

ACCESS *housing*

March 2007 – Number 6

A FinMark Trust publication
exploring innovation in housing
finance for the poor in Africa

Exploring access issues in Africa

March was supposed to have been the last month of the FinMark Trust, established for a five year period in March 2002 by the South African office of the UK Department of International Development (DFID) to “make financial markets work for the poor” in the Southern African Customs Union (SACU) countries. Last September, however, FinMark Trust received a three year extension to its mandate, to continue with its work in SA but also to broaden its operations and services into the rest of Africa.

FinMark Trust’s goal is still focused: To support systemic change in the way Africa’s financial markets operate so that they work more effectively for the poor, whether consumers or producers.

As a first step, FinMark Trust has already promoted the application of FinScope™, its survey of individual usage of financial services, in nine African countries.¹ FinScope will provide baseline data to stimulate policy change and support innovation by commercial providers seeking to deliver products and services sustainably to consumers who are currently outside the formal financial system. FinMark Trust will build on the impact of FinScope by promoting and supporting change processes across the continent.²

For FinMark Trust’s housing finance theme, understanding the nature of an ‘access to housing finance’ question on the wider African continent, and targeting what areas of enquiry

¹ FinScope™ is a nationally representative study of consumers’ perceptions on financial services and issues, which creates insight to how consumers source their income and manage their financial lives. The sample covers the entire adult population, rich and poor, urban and rural, in order to create a segmentation, or continuum, of the entire market and to lend perspective to the various market segments. FinScope explores consumers’ usage of informal as well as formal products and builds a picture of the role that the informal sector can play in the financial markets of developing countries. Since FinScope is a perceptual study, it also encompasses attitudes, behaviours, quality of life factors and consumption patterns. See www.finscope.co.za

² By 2012 it is intended that some 20 countries in Africa will have the survey. Repeat studies will take place on 2-3 year cycles, enabling trends within countries to be monitored and providing the basis for cross-country comparison especially around access to finance. FinScope data will provide financial service providers and regional integration initiatives with comparable, standard and reliable data about demand for financial services across borders. (FinScope Africa Brochure)

are relevant in an African context, has been challenging. Certainly, there are many local and international players already operating throughout Africa. What role can the FinMark Trust play in this environment?

A recent article by Dr Michael Lea in a special Housing Finance edition of *The Banker*³ argues that “housing finance is enjoying robust growth in many countries across the globe, in both developed and emerging markets”. Citing growth of mortgage markets internationally, Lea notes that even in some emerging markets, mortgage debt exceeds 10% of GDP (China, Mexico and Thailand). In South Africa, the figure is 20%. And yet, as Cas Coovadia notes in the same edition, “Africa’s home-financing sector is generally in its infancy.” The exceptions, he writes, are South Africa, Ghana, and to a lesser extent, Kenya, Uganda and Tanzania.

The focus of the various articles in January’s *The Banker* supplement are all on the growth of mortgage finance – indeed this seems to be the case with most of the literature on housing finance in Africa.⁴ And yet, as the article on housing finance issues in Zambia (set out later in this edition of *ACCESShousing*) illustrates, the key constraint to functioning mortgage markets in African countries may be affordability.

Of course, affordability is relative and the standard definition of \$2/day can be debated in context. That said, with 75% of populations throughout Africa earning less than two dollars per day and 40% earning less than one dollar per day⁵, affordability for mortgage finance – indeed for the purchase of an entire house – is clearly limited, and certainly not an option for the vast majority. And even if affordability is defined empirically, there will be many (millions?) who might technically be able to afford, but who will still be reluctant to commit to long term mortgage debt because their lives are inherently precarious. We’ve seen this in South Africa – we have no reason to presume otherwise in the rest of the African continent. An obvious option, therefore, must be the incremental housing approach which sees the

³ *The Banker* is published by Financial Times Business Ltd, in the United Kingdom. Visit www.thebanker.com

⁴ A review of the literature on housing finance in Africa will soon be completed and published by the FinMark Trust. An executive summary of this will be included in the next (May) edition of *ACCESShousing*.

⁵ Global Report on Human Settlements 2005 - Financing Urban Shelter



Access to housing finance: what would it look like when it works?

development of housing in short, separately financed phases, “one room at a time”.⁶

Ferguson (2004) makes the point dramatically: “Only a small share of the population can qualify for a traditional mortgage to purchase the least expensive commercially built unit... Hence, housing for most people throughout the developing world is quintessentially progressive.” However, a blind spot among policy makers, development practitioners and financiers throughout the developing world leads to what he calls the ‘housing finance syndrome’.

The Global Housing Finance Syndrome (Quoted directly from Ferguson (2004) *The Key Importance of Housing Microfinance*, in Daphnis, F and B Ferguson (eds.) *Housing Microfinance: A Guide to Practice*. Kumarian Press Inc. Bloomfield, CT, USA (page 17-18)

1. *The small amount of mortgage finance available goes for the purchase of new, commercially built units of upper-class and some middle-income households. Most households cannot afford the debt service on even the smallest commercially built unit. Sometimes the central government attempts to bridge this affordability gap by creating a large subsidy system to drive mortgage finance down market. But these subsidies end up going disproportionately to middle- and upper-income households.*
2. *The remainder of the population must build and finance their own homes incrementally. Without support and guidance, this process generates enormous public costs. In particular, the reordering and extension of basic infrastructure (water, sanitation, roads, drainage, common facilities) to informal settlements typically costs three times the amount of extending infrastructure to formal-sector settlement. Thus, governments usually end up behind the curve of housing and urban demand and try to catch up at enormous public cost. Governments lack the subsidies to bridge the affordability gap necessary to satisfy new household formation, thereby creating great pent-up demand that households satisfy through informal settlement (land invasion and informal subdivisions) and unsupported progressive housing, whose costly regularization further depletes government resources – thereby aggravating this vicious cycle.*
3. *No significant amounts of institutional debt finance go to support the progressive housing process of the low- to moderate-income majority (three fourths of the population), to rental housing, or to development finance (land/ infrastructure) or construction finance of formal sector housing. For this and other reasons, housing fails to fulfill its economic function – in particular, that of building household wealth and assets – and falls short in its social function, as too few and too low-quality units get built to house an expanding population.*

How does this happen when housing affordability challenges are clearly obvious? Why do development organisations and commercial lenders persist with promoting a mortgage finance instrument that is appropriate only for a small segment of the population? And what again, does this mean

⁶ See Malhotra, M (2003) Financing her home, one wall at a time. *Environment and Urbanisation* 15:217. Available on <http://eau.sagepub.com/cgi/content/abstract/15/2/217>

for FinMark Trust’s housing finance work in the rest of Africa?

At least some of the answer seems to rest with the role that a functioning housing market plays in an economy, and specifically, the importance of this for effective private sector engagement in development. Financial market development initiatives by the World Bank (currently into its Second Generation of Financial Sector Reforms in most African countries), include interest rate liberalizations, removal of credit ceilings, restructuring and privatizing of state-owned banks, and so on. Senbet and Otchere⁷ argue that the development of capital markets and financial sector reformation is viewed as an important means of integrating Africa in the global financial economy and attracting international capital while also promoting regional integration. This is right. In her paper, “Bridging the Gap”, Ruth McLeod argues that commercial lending has often been crowded out in cases where Governments borrow extensively on the domestic market, usually by issuing Treasury Bills.⁸ Given the scale of development required, commercial banks will be important participants, so their involvement must be facilitated.

Even so, the involvement of the commercial sector need not be equated with mortgage finance, which in Zambia realistically is only relevant for the 8% who say they are salaried employees and also have a bank account.⁹ Given the degree of informal employment or agriculture-related (often seasonal) employment, mortgages are the wrong systemic change to target, even if the aim is to draw in the private sector in support of housing. Other innovations such as pension-backed lending, or shared equity products might be more appropriate given the socio-economic profile of residents in African countries. Access to housing finance is an issue even for those living in the middle of the pyramid – this is where Africa’s fast urbanizing and soon-to-be salaried are positioned. Surely this kind of innovation should be the focus of the ‘facilitation industry’ that has emerged in support of housing finance in Africa, providing guarantees, subsidies, security deposits, etc¹⁰ to help lenders make their way down the pyramid.

Meanwhile, what are households doing now to house their families – and what can we learn from their efforts?

It is well known and fairly well documented that commercial banks struggle with understanding the mechanics (and

⁷ Senbet, L and I Otchere (2005) *Financial Sector Reforms in Africa: Perspectives on Issues and Policies*, paper prepared for the Annual World Bank Conference on Development Economics (ABCDE), Dakar, Senegal.

⁸ See McLeod, R (2002) *Research on Bridging the Finance Gap in Housing and Infrastructure and the Development Of Cliff*. Available on: www.homeless-international.org

⁹ FinScope Zambia found that while 28% of Zambia’s adult population is formally employed, only 8% say they are salaried AND have a bank account.

¹⁰ For a review of international financing facilities for slum upgrading and infrastructure provision in developing countries, go to Comhabitat’s listing: http://www.comhabitat.org/struct_docs/OverviewOfFacilities20060112231319.pdf

Access to housing finance: what would it look like when it works?

concomitant ‘security’) of the incremental housing delivery process that is a reality for the poor. This is terrain normally left to NGOs and CBOs, micro lenders and other non-bank credit providers. While their approach may be appropriate, however, their capacity is miniscule compared to the challenge, largely hampered by limited access to capital – something the commercial lenders have. Is there an opportunity for collaboration and what might this involve? Further, as Ferguson (2004) notes, the incremental housing process raises a whole host of technical challenges relating to sustainable and viable infrastructure financing, in addition to the land and construction issues that we see in South Africa. What options are available for addressing these challenges?

These are especially interesting and important questions for FinMark Trust as it seeks to support enhanced access to housing finance, and the housing asset, by the poor across Africa. It will be the focus of our explorations over the next three years as we seek to understand (1) how national housing finance systems in various African countries work; (2) how the poor meet their housing needs and where are the gaps given existing arrangements; (3) what sorts of housing finance interventions might immediately support them in their efforts; and (4) what is needed from a regulatory, policy, institutional and financial perspective to make this possible.

FinMark Trust certainly isn’t the first to operate in this space. The International Institute for Environment and Development (IIED) and Homeless International have contributed extensively to the literature and the development of policy and practice in this area, as have CHF International, the Development Innovations Group, Rooftops Canada / Abri international, and others, not to mention the World Bank, IFC, USAID, Opic, the African Development Bank and other multilateral donor and lending agencies.

At FinMark Trust, we are especially interested in the link between the functioning of the wider financial market and the performance of housing finance initiatives that meet the immediate housing needs of the poor in Africa. This requires, of course, understanding the make-up of the pyramid: knowing what those needs are, and who is operating at the local level – be they individuals, NGOs, CBOs, private sector organisations, or government agencies. We will spend the next three years trying to find out, and sharing our findings through this and other publications, as well as at meetings, conferences, seminars, and so on. We invite you to join us in the debate as we seek to make access to housing finance a reality for the poor in Africa.

Kecia Rust

Housing Finance Theme Champion, FinMark Trust

In this issue:

- FSC Update
- The US sub-prime market crisis and its relevance for SA
- Low income housing tax credits: an option?
- Exploring housing finance issues in Zambia

FSC Update

The Financial Sector Charter has just seen the close of its third year – at the end of December 2006, the Charter was 36 months into its first 60 month term which ends on the 31st of December 2008. By then, investment in low income housing must equal R42 billion in origination, or R31,8 billion net balance sheet movement.¹¹

According to the FS Charter (and as reported on the FSC website), “each financial institution will report annually to the Charter Council on its progress in implementing the provisions of this Charter. The first annual report will be for the year ending 31 December 2004, and must be submitted to by 31 March 2005. Thereafter each financial institution will report as at 31 December each year thereafter, and submit the report by 31 March of the following year.”¹² Once the figures are submitted to the FSC Council, an auditor confirms the achievements which are then released in about May of that same year.

On the 31st of March of this year, the Banking Association submitted the following statistics on the banks’ origination to 31 December 2006. These are unaudited figures and therefore only indicative of progress made. The FSC Council will appoint an auditor to interrogate the figures, and only once they are confirmed will they be released by the FSC Council as official figures.

According to the Banking Association, banks have originated just under R28bn, bringing them 66.5% of the way towards the R42 billion target – slightly ahead of schedule. A total of 512 200 loans have been disbursed. Contrary to expectation, the majority of these have been fully guaranteed (pension backed), rather than mortgage. At 35%, unsecured (housing micro loan) lending has also been more prevalent than mortgage lending, which accounts for only 26% of the total loans originated so far.

Unaudited Banking Association figures of FSC bank lending for housing				
Product	Number originated (Jan 04-Dec05)	%	Number originated (Jan 04-Dec06)	%
Mortgage	90 000	27%	133700	26%
Fully Guaranteed	135 000	41%	199800	39%
Unsecured	105 000	32%	178700	35%
Total	330 000	100	512200	100

Compared with last year’s unaudited figures, banks estimate they disbursed 182 200 additional housing loans to FSC target market clients within 2006. This suggests significant housing activity – indeed the just the mortgage disbursement of an additional 43 700 loans in the last twelve months is

¹¹ Remember that there are two housing targets – the R42 billion that has been so widely publicized is an origination target (i.e. gross sales) – a commitment by the banks to originate R42 billion worth of loans. The FSCC, however, monitors a targeted investment target of R31,8 billion – that is, the net movement in the balance sheet.
¹² For more details on the FSC, go to their website: www.fscharter.co.za

Access to housing finance: what would it look like when it works?

over double (almost triple) the annual housing delivery rate in the target market over the past few years.

In value, mortgages constitute the most significant investment – 69% of the total R27,9 billion disbursed has been to that product. As expected, unsecured loans are the smallest in value although the number of actual loans is greater. From last year's to this year's unaudited figures, there appears to be greater growth in the number of unsecured loans disbursed. However, it is still too early to tell if this represents a significant growth area for banks as they seek to meet their housing targets throughout the FSC target market (unsecured loans are generally targeted at lower income households).

An important component of future origination opportunities is found within the 14% originated to date to developers and as wholesale finance. Not included in the loan numbers total, this is part of the banks effort to stimulate supply in the affordable housing market – something that the loan origination numbers already suggest they're succeeding at.

individual income? The distinction is not always so clear, especially in low income households where income sources may be many, varied and erratic.

From a research perspective, it would also be useful to know what percent of mortgages are being originated for new housing vs. existing (resale) stock. What kinds of housing are the pension-backed (fully guaranteed) loans being applied against – is this home improvement, the resale market or new house construction?

An interesting developmental question is whether the clients of the 178 700 unsecured loans originated are using their loans to improve their homes towards being mortgageable, thereby contributing to the potential supply, and potential for greater secondary (resale) market churn in the affordable housing market. It would do the banks well to consider this in their product and marketing strategies – through this process, housing lending might actually contribute towards enhanced asset wealth of low income households, all the while adding to the potential demand for FSC target market mortgages.

The US Sub-Prime Market crisis

Standard Bank's most recent Residential Property Gauge¹³ explores the relevance of the US sub-prime mortgage market crisis to the South African property sector. The report argues the impact will be minor – largely because "local house prices are driven primarily by local economic factors". This position is supported by FNB's property strategist John Loos, who argues that the sheer scale of demand in South Africa, within the context of limited supply, will keep property prices high so that a dive as seen in the US market will not happen here. And yet the US crisis should raise some alarm bells, especially for SA's young FSC target market borrowers.

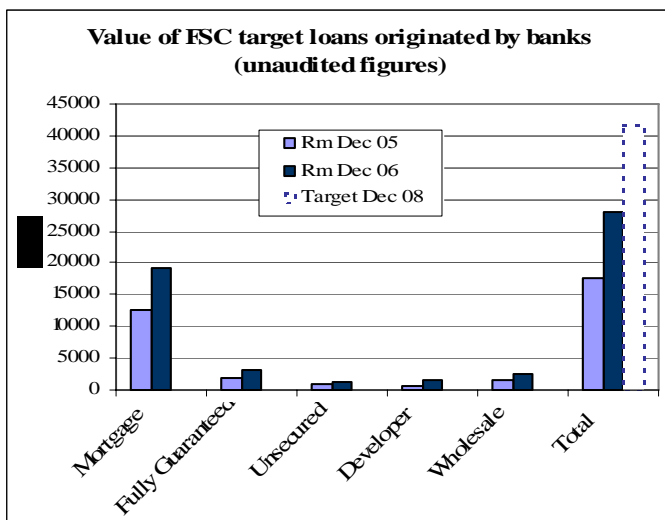
The sub-prime market in the US comprises borrowers who would not qualify for normal (prime) loans. Standard Bank reports that reasons for not qualifying for prime loans "usually include small or no deposits, a poor credit history, and/or insufficient or no proof of income". Regulatory changes in the US in the 1980's contributed to a growth in sub-prime lending, critical for many low income families for whom housing finance had previously been inaccessible.

Of course, likening the US sub-prime market to SA's FSC market is not entirely fair. While the US sub-prime market includes borrowers with poor credit history, the FSC market is only income defined – all households earning between R1500 – R7500 (adjusted annually for CPIX) qualify for FSC housing loans. But consider the similarities in product:

- Some SA banks are offering loans with a loan to value (LTV) ratio of as much as 108%. In an environment where the property market has peaked, what risks are

¹³ To download the report, go to: http://www.sapropertyinvestor.co.za/downloads/SAGE_RPRP_030407.pdf

Value of loans originated between Jan 04 and end December 06 (unaudited)		
Product	Rm	Percent of total
Mortgage	19 230	69%
Fully Guaranteed	3273	12%
Unsecured	1394	5%
Developer	1468	5%
Wholesale	2568	9%
Total	27 933	100.00%



The importance of the FSC Council's audit process is evident in the number of questions this data raises. For instance, what is the spread of allocation throughout the FSC target income range? Are loans clustered at the top end as would be expected, or are they spread throughout the target market? Does the growth in unsecured lending represent a focus on the bottom end – and critically, how do banks verify that such loans are actually used for housing purposes? In its 2006 Annual Report, the FSC Council questioned the definition of income – are banks using the FSC target income range in respect of household income (as they should) or

Access to housing finance: what would it look like when it works?

being passed onto the borrower and what happens in the case of default when the loan is still greater than the value of the property?

- The US “adjustable-rate mortgage” is similar to products being developed in SA, where a fixed interest rate is increased over the life of the loan with the expectation that the borrower’s income will increase, or where payment on the capital portion of the loan is held off for some time to improve short term affordability.

John Gapper of the Financial Times provides an astonishing overview of bad lending practice and property market dynamics that put the US sub-prime mortgage market into the crisis position its in today. From 1 June 2007, our own National Credit Act should address many of the problems he highlights, while allowing for the kind of innovation we’re seeing in new product development to truly enhance borrower housing affordability. Gapper quotes a CE of a lender and credit union who estimates that 2.2 million families could lose their homes to foreclosure because they are unable to pay their mortgages. Suggesting that this could become “the largest loss of African-American wealth in American history”, he argues it could have been avoided if borrowers had been better advised and had been given more suitable loans. Certainly something to think about in South Africa.

(Please e-mail me Kecia@iafrica.com for scan of the FT article. It makes for very interesting reading.)

Low income housing tax credits?

In recent months, the idea of “low income housing tax credits” has been mooted as an American innovation worth importing into South Africa.¹⁴ In a national Department of Housing document¹⁵, tax credits are suggested as one means of promoting inclusionary housing in South Africa. The Department of Housing document describes tax credits as follows:

The Low-Income Housing Tax Credit (LIHTC) in the US, is a federal programme aimed at increasing the supply of affordable housing, by providing dollar-for-dollar credits against tax payable. Developers, who agree to build units that will remain affordable for a minimum period of thirty years, receive a ten-year stream of credits that they can set against federal income tax payable. These incentives are tradable... [which means] even small firms and charities can participate in the programme by selling the tax incentives to investors for cash. All these elements, except for tradable credits, have been used in the UK as well.¹⁶

¹⁴ The idea has been raised by, among others, Jopie van Honschooten, former head of the Banking Association housing task team, and Dan Smit, consultant.

¹⁵ For the full document on inclusionary housing, go to <http://www.housing.gov.za/Content/Documents/Content/Documents/Inclusionary%20Housing%20in%20SA.pdf>

¹⁶ Smit, D (2006) A Review of the International Experience with Inclusionary Housing Programmes: Implications for South Africa, p 24.

In that document, low income housing tax credits are suggested as the “most appealing and feasible” approach to incentives to promote inclusionary housing. Meanwhile, as suggested below, it is also an expensive and highly complex model. Will South Africa be able to tailor the US example to address the specific priorities these proponents have in mind?

The following overview of the US model is drawn, with permission, from a paper by Dr Marja Hoek-Smit¹⁷, the director of the International Housing Finance Programme at the Wharton School, University of Pennsylvania.

The US Low Income Housing Tax Credit Program

By Marja C. Hoek-Smit

The basic premise of the LIHTC is to offer federal tax credits to private investors in return for their providing equity for the development of affordable rental housing. The tax credits are available for a maximum of 10 years, while affordability restrictions will remain in effect for at least 15 years.

The US LIHTC program was started in 1986 when the Tax Reform Act of 1986 wiped away all other rental tax credit programs and the LIHTC was instituted as the only tax-based rental program. It has grown into the *de facto* rental housing production program of the federal government. It is a flexible program that has built different types of housing in various markets, both city and suburban. LIHTC project rents must be restricted in either of the following ways:

- at least 40% of units are affordable to households earning 60% or less of the median income for the specific region, or
- at least 20% of the units are affordable to households earning less than 50% of the median income.

The LIHTC projects serve low and moderate income households but are typically beyond the reach of most poor households without additional rental subsidies. For example, in 2002 approximately 45 percent of the qualifying low-income tenants in LIHTC programs received additional rental allowances.

The actual number of credits generated by a project is based on:

- the percentage of low-income units in the project as a proportion of total units or
- the percentage of floor area in low-income units as a proportion of the aggregate floor area of all units.

The tax credits are then calculated based on a set of depreciable costs chargeable to the project’s capital account

¹⁷ Dr Hoek Smit was in South Africa in November, as a guest of the USAID. During her time here, she spoke at a FinMark Forum. See her presentation, “Housing Finance and the Role of Government: Incentives without Distortions” on http://www.finmarktrust.org.za/forums/Presentations/powerpointfiles/2006/FPres_RoleofGov.pdf

Access to housing finance: what would it look like when it works?

prior to the end of the first taxable year in which the building is placed in service. The dollar value of each LIHTC allocation is equivalent to the present value of either:

- 70% of the qualified portion of the project for new construction or substantial rehabilitation projects not subsidized by other federal funds, or
- 30% of the qualified proportion of existing projects that are acquired or for projects that are subsidized by federal funds other than tax credits.

For each category the rates at which the tax credit is calculated differs and are approximately 9% and 4% respectively, adjusted monthly by the federal government. If a project is in a “Difficult to Develop Area” or a “Qualified Census Tract”, the tax credits are increased.

A market has developed where project developers, through intermediaries or “syndicators”, sell these credits to corporations. These corporations include commercial banks (often the bank lender in a LIHTC project will also buy the credits generated by the project), utilities, and sometimes (but much more rarely) large consumer goods companies. Initially buyers purchased credits for less than \$1 per \$1 of tax credit. More recently, buyers have begun to include the after-tax value of the depreciation and interest tax shields in a project in the price of the tax credit, and are often paying more than \$1 for \$1 of tax credit.

The actual transaction usually involves the partnering of specific project developers with specific buyers of tax credits in a project-specific joint venture, or “single purpose entity” (SPE). Typically, the corporate investor commits equity proceeds to the SPE in return for 99.99% ownership of the SPE and a role as a Limited Partner. The investor then “owns” substantially all of the SPE, and is entitled to nearly all of the credits and tax shields generated by the project. The developer owns the remaining 0.01% stake and occupies the role of General Partner, with the responsibility to develop and manage the property. Based on agreements between the partners, the General Partner usually also receives the cash flows from the stabilized asset as well as an option to buy out the Limited Partner(s) at the end of the required compliance period, which is 15 years. Rules guiding syndicators are vague and may allow fraudulent partnerships to occur. There are no limits on the amount syndicators can charge for the syndication process that guides the relationship between syndicators, developers, and investors.

The program is administered by states (or local governments) who receive an allocation based on the size of their population. As of 2005, each state is allocated a credit amount up to \$1.85 per resident, adjusted for inflation. States set the goals for the program and allocate the credits. States also decide which projects will receive additional subsidies in the form of below market debt through tax-exempt bond financing. Lastly, states monitor whether LIHTC projects remain in compliance. If a project is found in violation of the guidelines (i.e., on the number of units which are charged affordable rents), the investors must return the full value of

used credits, forfeit unused credits and pay additional fine/fees to the Internal Revenue Service.

Overall project financing for LIHTC projects

The only comprehensive evaluation of the program was done in 1999 by Cummings and DiPasquale.¹⁸ The figures below are from that study. These may have changed slightly but not fundamentally since the time this evaluation was done.

The proportion of Total Development Costs (TDC) financed by tax credits increased during the early years of the program and has reduced the proportion of first mortgages (table 1)

Table 1. Sources of Finance for LIHTC Projects

Financing of Total Development Costs	1987	1995
Share of TDC Financed by a First Mortgage	57%	39%
Share of TDC Financed by Tax Credit Equity	25%	43%
Share of TDC Financed by Gap Financing or Other Sources	18%	18%

Most LIHTC development projects receive additional subsidies up and above the tax credits. On average total subsidies in LIHTC projects account for 68 percent of total development costs of which two thirds are from low income housing tax credits. Most of the additional subsidies are in the form of subsidized loans from State and Local (Table 2). In addition, **45 percent of the qualifying tenants receive housing allowances.**

Table 2. Source of First Mortgage Loans for LIHTC Projects

Private Banks	40%
State Governments (subsidized)	26%
Local Governments (subsidized)	19%
Nonprofit Organizations (subsidized)	9%
Other	6%

In addition to the tax credits and first mortgage financing, 40 percent of the LIHTC projects required gap financing. Table 3 shows the sources of loans and grants used as a gap financing (not the associated dollar amounts).

Table 3. Source of Gap Financing for LIHTC Projects

State and Local Government	70%
Nonprofits	11%
Private Banks	5%
Nonprofit Organizations	9%
Other	5%

Finally, Table 4 shows the layering of subsidies necessary to make the LIHTC units affordable to the targeted group.

Table 4. Summary of total Subsidies attached to LIHTC Units

Type of Assistance	% of LIHTC Units
Tax credits only	29%
Tax credits and other assistance to property only	32%
Tax credits, rental assistance, and other assistance to property	29%
Tax credit and rental assistance only	11%

¹⁸ *The Low-Income Housing Tax Credit: An Analysis of the First Ten Years*, Cummings and DiPasquale, Housing Policy Debate, 1999

Access to housing finance: what would it look like when it works?

Lessons

The LIHT program is effective in drawing in private investors in low-income rental housing. The program reflects, however, the complexity of the US housing subsidy environment: 1) standards of subsidized housing are set relatively high (a political issue in all subsidized programs) and require a multitude of subsidies to make the units affordable to the targeted group, 2) several intermediary institutions are involved that may not be available in other countries and that respond to specific incentives in the US tax code and regulatory environment (e.g., the Community Reinvestment Act) that may not exist in other countries.

Even with high subsidies to the production, investor, and consumer side the units are not affordable to the real low income groups (let us say below the 25th percentile of the income distribution). It remains difficult to attract private investors through such programs to the real low-income rental sector, not just in the US but in most other countries.

At the same time the layering of subsidies creates inefficiencies and a lack of transparency, particularly in an environment of weak management at the local level. The long term nature of the projects (15 years) makes effective monitoring difficult but necessary. Regular analysis of the program is further hindered by the fact that it is financed by tax expenditures rather than by congressional budget appropriations and falls outside of the direct purview of the housing institutions. This is a typical weakness of tax-based subsidy programs.

Exploring housing finance in Zambia

This section quotes extensively from a report drafted for FinMark Trust by David Gardner following his visit to Zambia in November 2006. The report will be available shortly on the FinMark Trust website.

Since the advent of the new democratic dispensation in Zambia in 1991, there was a decade of slow but noticeable improvement in the country's economy. Over the last five years, Zambia has entered a period of more sustained economic growth, with improved (yet still not stable) economic fundamentals.

From a very poor base of a command economy, negative growth, very high inflation and effectively no capital market activity, the economy is now starting to show the benefits of the political, regulatory and financial reform process that has been undertaken over the last decade. Most recently, Zambia has just completed the fifth year of the Highly Indebted Poor Country (HIPC) Programme. It has been through this process that the country has made its greatest strides.¹⁹

¹⁹ The **growth rate** has been at a constant 5% for the past three years, and was projected to (increase) slightly during 2006 on the back of good agricultural yields. According to the Bank of Zambia, **inflation** has dropped from over 30% in 2002 to 15.9% in 2005. This was projected to reduce

Housing demand and supply

Gardner says all those he interviewed agreed on the existence of a huge, untapped 'housing need' in Zambia. Effectively no new formal accommodation has been built for over a decade, and the rapidly urbanising population further adds to urban housing requirements. The National Housing Policy of 1996 estimated a housing shortage of 846 000 units, and common consensus is that this shortage has now grown to over a million units (at five people per household, roughly half the population).

There are very few housing developments of any reasonable scale offering suitable, affordable housing products being developed at present. Seemingly, a well-functioning housing supply sector is beset by a range of obstacles, and is still a way off. Major impediments to housing supply include (amongst others):

- Land titling and transfer problems. Primarily, this originates from a centralised, convoluted, inaccurate and corrupt land registry system;
- Very poor engineering service reticulation and bulk infrastructure installations (water, roads, sewer, electricity, solid waste removal)
- Resource-poor and ineffectual local governments with very limited capacity to administer services, and effectively no capital resources to extend or improve infrastructure networks
- A limited building materials supply industry that has not been required to support any significant development for decades²⁰.
- A limited local professional and artisanal skills base; and
- A nascent and inexperienced housing finance sector hampered by the non-availability of long-term, reasonably priced capital for housing lending.

There is a common and growing sense amongst many people interviewed that scale development of new housing in Zambia (and most likely in many parts of Africa) will only result from large-scale, comprehensive neighbourhood or

further during 2006: the target was to manage inflation to under 10%. In general terms, the **Kwacha** has been strengthening against major currencies over the last two years. This is a reversal of the consistent devaluation over the period 1999 to 2004. However, while the trend seems to be downward, there have been some periods of substantial devaluation. This continues to create uncertainty in the capital markets and continues to hamper efforts to mobilise external sources of financing in Zambia. **Prime lending rates** have reduced from very high levels (46% in 2001) to 28% in 2005. This has now reduced substantially over the last year. A review of the yield rates for T-bills and bonds over the last 3 years indicates the major strides being made:

Indicator	2005 Avg	2006 Avg	2007 (Jan)
Prime Lending Rate	28.2%	21.6%	21.0%
Commercial Bank Lending Rate	34.5%	27.9%	27.3%
T-Bill (91 day)	15.2%	9.5%	9.0%
T-Bill (364-day)	N/A	11.1%	11.0%
Bond (3 Year)	N/A	13.9%	12.2%
Bond (5-Year)	N/A	15.9%	13.6%

²⁰ However, it must be said that a number of relatively large commercial developments have been undertaken, and the materials supply sector is actively expanding its capacity.

Access to housing finance: what would it look like when it works?

new town-type urban development initiatives. Such programmes would encompass all the requirements of a successful development (including land purchase, planning, subdivision, titling and transfer, bulk and internal infrastructure development, management and maintenance and housing construction). Committing any one of these vital components of a successful development to the vagaries of the currently responsible bodies (be they national, state or provincial government entities or specially formulated bodies)

The few, isolated pockets of housing development that are being undertaken happen in spite of almost insurmountable obstacles facing them. They are in essence all pilot projects of questionable replicability, mostly being developed due to the extraordinary commitments and financial backing from a multitude of players. Key developments are outlined below.

Lilayi, Lusaka The Lilayi development in Lusaka is a 5 000-unit development that commences construction in January, 2007. To get to the point of turning earth on site has taken the extraordinary commitment of the key players over five years, 47 different legal agreements, a convoluted financing mechanism and the backing of a range of international players including DFID, USAID and others.

Mwena New Town A new mine in Zambia requires the development of an entire town in the surrounding area to support its labour requirements. Numerous players, including the government, the mine owners, NAPSA (sources of capital), PABS (loan administration), and others are in discussions to determine a structure through which to develop and dispose of housing for employees.

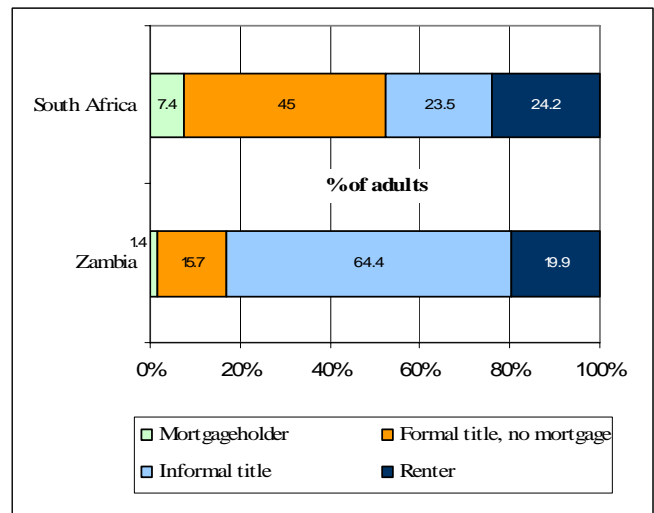
Maheni Construction, UK Maheni is a proposed development of between 1000 and 2000 houses. Land has been allocated to the developers, who aim to develop a type of prefabricated construction on the land. Status of the development is not known at present. FBS indicated they may be financing agents for the development.

National Housing Corporation Once the major housing developer in Zambia, the NHC now undertakes limited new developments annually (reaching a few hundred units maximum). These are also inevitably developed via some non-replicable financing mechanism including hidden subsidisation, and are aimed at one or other specific public sector target market.

Demand for Housing Finance

Notwithstanding the huge latent housing demand, this must not be confused with the effective demand for housing finance. In fact, until recently the demand for housing finance (at prevailing parameters) was effectively nullified. High inflation (and hence eroding real incomes), very high interest rates and the inability to secure financing at a term beyond a year were major constraints on the growth of housing finance. With the slowdown in inflation, improvement in exchange rates, drops in bank lending rates and increasing availability of longer-term financing, a more viable market for housing finance is now developing. However, there are challenges.

Porteous (2006)²¹ highlights the tenure constraint, using FinScope data to compare tenure in SA and Zambia.



Within these parameters, however, demand for housing finance is more nuanced. Porteous explores the different tenure types further in the following table:

Of each column category:	% of total in each column group			
	1. Bond & formal title	2. No bond, formal title	3. No bond, informal	4. Renters
1. Location: % urban				
SA	98.5	57.1	53.4	87.3
Zambia		64.1	20.8	73.6
2a. Housing situation: living in a formal (SA)/ brick (Zambia) house				
SA	99.8	74.7	62.5	89.2
Zambia	100	60.1	46.8	79.3
2b. % with water, sewage in house and cook with electricity (SA); use electric stove with oven (Zambia)				
SA	95.4	40.8	25.9	71.8
Zambia		46.5	4.8	28
3. Attitudes				
3a. % who would invest in home improvement				
SA	25.1	25.4	19.5	24.6
Zambia		28	29	26
3b. % who see home as tradable asset				
SA	78.2	34.4	13.1	0.0
Zambia		83.1	39	0.0

Source: as for Figure 5 calculated from FinScope SA (2004); FinScope Zambia (2006), in addition: 2a & 2b. House quality: Type of house Q4b; services in house: Q35 3a. Home improvement: answer to question 14a, 1 21: "would consider investing in improving own house" 3b. Tradable asset: Answer to Q48d

The above table illustrates a relatively similar level of interest in home improvements among Zambian households as SA households – and a higher percentage of households who see their home as a tradable asset.

Still, Zambia remains an extremely poor country. Wikipedia reports that “unemployment and underemployment are serious problems. Per capita annual incomes are currently at about one-half their levels at independence, and at \$302, place the country among the world's poorest nations.”

FinScope Zambia found the following employment profile:

²¹ Porteous (2006) Assessing the potential of financial markets: connecting low income borrowers. Paper commissioned by KfW for the 2006 KfW Financial Sector Development Symposium, Financing Housing for the Poor: Connecting Low-Income Groups to Markets. November 9-10, 2006, Berlin.

Access to housing finance: what would it look like when it works?

- Salaried 20%
- Self-Employed: 39%
- Unemployed 17%
- Housewife / Student, etc 24%

From a housing finance perspective, few self-employed people earn sufficient to qualify for a home loan. This leaves the 20% of all Zambians that are formally employed (2.2-million) as the potential market for housing finance – but when considered together with the number of people who have a bank account, only 8% might be able to qualify for mortgage finance.

Affordability appears to be the most significant constraint, however. FinScope Zambia obtained the following monthly income profile for Zambian households:

Monthly Income	\$ Equiv	% hh	No. H/Holds (@5/hhold)	Est. housing affordability @ 15%, 20 yrs
No Answer / Don't Know	-	21%	532800	-
No Income	-	4%	-	-
< K50 000	\$12.50	5%	111 000	
K50 000 to K150 000	\$37.50	15%	333000	Up to \$854
K150 000 to K300 000	\$75.00	11%	2200	Up to \$1708
K300 000 to K450 000	\$112.50	6%	133200	Up to \$2563
K450 000 +	\$112.50 +	18%	399600	

Source: FinScope Zambia

The notional housing affordability profile indicates that housing affordability is very constrained. Even in the highest income category, housing affordability is still minimal compared to the costs of the limited number of housing products available on the market.

Future challenges for access to housing finance

Gardner lists seven challenges facing Zambia as it seeks to address its housing crisis and enhance access to housing finance:

1. **Regulatory Environment:** especially with respect to the Building Societies Act
2. **Housing affordability:** unemployment and underemployment remains very high. Household income levels are generally very low, even amongst the formally employed. Below a very thin band of higher-income earners are the majority of formally employed people whom would battle to qualify for a bond large enough to purchase a small house with formal title. Only 18% of Zambians earn above \$112,50 per month.
3. **Longevity:** It is well known that Zambia has one of the lowest life expectancy of any country in the world. This places pressure on financial institutions with respect to the ability of the average Zambian to service a long-term mortgage. General perceptions are that, with readily available mortgage protection insurance and due to the high regard Zambians place on housing, most bondholders

that pass away prematurely will be covered by contributions by family in order retain their housing.

4. **Over-Indebtedness:** Economic liberalisation and macroeconomic stabilisation have lead to the widespread availability of consumer credit and a consumerist society. Daily, Zambians are presented with more opportunities to buy consumer goods using short-term credit .There is little doubt that at some stage in the future, this will result in a 'correction' in the microfinance sector.
5. **Inflation & Interest Volatility:** Zambia's macroeconomic conditions are not yet stable, although they are improving. Encouraging high levels of indebtedness (especially in relation to long-term housing financing at medium to high interest rates) must be approached with caution until Zambia has a proven macroeconomic track record.
6. **Capital Markets:** Limited sources of local, long-term (over three years) capital is considered to be one of the greatest impediments to the growth of the housing finance sector specifically, and the economy in general. Indications that this situation is easing do exist, but it remains a critical area for intervention.
7. **Sovereign Rating:** Zambia currently does not have a credit rating from the major international rating agencies. This does inhibit the views of the country from a potential investor perspective. It is suggested that a concerted effort should aim to obtain such a rating for Zambia.

Gardner's report concludes that there are significant opportunities for the growth of a housing finance sector in Zambia. From a very poor base of a command economy, negative growth, very high inflation and effectively no capital market activity, Zambia's economy is now starting to show the benefits of the political, regulatory and financial reform process that has been undertaken over the last decade. There is a general trend towards stabilisation and growth, even though there is still periodic exchange rate and interest rate instability. Specifically, the housing finance sector is showing signs of development and growth. A few banks and Building Societies have commenced housing lending and have small but growing mortgage portfolios, and others are considering entering the market. The focus on mortgage finance, however, is excluding the vast majority from accessing housing finance. This provides FinMark Trust with the opportunity to support the development of appropriate housing finance products that meet the needs of the entire Zambian population and not just those at the top of the pyramid.

For more information, or to subscribe to ACCESShousing please contact Kecia Rust, the FinMark Trust's housing finance theme champion, on Kecia@iafrica.com or on +27-83-785-4964.