

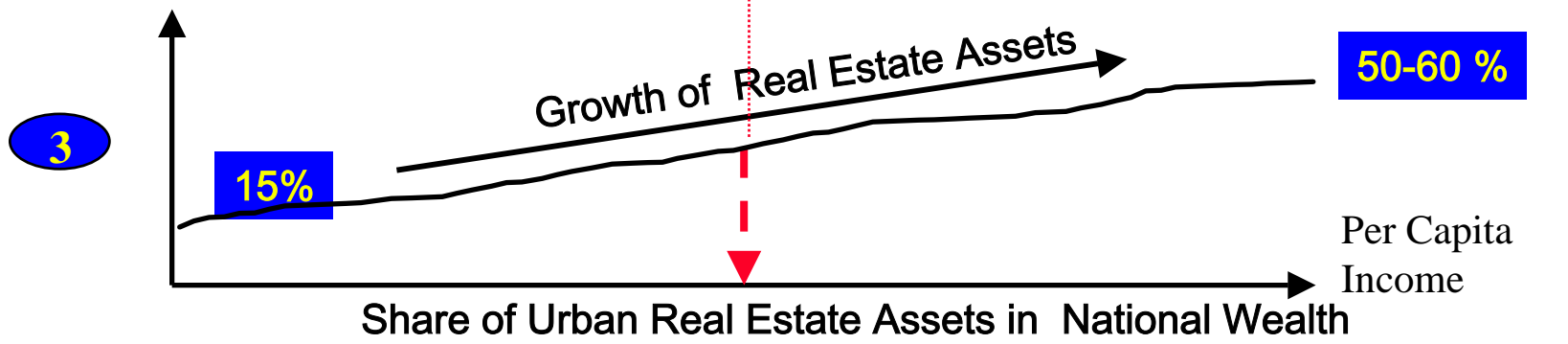
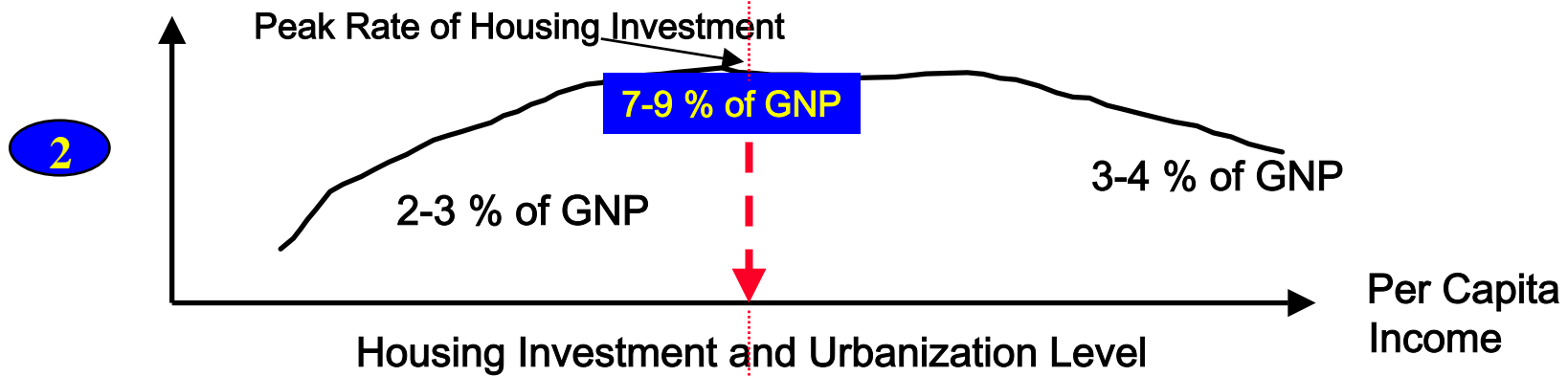
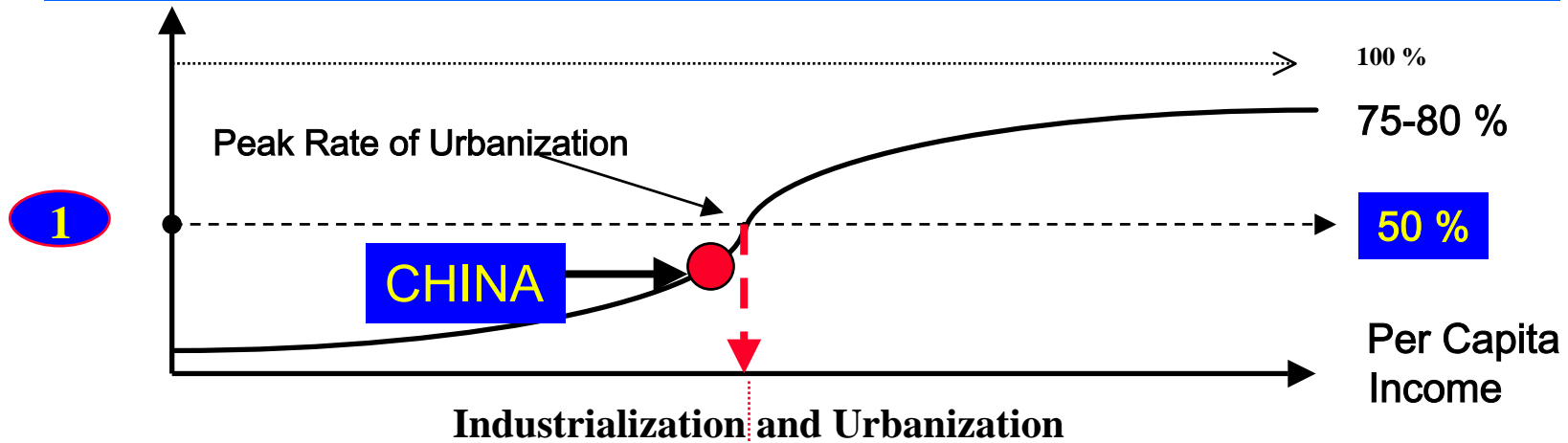
HOUSING FINANCE IN TRANSITION ECONOMIES AND IN CHINA

Bertrand RENAUD
The World Bank

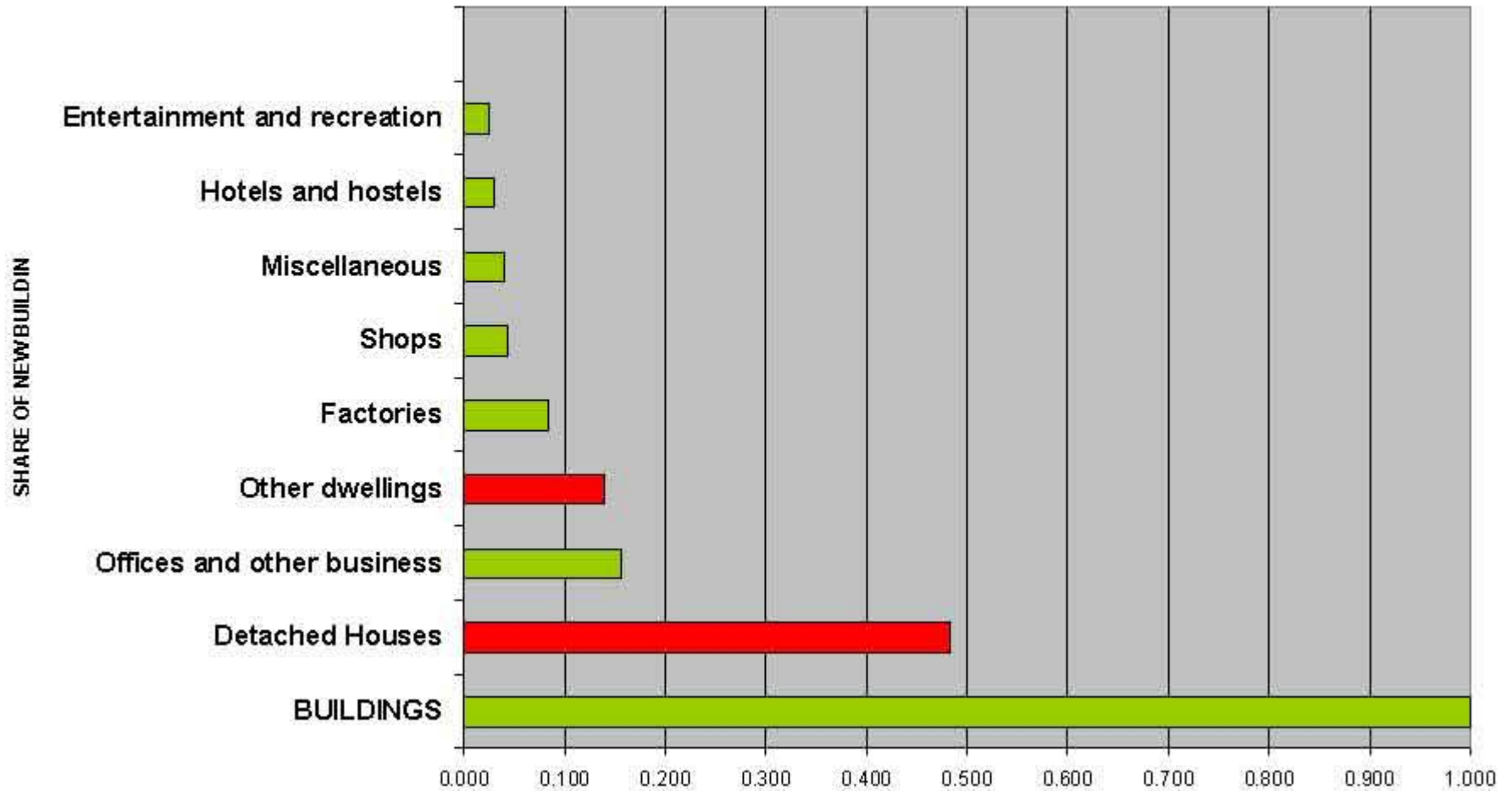


Housing and Real Estate Development
Pilot Distance Learning Course for China , May 2001

CHINA: RATE OF URBANIZATION IS REACHING ITS PEAK



VALUE OF NEW HOUSING in the CITY



**CITIES ARE BUILT
THE WAY
THEY ARE FINANCED**

Impact of Financing on Housing

- **Informal financing:**

- The visible outcome of policy and institutional failures
- Slow incremental housing based on retained savings
- “Self-development” by owners using small craftsmen

- **State financing:**

- Standardized, monotonous, low value units (high resource cost, low use value for the occupants)
- Inefficient industrial housing systems
- Elimination of the real estate and financial services professions leading to critical “SKILLS CONSTRAINTS”

- **Commercial bank financing:**

- Diversified supply of housing units,
- Production completed in short amount of time
- Professional developers & organized R.E. industry

Informal housing



State housing



Commercial housing



“The invention of the amortized loan is of such importance [...] that it should rank with the invention of the steam engine in changing the face of Britain.”

A.A. Nevin, *Housing, Taxation and Subsidies*, (1966)

Why do we need mortgage finance? The Housing Price to Income Ratio

1. Valuation of a house (income method):

[Market Price of a House] = [flow of rents] / [cost of capital]

$$P = R / i$$

2. If Household capacity to pay rent is 25% of income (Y)

$$R = 0.25 Y$$

3. Housing Price to income ratio: P/Y

$$P = 0.25 Y / i$$

assuming a real interest rate of 5%

$$P = 0.25 Y / 0.05$$

$$P/Y = 5$$

A house is usually worth 3-5 times annual income of the occupant

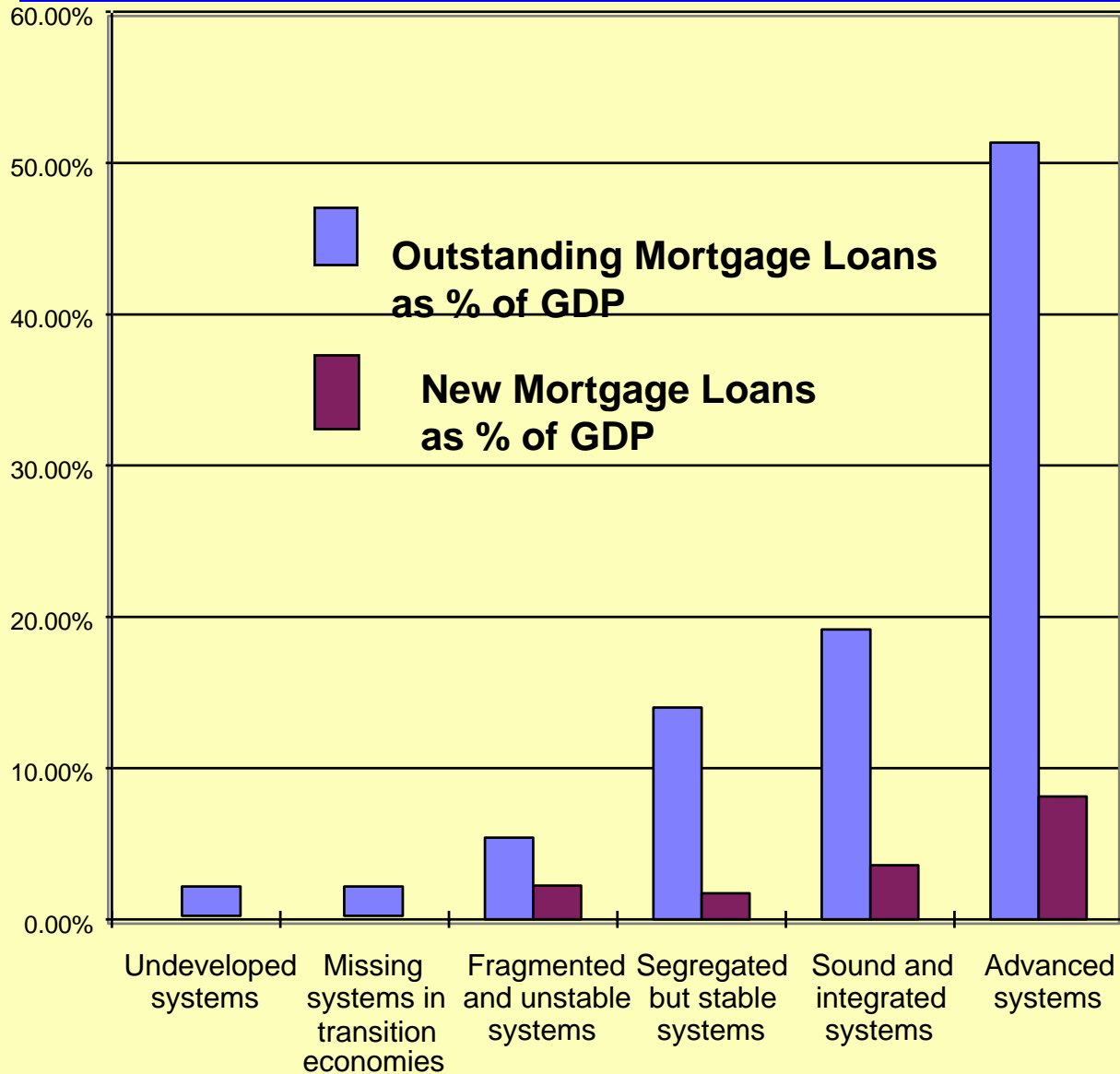
Factors Shaping Housing Finance

- **MACROECONOMIC & FINANCIAL POLICIES**
 - Integration to world economy
 - Exchange rate policy
 - Interest rate and credit policy
 - Associated level of domestic price stability
- **FINANCIAL INFRASTRUCTURE**
 - Laws
 - Accounting systems
 - Regulation & supervision
 - Payment system
- **URBAN LAWS, POLICIES & PRACTICES**
 - Clarity of ownership and enforceable property rights
 - Economically sound, market sensitive urban planning
 - Predictable land development codes & practices
 - Coherent, stable national and local taxation of housing and real estate

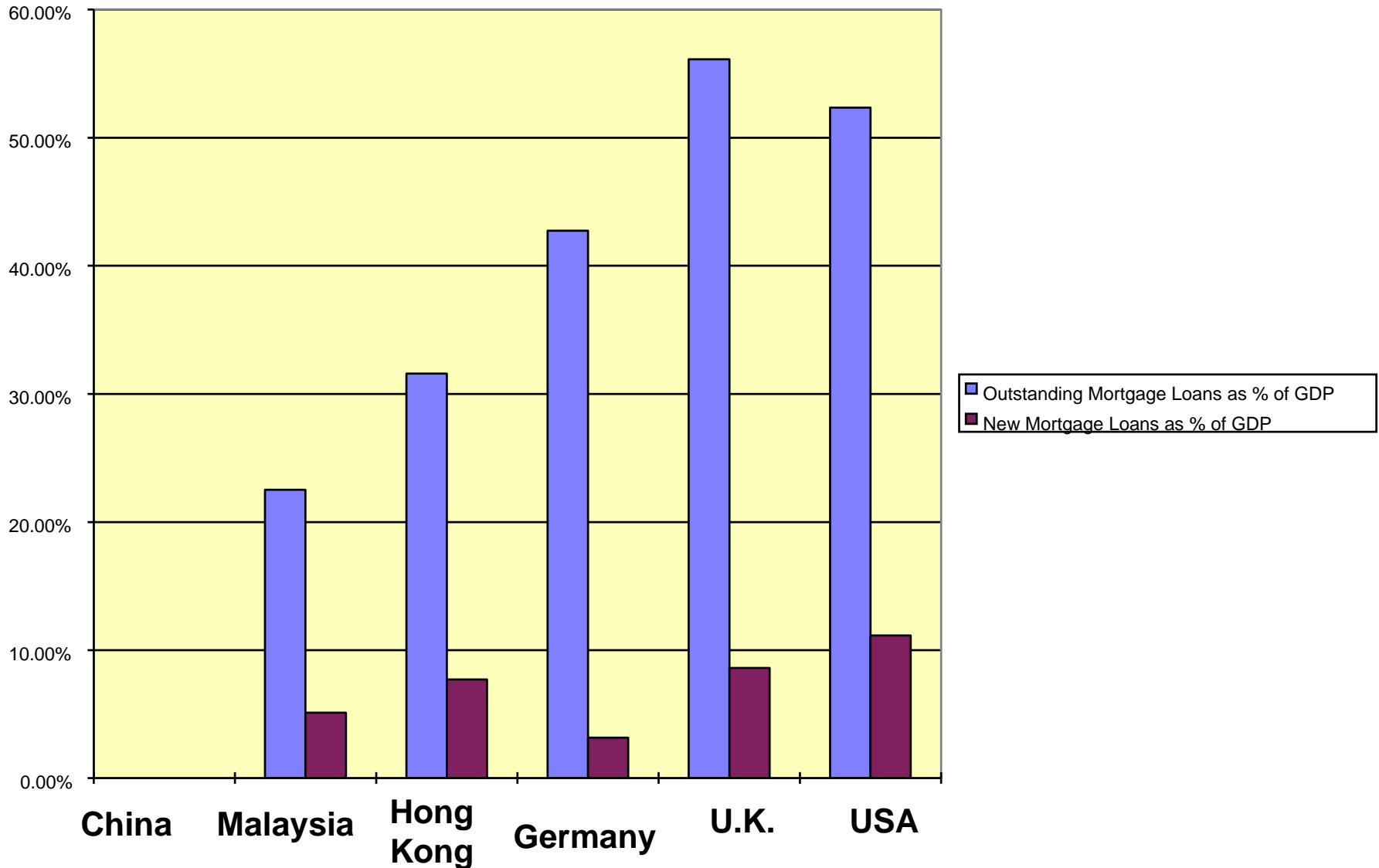
SIX TYPES OF HOUSING FINANCE SYSTEMS

1. Undeveloped
2. Missing in transition economies
3. Fragmented and unstable
4. Fragmented but stable
5. Sound and integrating
6. Advanced

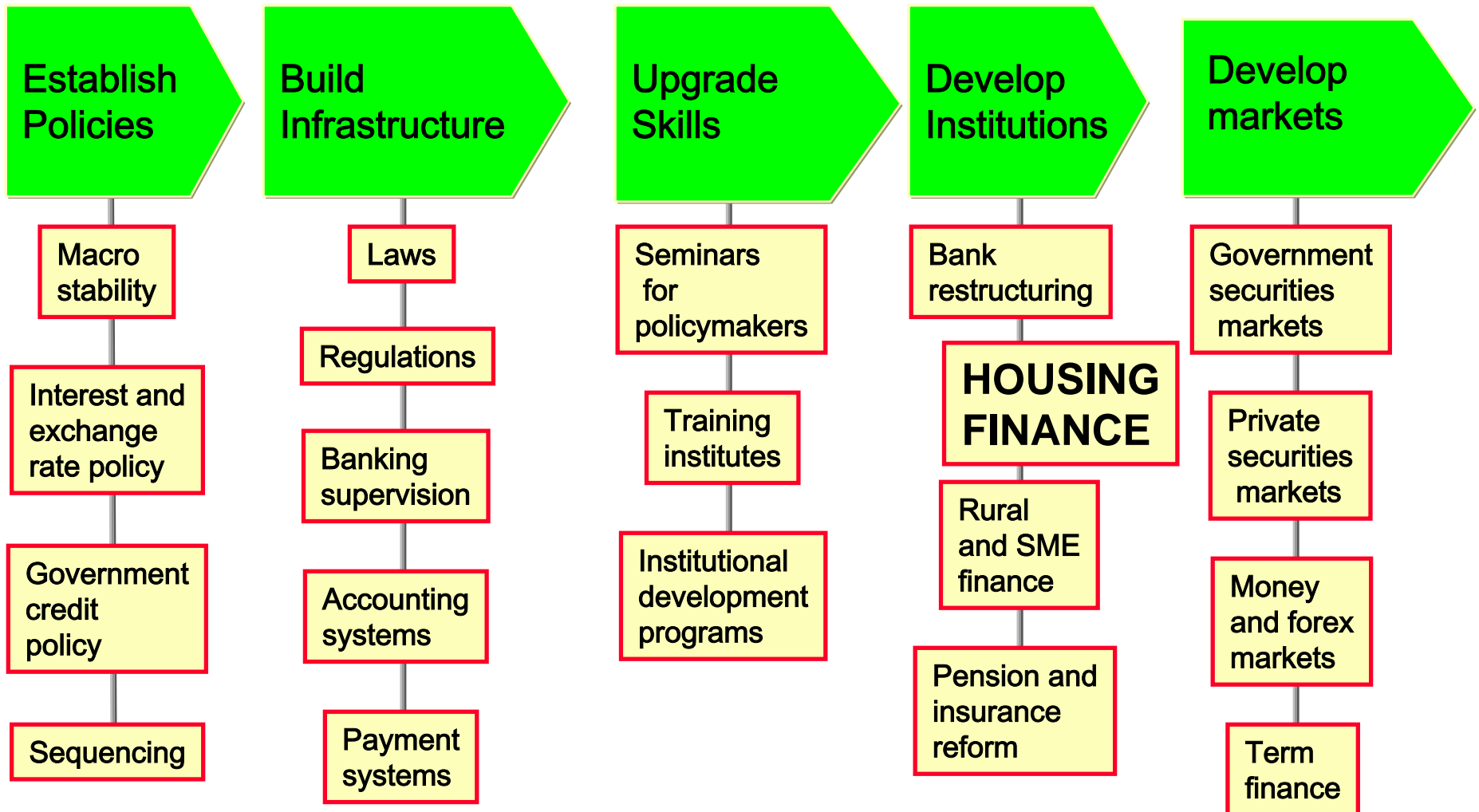
Depth of Housing Finance Systems by Types



Country Examples, 1994



FINANCIAL SECTOR REFORMS



HOUSING FINANCE STRATEGY

The Core Question: Why banks do not lend for housing?

- **Credit Risk**
 - Property Law? Condominium Law?
 - Stable, Sound Land Use Systems?
 - Credit and Collateral Laws?
- **Liquidity Risk**
 - Access to Refinancing Market?
- **Interest Rate and Market Risk**
 - Volatile Inflation?
 - Interest Rate Controls?
 - No Secondary Market Facilities?
- **Inadequate Capital**
- **Lack of Credit Skills**