Development of housing finance and its impact on socio-economic uplift in the emerging economy in Bangladesh

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1. Introduction

Housing not only provides physical shelter but also has significant impact on the lives of the dwellers in terms of skills enhancement, income generation, increased security, health, self-confidence and human dignity. Housing finance development, therefore, plays a role in boosting equitable economic growth and reducing poverty through helping households build assets, improving living conditions, empowering the middle- and lower-income population, and strengthening communities. Despite its considerable economic and social potential, housing finance remains underdeveloped in Bangladesh. The House Building Finance Corporation (HBFC), which has traditionally dominated the housing finance sector, is now a declining player, in part because of decreasing government support, and in part because of its history of operational ineffectiveness. In its place, domestic and international commercial banks and a few new specialised institutions have entered the market, and have a significant potential for growth.

It is desirable to promote growth in home financing to a wider population group at lower cost. The government of Bangladesh recognises the importance of the housing sector and its potential to contribute to long-term economic development. Accordingly, it has taken steps to address present weaknesses and encourage the development of a more stable and vibrant housing sector. The present study builds on these efforts and attempts to formulate recommendations for improving access to housing credit for various groups of presently underserved urban and rural households.

2. The economic context of Bangladesh

Bangladesh faces continuous challenges in maintaining economic stability, improving public sector efficiency and inducing economic growth sufficient to alleviate the desperate poverty of a large segment of the population. This section briefly reviews current trends in the economic and financial environment with particular reference to the housing sector.

Since the 1980s, Bangladesh has moved towards establishing a liberal market-based and private sector driven economy. Prudent macro-economic and fiscal policies have resulted in the highest foreign reserve in decades, increased GDP and a boost to the value of the taka compared to other currencies in the region. It appears that the economic turmoil in East Asia has had only a small impact on Bangladesh.

The economy has been diversifying. The agricultural sector, which provided 62% of GDP in 1975, presently accounts for roughly 30% of GDP. The services sector is the largest and fastest growing, contributing 50% of GDP and growing at a rate of 6.5% during 1996. Housing services have remained at 7% of GDP in constant prices. By far the largest export

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product is garments. The garment industry has seen an unprecedented increase during the last decade, employing an increasing proportion of the labour force, of which female workers are the majority.

Inflation has increased in recent years, but remained modest. However, in February 2008, the year-on-year rate was 8.1%, while in previous years it had declined steadily to below 5%. Housing costs have risen faster than the overall CPI.

The Government of Bangladesh has contained spending by downwards adjustment of its Annual Development Programme (ADP). Unfortunately, the efficiency and cost-effectiveness of programming and implementing the ADP is considered inadequate across sectors, including the housing sector. Allocation to the housing sector is approximately 5 to 6% of the ADP.

Access to housing finance is a critical bottleneck for the majority of the population in developing countries. The lack of available and accessible housing finance has been identified by the Government of Bangladesh as one of the important hurdles in improving housing conditions for middle- and lower-income households. Although several potential sources of housing finance for mid- and high-income consumers exist, most of the low-income families' needs are still unmet.

Different tiers of the housing market:

The residential housing sector of Bangladesh is characterised by a three-tier market. ***First*** are those households with the highest disposable income (less than 3% of the housing market), who are able to afford high-quality housing in fully serviced neighbourhoods, and able to utilise bank financing or specialised housing finance institutions. The ***second*** tier is the relatively narrow stratum of middle-income households (representing 12 to 15 % of the housing market), who are the main users of specialised housing financial institutions such as Bangladesh House Building Finance Corporation (BHBFC). This group is the major beneficiary of available public subsidies and is composed predominantly of public servants and wage/salary earners of large private companies and public sector corporations. The ***third and largest*** of the tiers is low-income households, for which housing is provided largely by the private sector, often under illegal and unsatisfactory site conditions.

3. Housing conditions in Bangladesh

The poor economic situation and income inequality in the country is reflected in the quality of the housing stock. It was estimated that close to half of all housing units in the country were made of temporary materials and needed replacement within a one- to five-year period. Approximately one third of all houses in urban areas were constructed outside of the formal regulatory system, mostly on land to which the homeowner does not have a formal title.

Table I shows some characteristics of the housing sector compiled from different studies conducted by the Centre for Urban Studies.

Tragically, the recent floods have destroyed more than 900,000 houses, mostly in rural areas, and another 1.3 million houses were seriously damaged. Of course, most of the houses affected were in the low-income category.

The only detailed figures on the type of housing in urban areas are available for Dhaka. Although the data are old, the situation has not changed much for the better and it is, therefore, still relevant to provide a broad picture of the urban housing conditions. The higher and middle-income groups are housed in either low-rise single-family houses, or, increasingly, in multifamily apartment buildings. The lower-income households, approximately 70% of the urban households, are housed in a variety of house types that can be described as follows:

- Approximately half of the low-income housing units are in bustees, informal settlements areas that include both private rental and private ownership housing, built on either privately owned land or illegally occupied public land.
- Conventional tenement slums (rental and owner occupied) take up another quarter of the low-income sector. Overcrowding in these buildings has increased over the last years due to an influx of rural migrants to work in the expanding garment industry.
- Other categories of low-income housing include: government-provided squatter resettlement camps, plots of land with basic services that are provided on a leasehold basis; employee housing consisting mostly of small apartments in high-rise complexes provided by the government; squatters who have built makeshift houses on illegally occupied public or private land; and pavement dwellers.

Table 1

Housing sector characteristics of Bangladesh

2006

Total number of dwelling units:	
Bangladesh	25,020,489
Rural	18,474,566
Urban	6,545,923
Per capita floor space:	
Bangladesh	54.9 square feet
Rural	53.5 square feet
Urban	62.3 square feet
Occupancy level in 2006:	5.48 people/dwelling unit
Access to clean water:	
Rural	78%
Urban	42%

Source: Centre for Urban Studies.

Housing production

Suppliers of housing are the public sector, and the formal and informal private sector, including owner-households and NGOs.

Rural housing

Housing in the rural areas is mostly produced incrementally by owner households. While most owners build on their own or rented land, informal occupation and squatting are increasing in rural areas. The Grameen Bank pioneered a housing loan programme that provided basic building materials for a simple new house for which repayment could take place over a 15-year period. Other NGOs have followed this example, with shorter payment periods and a total of approximately 700,000 housing units have been constructed using microfinance facilities from the time these programmes were put in place in the 1970s.

After the Liberation, the then government inaugurated a programme to rehabilitate the poor and the homeless in a number of *Guscho Gram* (cluster villages). Later, various governments developed different programmes to support the rural landless and homeless people. Sheikh Hasina's government initiated programmes like *Asrayon* (shelter), *Gharey Phera* (return home) and *Ekti Bari Ekti Khamar* (one homestead, one farm). *Grihayan Tahbil* (housing fund), administered by the Prime Minister's Office, provides low-cost funds to NGOs and private sector developers for the construction of houses for low- to moderate-income group people.

Urban housing

Because of the scarcity and high cost of buildable land in the large urban areas, most new formal sector residential construction in Dhaka and some other large urban areas has, over the last few decades, been in the form of multifamily units. In small towns single-family units prevail.

The public sector. Several public agencies are, or have been involved in the financing and development of housing and residential infrastructure projects: the Housing and Settlement Directorate (HSD) and Public Works Department of the Ministry of Housing and Public Works; the Local Government Engineering Department of the MLGRDC; and the City Corporations of the four larger cities. Their funds come mostly from foreign aid and to a lesser extent from national revenues. Both City Corporations and the central government are developing residential subdivisions for lease to upper- and upper-middle income households, and resettlement programmes and site-and-services schemes for lower- to middle-income groups. The tenant purchase and sales projects require large down payments (25 to 30%) and a small number of annual payments. Arrears are a major problem with all government projects. In addition, it has always been difficult to reach lower-income households with the site-and-services projects and the size of the combined public housing programmes has remained extremely small in relation to housing requirements and new construction. Altogether the public sector has only produced approximately 1–2% of total urban residential land and housing requirements (not more than 6,000 units per annum) over the past few years.

Non-governmental sector. The NGO sector has only been marginally involved in urban housing. The discrepancy between urban land and house prices, and incomes of the below-median income groups has made sustainable housing solutions difficult to conceive for this income group. Recently, the larger microfinance institutions have shown an interest in entering the multifamily residential market for moderate and lower-income households. Proshika and BRAC have plans to invest in large-scale low-and moderate-income housing developments 30 to 40 km outside Dhaka. Some projects will receive free government land. The plan is to develop hostel-type rental housing for urban workers and small low-cost family apartments for tenant-purchase. The NGOs have access to international funds, which they complement by borrowing and other income sources. Their cheap sources of funds make it possible for them to make long-term investments in social housing. None of these plans, however, has been implemented as yet.

The formal private and cooperative development sector. Private developers are increasingly important players in the urban land and housing markets, particularly in the market for apartment buildings. They operate as individuals or as businesses under the Companies Act, or form a housing cooperative and jointly develop a housing project partly for owner-occupation and partly for rental or sale. Interestingly, private developers feel that the higher-income apartment market is becoming saturated and they attempt to move down-market. The most serious constraint in doing so is the lack of *mortgage financing*. Finding accessible and *affordable land* for middle-income housing construction is another challenge, particularly in Dhaka. One of the largest developers in Dhaka felt, however, that there was sufficient land available for the foreseeable future, but the lack of long-term finance for middle-income households would prevent them from expanding a middle-income line of housing production. *Infrastructure* provision is the third main concern hindering private sector production of middle-income houses. Services and infrastructure are the responsibility of the City Corporations and priority is given to their own land developments. It can take a long time for road networks and other services to be installed in new developments.

The formal or semi-formal individual homeowner construction sector. This is by far the largest housing supply system in all but the main metropolitan areas. Households acquire land, mostly on a freehold basis, and gradually construct their house with or without official approval of plans. Only a small proportion of households access housing finance.

Informal private rental housing sector. Landowners in urban areas construct high-density, low-rise housing units for rental, without adequate services, either for individual households or for group living (mess housing).

Squatting. People building makeshift houses on public or private land, or squat in buildings.

Sources of housing financing in Bangladesh

Besides the state-owned BHBFC, other sources of housing finance currently available in Bangladesh are commercial banks, employee loans, life insurance policies, and informal means. In the rural sector, the housing cooperatives are the major providers of housing finance. Recent survey of homeowners of newly constructed houses showed that the most important source of housing finance was household savings (more than one third). Loans from relatives and friends were the second most common form of finance, followed by the sale of other parcels of land.

Besides government efforts, a large number of NGOs are providing microcredits to the poor. The enactment of the Financial Institutions Act 1993 opened the door for private housing finance companies. There are now 23 private companies that extend housing finance in Bangladesh. Prominent among them are the Delta-BRAC Housing Finance Corporation Ltd. and the National Housing Finance and Investment Ltd. These companies make loans for the construction of houses, acquisition of flats and houses, extension and improvement of existing housing, and the purchase of housing plots. Most of the private sector players, though relatively new, have nonperforming loans (NPLs) of below 1%. But their interest rates are very high compared with the nationally owned BHBFC. For example, Delta-BRAC Housing charges interest rates as high as 16%, which is higher than that of BHBFC by 1%. The contribution of microcredit lenders (such as Grameen Bank, BRAC, ASA and Proshika) in this sector is very insignificant.

In the next section, we will briefly describe public, private and private-NGO collaborated financial institutions that are engaged in real estate financing in Bangladesh.

Bangladesh House Building Finance Corporation (BHBFC)

BHBFC provides credit facilities for construction, repair and remodelling of dwelling houses and apartments in cities, towns and other urban areas. In general, priority is given to civil servants, and within that group to those with the most years of service. BHBFC offers 15–20 year mortgages to individual households at commercial interest rates that increase as the loan amount increases.

BHBFC was funded by the Bangladesh Treasury, with a cost of 5% per year, an amount well below the market rate of interest. Moreover, the corporation enjoys a number of advantages – it is exempt from tax, has much laxer capital requirements than other financial institutions in Bangladesh, and its bonds are guaranteed by the national government. But since losing its direct government funding, its volume has stagnated, and its market share of mortgage debt outstanding has dropped in recent years.

A study group in 2007 identified some inefficiency in the operation of the state-owned BHBFC. First, BHBFC approval times were exceptionally long – sometimes as much as a year from application to approval. Second, because mortgages were issued at below market rates of interest, and were essentially granted by the government, they were allocated via rationing, rather than underwriting. The allocation process was political, rather than financial. Third, because BHBFC was for many years not held to performance standards, the agency had little incentive to service loans, and so loan performance was poor. Typically, 20% of loans would be in arrears. When BHBFC did foreclose, it would typically collect less than 50% of the outstanding loan balance.

In recent years, two private housing finance companies have been registered as public limited companies. We discuss these along with some other private housing finance companies and their contributions in this sector in the next section.

Delta-BRAC Housing Finance Corporation Ltd. (DBH)

DBH is the pioneer, the largest and the specialist housing finance institution in the private sector in Bangladesh. After commencing operation in the early 1997, the company registered commendable growth in creating home ownership among more than 7,500 families in Dhaka and other major cities of the country. At the same time, the company played an active role in promoting the real estate sector to broad cross sections of prospective clients who had an unfulfilled dream of owning a good home. Mortgage loans have a maximum term of 15 years and are discretionary adjustable-rate mortgages. The present rate is 16.5%. For owner-occupied properties, monthly payments cannot exceed 30% of household income and in higher risk cases, third-party guarantees are required.

National Housing Finance and Investment Ltd. (NHFIL)

NHFIL, a private sector housing finance company, provides loans for construction of houses, purchase of flats or houses, extension and improvement of existing houses or flats, and purchase of housing plots. Up to 30 June 2008, the NHFIL provided a total amount of term loans of BDT 5545 million.

The banking sector

Until recently, mortgage lending was never considered quite profitable for commercial banks, so that they imposed serious kinds of restrictions upon their mortgage business, in terms of both individual mortgages and size of mortgage portfolio. Only recently, some commercial banks, both public and private, specialised banks along with other financial institutions, invested a considerable proportion of their combined assets in housing.

The total housing related advances of the country’s banking sector in 2007 was approximately BDT 24 billion, about two thirds of which was made up by the NCBs. The housing loans by the banking sector amounted to only 4% of their assets. The private banks have the largest proportion of housing-related assets (9%), and foreign banks have the least involvement in the sector (2%).

Table 2

Percentage of outstanding housing sector advances of different types of banks

	2006	2005	2004	2003	2002	2001	2000
NCBs	41.17	45.35	50.26	53.97	62.75	59.56	62.87
SBs	3.01	2.98	2.57	0.87	2.21	3.27	2.87
FCBs	0.98	0.69	0.56	0.60	0.44	1.23	3.61
PCBs	54.84	50.98	46.61	44.56	34.6	35.94	30.65

Over the years, major problems in loan recovery began to plague the housing portfolios and the banks gradually decreased the proportion of advances for housing. The recovery rate of housing sector loans in the banking sector averages approximately 70%. The poor recovery rate is due mostly to older loans; recovery exceeds 80% on loans disbursed after 1990. Even the rural house lending programme sponsored by the government, through a 3% refinancing window at the Bangladesh Bank, was stopped because of alleged poor recovery rates.

Table 3

Outstanding housing sector advances with interest in billion taka – all banks[1]

	2006	2005	2004	2003	2002	2001	2000
Housing societies	14.52	13.00	10.64	11.83	8.98	3.26	2.19
Urban housing	43.47	40.19	36.33	29.94	30.18	22.91	22.37
Rural housing	1.66	1.08	1.14	1.47	1.79	1.66	1.63
Apartment housing renovation	2.26	–	–	–	–	–	–

[1] All banks include nationalised commercial banks (NCBs), foreign commercial banks (FCBs), specialised banks (SBs), and private commercial banks (PCBs) in Bangladesh.

Source: Scheduled Banks Statistics, Bangladesh Bank

From the above data, it is clear that NCBs were reluctant to extend lending to the housing sector. A number of NCBs only consider housing loans for clients that have other businesses with them and have the income and assets to support these loans. There is not much competition in the housing lending market and most banks offer the same terms for the different client options. All loans are for new house construction only, and banks only lend for urban housing in secure submarkets, which can easily be understood from the table above. Clearly there is an upward trend of contribution in housing societies and urban housing. The contribution towards rural housing is only boosted when the government takes initiatives like *Grihayan Tahbil* (housing fund) or extends credit to the commercial banks at lower interest rate. Only recently have commercial banks started extending credits for apartment renovation.

Housing cooperatives and credit unions

Although the cooperative movement is widespread in Bangladesh, particularly in the agricultural sector, it has not played a significant role in housing financing. Of the 145,000 cooperative societies in Bangladesh, only 144 are housing cooperatives.

4. Main challenges in expanding the formal housing finance system

There are several constraints that hamper the expansion of formal housing finance system in Bangladesh. They are:

Distortions in the savings rates and resource mobilisation

High interest rates offered by various government savings plans compared to that of private deposit taking institutions distort the financial system, which makes it difficult for private sector institutions to raise household funds.

Interest rate subsidies

Interest rate subsidies have some drawbacks apart from suppressing private mortgage market development, such as (1) a below-market interest subsidy encourages people to borrow as much as possible and repay their loans as slowly as possible; (2) the subsidies increase with inflation when interest rates go up, a poor link for subsidisation; and (3) the subsidies are not transparent.

Subsidy targeting

The government subsidises housing for middle- and upper-income households and a scattering of low-income households through BHBFC. The targeting of the existing interest rate subsidy system is inefficient. Subsidised loans are presently provided to those who could participate in the private market without assistance. BHBFC's sole objective is to provide credit facilities for construction, repair and remodelling of dwelling houses and apartments in cities, towns and other urban areas. So if any subsidy programmes are devised, only the city dwellers or government officials benefit.

Risks, affordability and mortgage instruments

There are only a few different mortgage instruments such as fixed rate mortgage (FRM), graduated payment mortgage (GPM) to address the perceived risks in mortgage lending or to make mortgage finance more affordable to middle-income households.

5. Alternative housing finance system

In recent years, as an alternative to the existing formal financing system, housing microfinance system has evolved. In addition to Grameen Bank, several other microfinance institutions (MFIs), such as Proshika, BRAC, and ASA now provide long- and short-term credit for housing in Bangladesh. Loans are made on the basis of established membership in lending programmes instead of collateral and a sound track record of repayments on previous loans. Group pressure and mutual support are used as guarantees for loan repayment. There is no recourse by the financial institution in the case of non-payment other than the persuasive and legal ways to recover the loan and future exclusion of the borrower from the credit programme.

In the next section, we discuss the contribution of the largest MFIs in housing loan programmes.

Grameen Bank

Grameen Bank introduced the "*Moderate Housing Loan*" programme in 1984 with a current loan maximum of BDT 25,000. After the floods of 1987, the Bank introduced a "*Basic Housing Loan*", which presently has a loan maximum of BDT 12,000. It targets the poorest rural households, similarly to income-generating credit. This programme has remained the most popular among its target population. There is also a loan programme for the purchase of small parcels of land and one for the repair of houses. The ratio of basic housing loans to original moderate housing loans is approximately 7:1. Besides these, another kind of housing loan called "Pre-Basic Housing (PBH)" loan amounting BDT 7,500 to 8,500 has been introduced to meet the demand of house dwellers in the northern part of the country. The interest rate of housing loans is 8% per annum.

The housing loan, like the other Grameen Bank loans, are provided without collateral, but the borrower must have a title to the land, must sign an individual pledge that includes a repayment obligation, and must obtain a pledge from all members of the group or centre, which commits them to repayment in case the borrower fails to do so. Repayment is made in weekly instalments, beginning five weeks after the start of construction of the house. The repayment period is calculated on the basis of repaying BDT 1,000 per year, which is the standard loan repayment for other loans by the Grameen Bank. There is a maximum repayment period of 10 years, but faster repayment is encouraged. To date the loan repayments have been excellent. As of September 1999, a total amount of BDT 7420.62 million (USD 185.09 million) have been disbursed as housing loans for 510,310 houses. The average loan size was about BDT 13,847 (only USD 277).

Proshika

Proshika started a housing programme for rural areas in 1988 and has provided assistance for the construction of more than 30,000 houses to date. Proshika's housing loans are based within the group and the group selects the member most deserving of a housing loan under strict allocation rules; ie only three housing loans per year per group, housing loans can only be provided to groups that have been in existence for at least three years. Only those that have a loan for income-generating activities are eligible for a housing loan, in order to ensure repayment capacity.

BRAC

BRAC's housing loans programme started just after the flood of 1988 and focused on the same rural poverty group. Only members who have successfully repaid an income-generation loan and have saved an amount equivalent to the monthly repayments for a housing loan are eligible for this loan.

BRAC is considering establishing a moderate-income rural housing loan programme with loans of up to BDT 20,000. It is also concerned about moving into this market in view of the massive defaults that plagued the housing portfolio of the Grameen Bank after the recent floods.

ASA

ASA started a rural housing credit programme in 1989–90. ASA's management considers housing loans to the lowest income group not feasible and intends to target the rural middle-class farmers for lending activity. Interestingly, a sizable group of borrowers (close to 15%) use part of the income-generating loans they receive for other purposes such as the improvement of their homes, even though that is explicitly forbidden. This is an indication that the demand for housing loans is large.

6. Policy challenges

The Housing Finance Group of the IFC has identified numerous challenges that must be overcome if the housing finance sector is to fulfil its objective of increasing the availability and affordability of residential housing in developing countries.

In the following section, we address the above issues one by one in more detail.

1. If the housing problems are to be addressed more effectively, housing policies, and especially financing issues, must be taken into consideration. Stronger, more effective enabling strategies must be developed by the public sector to allow housing markets for the various tiers to leverage the activities of the private sector.
2. The objectives of the subsidy scheme should be to assist those who do not qualify for a formal sector mortgage loan, thereby increasing the number of middle-income households that can avail themselves of housing finance. However, we need to keep in mind that subsidised funding for state-owned housing finance entities creates distortions in the market and it should be stopped. Fortunately, for the last few years, BHBFC could not avail itself of any subsidised funding through the government or government guaranteed debt.
3. Real estate loan recovery rate in the public sector is very low and well below that of the commercial banks. In the past a rural house lending programme, sponsored by the government through a 3% refinancing window at the Bangladesh Bank, was stopped because of alleged poor recovery rates. Over the years, major problems in loan recovery began to plague the housing portfolios and the banks gradually decreased the proportion of advances for housing.
4. In order to develop a primary mortgage market, financial assistance to different market players (eg banks extending housing loans, specialised housing finance originators) through equity participation, loans, credit lines and warehouse lines is needed.
5. National housing finance systems have failed to prove themselves competitive in mobilising and allocating capital efficiently. BHBFC has made only very limited progress in becoming self-sustained or in reaching lower-income households.
6. Age-old Insurance and Trust Acts are not facilitating lending by long-term investors in the housing sector. Sometimes developers are accused of not properly following the procedures for borrowing money from financial organisations. The involvement of all three parties (the developer, the landowner from whom the land was leased, and the apartment buyer) in the process makes the borrowing cumbersome.
7. However, it is evident that, over the last two government periods, most of the government-built houses were for the upper-grade government employees and political leaders, rather than lower-income government employees or poor people in general.

8. There are no incentives to promote the primary mortgage market and to establish a secondary mortgage market to provide alternative funding mechanisms to the primary lenders.

7. Analysis and main recommendations

7.1 Summary of main issues

One of the main determinants of housing affordability is the cost and availability of housing credit, both short-term construction credit and long-term mortgage credit. Urban housing, which is more expensive than rural housing because of land costs and higher building standards, and is increasingly dominated by multifamily housing, is particularly affected by the availability of credit. With the current high urbanisation rates in Bangladesh, the need for urban lower-middle and low-income housing is enormous and this drives the need for improvements in the housing finance system. Without upfront finance for house construction or purchase, delivery of formal sector housing, even to middle-income households, becomes impossible. In rural areas and informal urban areas, small non-collateralised loans for house construction or improvement can facilitate the improvement of housing conditions.

The present housing finance system in Bangladesh is extremely small and highly segmented:

- Formal mortgage finance is available only to households with incomes above BDT 25,000 per month (well above the 10th percentile of the urban income distribution) and is restricted to selected housing submarkets in Dhaka. Within this section of the market, government-subsidised housing finance through the BHBFC is most prevalent, while the NCBs are decreasing their housing loan portfolios. Recently, new private housing finance institutions have started to operate in this market.
- Non-collateralised credit for house construction by MFIs is available to only a small proportion of poor rural households that have participated in income-generation credit programmes.

7.2 Downward-market expansion of formal mortgage lending

The formal housing and housing finance sectors are in a state of transition. There is presently some tension between movements in the property market for space and the responsiveness of the asset market driven by developers.

Government-funded housing credit will remain limited and the weak financial position of the NCBs will prevent an increase of housing finance through those institutions. The expansion of the sector has to come through new private sector mortgage lenders. With existing capital constraints in the financial sector, the competition by government savings and lending institutions and the weak debt market, new HFIs face a challenge in mobilising funds and it is unlikely that the cost of longer-term funds will come down in the short term. In addition, the housing finance sector has to show that it can be a profitable investment sector with long-term potential. This is the dilemma faced by DHB and other new housing finance companies. When more technically and financially strong HFIs enter this sector, these should be transitional problems. With the right support and policy changes, the private development and housing finance sector could move down-market to serve a much larger proportion of middle-income households. In turn this will alleviate the pressure on lower-income housing. Several reforms and innovations could be considered and discussed.

Expanding financial resources available to the private housing finance sector.

- ***Changes in the trust laws and Insurance Act*** in order to allow long-term investors to participate more freely in the housing finance sector.
- ***Assistance in the development of a debt market*** that would facilitate the link between housing finance institutions and long-term investors. The World Bank is launching a project to support non-bank financial institutions through the establishment of a credit, bridge and standby facility and the development of debt and equity markets. While HFIs are excluded from participating in the first round of the project because of their short track record and specialised nature, it would be critical to include them in a later phase.
- ***Enforcement of the rules guiding participation in the Government of Bangladesh's special savings schemes*** to those lower-income individuals for whom these were intended.
- ***Encouragement to the larger and professionally run MFIs to set up banks or non-bank financial institutions*** in order to create a more vigorous domestic financial sector environment that can provide support for the emerging housing finance sector and its move towards middle-income lending. Encouragement of joint ventures between MFIs and new HFIs, as is the case in the new DBH.
- ***Stimulation of foreign investment in, and foreign lending and guarantees to the new HFIs*** by carefully selected parties (eg IFC, FMO, HDFC), to strengthen both technical ability and financial stability. In particular, arrangements are needed to deal with the foreign exchange risk of potential investors.

Levelling the housing finance playing field.

- ***Deciding on the role of BHBFC and detailing an implementation strategy.*** If it is perceived that it is unlikely for BHBFC to change to an efficient and innovative middle and lower-income mortgage lender, its borrowing / debt-raising privileges could be adjusted in order to discourage competition with the newly developing private HFIs for the same customers.

Increasing access to formal mortgage finance by middle-income households

- ***Discussion of introducing alternative subsidy instruments for presently under-served lower and middle-income households in specific housing markets*** that will not distort private mortgage market development and can be utilised by all mortgage lenders, public and private. These would replace BHBFC subsidised funds and public servant-subsidised government lending schemes.
- ***Decreasing the administrative costs related to mortgage lending.*** Presently, the administrative requirements and costs related to the construction and mortgaging of a house are considerable and have been identified by REHAB as an unnecessary hurdle to acquisition of a house.

Improving the efficiency of the primary mortgage market

- ***Training in state-of-the-art mortgage lending and servicing operations for those actively involved in changing the mortgage industry in the country.*** There are presently few professionals in Bangladesh with detailed knowledge of mortgage design, specific risk management issues related to mortgage lending and loan underwriting, and processing and servicing procedures necessary to establish a healthy mortgage sector.

- ***Improving the regulatory system for new HFIs***, which is now divided between various agencies, none of which have experience with mortgage lending operations and risks.

7.3 Expanding access to microfinance for housing in urban and rural areas

Improving the sustainability of microfinance housing programmes

- ***Limiting cross-subsidisation of housing loans.*** If housing lending is to be extended to a variety of rural income groups and to urban lower-income households, it cannot depend on internal cross-subsidisation, which increases the cost of microcredit and will, by necessity, limit the scale of the housing programmes. It is, therefore, timely to consider separating longer-term housing finance in MFIs from the general microfinance portfolio, both in terms of sources of funds and as a credit programme with its own types of lending terms, conditions and break-even requirements.
- ***Targeting borrower groups that can afford longer-term loans.*** A second consideration to make housing credit programmes more sustainable is to target households that have already established a solid income base through previous income-generating credit programmes or microfinance loans.
- ***Requiring savings accounts.*** Carefully crafted income and employment requirements ought to guide the loan underwriting process. In addition, a more stringent savings requirement could be built into the housing loan package, not only for upfront payment for part of the house, but also as a savings account that would be accessible in case of possible delinquency.
- ***Assessing housing quality and location for disaster vulnerability.*** Housing loan programmes could analyse more carefully the minimum quality of housing required to withstand flooding or cyclones. Similarly, the location of funded houses should minimise the risk of the house's being damaged.

Extending microfinance for housing to urban households

- ***Extending housing rehabilitation and extension options in housing credit programmes.*** A housing improvement loan programme for owners of informal housing may be a starting point for the extension of microcredit to urban households, for example, in conjunction with existing services improvement projects (UNICEF) in bustees.
- ***Analysing lending options for new urban lower-income housing.*** Given that the cost of land is the main constraint for urban housing programmes, a possible collaboration with local government land allocation and development programmes may be explored. In addition, NGOs / MFIs could experiment with joint land ownership forms for low-income housing projects, where credit for ownership housing is provided for the unit only, but the land remains the ownership of the group.
- ***Establishing more professional micro and mortgage lending programmes for housing.*** Moving towards urban lending programmes for new house construction for lower-income households will require MFIs to develop a different set of underwriting criteria, equity and savings arrangements and interest rate structures based on the actual risks to which they are exposed. Subsidies may have to shift more towards land cost than the cost of finance.

Creating a funding and monitoring window for microfinance for housing through PKSF:

Expanding and professionalising the housing loan programmes by interested MFIs will require a more reliable source of finance earmarked for housing; an apex housing fund for low-income housing lending.

8. Conclusion

In conclusion it can be said that the formal mortgage market can expand its lending operations to middle-income households by improving efficiency, mobilising additional resources for housing lending from long-term investors, and redirecting present mortgage subsidies tied to government programmes and institutions towards demand-oriented programmes that can be implemented through the public and private mortgage lending sector. At the same time, non-collateralised housing credit can be expanded by the professional MFIs through increasing access to funds earmarked for housing, reducing the need to provide internal cross-subsidies for housing loans, broadening the target population to rural entrepreneurs and urban lower-income households in specific geographic locations, and developing more varied and professional housing finance products. The combination of these two approaches has the potential to increase access to housing credit and finance for low and moderate-income households dramatically, with related improvements in the quality of housing in Bangladesh.

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