Experiences with housing finance in developing countries: The case of Selected Caribbean Community (CARICOM) countries – presented by Claremont Kirton, Joseph Bailey and Georgia McLeod.

Introduction

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This presentation focuses on the provision of housing finance by formal financial institutions in selected Caribbean countries. It begins with a brief overview of the housing sector in these countries, followed by a summary of their housing policies. The paper examines the performance of housing finance institutions in the context of satisfying the demand for housing finance, especially as this relates to low-income households.

The presentation begins with a summary of the housing problems experienced by Caribbean countries since political independence. It then provides a brief description of the selected Caribbean Economic Community (CARICOM) countries which are discussed in the paper. Background information on the housing sector in the countries selected is then discussed. Following this, housing policies for the various countries are outlined. The main thrust of the presentation focuses, in some depth, on housing finance at the institutional level and providing information on the activities of these institutions. Finally, we identify three institutional arrangements which are suggested as best practices in the Caribbean context.

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Most Caribbean countries have experienced a wide range of housing problems since political independence. Among these are:

- Unavailability of land for housing
- Large numbers of dilapidated, overcrowded tenement houses/`yards' located mainly in the inner cities
- Unplanned, spontaneous housing settlements on both state and private lands
- Limited availability of affordable owner occupied housing
- Limited availability of affordable rented accommodation
- Distorted real estate markets and
- Shortages of affordable housing finance.

During slavery in the Caribbean, African slaves had very little control over their housing conditions and lived mainly in barrack type accommodation of low quality. Indian and Chinese indentured labourers, who typically replaced African slave labour, lived under equally horrendous conditions. Given the colonial legacies of neglect in meeting the housing needs especially of the poor in the Caribbean region, post-independence Caribbean governments have inevitably identified the provision of adequate housing as a critical policy goal. However, the limited financial resources available to these governments have considerably restricted their role in providing affordable housing for the majority of their population, especially the poorer strata. In addition, the private sector in most Caribbean countries has not filled this shortfall with any degree of success. As such, the persistence of a mismatch between the supply of and demand for affordable housing, characterised by critical supply shortages, represents a serious challenge facing the housing sector throughout the Caribbean.

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The Caribbean Community (CARICOM) is a regional grouping of fifteen developing countries in the Caribbean. The CARICOM countries selected for analysis are Belize, Guyana, Jamaica and Trinidad and Tobago.

Firstly, selection is premised on the position that these countries, historically, have fairly well articulated housing policies. Additionally, relative to other Latin American and Caribbean countries, Jamaica and Trinidad and Tobago have developed financial sectors as evidenced by their financial depth (credit or money/GDP). Jamaica and Trinidad and Tobago also have sizeable stock exchanges. Guyana and Belize are selected for their large geographical size, with underutilized land usable for low-income housing, especially in the context of low levels of urbanization. In addition, the housing needs of the economies selected are significant. Lastly, these four are the countries from which the data for our analysis were readily available.

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With the exception of Guyana, Haiti and Suriname, the CARICOM Member States are characterized by small size in terms of land area, population, and output levels. In only four of these countries – Haiti, Jamaica, Trinidad and Tobago, and Guyana – is the population greater than 300,000. Four countries –Bahamas, Barbados, Antigua and Barbuda, St. Kitts and Nevis, and Trinidad and Tobago - have per capita income levels ranging from US$6,000 to US$15,000. According to the UNDP Human Development Report (2003), of the fifteen

CARICOM Member States, 11 are classified at the level of 'medium human development'. Barbados and the Bahamas are ranked in the category of 'high human development', while Haiti is grouped among the countries with 'low human development'.

Overview of the Housing Sector

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Available data for the 1990s for Jamaica, Trinidad and Tobago and Guyana, indicate where significant housing gaps exist. For Jamaica, 64 percent of existing housing needs have not been satisfied, while the comparable figure for Trinidad and Tobago is 65 percent. In the case of Guyana, approximately 34 percent of housing needs are unmet.

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In examining homeownership rates for Jamaica, there has been a decline during the 1990s. Possible explanations for this trend are high costs of mortgage financing, reductions in private sector residential construction and growth rates in household formation far exceeding annual increments in supplies of new, affordable housing units. In the case of Trinidad and Tobago, the situation is reversed with an increasing growth trend in homeownership. With respect to Guyana, homeownership has remained relatively stable during the 1990s. Homeownership rates represent a critical element in wealth accumulation by families and reflect their financial capacity. In addition, declining home ownership is a manifestation of economic problems which can generate social problems. Declining homeownership in the formal housing sector can also lead to increases in informal housing development, with its attendant problems.

Housing Policy

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The housing policies of all four of the countries selected focus primarily on increasing supplies of affordable housing to their populations. In Belize, the main institutional vehicle through which housing policy is implemented is the housing co-operative, which is supported by government through provision of fiscal incentives. The Belizean government also offers incentives to private land developers as a means of promoting housing development on private lands. A critical element of housing policy in Belize is credit facilitation which entails providing affordable long term housing credit facilities for housing construction, mainly to low-income earners.

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The main housing policy objectives of the Guyanese government are:

i Rapid expansion in the number of housing units

ii Improve affordability of housing

iii Improve access to housing for poor families

The main thrust of Guyana's housing policy targets low-income families. This involves government provision of rental supplements to low-income families as well as supplementing mortgage payments of low-income families. Land for housing is provided free to all families living below the poverty line. These allocations are based on reviews by regional land selection committees which make recommendations to the Central Housing and Planning Authority (CH&PA), which is the sole government executing agency for housing projects. In addition, government provides lots to needy families especially those who are involved in co-operative ventures. In cases where persons are squatting on government land, the policy objective is to regularize their situation and assist with improving existing shelter conditions as well as providing basic infrastructure.

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In 1987, as part of its stated objective to address the problem of insufficient housing, the Jamaican government outlined a National Shelter Strategy whose main goals were the creation of appropriate market conditions in the housing sector, provision of the necessary incentives to the sector and enhancing the flow of resources to augment shelter supply. Simultaneously, this strategy was geared towards making shelter programmes more accessible to the poor; encouraging greater private sector participation in housing solutions; increasing the rate of home improvement; and upgrading the country's housing stock.

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Although initially suggested in 1982, a joint venture policy was reintroduced in 1992. This entailed an initiative of public-private partnership in the housing sector under a Joint Venture programme. The joint venture policy establishes a framework for integrating public sector land, regulation and approval systems with private sector finance, technical, and professional skills. An important objective of this policy is to improve the efficiency, transparency and equity of the operations of the housing delivery process in the public sector and specifically, the Joint Venture programme.

A National Plan of Action, which was geared towards directing housing policy in Jamaica, was prepared in 1996 (Jamaica Habitat II National Report, 1996). The critical strategy identified in the Plan was to "redress the physical and socio-economic degradation experienced by the residents of inner-city communities". The main policy thrust focused on a "popular approach" to housing solutions focusing on land access, housing, finance, infrastructure and environmental quality.

As part of its Plan of Action, the Jamaican government prepared a National Land Policy in 1996. An important institution, established as part of this policy, was the Programme for Resettlement and Integrated Development Enterprise (Operation PRIDE). In addition to Operation PRIDE, the government created the Emancipation Lands and the Community Economic Centres programme. These three programmes were geared towards divestment and distribution of government owned lands.

Operation PRIDE was initiated as an attempt to satisfy the demand for housing among low-income groups. This programme was designed mainly for those in the poorer strata of the population who have very limited access to legally secure and affordable land for settlement activities. It is based on the concept and model of incremental development applied to the housing sector. This programme has utilised a step-by-step approach in which targets are set and beneficiaries identified, following which infrastructure upgrades are facilitated. The programme has utilised the community Industrial Provident Society (IPS) in implementing construction and financing of settlements. To facilitate the activities of PRIDE, a National Land Agency was established, with a technical arm providing efficient service to the public concerning land access and related land information.

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Beginning in the 1970s, the major emphasis of housing policy in Trinidad and Tobago was construction of single-family housing units in large housing development projects using mass production techniques. These houses were to be constructed by government for allocation to low and middle-income households. Among the objectives identified were developing single unit house types, maximizing the average density of housing units per acre. Other objectives included a reduction in land lease rates, increases in mortgage loan size and security of tenure on housing land.

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In 1986, the government articulated a new housing policy (The Settlements Policy) as part of its Medium Term Macroeconomic Plan. Among the main policy features of the Settlements Policy, is the regularization of squatters. Funding is provided for squatters in an attempt to assist with the purchase of building materials for housing construction. The policy also places special emphasis on increased provision of rental units. In addition, the development of a Rent-To-Own programme facilitates homeownership for tenants. The policy allows for a tenant, after five years with a good payment history, to have the unit conveyed to them and assume the mortgage given that he/she satisfies the financial requirements.

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The main policy features also focus on land development particularly as it relates to the State's intervention on the resale of privately owned tenanted lands to tenants at affordable prices. Additionally, special provisions are made for the subsidized housing primarily to persons having special needs. Non-profit organizations and religious groups are eligible to receive 100 percent financing for housing construction for the elderly, physically and mentally challenged. Provisions are made for special purpose shelters for battered women and families in crisis. Government policy deals with providing housing credit facilitation for housing construction and home improvements.

Housing Finance

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Typically, Caribbean financial systems are small, with M2 of less than US$1 billion. Small financial systems tend to be more volatile than larger ones, have fewer financial institutions and are usually less competitive. In addition, they are characterized by non-existence of some critical financial institutions and elated financial systems. In many small financial systems securities markets tend to be absent or thin.

Historically, commercial banks have dominated the financial sector in the Caribbean region. The orientation of commercial banks has been toward lending mainly for trading activities and consumption. However, in recent years, the dominance of commercial banks has been reduced as a result of increased competition from non-bank financial intermediaries like building societies and credit unions. The financial sector in the region has also experienced growth in the number of financial conglomerates that involve banks, non-banks and non-financial institutions.

The provision of housing finance in the Caribbean is dominated by commercial banks, building societies and government owned specialised financial agencies. Small amounts of housing finance are provided by credit unions and informal financial arrangements such as partner and lawyers.

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In Belize, commercial banks and the Development Finance Corporation (DFC) provide over two-thirds of the funding allocated to the housing sector. Over the last five years, while the percentage of total loans and advances to the housing sector provided by the commercial banks has remained relatively stable the comparable amounts provided by DFC have increased to over 40 percent of total. Commercial banks lending is typically at market interest rates with borrowers using this source either for 'bridging finance' or as a lender of last resort.

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The Development Finance Corporation is a fully owned entity of the government of Belize. It provides funding through financing of a wide range of projects in agriculture, tourism, manufacturing, services, education and housing. In terms of mortgage financing, DFC provides loans for the following activities:

i. construction of homes

ii. improvements or extensions of existing homes

iii. purchase of new homes (less than one year old), including those sold by DFC.

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DFC also provides these funds for a period of between 15 to 25 years. Interest rates average around 12 percent per annum based on loan size and borrower income.

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DFC has used a range of financial instruments including mortgage securitisation on both the Caribbean and North American financial markets, issuing of bonds and other means of using its assets to mobilise additional funds for further lending. DFC has liquidated some of its assets to repay central government borrowing and to reduce its overall debt structure.

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In the context of Guyana, there are very few specialised mortgage finance institutions. Mortgage financing in Guyana is dominated by activities of building societies, commercial banks and government agencies. In general, mortgage financing in Guyana is limited and inadequate. The staff of these institutions is relatively unprepared for some of the critical tasks involved in evaluating mortgage loan applications. Relatively high interest rates required by commercial banks mitigate against borrowing for housing finance especially by low income families.

As part of its housing policy reform, government has critically examined the role of mortgage finance institutions with a view to providing incentives, especially to building societies. Such incentives include, increasing maximum mortgage loans to 90 percent of property value and provision of short-term loans to fund the acquisition of serviced sites. Government is also assisting financial institutions in recovering collateral in cases of loan default.

Like other Caribbean countries, commercial banks dominate the operations of the Jamaican financial sector. However, in recent years, building societies have increased their share of total financial assets in the economy. As the most significant of the financial institutions operating in Jamaica, commercial banks provide interim or 'bridging finance' for the housing sector. Bank lending to housing has shown a declining trend during the 1990's. Among the reasons presented as an explanation of this trend are the risk-averse approaches to lending adopted by commercial banks following financial sector problems in the 1990's; reduced demand for housing finance from commercial banks mainly as a result of the availability of subsidised, low-interest loans from the National Housing Trust (NHT); low down-payment requirements, especially for government housing; acceptance of higher leverage payments for mortgages; and increased savings available for housing through credit unions, partner and remittances from abroad.

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Over the last five years, NHT is the major source of mortgage financing in Jamaica. NHT has provided on average, over half of the value of total mortgages provided by institutions in Jamaica.

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Established in 1971, the main objective of NHT is the provision of access to affordable land and housing, especially for low-income groups. Under the NHT Act all employed persons 18 years old and above are required to contribute 2 percent of their earnings, while their employers are required to provide 3 percent of these wages to NHT. Self-employed are also require to contribute between 2 and 3 percent of their income to NHT.

NHT's asset base has increased from US$438 million (1997) to US$840 million (2001). The number of mortgages provided by NHT has risen from 4313 in 1997 to 7317 in 2001. Loans to NHT beneficiaries increased from US$75 million (1997) to US$100 million (2001). NHT provides six different types of housing loans, including:

i. build-on-own-land

ii. house lots

iii. open market

iv. home improvement

v. NHT financial scheme

vi. NHT financed service lots.

Between 1997 and 2001, average interest rates on NHT loans approximated 9 percent. In 2002, NHT mortgage rates have been reduced to between 2 percent and 9 percent. The largest percentage of NHT loans are provided for open-market purchases, while the second most important category is NHT built schemes.

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The second most important source of mortgage financing in Jamaica is building societies. By the end of the 1980's total assets of building societies reached US$400 million, rising from US$69 million in 1971. Historically, because building societies were unable to adjust their mortgage rates easily, mortgage finance provided by these institutions to their members has been cheaper than comparable funding from other institutions. Simultaneously deposit interest rates of building societies have been legally required to remain low, based on the low mortgage rates. However, in spite of these low interests rates on deposits, building societies deposits have increased significantly over the last decade. This is due mainly to mortgage facilities that are accessible to building society membership.

Loans from building societies are primarily in the area of mortgage financing to members. Most of this financing is provided to the owner occupied category of borrower. During the period 1992/2002, an annual average of 76 percent of new mortgage loans by building societies was for owner-occupied housing. Another large category-housing schemes accounted for 6 percent of total mortgage loans by building societies for the period 1997 to 2002, while mortgage finance for building lots and land averaged 5 percent of total mortgage loans during the same period. In terms of total mortgage finance by number and value of mortgages, building societies are second to the NHT.

Credit unions provide small amounts of funds for mortgage finance. Approximately one-fifth of total loans provided by credit unions are for housing-related activities, mainly home improvement and home repairs.

Insurance companies mobilise a significant amount of long-term funds from Jamaican policyholders and are well placed to provide medium to long-term mortgage finance. However, the number and value of mortgages provided by insurance companies have declined during the 1990's.

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Historically, many Jamaican households have used informal sources to finance construction of housing as well as housing improvements. A number of characteristic features of informal housing construction and informal housing finance are observed. Firstly, there is the `stages' approach to construction; here, house building is undertaken in stages beginning with a basic unit with amenities, and expanding as and when financial and other resources become available. Secondly, based on the principle of reciprocity, the person planning to construct a home begins with mobilising human and other resources mainly from their family, friends and community members, with the agreement that he/she will assist those who have helped him/her with similar resources for their housing construction in the future. Thirdly, many potential homeowners use several informal sources of financing, including informal loans from family and friends, `partner' funds, and short-term borrowing from moneylenders. In addition, financing is usually obtained from both legal and illegal informal economic activities. Another widely used informal funding source is remittances from relatives and friends overseas.

No official statistics are provided for informal housing and informal financing. However, based on research conducted during the 1990s (Kirton, 1995 and Handa and Kirton, 1999), some data has been generated on the Jamaican rotating savings and credit association (ROSCA) termed `partner'. Typically, low-income earners engaged in elementary, largely unskilled and semi-skilled occupations, invest a large share of their total income in `partner', averaging about one-fifth. Higher income groups in the professional categories usually save a lower percentage (about 10%). Many of the lower-income earners have used the 'forced savings' of `partner' funding for house construction and home improvement. However, there are certain costs and benefits involved in informal financing of housing construction and home improvement that need to be serious researched.

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The Trinidad and Tobago Home Mortgage Bank (HMB) represents a joint under-taking of public and private enterprise. The major shareholders of HMB are the Central Bank of Trinidad and Tobago, the National Insurance Board, commercial banks and insurance companies operating in Trinidad and Tobago and the International Finance Corporation (IFC).

The main goals of HMB are:

1) to develop and maintain an organised secondary mortgage market geared towards increasing the availability of more affordable mortgage financing.
2) Mobilization of long-term savings for housing investments.
3) Developing new programmes and techniques for affordable housing finance.
4) Promoting the growth and development of the capital market.

HMB purchases mortgages made by primary mortgage lenders including life insurance companies as well as trust companies. These purchases are financed by the sale of mortgage bonds to institutional and individual investors. The funds mobilized are then allocated by the lending institution to provide additional mortgage finance, which increases the availability of funds in the residential mortgage market.

Consumer home improvement loans grew at an annual average of 19 percent between 1995 and 2000. During the same period, residential mortgage lending increased by an average of just over 2 percent annually. Among the reasons put forward for this significant rate of growth of home improvement loans are:

1) Limited number of persons having access to free titles for use as collateral.
2) Financial advantages involved in avoiding closing costs.
3) Lengthy approval process for residential mortgages.

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In 2004, Trinidad and Tobago introduced the Approved Mortgage Company Initiative. Under this facility, approved lenders who provide mortgages at concessionary rates to prospective homeowners can in turn receive tax free income on these mortgages. In addition, this initiative caters not only to first time homeowners, but also to those planning to acquire land for building purposes or to implement home improvement. The initiative allows borrowers to access 95 percent financing over a 30 year period. Interest rates on this facility are between 6 and 8 percent. Additionally, provision is made for tax-deductible allowances to first time homeowners of one sixth of the purchase price of the house. As part of its policy geared towards facilitating affordable housing finance, government has introduced policies which allow for lower up-front costs to the borrower and tax rebates to homeowners on construction materials up to a specified limit.

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We have summarised the Caribbean experiences in housing finance and consider it in order to isolate certain best practices across countries. We believe that a deepening of these models will enable a large proportion of underserved households to be properly brought into the housing market.

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Housing micro-finance products include, terms, underwriting, construction supervision, guarantees and, most critically, servicing.

This instrument is important from two perspectives (a) it helps to meet effective demand for shelter and settlement finance of low income families and (b) it can contribute to the business development modes of financial institutions that have low income households as their clientele. Daphnis and Ferguson (2004) in making the case for housing microfinance, have argued that less than 25 percent of households in emerging markets can afford to buy the least expensive developer-built house using a traditional mortgage because of entrenched inter-connected factors – high interest rates, the unavailability of long-term funding on domestic markets which pushes up interest rate risks. There are also costly statutory requirements (e.g. land use laws, property transfer taxes) which force low – moderate income families into informal settlements, and poorly functioning rental markets among others.

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There is the need for appropriate instruments to enhance affordability as prevailing tendencies adversely affect demand in the owner-occupied sector. High interest rate structure coupled with the requirement for a large downpayment to absorb the credit risk of mortgage lenders explain the difficulties for people who cannot afford to finance significant downpayments or meet minimum living costs after meeting interest and debt payments. These are very real constraints affecting investment in housing for low-and-moderate income families. The guarantee fund effectively transfers credit risks of lenders to another level, enabling them to accept lower down-payments.