and sustainability of housing finance instruments

Contractual savings schemes for housing:

- Saving phase linked to right to receive a mortgage loan; loans are disbursed only to previous savers
- Interest rate of the loan and on deposit predetermined at the contract stage for the whole duration (interest rates usually below market rates)
- Independent of capital market; offers fixed interest loans in local currency

<u>Economic and social sustainability good:</u>

- Maturity mismatch greatly reduced, liquidity risk marginal
- Saved up equity as risk-buffer for borrower and lender
- Offers higher LTV ratios on solid reference values; low interest rates; fixed interest
- Generating prior savings needs time; relatively short redemption time
- Loans usually only of modest size; additional finance sources needed

<u>Fiscal sustainability good:</u>

- Special security architecture makes government involvement unlikely

<u>Ecological sustainability good:</u>

- Small loan amounts are the rule; no surcharge

3. Typology and sustainability of housing finance instruments

Unsecured debt:

-Important source of funding for credit institutions in general
-Claim on the bank's balance sheet as a whole
-Different maturity periods and ranks (senior, subordinated, residual)
-Available on a short notice

Economic and social sustainability moderate:

-Reduced liquidity and interest rate risk for lender; maturity transformation an issue
-Good price-to-income and LTV ratios, fixed interest loans available
-"Price" for unsecured debt dependent on bank's rating
-Easily negatively affected by external shocks and volatilities of capital market

Fiscal sustainability questionable:

-Biggest investors are institutional investors; major default in unsecured bank debt would threaten collapse of the whole financial sector

Ecological sustainability neutral:

-Small loan amounts without high surcharge should be available

3. Typology and sustainability of housing finance instruments

Covered bonds:

-Dual recourse: backed by pool of mortgages and bank's solvency
-Overcollaterisation: face value of mortgages in pool exceeds the value of the bonds
-Mortgage pool remains on bank's balance sheet; its size is maintained
-Long maturity periods; maturity match possible; fixed-interest loans

<u>Economic and social sustainability good:</u>

-Very low liquidity and interest rate risk for lender
-Low interest rates, fixed interest loans, good price-to-income and LTV ratios but maximum LTV ratios legally prescribed so that supplementary finance often needed
-Dependent on capital markets
-Regulatory issues: covered bonds as "sleeping" good bank in a universal bank; special banks avoid issue but need liquidity backups

<u>Fiscal sustainability maybe problematic:</u>

-Governments have been reluctant to put the security structure to the test; outright purchases by ECB might result in losses for taxpayers

<u>Ecological sustainability mediocre :</u>

-Small loan amounts available only with a surcharge

3. Typology and sustainability of housing finance instruments

Mortgage-backed securities:

-Pooled mortgages are sold to capital market; separate entity (SPV) is issuer
-Off-balance sheet claim; mortgage pool is static so that investor bears all risks
-The use of tranches allows bonds to differ in risk, yield and maturity
-Long maturity periods; maturity match possible; fixed-interest loans

<u>Economic sustainability moderate but social sustainability good:</u>

-Very low liquidity and interest rate risk for lender
-Very good price-to-income and LTV ratios possible; low fixed interest loans
-Dependent on capital markets
-Complex process implies major fixed costs; government involvement often needed
-Moral hazard and fraudulent lending an issue (if “originate-to-distribute”)
-Risk might not be dispersed but circulated (risk clustering/centralisation)

<u>Fiscal sustainability moderate to negative:</u>

-If governments guarantee investors timely payment risk for taxpayers might be enormous; if there are only private-label issuers risk is similar to covered bonds

<u>Ecological sustainability mediocre :</u>

-Small loan amounts available only with a surcharge

4. Conclusion – sustainable housing finance

<u>A single channel of funding is not sustainable:</u>

-Needs of borrowers and lenders met properly only with a set of channels
-At various points in time, some markets are more functional than others
-Conventional deposits are likely to continue to be the backbone of housing finance as they are usually an available and relatively cheap source of funding; as they do not excel in sustainability they must be accompanied with other sources of funding; contractual savings schemes are the more attractive and sustainable form of deposit-based housing finance

<u>Pure debt financing is not sustainable:</u>

-Equity is a form of self-commitment; equity forms a risk buffer
-Contractual savings schemes as form of self-imposed rule/ auto-discipline

<u>Flight to secured debt is not sustainable:</u>

-If the only source of funding available is secured, it is also unsustainable

5. The role of Bausparen

Contractual savings systems are…

-a type of deposit finance which tackle the maturity transformation risk

-providing mortgage loans with fixed interest rates in local currency

-a risk buffer for lenders and borrowers because they support the formation of equity

-catering particularly to lower and middle income groups

-a tool to detect the creditworthiness of customers because of the savings phase

-suited to support incremental building

-a particular safe way for housing finance

The characteristics and advantages of the Bauspar system make it especially suited for developing countries. It successfully addresses the two main bottlenecks: 1.) the lack of viable providers of private equity capable of serving the market for households with low to medium income; 2.) the lack of long-term funding in local currency.

5. The role of Bausparen

The Bauspar system is a very robust and safe system, but some preconditions are needed for its successful establishment:

- Stable macroeconomic environment
- Low inflation rate (or at least stabilising)
- Well-functioning banking law
- Strong supervisory authority for credit institutions
- Special Bauspar Act (optional, but recommended)
- Savings bonus (optional, but recommended)

Questions?

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Thank you for your attention and see you in Vienna!

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