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The Philippines Housing Finance

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CURRENCY EQUIVALENTS

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PREFACE

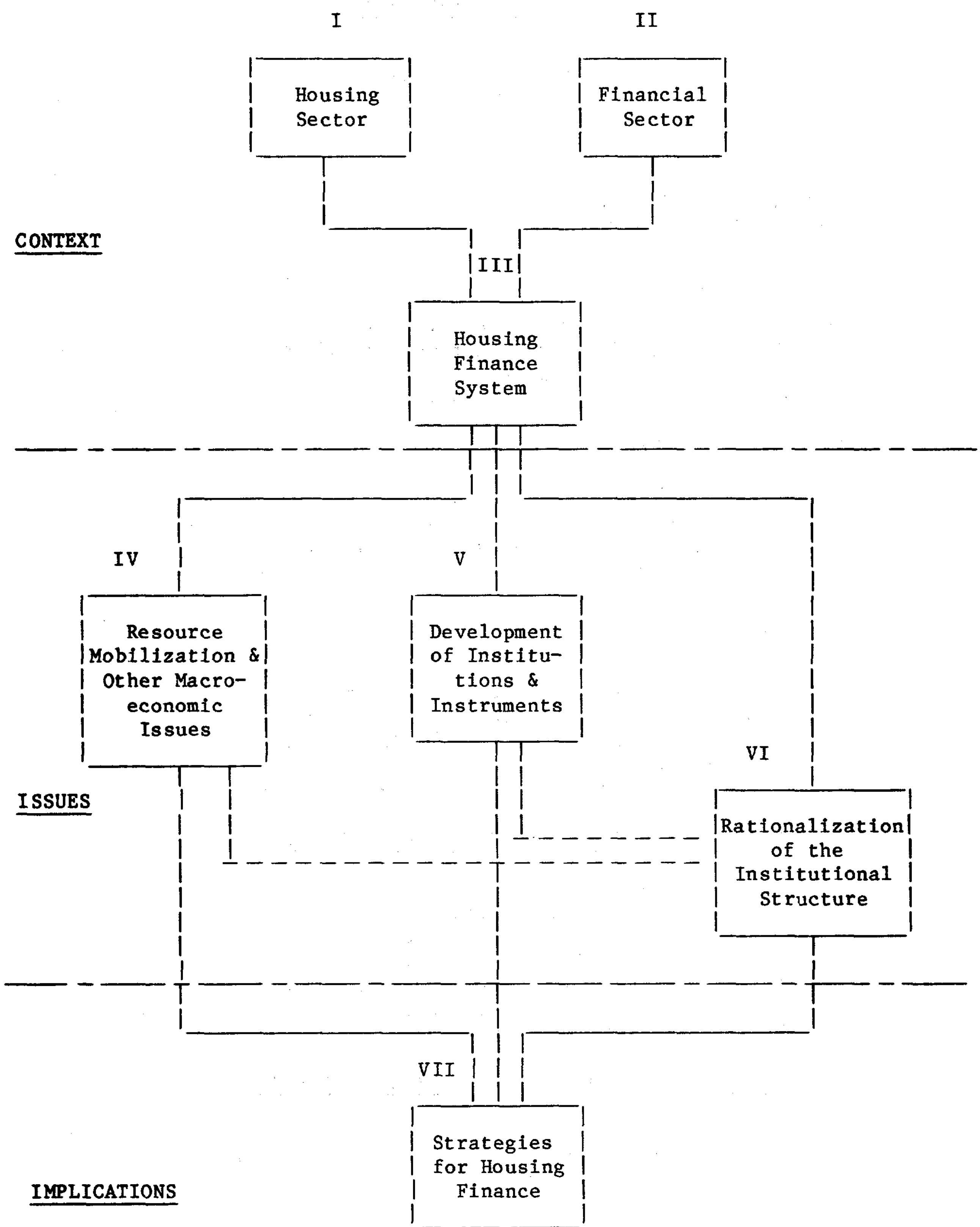
This document is the report of a study undertaken in 1981 by the World Bank on Housing Finance in the Philippines. The Bank has been extensively involved in the housing sectors of its member countries, particularly through its financing of urban projects. Furthermore, the Bank maintains a sustained interest in the financial systems in the course of its operations. This report reflects a synthesis of these concerns and those of the Government of the Republic of the Philippines which requested this study. In particular, the report focusses upon the issues of resource mobilization and its macroeconomic implications, the development of appropriate institutions and instruments, as well as access to housing finance. At the request of the Government, special attention has also been paid to the rationalization of the institutional structure of the system.

A mission comprising Messrs. Madhusudan Joshi (Chief of Mission) and Anupam Khanna, both of the East Asia Country Programs Department, together with Messrs. Raymond Struyk, John Tuccillo and Marcelo Bueno, Jr. (consultants), visited the Philippines during October 4 - 24, 1981. Mr. Edward K. Hawkins, Senior Departmental economist also joined the mission to participate in the policy discussions with the Government. The report takes account of discussions with Government officials and their comments on an earlier draft in March 1982.

The mission wishes to acknowledge the extensive assistance provided by the Interagency committee established as counterpart staff team by the Minister of Finance. The mission also benefitted greatly from discussions with other officials in the Government as well as members of the private sector in the Philippines who were very generous with their time and information.

The mission is grateful for the advice and support of colleagues in the World Bank, including the editorial assistance from Ms. Christine Morgan and the logistical support of Mesdames Georgia O'Donnell and Myung Ja Oh as well as the Support Services Section.

ORGANIZATION OF THE REPORT



THE PHILIPPINES

HOUSING FINANCE STUDY

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GLOSSARY OF ABBREVIATIONS

BLISS	-	Bagong Lipunan Improvement of Sites and Services
BMPC	-	Bahayan Mortgage Participation Certificate
CB	-	Central Bank
CBCI	-	Central Bank Certificate of Indebtedness
DBP	-	Development Bank of the Philippines
FIES	-	Family Income and Expenditure Survey
GSIS	-	Government Services Insurance System
HCF	-	Housing Contributory Fund
HDMF	-	Home Development Mutual Fund
HFC	-	Home Financing Corporation
HSDC	-	Human Settlement Development Corporation
HSRC	-	Human Settlements Regulatory Commission
LBP	-	Land Bank of the Philippines
LOI	-	Letter of Instruction (Presidential)
MHS	-	Ministry of Human Settlements
MOB	-	Ministry of the Budget
MOF	-	Ministry of Finance
NCSO	-	National Census and Statistics Office
NEDA	-	National Economic and Development Authority
NHA	-	National Housing Authority
NHC	-	National Housing Corporation
NHMFC	-	National Home Mortgage Finance Corporation
PAB	-	Philippine Amanah Bank
PAGIBIG	-	A popular acronym for HDMF
PD	-	Presidential Decree
PDB	-	Private development banks
PNB	-	Philippine National Bank
SSLA	-	Stock savings and loan associations
SSS	-	Social Security System

SUMMARY AND CONCLUSIONS

Introduction

1. A World Bank mission visited the Philippines during October 1981 to review selected aspects of housing finance in the country. In particular, the mission looked at recent developments in light of the need to increase the flow of funds into the housing sector and improve access to such funds through the formal financial sector. Although the public sector's role would be limited in this area, the emphasis is on its becoming a catalytic agent to encourage private sector participation and to broaden the scope of formal financial institutions. This report focuses on three interrelated sets of issues, namely resource mobilization and the macroeconomic implications; development of institutions and instruments for housing finance; and the rationalization of the institutional structure. Rather than design an ideal system for an ideal world, the emphasis is on feasible systems, and how best to improve them, taking the political economy of the sector as given.

2. Housing finance represents a confluence of issues in the financial and shelter sectors of the economy, both of which involve wide-ranging and complex concerns. The report, therefore, should be viewed as a continuation of previous efforts in the financial sector, where issues pertaining to housing finance were deferred, and as the first step in a longer process of policy dialogue on housing finance.

3. Finance is a part of the housing problem; the report does not deal in detail with other issues, such as land tenure and public delivery systems for housing. It also does not attempt a comprehensive sector analysis of the residential construction industry. (A separate study is currently underway as part of the Bank-financed Third Urban Project). Similarly, the study does not include any discussion of rental and rural housing. Even in the area of urban housing finance, this study has not investigated the informal mechanisms in any detail. As in most developing countries, the informal sector accounts for a significant, if not the bulk of the housing services delivered in the Philippines, especially for the lower income groups. However, the unavailability of any systematic information precludes a meaningful analysis and the report draws upon previously published accounts for the cursory description it contains.

4. The above caveats are not meant to imply the exclusion of issues pertaining to access to housing finance for low-income groups. In fact, improving access to housing finance has been one of the primary criteria by which the implications of the current system, various government initiatives and other possible changes have been assessed. There is a need for further

HDMF may be less than anticipated and secondly they may be channeled to the higher income groups in its membership. This is because of the apparent ease of exemption, and the qualifications necessary to receive a mortgage loan.

12. Another mode of resource mobilization is public borrowing. The monetary authorities have approved the issuance of a debt instrument, the Bahayan Mortgage Participation Certificates (BMPC). These securities are supposed to tap long-term resources for housing development, specifically for mortgage lending. Since they may be expected to displace other government securities, it raises the issue as to what share of public borrowing it is appropriate to earmark for housing. It thus appears desirable to have the Monetary Board continue to approve the issue of BMPCs within a consolidated program of government borrowing.

13. Furthermore, the Government has also been making budgetary appropriations of government revenues for housing. The direct government assistance for the national housing program has been significant, totaling more than ₱ 2.2 billion between 1976 and 1980, with almost 80% of the total being in the last two years. Although a large part of the government contribution is supposed to be in the form of equity to various MHS corporations, this may in fact be no different from general subventions, particularly for the nonfinancial corporations in the public sector.

14. The combination of these efforts has various macroeconomic implications. It is expected that there will indeed be some net generation of additional personal savings in the economy through HDMF. There will be a diversion of investible funds into housing in two ways. First, part of the savings in HDMF represent substitution for other forms of financial savings which would otherwise be in various private financial institutions. This, together with the effect of borrowing will lead to a higher cost of capital in the economy, which in turn would affect industry and other sectors in the short run, though possibly promoting labor intensity in the long run. Channeling of additional capital resources into housing, however, should lead to some increases in output and employment.

15. The operation of HDMF will also have a significant fiscal impact as well, both in terms of budgetary revenue foregone as well as increased government expenditure. A significant proportion of the total resources mobilized by the fund will be an effective transfer from government revenues. In aggregate terms, this effective transfer would be between 24% to 34% of the cumulative collections of HDMF. In addition the exemption from taxes of interest earnings from HFC insured mortgages as well as the yields of tax exempt BMPCs will also have a negative net budgetary impact.

16. There are two implications for interest rate policy as well, one pertaining to the relative level of mortgage rates, and the other to the implicit cross-subsidy. The interest rate of 9% on HDMF loans and the rates

on mortgage loans by other public sector financial institutions are significantly below the open-market rates or the opportunity cost of capital in the economy. It may be advantageous to maintain flexibility on the interest rates, since it would not be desirable to have a fund as large as HDMF to be totally locked in at concessional rates and insulated from the rest of the economy. A major drawback of the present interest rate subsidy is that it is regressive in nature since the amount varies in direct proportion with the loan size. The high relative and absolute magnitude of the various transfers in the system make it imperative for the government to make an explicit consideration of the full costs and benefits in an economywide context as well as to recognize the importance of appropriate targetting.

Development of Financial Institutions and Instruments

17. A distinctive feature of the approach to institutional development in the Philippines is that it has not followed the conventional path of the establishment of specialized financial institutions for housing finance at the primary level. This is in line with the thrust of the recent financial sector reforms. Instead recent efforts have focused on the creation of a secondary market institution, namely the National Home Mortgage Finance Corporation (NHMFC). In the secondary market system, NHMFC is the sole buyer of home mortgages originated by accredited banking institutions in accordance with standard underwriting guidelines. Thus, in addition to providing liquidity for long-term mortgage paper, NHMFC would also be instrumental in the standardization of the mortgage instruments. NHMFC is funded through government equity and debt issues (BMPCs) which finance its mortage purchases.

18. The operations of NHMFC, which have not included any significant private sector participation, are dependent on a thin source of funds and at present are closely tied to HDMF. NHMFC has concentrated its activity on concessionary government sponsored loans; thus the originating bank's involvement is just a servicing one for a fee and represents no real portfolio commitment. The major purpose of a secondary market for mortgages is to reduce the risk of mortgage lending by assuring a liquid market for mortgage paper. To be effective, however, the purchases must be at prices that will reflect the rates at which the financial institutions have been lending.

19. NHMFC sees its real commitment with the private sector coming through the sale of BMPCs. The yields, however, are low relative to market rates and the securities are purchased for the regulatory benefits attached to them. Their market will remain thin unless the yields are competitive with other market securities. This could be done through collateralizing their issue with market rate mortgages, although this would weaken the relationship between HDMF and NHMFC.

20. There has been very limited use of mortgage instruments in the Philippines, other than fixed term, fixed rate instruments. Graduated payment mortgages would appear to be an attractive instrument to address the

access problem since they reduce the amortization payments in the early years of the mortgage and thus reduce the minimum household income needed to qualify for a loan. However, from the lender's point of view, the risk of default is higher, but this problem could be mitigated with government insurance. Variable rate mortgages may increase the supply of funds into housing since they shift the interest rate risk to the borrower. However, this increases the risk of default as well, and the prospect of mass default together with the resulting political pressure to keep interest rates low would make such instruments difficult to use on a wide scale.

21. There are two distinct features of the financing system for the construction of homes that merit attention. The first concerns the inability of small developers to secure interim financing for residential construction projects while the second pertains to the unavailability of financing for sites and services residential projects. Both these problems may be alleviated to a significant extent through guaranteed take-out mortgage financing. Thus greater funds for construction finance would be mobilized from private financial institutions as well as on a decentralized basis from the personal savings and informal mechanisms in the sites and services projects. Other direct methods for alleviating the bridge financing problem for small developers include the improvement and extension of the guarantee system as well as a special construction credit program by DBP.

Rationalization of the Institutional Structure

22. The institutional structure of public sector involvement in housing in the Philippines has seen several changes since the mid-1970s as the Government has sought to determine an effective mode of intervention. It is not clear, however, that the process has been strictly evolutionary, as the general tendency of the Government's reaction to problems and structural deficiencies in all sectors appears to be the ad hoc creation of new institutions. In early 1982, the MHS created the National Shelter Development Program Secretariat to coordinate the operations of various agencies and implementation of all housing projects. The intention is to eliminate the duplication and overlapping of functions and activities of various government institutions. Direct government construction of housing through NHA and the MHS sponsored BLISS projects have not been very successful. It should, however, be noted that NHA has made significant progress in slum upgrading and sites and services projects.

23. Based upon the realization of the limited impact possible with direct government construction, the nature of intervention is undergoing a qualitative change. Specifically, there is emphasis now in the five-year national shelter development program on greater private sector involvement particularly in the areas of housing finance as well as in the procurement and supply of construction materials.

24. In view of its ambitious targets and the significant level of private sector involvement envisaged, the Government has initiated a variety of measures to stimulate activity on the supply side, which include regulatory reforms, supply of construction materials, credit for materials, take-out finance and project management assistance. Some of these are already in place, with mixed results, while others are in the process of implementation. For example, it appears that there has indeed been some streamlining of the regulatory process, and the introduction of variable standards should allow housing development appropriate to income levels through cost reduction. It is too early to pass judgment on the construction materials program but there are several factors which may limit its success, including over-optimistic estimates of cost reduction and speed of development, limited administrative resources and capability, and inadequate attention to problems of entry and budget financing. Credit for construction materials may be limited in scope and geographical coverage as well as in terms of private sector participation. Take-out finance through HDMF and NHMFC appears to be stimulating activity and may also be alleviating the bridge financing problem somewhat; it thus appears to be a promising instrument for steering the industry.

25. A major issue concerns the targetting of benefits of the several programs providing end-use finance to prospective homeowners. The system suffers from problems of duplication, inequities and the unavailability of finance to lower-income groups. HDMF is envisaged as becoming the dominant actor in the provision of mortgage loans, and an issue of concern is the relative balance of the distribution of the burden and benefits to the members. According to the projections made by the management, even with a conservatively estimated average loan size of ₱ 50,000, there will be only one borrower per forty eligible members of the fund by 1985. It is doubtful that even this ratio will be achieved in the absence of a major redirection, since the current trends in the sector indicate that the loan amounts may be expected to continue to rise.

26. It is apparent that HDMF is indeed serving a consolidating function in the market. Hence, it would appear desirable that the fund be used to direct the composition or mix of homes financed so as to ensure a non-regressive operation and a socially responsible housing policy. One way of doing this would be through a direct lending facility to its members instead of maintaining its sole current role as a supporter of the secondary mortgage function of NHMFC. The fund could continue to use the current system of originating banks with essentially the same procedures as at present but would specify the distribution mix of loan sizes in its take-out commitments. Of course, the adoption of similar eligibility criteria by the various other lending agencies would facilitate coordination with HDMF which in turn would rationalize the nationwide distribution of benefits.

27. Another issue of concern relates to the fact that HDMF operates in a fairly close relationship to NHMFC, an arrangement which may not be very efficient in the long run, since it constrains both the institutions in their operations. There may be several advantages to their disengagement. First, the mortgage benefits of HDMF would be available to more members, and could thus be targetted down the income scale. Second, NHMFC would be dealing with private lenders on both sides of its portfolio in a meaningful way and would be on the road to real secondary market development. Third, the inefficiencies created by loading the expenses of two different programs on top of each other would be eliminated and the flow of funds to housing finance increased. Finally, such a system would separate out the respective functions thereby facilitating the analysis and design of further government initiatives in support of such functions.

28. Both NHMFC and HFC share the common goal of increasing the flow of investible funds into housing through their liquidity and guarantee functions respectively. It is, however, necessary for a true insuring function to be developed within the housing finance system in the Philippines, a function which must be separated from the secondary market system. As regards the guarantee function, however, there may be some redundancy between HFC and NHMFC, and it may be desirable to consolidate the guarantee operations of HFC with those of NHMFC. This could serve to streamline their operating functions, provide better coordination and facilitate rapid processing, thereby obviating some of the bottlenecks currently appearing on the supply side. Finally, there appears to be some overlap between HFC and HSDC, particularly in the areas of construction materials supply and project management functions. These need to be rationalized with a clear demarcation of responsibilities and initiatives.

Implications

29. Three broad criteria may be employed to judge the performance of the housing finance system. These are, first, the degree to which the system provides access to housing in the formal sector for households with different incomes. The second criterion is the extent to which the quantity and quality of housing in the active stock will improve over the next decade. The net macroeconomic impact, the last criterion, has three different aspects, namely: the effect of resource mobilization for housing on aggregate savings and availability of funds for other sectors; the impact on the national budget; and the amount of employment and value added generated by the housing industry.

30. The current system of housing finance provides access to only the upper strata of the income distribution, and even the major government initiative viz. HDMF, can have only a limited impact under present arrangement. There is also little prospect of extraordinary changes in either the quality or quantity of the housing stock, although the recent government initiative in the building materials area, if successful, may have some beneficial effects. Finally, in terms of macroeconomic impact, although there is the expectation that resource mobilization through HDMF will lead to a net increase in savings, it will be at a significant cost to the national exchequer. Various other programs in the housing sector will add to this burden.

31. There is scope for further changes in the housing finance system. These changes include the consolidation and improvement of the primary mortgage market through either homogenization of mortgage lending practices or the introduction of alternative instruments, or both; the strengthening and expansion of the secondary mortgage market through one or more of three mechanisms, namely the provision of a true mortgage insurance function, a market-rate purchase program for NHMFC, and a secondary market program for sites and services loans; the use of HDMF to organize the mortgage market; and facilitating entry into homeownership through the use of HDMF contributions as downpayment and the reduction of underwriting standards accompanied by the establishment of a special risk fund.

32. Analysis of these alternatives shows that relative to the current system, there are a number of potential changes that will improve the access to housing for lower income families. In particular, they include the use of alternative mortgage instruments, the secondary market purchase of sites and services loans and the more liberal use of HDMF. The last refers to a situation where HDMF would be used to accumulate downpayments and to organize the primary mortgage market. Still beneficial, but somewhat less so, would be the provision of a true mortgage insurance function and a purchase program for market-rate mortgages. Both these affect the secondary market directly and have an indirect impact upon access to primary sources of housing finance.

33. Most of these measures would also increase savings. Those who are recently enfranchised in the formal housing sector will increase their savings in the form of equity in owner-occupied housing, while those crowded out of the sector will divert their savings to other forms. The sole exception to this is the use of HDMF to accumulate downpayments. Here HDMF contributions would substitute in part for other savings, with the result that a lesser flow of funds would result than under the current program. Some of the changes would result in either an expansion or improvement of the housing stock.

34. These benefits however, are achieved only at a cost to the budget or to investment in sectors other than housing. Each of the changes requires that more resources be devoted to housing, thereby removing them from other sectors. This can be accomplished either through an increase in government spending, increased borrowing, taxation or monetary expansion, or a reduction in government development efforts in other areas of the economy. Thus, the implementation of any of these housing sector changes will require some reallocation of resources and consequently a change in development policy.

35. A potential implication of the issues analyzed above pertains to the possible establishment of a lead institution for housing finance. Such an institution may be worthy of consideration in case the Government decides to rationalize its intervention in the system through the use of general subsidies from revenues. Under such an institutional framework, HDMF would be a prime candidate for such an institution since it would have a system of accredited originating and servicing banks, appropriately standardized instruments for mortgages and, most importantly, procedures devised for targetting various segments of the population. Conjointly, as part of the same program, HFC could establish an experimental risk fund for insuring mortgages to what would presumably be high risk subjects, who would otherwise be excluded from access to formal housing finance. Furthermore, such a role for HFC would also make it suitable for being a monitoring agency for the program as well.

36. As noted earlier, HDMF lending operations can be made more relevant for a larger part of its membership and can reach further down the income scale through an appropriate targetting effort. It is nevertheless true that unless the general economic situation, and the distribution of income in particular, improves significantly, a large number of Filipinos will continue to be shelter-poor as well. Thus, while streamlining of the housing finance system is an important part of a fully articulated housing policy, it cannot be an adequate substitute for other aspects of such a policy, including such items as low-income housing programs and slum upgrading.

I. THE HOUSING SECTOR

1.01 The subject of this report is housing finance in the Philippines;/1 however, to provide the essential background against which to view the functions which the housing finance system must serve, this chapter describes the current housing situation in the country. In addition to dwelling conditions, the extent of homeownership, and the demand for housing, the discussion also covers some selected features of the residential construction industry. Finally, it should be noted that the focus of this chapter, and indeed of the whole report, is on urban housing.

1.02 The Philippines' urban population in 1980 was counted to be 18.2 million, or approximately 38% of the country's total population of 47.9 million. Metro-Manila continues to maintain its level of primacy accounting for 12% of the national population or 32% of that in urban areas. There are 26 other centers with population above 100,000 and a further 28 centers with urban population between 50,000 and 100,000. The urban population continues to grow at 6.3% compared to 2.8% growth rate for the total national population.

A. Current Situation and Recent Trends

1.03 The distribution by type and facilities of the dwellings located in urban areas, in rural areas and in urban areas of Rizal province,/2 for 1970 /3 is presented in Table 1.1. Table 1.2 provides a comparison with the figures for 1960. The data must, however, be interpeted carefully. First, the definition of a dwelling is extremely broad, being essentially anything occupied by a household and does not require that it contain a place to prepare meals, or have sanitary facilities or water supply. Thus, although the dwelling conditions in urban areas appear superior to those in rural areas, they may not adequately reflect the quality of life in the habitat, especially in terms of the size of units and the density of the communities, as well as the proportion of household income devoted to housing.

/1 The report covers mainly the formal housing finance sector; the informal sector is difficult to identify and virtually impossible to quantify. (see Chapter III, Section E.) The report also does not deal in detail with other important issues of the housing problem such as, land tenure and failures of the public delivery system.

/2 Metro Manila consists of four cities and 13 municipalities of which all but one municipality are in Rizal province. There is, however, considerable urban population outside the boundaries of the cities and municipalities. Hence, urban Rizal may be more representative of the whole area loosely thought of as Metro Manila.

/3 Since the data from the 1980 Census has not been processed, 1970 is the latest year for which information on the physical aspects of housing is available.

Table 1.1: INDICATORS OF DWELLING CONDITIONS: 1970
(Percentages)

	Philippines	Urban	Rural	Urban Rizal province
Distribution				
Type of dwelling				
Single	88	78	93	68
Duplex	3	6	2	11
Apartment/accessoria	4	11	1	18
Barong-barong (makeshift)	4	2	4	2
Communal, etc.	1	2	/a	1
Roof material				
Aluminum/galvanized iron	42	69	31	92
Asbestos	/a	1	/a	1
Tile/concrete	1	1	/a	2
Cogon	18	3	25	/a
Nipa	36	25	41	3
Other	2	1	2	1
Type of water supply				
Piped water	24	54	11	72
Artesian well	8	10	8	10
Pump	29	25	30	18
Open well, etc.	39	11	51	/a
Type of cooking fuel				
Electricity	3	8	/a	20
Kerosene	11	26	/a	43
Gas	6	15	2	23
Wood	79	49	92	13
Charcoal	/a	1	/a	/a
Other	1	1	1	/a
Type of toilet facilities				
Flush	22	48	11	72
Closed pit	16	19	14	11
Open pit	23	11	28	5
Public toilet	2	2	1	2
None	37	17	45	11

/a Less than 0.5%

Source: 1970 Census of Population and Housing.

Table 1.2: INDICATORS OF HOUSING CONDITIONS IN THE PHILIPPINES, 1960 AND 1970
(Percentage distributions)

	Philippines 1960	Philippines 1970	Rizal province /a 1960	Rizal province /a 1970
Type of Unit				
single	85	88	75	68
duplex	1	3	4	11
accessoria/apartment	2	4	14	17
barong-Barong	11	4	4	2
other	1	1	2	1
Tenure /b				
owner occupied only	87	85	48	51
owner occupied and rented	1	1	4	2
rental only	6	8	42	39
occupied rent-free	6	6	5	7
Type of toilet				
flush	8	22	56	68
closed pit	9	16	8	11
open pit	36	23	12	6
public toilet	2	2	10	2
none	45	37	13	12
Cooking fuel				
electricity	1	3	13	19
kerosene	3	11	27	43
gas	1	6	11	22
wood	93	79	47	16
charcoal and other	2	1	2	-
Construction materials /c				
strong	12	38	/d	/d
mixed	30	23	/d	/d
light	58	39	/d	/d

/a Includes Manila; note also that the data includes both urban and rural areas of Rizal province. This differs from the figures in Table 1.1 which are for urban Rizal only.

/b Definitions of shared units differ between 1960 and 1970, especially those involving households living rent-free.

/c Definitions of buildings materials:

Strong: built of durable materials such as concrete, brick, wood, etc., with galvanized iron roofing, aluminum sheets, tile.
Mixed: combination of strong and light materials. A house made of wood with nipa or cogon roof falls in this category.
Light: constructed of nondurable materials like nipa, bamboo, cagon, etc. building materials.

/d Data not available.

Source: Census of Population and Housing, 1960 and 1970.

1.04 Second, and in a similar vein, although the quality of the housing stock appeared to have improved in the intercensal period (1960-70) /1 and despite the increase in the number of dwellings from 4.8 million to 6.0 million, these were outstripped by the growth in number of households. Specifically, the average annual growth rate in the number of dwellings was only 2.4% compared to 3.1% and 2.8% for population and households respectively. The consequent backlog led to the doubling up of families. Table 1.3 provides some information on the ways in which doubling up is accomplished. In urban areas, including urban Rizal province, the majority of second households rent space from the householder with only about one-third of the second households living there rent free. By contrast, in the rural areas, 82% of second households live rent free with the householder.

1.05 Table 1.4 shows several tenure arrangements by location and by income class as of 1975. If one examines the simple incidence of owning a home (but perhaps squatting on the site) across income classes, a "u"-shaped pattern for both urban and rural areas is seen. This presumably reflects a shift from the meanest form of squatting at the lowest income levels to some rental (perhaps of the lot at somewhat higher levels) to ownership of house and lot at the highest levels. The data in Table 1.4 also show that the majority of households are owner-occupants. The formal rental market - comprised of units of sufficient quality and security of title that one could obtain mortgage financing on them - appears to be a small share of the total housing market.

1.06 Not surprisingly, as Table 1.5 shows, there appears to be a positive relationship between the quality of construction materials used in a dwelling and tenure. This is, of course, partly due to the correlation of both with income (see para. 1.05 above) but an additional factor may be the increased willingness of households to invest in their dwelling units under the security of tenure on the site./2 The data for 1967 show that stronger materials were much more likely to be used when the household owned both the dwelling and the site than when the household owned the dwelling and either squatted or rented the site. The somewhat anomalous figures showing that those renting both the house and lot live in units made with strong materials, possibly reflect the middle-income rental market; lack of information precludes a more definitive statement.

/1 E.g. the share of barong-barong type of makeshift dwelling dropped from 11% to 4% over this period.

/2 See for example, L.S. Burns and D.C. Sharp, "Effects of Resident Control and Ownership in Self-Help Housing," Land Economics, 1981, pp. 106-114.

Table 1.3. INDICATORS OF CROWDING IN HOUSING, 1970

	Philippines	Urban areas	Rural areas	Urban Rizal Province
Percentage of Dwellings Occupied by				
One household	95	92	99	/a
Two households	4	6	3	/a
Three or more	1	2	/b	/a
Distribution of Types of Dwelling Sharing Arrangements				
Owned + part rented	30	36	17	43
Owned + part occupied free by others	60	36	82	28
Rented and part rented out to others	10	28	1	29
Total /c	100	100	100	100

/a Figures not available.

/b Less than 0.5%.

/c Excludes very small numbers of dwellings: (a) rented with part occupied free by others and (b) occupied free with part rented to others.

Source: 1970 Census of Population and Housing.

Table 1.4: TENURE DISTRIBUTION BY INCOME CLASS AND LOCATION: 1975

	Under ₱ 2,000	₱ 2,000-3,999	₱ 4,000-9,999	₱ 10,000-19,999	₱ 20,000 and over
Urban					
Rental of house and/or lot	26	42	37	38	34
House and lot	13	19	16	16	10
House only	10	15	12	9	9
Others/a	3	8	9	13	15
Owned/b	74	58	63	62	66
Rural					
Rental of house and/or lot	7	8	11	12	7
House and lot	2	3	3	3	1
House only	5	5	8	9	6
Others/a	-	-	-	-	-
Owned/b	93	92	89	88	93

/a Includes rental of land only, apartment rental, and other rental arrangements.

/b Includes units occupied without rental payment.

Source: Unpublished tabulations of the FIES data.

Residential Construction

1.07 Given the sharp limitation in the quality of relevant data series, it is difficult also to assess in any meaningful manner the recent trends in the production and supply of shelter services. Any measurement of progress, especially the aggregate impact if any, of the various government initiatives taken in the second half of the 1970s must also await the analysis of the housing information from the 1980 census. The discussion below represents an attempt to use available information to sketch roughly the trend in residential construction activity and is indicative at best.

1.08 The share of GDP devoted to housing investment has long been a standard figure for judging the effort a country is making in the housing sector. However, the official figures, which indicate the stability of the share of GDP represented by residential construction at 4% during the last five years, reflect the lack of faith in the actual figures obtained as a basis for changing it rather than any real view that the share has been constant./1 Also, these figures essentially ignore all investments made in dwelling upgrading.

Table 1.5: CROSS-TABULATION OF BUILDING MATERIALS BY TENURE IN 1967

Location & type of material	Count ('000)	House: Site:	owns owns	owns squats	owns rents	free free	rents rents	Total
		Percentage distribution of tenure by type of materials (%)						
Philippines	5,013		50	28	11	4	6	100
Strong	1,585		56	10	11	6	17	100
Mixed	2,580		49	34	12	3	1	100
Light	822		42	47	7	4	0	100
Urban	1,515		39	17	18	6	19	100
Strong	927		41	10	14	6	28	100
Mixed	478		39	24	27	6	5	100
Light	105		22	46	22	8	2	100

Source: "Living Quarters in the Philippines," Journal of Philippine Statistics, Vol. 19, No. 3 (July-September 1968), p. ix-xxiii.

1.09 An alternative indicator of residential construction activity may be constructed from the building permits data. However, there are problems with this too, since coverage has been sporadic and very uneven. In fact, the data may be more representative of activity related to formal housing finance than

/1 Major changes were made in the methods of collecting information on building activity. The current establishment-based approach suffers from serious under-coverage problems which are readily admitted by the concerned national income accounts staff of the NEDA.

to aggregate residential construction, because the buildings for which permits are secured consist mainly of those for which mortgage loans are obtained, since the permit is part of the required loan application package.

1.10 Examination of such data suggests that roughly 25-30,000 dwellings /1 have been constructed annually by privately financed builders over the past five years. It should be noted, however, that there have been major attempts to improve coverage of building permits over the 1976-1980 period. Yet, the number of dwellings covered by permits has been roughly constant. This leads to the observation that actual level of building of the type of units covered by permits in principle has probably declined somewhat over the period. In addition to private residential construction, the two main government housing development agencies, namely the National Housing Authority (NHA) and the Human Settlements Development Corporation (HSDC) have also been building housing units; together they accounted for 5,800 new units in 1979 and 8,800 in 1980./2

1.11 The building permits data also reveals that approximately 90% of the permits issued have consistently been for single-family units, accounting for about 80% of the total value of residential construction recorded thus. The average single-family unit was significantly larger than other types of units with floor area above 100 sq. m, while duplexes and apartments averaged only about 60 sq m.(Table 1.6). The average recorded value of the single units in 1980 was almost ₱100,000 /3 (see also Section C).

1.12 Given the relatively low average degree of crowding and new household formations of about 350,000 per year, it is evident that the vast majority of dwelling units is being built without permits and hence outside the formal financial system. Indeed, in a situation such as in the Philippines, the upgrading of dwellings is an important, perhaps the primary, method for expanding housing stock whose quality exceeds some minimum standards. Unfortunately, no systematic information is collected on the amount of such upgrading./4

/1 The permit form does not require the number of units included in multi-unit structures. Hence, this estimate reflects some assumptions on the distribution of types of buildings and number of units in apartments and accessorias.

/2 These figures exclude sites and services units and slum upgrading.

/3 A study by the NEDA National Income Accounts office judges that the recorded value figures are underestimates by about 25% on the average.

/4 One documented case, which may be representative of the general process is that of the Tondo area in Manila; however the high degree of improvement over a short time period is atypical. See various reports of the Research and Analysis Division, NHA (1980).

Table 1.6. AVERAGE FLOOR AREA AND VALUE PER UNIT OF UNITS BUILT WITH PERMITS IN 1980 /a

	Floor area (sq m)	Value (P'000)
Single units	106	98
Duplex	63	58
Apartment/ /b	62	80

/a For units issued permits in the third quarter of 1980.

/b Assumes eight dwellings per permit; the actual numbers of units is not reported in the building permit form.

Source: Tabulations of unpublished data provided by NCSO.

B. The Formal Residential Construction Industry /1

1.13 Residential construction in the urban Philippines is dominated by a few big developers who acquire land and prepare serviced lots. Some have their own building contractors associated with them, but nearly all will sell serviced lots to households for them to contract (eventually) on their own for a home or sell to contracters for home building. Building contractors within Metro-Manila fall into three groups. The first group comprises no more than a dozen large firms each of which can construct over 500 units a year; together they typically account for about 20% of all the housing built annually. The second group is composed of those capable of building perhaps as many as 150-200 units a year but more often somewhat fewer; this group again constitutes about a fifth of the market. The balance of dwellings or 60% of the units, are built by small contractors who might do 5-10 homes a year. It is common for a family to purchase a lot and sometime later find a small contractor to erect the home. The extremely low overhead expenses of the small contractors allows them to compete with the larger firms.

/1 This section is based upon impressionistic information obtained through various interviews and data furnished in the field. A detailed study on the Construction Industry in the Philippines, sponsored as part of the Bank financed Third Urban Project is currently underway.

1.14 Outside of Metro-Manila there are very few even middle-size contractors. Small firms are the rule. "Foremen" who operate out of their homes account for two-thirds or even more of the market. The small contractors and individual skilled craftsmen serve the informal housing market needs for major improvements to existing, often low-quality units. To reduce out-of-pocket expenditures, it is common for members of the household to work with the hired craftsmen or additionally to assemble other family members and friends as well. Furthermore, the information flow on locating and hiring such craftsmen appears to be very good.

1.15 In reality there is a second tier of subcontracting that goes on, in which small contractors work for the big developers and their associated general contractors. Actually two variants exist here. The less frequent is for the developer to contract on a turnkey basis, with the subcontractor providing both labor and materials. A major advantage of this arrangement to the developer is that the subcontractor provides some of the interim financing. The more common arrangement is for the developer to contract with a foreman or labor contractor. The developer provides the materials, and the subcontractor is paid on the basis of completed work. Labor subcontractors range in size from a foreman and a crew of five to as many as 300 workers. On all jobs involving labor subcontracts the developer has to exercise tight quality control and carefully monitor the use of materials. The subcontractors have semi-permanent crews, often composed of people from their own villages of origin. They are able to expand their crews rapidly when the workload requires it, partially by bringing in more workers from the provinces. This contributes to the cyclical rural to urban migration patterns./1

1.16 The building activity in the formal sector appears to be concentrated on single-family units in the ₱ 70,000-₱ 150,000 range, with floor sizes ranging from 40 to 75 sq.m. To a significant degree this market has been formed by the availability of mortgage financing on concessionary terms for units in this range. There is little construction of units less costly and more modest than these. Sites and services with core units remain largely a preserve of NHA, although some private, generally church-sponsored projects are also underway. Houses costing well over ₱ 150,000 continue to be built, perhaps several thousand per year, to judge from the mean size of the units which were built with housing permits.

/1 For more on this see A.W. Stretton, "The Building Industry and Urbanization in Third World Countries: A Philippine Case Study," Economic Development and Cultural Change (1981).

1.17 Except for some luxury residential units and a few multi-storey structures, building technology in the formal sector is remarkably simple and uniform. Hollow cement-block walls, metal roofs (often GI sheets), poured-concrete pads, and a sanitary core with a septic tank are the basic elements. Plumbing is extremely simple, as are window and door frames, although there appears to be only a moderate degree of standardization. In short, the majority of homes being built can be constructed with a minimum of skill, readily available materials, and little in the way of capital equipment./1

1.18 It has often been pointed out that the reason that poor households in developing countries live in inadequate housing is more the lack of suppliers creatively servicing this market than solely a lack of effective demand. This seems to be borne out in the Philippines, where the residential construction industry is extremely conservative in that it services well-developed markets; it is a follower, not a creator of markets. The reasons for this probably lie in the economic structure and organization of the industry.

1.19 The supply of more modest, and hence less expensive housing, appears to have been restricted by two factors: the profitability of the higher income residential market sector as well as commercial and industrial ventures to the established developers and contractors; and bridge financing from banks and thrift institutions to these same developers. Less established firms who might more aggressively service the less expensive segment of the market cannot obtain bridge financing from banks (see Chapter V). The Government Services Insurance System (GSIS) is producing a "no frills" basic 65 square meter dwelling for about ₱ 80,000 and is providing the development financing. Isolated instances of significantly more modest housing, often encouraged by government agencies, have also been found. But the majority of small builders turn to banks and thrifts only as a last resort, i.e, after having failed to raise the equity for the project among a syndicate of friends and business partners. For building single units, the homeowner secures the mortgage commitment and some development funds in advance using his lot as collateral, and the development funds are advanced for the contractor's bridge financing.

Cost Structure

1.20 The composition of development cost is of interest as it may signal areas where savings may be possible. Rough indicative estimates of the cost

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/1 A few large developers have begun using precast concrete wall units, which they claim reduce cost significantly and produce a much stronger unit. This may be so, but with labor constituting only 30% of the structure's hard cost, there must be both materials and labor savings present to offset the greater capital cost (plant plus trucks and flat-bed trailers) and transportation cost. Moreover, a steady market for these units will be required if the initial costs are to be amortized over a sufficient number of units to make the process competitive.

composition of "modest" housing were made based upon interviews and a small sample of completed standard cost forms prepared by the mission, (Table 1.7). The pattern obtained, viz. 23% of total development cost for land and site preparation, 56% for unit construction and 21% for soft costs /1, appears fairly reasonable. While it is difficult to judge how the share of total costs accounted for by soft cost compares with other countries,/2 the split in hard cost between land plus servicing and dwelling construction is closely in line with the 30-70 division reported for several cities./3

Table 1.7: DEVELOPMENT COST OF PRESENT PROJECTS

Project	Year built	Components of Development Cost (percent): Land and site improvement %	Dwelling construction %	Financing and other costs including builder's risk %	Unit size (sq m)	Total Development cost project (₱)
A	1980	33	47	19	50	94,115
B	1980	26	48	26	42	65,592
C	1980	22	55	23	65	118,453
D	1981	23	54	24	54	100,778
E	1981	15 /a	67	18	67	56,938
F	1981	17 /a	67	16	67	60,970

/a Land contributed

Source: Mission estimates based on data gathered from developers and contractors.

/1 Soft costs include those for financing, marketing, and carrying inventory as well as various fees and premia.

/2 It has been difficult to find figures to compare these with, because of the dearth of data on soft cost. O.F. Grimes, Housing for Low-Income Urban Families (1976), Table A12 mentions management costs only. If management includes all soft costs, then something of a comparison can be made. While this seems doubtful, it may nevertheless be worth noting that "management" accounts typically for about 10% of a unit's cost for the countries he considers, with a high of 17% (for Sri Lanka).

/3 Grimes, op-cit, Table A13. The projects judged to be comparable were Ahmedabad, Bogota, Madras, Mexico City, and Nairobi.

1.21 The split between hard cost for building a dwelling was consistently found to be 70% for materials and 30% for labor, about the reverse of the ratio in many developed countries. The high value of materials is certainly evident on the job sites where materials utilization is very carefully monitored, and pilfering heavily protected against. Obviously anything that might be done to economize on the use of materials would be a boon, including such things as greater standardization of material sizes combined with architectural plans geared to these sizes.

1.22 The differences in cost made by the use of different types of materials is evident from the figures given below in the per square meter cost of a structure built dominantly with these materials in 1979:/1

Material	Cost
Indigenous	₱ 260
Wood	476
Concrete	1,014
Mixed	781

These figures show, for example, that with roughly the same quantity of labor services required, the concrete structure costs twice as much as the wooden one. Of course, the longevity of the concrete structure is several times that of its wooden counterpart.

Housing Construction Prices

1.23 The Government only publishes indices on rents; fuel, light, and water; material inputs; and the labor component of repairs. All are helpful but are not quite the desired figures. It has been possible to construct a series for completed house prices of a standard dwelling by taking advantage of the fact that the Government Services Insurance System (GSIS) has been sponsoring the development of the same dwelling for its members for a number of years. The GSIS provided these cost figures from which the price indices shown in Table 1.8 were developed. Two notes on these indices are in order. First, the dwelling and serviced lot package are approximately constant quality; some small adjustments to both the dwellings and the quality of the infrastructure have occurred over time. Second, there are some discontinuities because GSIS did not renegotiate costs every year on each project; this is especially evident in the 1979/80 figures for outside Metro-Manila.

/1 See National Home Mortgage Finance Corporation, "Developments in the Housing Sector", 1980.

Table 1.8 : PRICE INDICES FOR HOUSES AND SERVICED LOTS 1977-81 /a

	Metro Manila /b			Outside Metro Manila /c		
	House and lot	House	Serviced Lot	House and lot	House	Serviced lot
1977	100	100	100	100	100	100
1978	114	117	140	111	110	117
1979	136	131	181	120	118	128
1980	156	148	211	188	176	217
1981	181	175	221	194	196	234

/a Figures from GSIS Projects which have developed a roughly constant quality dwelling over time at the same site. Some discontinuities appear in the series because the development costs are not renegotiated annually for all projects.

/b Based on experience of four projects.

/c Based on experience of one project in Bulacan province and one project in Pampanga province, both in Eastern Luzon.

Source: Mission estimates based on data provided by GSIS.

1.24 In brief, the figures show an 81% increase in the price of a house and serviced lot in Metro-Manila over the 1977-81 period, with the price increase of 75% for the house and 121% for the serviced lot. Interestingly, this compares with a 63% increase in the all item CPI for 1976-80 (50% 1977-80). Thus the price of housing appears to be rising faster than the CPI.

1.25 Increases in the price of land are often singled out as the main reason for price increases of homes. There is no systematic compilation of land cost data in the Philippines, but some fragmentary data for areas within Metro-Manila for the 1975-79 period are available from private sources which is presented in Table 1.9. The rate of increase is startling, never less than 100% over four years. Moreover, the range of increase is disquieting - up to 700% (from a very low base), and this is the area of the greatest development of moderate-income housing. Furthermore, these rates of inflation have been recorded over a period during which the national government launched various initiatives seriatim to curb speculation in land, some of which only added to an already confused situation regarding land titles and tenant rights to remain on agricultural land./1

/1 For a journalistic account, see "The Inhabitants of Pinahan and Malaya's Long and Lonely Wait for Land Titles that May Never Become Theirs", Philippine Panorama, pp. 34 ff.

Table 1.9: LAND PRICE INCREASES WITHIN METRO MANILA, 1975-79 /a

Area	1975 price (₱/sq.m.)	Percent change 1975-79
A. Manila, Pasay, Mandaluyong,/b San Juan		
- Developed sites	160	134
B. Quezon City		
- Development sites	150	117
- Raw land	18	150
C. Navotas, Caloocan, Malabon		
- Development sites	110	173
- Raw land	7	442
D. Muntinlupa, Las Pinas, Paranaque		
- Developed sites	78	317
- Raw land	9	733
E. Makati, Greenhills, Ortigas		
- Developed sites	350	214
F. Pasig, Marikina, Pateros, Taguig, Valenzuela		
- Developed sites	72	152
- Raw land	14	364

/a Based on means of reported high and low values.

/b Excludes the Greenhills and Ortigas areas which are included in Group E.

Source: Compilation of transactions data by the RGV Group of Companies.

Constraints

1.26 Five potential bottlenecks in housing construction come readily to mind: land, labor, materials, finance, and government red tape. The first three are not perceived as major constraints by developers and contractors, mainly because of the simplicity of the basic housing being produced. Furthermore, no one saw labor or materials availability as a potential bottleneck, even if there were sufficient demand to double the number of units built over a short period. However, as indicated above (para. 1.28) land prices have escalated dramatically in Metro-Manila and problems of land speculation remain despite various sporadic attempts by government to reduce its profitability. Financing and government red tape are already constraints in certain areas and could well become worse with an increase in demand. Moreover, these constraints also help explain the disadvantages faced by the smaller firms. The advantages of the larger firms are mainly in their ability to obtain financing, government approvals and supplier credits more quickly or on more favorable terms.

1.27 Land speculation only exacerbates the basic problem which is the shortage of urbanized land in Metro-Manila. This has led increasingly to the development of communities in the suburbs or on the periphery of the National Capital Region which may keep the final costs of dwellings down but would lead to higher direct and imputed costs of travelling longer distances for the residents. One possibility for alleviation may be vertical development of space as in Korea. This may, however, entail problems too, including those relating to cultural and individual preferences. Moreover, the smaller and less capitalized developers would find it more difficult to construct such dwellings due to the more sophisticated engineering and equipment requirements. In the regional cities and other urban centers there may be some constraints on land as well, though of a different variety. For example, in Cebu, an institutional barrier cited by developers pertains to the restrictions on the conversion of agricultural land to other purposes which together with the topography of the region poses some difficulties for large-scale housing developments. Smaller land packages are more easy to come by and may indeed explain the structure of the residential construction industry there.

1.28 Traditionally, even the presence of take-out financing for a unit has been insufficient to automatically assure obtaining development period financing. As described in a later chapter, the Home Financing Corporation (HFC) insures development period loans; but the importance of such insurance in increasing institutions' lending activity is far from clear. In any event, pumping more development period financing to small developers and contractors may well be the *sine qua non* of a broad-based expansion in housing production.

1.29 Small contractors are also reportedly at a disadvantage in obtaining government approvals. The HSRC is responsible for subdivision approvals and large developer-contractors claim that approvals take 60 to 90 days,/1 if their applications are in order, while for smaller firms, it can take twice as long. Similar differentials are reported in the time to obtain the necessary permits and approvals from local governments and Meralco, the electric utility firm serving the Metro-Manila area. One positive step

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/1 This is about half of the time required earlier when the National Housing Authority had this function.

recently taken by HSRC has been the decision to have different standards of subdivision development; this will make it easier for small firms to finance and carry out the site preparation and will also lower the cost of more modest housing.

C. Housing Needs and Demand

1.30 A number of estimates of housing needs have been made for the Philippines, the most recent by the National Census and Statistics Office (NCSO), 1979./1 Table 1.10 provides a summary of the results for two methods of calculating need for the 1970-2000 period. Several points emerge from the figures. First, the backlog in 1970 is certainly modest compared to the size of the additional requirements over the period; however, in absolute terms the backlog may represent three or four years of production at current rates of units made of strong materials in urban areas and all but make-shift units in rural areas. Second, much of the resources available for housing go simply to produce shelter for new household formations averaging about 350,000 annually - and only the residual will be available for upgrading. Third, the figures imply very high rates of replacement of existing units 96% of the 1970 stock should be replaced by 2000. These figures can be questioned on two counts: they seem to imply higher than realistic depreciation rates for various types of units, and more importantly, they can be misleading for some purposes. Many structures will be gradually and continuously rebuilt so that they never need to be "replaced." Hence, these should be omitted in adding up the requirements for new units. On the other hand, the cumulative investment needed to maintain an existing unit may be as great as that to build a new one. In any event, the resources required for maintenance do need to be part of the total resource estimate.

1.31 While these estimates give a useful overall picture, the split of households between urban and rural areas also must be addressed. The study from which the data in Table 1.10 are drawn provides urban and rural breakdowns which imply a constant 30-70 urban-rural split in the population from 1970 to 2000. By contrast, the figures in Table 1.11 show that in the past decade alone the share of population in urban areas has increased from 32 to 38%, although the share of the largest cities has remained virtually constant. Moreover, NCSO estimates a steady increase in the share of households in urban areas over the remainder of the century./2

/1 This study also reviews the earlier estimates.

/2 See also F.V. Nazaret and D.M. Mortel, "Urbanization in the Philippines 1970-75: An Analysis Based on the Barrio Schedule", NCSO, Manila (1979).

Table 1.10: PROJECTIONS OF HOUSING NEEDS IN THE PHILIPPINES: 1970-2000
(Numbers in Thousands of Units)

	Method A /a		Method B /b	
	Total	Average Annual	Total	Average Annual
A. Backlog as of 1970				
1. Crowding /c	514.9	-	423.7	-
2. Units of light materials/d	565.0	-	565.0	-
3. Subtotal	1,079.9	-	988.8	-
B. Additional Requirements				
4. Population growth	10,374.7	345.8	11,008.9	367.0
5. Normal replacements/e	5,511.0	183.7	5,551.0	183.7
6. Subtotal	15,885.7	529.5	16,519.8	550.7
Grand Total	16,965.6	565.5	17,508.6	583.6

/a UN World Housing Survey Method.

/b UN Component Method.

/c In the Survey Method was computed as number of units required to reduce the density to four persons per room. In the Component Method was computed as the excess of family nuclei over occupied housing units made of strong materials.

/d These dwelling units include those whose walls or roofs are made of bamboo, nipa, cogon, etc., in urban areas, and all "barong-barong", i.e., makeshift dwelling units.

/e The average life span for a dwelling unit is assumed by NCSO to be 50 years for those dwellings units made of concrete, 30 years for dwelling units made of lumber and GI sheets, and 20 years for dwelling units made of bamboo, nipa, cogon, etc.

Source: Compiled from data in NCSO (1979).

Table 1.11: PERCENTAGE OF POPULATION IN URBAN AREAS, 1970-1980

	1970	1975	1980
Urban areas	32	33	38
Largest 60 cities	20	20	21
Metro-Manila /a	11	12	12
Manila	4	4	3

/a National Capital Region.

Source: Tabulations of preliminary 1980 census figures, Nazaret and Mortel (1979), and 1970 census figures.

In addition, the NCSO needs study showed a disproportionate rate - almost double that expected on the basis of population - of units made of light materials in urban areas (see notes to Table 1.10). This suggests that the incidence of dwelling units made of light materials will increase with urbanization, thus making the housing problem even less tractable than indicated by the needs projections presented unless major initiatives are taken.

Income and Housing Expenditures

1.32 There has been considerable debate about the distribution of income in the Philippines./1 Since 1976, a quarterly income survey has been fielded which attempts to capture both in-kind and cash income. Nevertheless, it employs a sampling frame which may well under-represent high-income barangays and thus bias the entire distribution downward. In the absence of other figures, we use those compiled by the Government from its "integrated household survey." The reader should recall later in the report, especially where housing affordability is discussed, that the downward bias in the income distribution data means that the calculations will give the minimum number of households able to afford a particular unit.

/1 See for example, "Aspects of Poverty in the Philippines: A Review and Assessment", IBRD (1980) and M. Mangahas, "On the Construction of an Income Distribution Model", Unpublished, Manila (1978).

1.33 The basic income distribution figures are presented in Table 1.12./1 The sharply higher average incomes of the National Capital Region (Metro-Manila) are immediately evident. The median income in the entire country is between ₱ 6,000 and ₱ 8,000 annually, while in Metro-Manila it is between ₱ 14,000 and ₱ 16,000. The concentration of total income among those in the highest income categories is also readily apparent.

Table 1.12: INCOME IN THE PHILIPPINES, 1980
(Preliminary)

Income Class	Philippines: Number of households %	Philippines: Total family income %	National capital region: Number of households %	National capital region: Total family income %
Under ₱ 1,000	5.0	0.2	0.2	0.0
1,000 - 1,999	7.9	1.0	0.7	0.0
2,000 - 3,999	16.5	4.0	3.5	0.4
4,000 - 5,999	14.1	5.7	7.1	1.3
6,000 - 7,999	11.4	6.5	9.7	2.5
8,000 - 9,999	9.2	6.8	8.0	2.7
10,000 - 11,999	6.1	5.4	5.9	2.4
12,000 - 13,999	5.3	5.6	8.5	4.0
14,000 - 15,999	4.5	5.5	7.2	4.0
16,000 - 19,999	5.7	8.4	9.4	6.3
20,000 - 29,999	6.8	13.3	15.4	14.0
30,000 - 39,999	3.3	9.4	8.8	11.1
40,000 and over	4.2	28.1	15.6	51.2
Mean income (₱)	12,716		26,724	

Source: NCSO.

/1 The figures in Table 1.12 are preliminary in the sense that they are unweighted for the differential rates at which households are sampled from the various strata. Because households in manufacturing strata are oversampled and those in agricultural pursuits are undersampled, the effect of not weighting is to overstate incomes overall. Moreover, the divergence between the weighted and unweighted figures is probably greater for rural areas. Weighted data have been requested and should arrive in time to be incorporated into the final version of this report.

1.34 Beyond the straightforward figures just reviewed there are several aspects of the income generation process in the Philippines that should be understood as background for the ultimate discussion of strategies to improve the housing in urban areas. One is the strength and extent of the family network and the custom for family members outside of the immediate household to assist the household to avail itself of major opportunities such as housing or in times of particular need, e.g., a wedding or a death in the family. Second, there is an extensive pattern of temporary rural - urban labor migration./1 This type of rotational flow has been suggested in particular for construction workers./2 In any event, such visiting workers will very often stay with relatives in the city and contribute in-kind assistance while there and quite possibly bring rice or other food with them from the province. Moreover, the visitors will be prime candidates to assist the family with major modifications to their home, either through a cash gift or contributed labor. Both these factors point to the fact that the purchasing power for major durables is greater than either incomes or savings by themselves would indicate. They also suggest the extraordinary difficulties of gathering accurate income data.

1.35 There has been some confusion in the past about the share of income devoted to housing because the computations grouped all tenure forms together. Table 1.13 presents data for 1975 disaggregated by tenure form, income class

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/1 For example, F.L. Reyes, "Differential Characteristics of Outmigrants with Nonmigrants from the City of Manila, Philippines: 165-70", NCSO Monograph No. 14, Manila (1979) found very high outmigration rates over the 1965-70 period for two groups of persons who were residing in the city of Manila in 1965:

Percent outmigrating	Type of household
51.3	Those not born in Manila and were residing in the province of birth in 1960 but were residing in Manila in 1965
64.5	Those not born in Manila, were residing in a province different from the province of birth in 1960 and were residing in Manila in 1965

/2 Stretton (1981), op.cit.

and location. Several general patterns stand out. The share of income devoted to shelter and utilities declines steadily as income rises. This is consistent with the pattern of a less than unitary income elasticity of demand for housing observed for other countries, and is the opposite of the pattern found in the Philippines using aggregated data./1 In 1975 renter households with incomes of under ₱ 4,000 per year living in urban areas were devoting from 18 to 50% of their income on shelter plus utilities, although squatters are excluded from these calculations, as they are recorded as owner occupants. Out-of-pocket expenditures for homeowners were not collected in the expenditure survey as such, except for utilities outlays. Expenditures for utilities themselves, however, for the lowest income households are 14 and 20% of income in all urban areas and Manila, respectively.

The Structure of Demand

1.36 Quite often housing demand is discussed in a very restrictive framework. For example, the question posed is: assuming most households can afford up to 20-25% of their incomes for housing, how many can afford to own housing? This question assumes that the dwelling is purchased on a ready-to-occupy basis, that the household is unwilling and/or unable to devote more than this share of income to housing, that smaller units are unacceptable, and that conventional financial institution financing is the only way the household could obtain the funds required. In the Philippines, all of these assumptions appear to be more restrictive than necessary.

1.37 Future demand for new units that meet some minimum quality standard will depend on:

(a) the household income distribution, and the growth in incomes over time;

(b) the willingness of households to allocate funds to housing, which in turn depends on their tenure, and if an owner-occupant, whether or not the title is secure, and their preference for housing versus other goods;

/1 See G. Ingram, "Housing Demand in the Developing Metropolis: Estimates from Bogota and Cali, Colombia", IBRD (1981); J. Follain, G.C. Lim, and B. Renand, "The Demand for Housing in Developing Countries: The Case of Korea", J. Urban Economics (1980); E. Jimenez, "The Value of Squatter Dwellings in Developing Countries", IBRD (1980). For the Philippines, see E.A. Tan and G.R. Tecson, "Pattern of Consumption in the Philippines with Particular Reference to Demographic Factors", ILO (1974).

Table 1.13: PERCENTAGE OF INCOME SPENT ON SHELTER AND ON UTILITIES BY TYPE OF TENURE, LOCATION, AND MONTHLY FAMILY INCOME, 1975

	Under ₱ 2,000	2,000-3,999	4,000-9,999	10,000-19,999	20,000 and over
Urban					
Rental					
House and lot					
Shelter	26	17	12	10	9
Fuel, light, etc.	18	11	6	4	3
House only					
Shelter	7	7	3	4	5
Fuel, light, etc.	21	11	10	4	3
Owner Occupied/a					
Imputed rental	16	14	11	11	12
Fuel, light, etc.	14	7	5	4	4
Rural					
Rental					
House and lot					
Shelter	18	12	5	4	2
Fuel, light, etc.	10	11	5	3	4
House only					
Shelter	4	4	1	1	2
Fuel, light, etc.	14	7	7	4	3
Owner Occupied /a					
Imputed rental	11	9	5	4	3
Fuel, light, etc.	13	6	4	2	2
Metro-Manila					
Rental					
House and lot					
Shelter	31	19	9	10	11
Fuel, light, etc.	19	11	6	3	3
House only					
Shelter	12	11	5	5	7
Fuel, light, etc.	19	11	5	4	2
Owner Occupied /a					
Imputed rental	24	22	17	14	17
Fuel, light, etc.	20	13	6	4	4

/a Includes dwellings occupied rent-free.

Source: Unpublished tabulations of the FIES data.

(c) the size, cost, and location of dwellings available for purchase; and

(d) the terms on which financing is available, if any is available at all.

To properly work out potential demand would require estimating the share of households who could "afford" various types of units (i.e. different "entry costs") under alternative financing arrangements.

1.38 Four groups within the formal financial sector are distinguishable. The first involves those households who can afford to pay market mortgage rates (21% for 10-15 years) for housing costing at least ₱ 150,000; this is perhaps 2-3% of all households. The second group consists of those able to purchase complete dwellings under the concessionary terms granted by government or government-related institutions, described in Chapter III. The loans made by these institutions are a major share of all the activity in the formal sector. In 1980 they made 15,233 first mortgage loans, compared to 27,000 dwellings for which building permits were issued in the same year. An upper limit to the potential demand for such loans can be computed under the favorable assumptions of an ₱ 80,000 purchase price, a 0.9 loan-to-value ratio, and a 10% long-term mortgage interest rate. According to preliminary income distribution data from NCSO, about 12% of households nationwide and 26% of those in the National Capital Region could afford this home./1 However, a lower figure would be more realistic because some households are already homeowners satisfied with their housing and some would not qualify for such loans because they do not belong to the groups who qualify for the special terms, e.g., government employees. Nevertheless, a large demand at these terms remains.

1.39 The third group contains households who have access to housing finance at favorable terms because a family member is employed by some major firm or financial institution. This probably constitutes only 1 or 2% of all households, and the incomes of these borrowers probably overlaps heavily with those of the second sector. The final sector includes those households whose incomes preclude them from the other sectors but who have sufficient income and assets to participate in dwelling upgrading and sites and services programs. The bulk of the early participants in such programs in Metro-Manila had 1980 incomes of ₱ 700-800 per month or higher; households in this income class constitute about 40% of the households in the region. This sector is now served exclusively by government agencies with limited resources.

/1 Assuming 25% of income is devoted to mortgage repayments.

1.40 The general situation, then, is one in which private thrift institutions and commercial banks service a very small share of the market. A plethora of government-related agencies make mortgage loans to a much larger share (but still small in absolute terms) at concessionary terms, while the balance, constituting a significantly large proportion of the market, remains unserviced by the formal financial system. At the same time, informal financing is an important complementary element in the latter three sectors just described. It is also key for upgrading units which are owned but which are located on rented or illegally occupied property./1

1.41 An important question in analyzing the extent of demand in future years is the likely rate of growth in family income compared to house prices. In recent years inflation in house price has exceeded overall inflation rates (see paras. 1.24-1.26), and inflation rates have surpassed family income growth. Households will thus increasingly have to accept smaller homes than they have purchased in the past or be unable to enter the formal market. This idea is borne out by two other factors. First, real wage rates in urban areas have declined sharply since 1972; in 1980 they were only about 60% of their 1972 levels (Table 1.14). Second, labor force participation rates, especially of women, have risen significantly in recent years (Table 1.15) after being quite steady over the first half of the decade./2 Increased participation has helped to offset declining real wage rates and sustain family incomes. At some point, increases in labor force participation will slacken - either because all "possible" workers will be in the labor force or because of the discouraged searcher effect. In any case, incomes will be further reduced relative to housing prices, and the upgrading of the average housing quality will be extremely difficult in the absence of changes in the type of housing supplied or government assistance.

Government Activity /3

1.42 Faced with a steadily increasing housing deficit and given the political economy of shelter, the Government has intervened in the housing sector in a variety of ways. The focus of the efforts of public sector agencies has essentially been on middle-income housing; in fact, until the

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/1 See W. Keyes, "The Freedom to Build Project in the Philippines", in P.J. Swan (ed.), "The Practice of Peoples Participation: Seven Asian Experiences in Housing the Poor", Asian Institute of Technology (1980).

/2 There was a major change in the questions about labor force participations in 1976, so that data pre- and post-1976 are incomparable. However, participation rates for 1971-75 were very steady for both men and women.

/3 For detailed discussion, see Chapters III and VI and Appendix B.

Table 1.14: INDEX OF AVERAGE BASIC WAGE RATES OF LABORERS IN INDUSTRIAL ESTABLISHMENTS IN METRO MANILA: 1973-80 /a

	Skilled workers		Unskilled workers	
	Real	Nominal	Real	Nominal
1973	92	105	90	103
1974	76	115	73	111
1975	73	120	73	120
1976	71	124	72	126
1977	73	138	70	133
1978	76	154	68	138
1979	71	170	61	146
1980	64	181	53	152

/a 1972 = 100.

Source: Central Bank of the Philippines.

Table 1.15: LABOR FORCE PARTICIPATION RATES BY SEX AND LOCATION 1977-1979 /a

	Philippines	Urban	Rural
Males			
1977	77.9	70.8	83.6
1978	82.1	72.8	86.8
1979	82.4	/b	/b
Females			
1977	39.0	40.5	35.0
1978	44.1	45.1	43.0
1979	46.9	/b	/b

/a Data are for the second quarter of each year.

/b Figures not available.

Source: Tabulations provided by NCSO.

mid-seventies, its intervention in the urban low-income category was primarily regulatory, if not punitive, in approach as, for example, in its slum clearance programs. Since 1976, however, some reorientation of shelter policy has been underway, away from squatter removal and relocation, towards in situ improvement of slums and expansion of urbanized land for low-income settlement through sites and services projects. Nevertheless, a major part of government-delivered housing (e.g. BLISS /1) and almost all homes financed by public sector financial institutions continue to be for middle or higher-income groups, for whom the subsidized finance has had significant impact, particularly in Metro-Manila.

D. Housing Finance: A Prologue

1.43 An important implication of the segmented structure of the urban housing market is the key role that housing finance assumes as a catalytic agent in the various compartments. That is, the targeting of housing finance has strong stimulative effects in a particular sector but the spillovers to other sectors may be quite limited. Thus, when development period financing /2 demand is channeled there as well, to the extent that the incomes of would-be purchasers permit. The same effect results from the targeting of mortgage financing: financial institutions and government-associated institutions establish a market by setting mortgage limits and possibly even precommitting take-out financing./3 Developers respond by gearing their production to this market.

1.44 Housing finance in the Philippines has been characterized by both development period and mortgage financing being focused essentially on two segments of the market, luxury housing and "mass housing" in the ₱ 80,000 to ₱ 150,000 ranges. This harmony of supplier and household financing has made these the vibrant sectors of the housing market, but at the cost of undernourishment elsewhere.

/1 Bagong Lipunan Improvement of Sites and Services. The name may however, be a misnomer. See Appendix B.

/2 Development period financing is a loan to finance the cost of preparing undeveloped land for the construction of improvements; it may include grading or levelling of the land, construction of roads, installation of utilities, etc.

/3 A take-out loan is a permanent mortgage loan that is funded (money is advanced) at completion of construction or on compliance with other conditions in the loan commitment, with the funds being used to pay off (take-out) the construction lender

1.45 It appears that making either take-out or development financing available in a market segment could vitalize that segment. Guaranteed takeout mortgage financing, in the sense of a precommitment of funds, could enable developers to raise funds outside of financial institutions. Likewse, development financing for some types of housing could be sufficient to induce developers to do some speculative building. The risk is less to both the developer and financial institutions if the financing is coordinated. Indeed, the key role of government in housing finance is presumably to demonstrate the profitability of lending in the neglected sectors.

1.46 The availability and cost of housing finance can have a dramatic effect on which households are able to shift into the formal housing sector, i.e., a unit meeting minimum health and shelter standards with security of tenure. This point is illustrated by the data in Table 1.16 which show the percentage of Filipino households who could afford to purchase a serviced site with a core unit under alternative mortgage terms. In all cases the household is assumed to devote 30% of its income to mortgage payments. The three cases presented differ with regard to loan-to-value ratio, interest rate, and mortgage term. Cases 1 and 3 illustrate the effect of a lower interest rate (12 vs 15%) and longer repayment period (25 vs 15 years): with the more favorable terms 63% of all households could afford the unit compared to 54% under the less favorable terms. Both of these cases, though, use a 50% loan-to-value ratio - a very formidable downpayment hurdle for most households. Lowering the entry barrier by raising the loan-to-value ratio to 90% and keeping the other favorable terms (12%, 25 years) causes those who can afford the unit to fall to 41% because of the greater debt that must be serviced. Without financing, however, the barriers to purchase are insurmountable for all but a comparatively few high-income families.

1.47 The remainder of this report accepts the conclusion implicit above, i.e. the availability of housing finance is a major determinant of the shelter situation in the Philippines. Increasing the availability of housing finance, however, is not without costs and raises a variety of economic, financial and institutional issues, the identification and analysis of which constitute the primary object of study.

Table 1.16: EFFECTS OF HOUSING FINANCE ON AFFORDABILITY OF A SITES AND SERVICES PROJECT IN 1980 /a

	Case		
	1	2	3
Mortgage terms			
loan-to-value ratio	.5	.9	.5
interest rate	15	12	12
loan period (years)	15	25	25
Share of income going to loan repayment (%)	30	30	30
Monthly payment (₱)	140	190	110
Share of all Filipino households who could afford units (%)	54	41	63

/a Using preliminary 1980 NCSO income distribution data and updated cost figures from the Urban III appraised report.

II. THE FINANCIAL SECTOR

2.01 This chapter presents an overview /1 of the financial sector in the Philippines paying particular attention to the structural features of relevance to housing finance./2 More specifically, the focus is on the availability, or lack thereof, of long-term financial resources in the system.

A. Introduction

2.02 The financial sector in the Philippines is relatively sophisticated; it has rapidly grown and evolved during the last decade. The 1970s saw the broadening of the range of financial assets and an increase in the proportion of private savings in financial form. Over the period 1975-80 the growth in total gross assets averaged 8% p.a. in real terms while real GNP grew at 6%. However, the system continues to be unable to provide adequate long-term finance which is a major drawback given the needs of industrial development and other sectors, such as housing.

2.03 In 1980, total assets of the financial system stood at ₱ 311.1 billion or 1.15 times GNP. Table 2.1 depicts the structure and total assets of the financial system in 1980 and the real rates of growth of the various components since 1960; Table 2.3 portrays the composition each year between 1975 and 1980.

2.04 The largest part of the financial sector is the banking system comprising the commercial banks, thrift institutions, rural banks and specialized government-owned banks, which accounted for more than 60% of the total assets of the financial system. The commercial banks, the largest of which is the government-owned Philippines National Bank (PNB), account for almost 45% of the assets in the financial system. Thrift banks, which include savings banks, private development banks (PDBs) and stock savings and loans associations (SSLAs), have had the most rapid growth as a group during the second half of the 1970s, almost tripling their assets in real terms over this period. Savings (and mortgage) banks invest depositors' monies in bonds and housing loans, while development banks provide credit to small- and medium-scale enterprises and SSLAs extend credit for up to one year for a variety of purposes. Their sources of funds are primarily savings and time deposits. Rural banks are chiefly unit banks with the function of providing

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/1 A more complete description of the financial system in the Philippines is available in "The Philippines: Aspects of the Financial Sector", World Bank, May 1980.

/2 The housing finance system itself is described in detail in the following chapter of this report.

Table 2.1: PHILIPPINES: STRUCTURE OF FINANCIAL SYSTEM, 1980
(Billion pesos and percentages)

	Asset size		Real rates of growth p.a.			
	Amount (Pesos)	Composition	1960-65	1965-70	1970-75	1975-80
		(%)				
Central Bank	65.4	21.1	4.0	6.3	16.8	8.0
Banking System						
Commercial Banks	138.4	44.5	17.2	7.9	12.3	8.8
Private	85.1	27.4	17.0	8.8	14.0	7.3
Government	34.6	11.1	17.5	6.3	8.6	2.3
Foreign	18.7	6.0	-	-	-	-
Thrift Banks	10.6	3.4	28.2	15.0	-2.9	24.2
Savings	7.4	2.4	25.3	14.7	-5.5	25.3
Private development	1.6	0.5	46.5	9.2	-0.8	18.3
Savings & loan associations	1.6	0.5	-	-	17.3	25.3
Rural Banks	5.6	1.8	23.0	10.5	14.0	3.2
Other Banks	34.2	11.0	10.0	10.7	7.4	11.4
Development Bank of the Phil.	28.9	9.3	10.0	10.7	3.4	12.1
Land Bank	5.2	1.7	-	-	128.0	7.6
Philippine Amanah Bank	0.1	0.0	-	-	-	-8.4
Total Banking System	188.8	60.7	16.4	8.8	10.9	9.6
Nonbank Financial Intermediaries						
Insurance Companies	27.5	8.9	7.0	4.7	-4.5	6.3
Government /a	18.5	6.0	4.8	4.1	-3.0	7.1
Private	9.0p	2.9	13.3	6.2	-8.0	5.0
Investment Institutions	25.6	8.2	-	16.6	11.2	7.8
Finance companies	11.9	3.8	-	9.3	-3.5	14.9
Investment companies /b	5.0	1.6	-	-	-	7.2
Others /c	8.7	2.8	-	37.1	25.8	0.9
Trust Operations	1.7	0.5	-	23.7	18.8	-10.1
Other Financial Intermediaries	2.1	0.6	-8.4	22.3	13.9	-6.8
Security dealers & brokers	1.0	0.3	-	111.8	29.7	-8.1
Nonbank savings & loan assn.	0.3	0.0	-	-	-5.3	11.8
Agricultural credit admin.	0.5	0.2	-23.3	12.0	-9.0	-9.5
Pawnbroker	0.3	0.0	-	-	-	11.8
Total Nonbank Financial Intermediaries	56.9	18.2	11.5	8.5	2.7	9.5
Total Financial System	311.1	100.0	12.0	8.3	10.1	8.2

/a Includes GSIS and SSS.
/b Includes mutual funds.
/c Includes investment houses.

Note: (-) = insignificant
n.a. = not available
p = preliminary

Source: Central Bank of the Philippines.

Table 2.2: TOTAL ASSETS OF THE FINANCIAL SYSTEM: 1975-80
(Amount in billion pesos, end-of-year figures)

	Amount						As a % of total					
	1975	1976	1977	1978	1979	1980	1975	1976	1977	1978	1979	1980
Central Bank	26.1	29.0	29.0	38.4	51.0	65.4	21.3	20.3	18.3	19.2	20.2	21.0
Banking System												
Commercial Banks	53.2	58.7	68.7	89.8	113.9	138.4	43.4	41.2	43.3	45.0	45.0	44.5
Private	35.1	40.2	42.6	56.4	70.0	85.1	28.6	28.2	26.9	28.2	27.7	27.4
Government	18.1	18.5	18.6	22.3	28.9	34.6	14.8	13.0	11.7	11.2	11.4	11.1
Foreign	-	-	7.5	11.1	15.0	18.7	-	-	4.7	5.6	5.9	6.0
Thrift Banks	2.1	3.0	4.1	5.8	7.7	10.6	1.6	2.2	2.6	2.9	3.0	3.4
Savings	1.4	2.0	2.8	3.9	5.4	7.4	1.1	1.4	1.8	2.0	2.1	2.4
Private development	0.4	0.5	0.6	0.8	1.0	1.6	0.3	0.4	0.4	0.4	0.4	0.5
Savings & loan associations	0.3	0.5	0.7	0.9	1.3	1.6	0.2	0.4	0.4	0.5	0.5	0.5
Rural Banks	2.8	3.0	3.4	4.1	5.0	5.6	2.3	2.1	2.1	2.1	2.0	1.8
Other Banks	11.8	15.2	19.1	21.7	27.4	34.2	9.6	10.7	12.1	10.8	10.8	11.0
Development Bank of the Phil.	9.6	12.7	15.9	18.1	23.2	28.9	7.8	8.9	10.0	9.0	9.2	9.3
Land Bank	2.1	2.4	3.1	3.5	4.1	5.2	1.7	1.7	2.0	1.8	1.6	1.7
Philippine Amanah Bank	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Total Banking System	69.9	80.0	95.3	121.2	154.0	188.8	56.9	56.2	60.1	60.8	60.8	60.7
Nonbank Financial Intermediaries												
Insurance Companies	11.9	15.2	17.5	21.6	24.6	27.5	9.7	10.6	11.0	10.8	9.8	8.9
Government /a	7.7	10.0	11.3	13.8	15.6	18.5	6.3	7.0	7.1	6.9	6.2	6.0
Private	4.2	5.2	6.2	7.8	9.0	9.0	3.4	3.6	3.9	3.9	3.6	2.9
Investment Institutions	10.3	13.2	14.5	16.0	20.4	25.6	8.3	9.1	9.2	8.0	8.0	8.2
Finance companies	3.5	4.6	5.8	6.8	9.7	11.9	2.8	3.2	3.7	3.4	3.8	3.8
Investment companies	2.0	3.8	3.9	4.4	4.1	5.0	1.6	2.6	2.5	2.2	1.6	1.6
Others	4.8	4.8	4.8	4.8	6.6	8.7	3.9	3.3	3.0	2.4	2.6	2.8
Trust Operations	2.6	3.3	0.5	0.8	1.2	1.7	2.1	2.3	0.3	0.4	0.5	0.5
Other Financial Intermediaries	2.0	2.1	1.7	1.9	1.9	2.1	1.7	1.5	1.1	0.8	0.7	0.7
Security dealers & brokers	1.1	1.1	1.0	1.1	1.0	1.0	0.9	0.8	0.6	0.6	0.4	0.3
Nonbank savings & loan assn.	0.1	0.1	0.1	0.2	0.3	0.3	0.1	0.1	0.1	0.0	0.1	0.1
Agricultural credit admin.	0.7	0.7	0.4	0.4	0.4	0.5	0.6	0.5	0.3	0.2	0.2	0.2
Pawnbrokers	0.1	0.2	0.2	0.2	0.2	0.3	0.1	0.1	0.1	0.0	0.0	0.0
Total Nonbank Intermediaries	26.8	33.8	34.2	40.3	48.1	56.9	21.8	23.5	21.6	20.0	19.0	18.3
Total Financial System	122.8	142.8	158.5	199.9	253.1	311.1	100.0	100.0	100.0	100.0	100.0	100.0

/a Includes Government Service Insurance Systems (GSIS) and Social Security Systems (SSS).

Source: Central Bank of the Philippines

credit to farmers, merchants and cooperatives, the main source of funds being the government. The banking system also includes three specialized government-owned banks, the dominant one being the Development Bank of the Philippines (DBP)/1 which is the principal source of long-term credit in the nation; its ₱ 28.9 billion in assets in 1980 accounted for 15.3% of those in the banking sector or 9.3% of the financial system.

2.05 The private sector group among the nonbank financial intermediaries includes the insurance companies as well as finance companies, trust funds and investment houses; its assets amount to about 12% of the total financial system or two-thirds of the nonbank sector. The insurance companies are important institutional investors on the securities market; in addition to real estate mortgages their loans to policy holders including housing loans comprise about one-fifth of their portfolio. The activities of the finance and investment companies remain specialized to consumer finance and security underwriting respectively, with neither having any real role in housing finance.

2.06 The public sector agencies among the nonbank financial intermediaries include the Social Security System (SSS) and the Government Service Insurance System (GSIS) which are major institutional sources of long-term finance in the Philippines./2 Both are public pension funds with the former covering all formal sector employees except those in government service who are covered by GSIS. Their assets of ₱ 18.5 billion are about one-third of the nonbank sector or 6% of the total assets of the financial system. SSS has been investing primarily in government securities, while GSIS is involved to a signficant extent in real estate loans and direct equity investments as well. Both agencies provide a variety of loans, including housing loans, to policy holders.

2.07 The capital market has been marginal in the Philippines and is unlikely to mature significantly in the near future. On the other hand, the money market, which was organized in 1966 and grew very rapidly in the early 1970s, has assumed major significance in the financial system.

2.08 As the total resources of the financial system have increased dramatically during the last five years, so have the number of bank and nonbank facilities; Metro-Manila continues to maintain its primacy in the

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/1 The other two are the Land Bank of the Philippines (LBP) and the Philippine Amanah Bank (PAB).

/2 The National Investment and Development Corporation (NIDC) and the Agricultural Credit Administration (ACA) are other members of this category.

geographical distribution. In 1980, the total number of financial institutions in operation was 4,973 (Table 2.3) of which approximately one-half were head offices predominantly located in Metro-Manila. The figures also reveal a much more rapid expansion of facilities of the banking institutions, especially thrift banks, and of branch operations in particular.

2.09 The government initiated a series of reforms in 1980 designed to increase the efficiency and competition in the banking system. The essential features include measures to provide the framework for the evolution of a more flexible and less specialized banking system through the introduction of universal banking; monetary policy reforms to encourage term-lending and term-transformation; and a gradual deregulation of interest rates. As a result, both the system and policy are still in a state of transition.

B. The Banking Sector

2.10 Commercial banks play the dominant role in the banking sector. For the most part, the credits outstanding in commercial bank portfolios are of a short-term nature, partially due to the rapid development of the money market in the Philippines, and partially because of the uncertainty in the future level and direction of inflation and interest rate. On the other hand, the changing structure of commercial banks' assets and liabilities shows that the banking system has increased its level of medium- and long-term liabilities (Table 2.4) allowing for a situation where term transformation /1 may be increased by commercial banks with the availability of such funds. From 1978 to 1980, medium- and long-term funds have increased from 45% to about 66% of total liabilities. Time and savings deposits combined now account for 82% of total commercial bank deposits (Table 2.5). Since savings deposits are legally liquid, the important feature to note is the sharp increase in time deposits which have increased their share of total deposits from 19% to 51% during 1970-80.

2.11 Table 2.6 displays the structure of peso time deposits in the banking system. For the private institutions, the bulk of these deposits bear maturities greater than two years. For example, over 76% of commercial bank deposits have maturities of two years or above, with nearly 45% carrrying maturities greater than three years. This pattern is significant when viewed against the tendency of banks to lend only for short periods.

2.12 On the asset side, the steady pattern of about two-thirds of the total lending of commercial banks going to loans and discounts, most of which are in the short-term spectrum, seems have continued through 1980. (Table 2.7

/1 Term transformation is the use of shorter term liabilities as the basis for longer-term assets.

Table 2.3 NUMBER OF FINANCIAL INSTITUTIONS IN OPERATION, 1975-80
(As of December 31)

	1975		1976		1977		1978		1979		1980		Percentage change 1975-80	
	Total offices	of which head office	Total offices	of which head office	Total offices	of which head office	Total offices	of which head office	Total offices	of which head office	Total offices	of which head office	Total offices	of which head office
Banking Institutions	2,129	891	2,461	934	2,669	998	2,904	1,092	3,206	1,171	3,364	1,164	58.0	30.6
Commercial banks	996	33	1,109	31	1,208	32	1,287	32	1,405	32	1,503	32	50.9	-3.0
Thrift banks	246	87	392	95	447	113	509	126	589	134	673	144	173.6	63.6
Private development banks	86	33	98	33	109	34	117	36	130	38	154	43	79.1	30.3
Savings & mortgage banks	91	10	162	10	184	10	207	10	236	10	268	10	189.1	-9.1
Stock SLAs	69	44	132	52	154	69	185	80	223	86	251	91	209.9	106.8
Rural banks	820	768	887	805	933	850	1,024	931	1,123	1,002	1,096	985	33.6	28.2
Specialized government banks	67	3	73	3	81	3	84	3	89	3	92	3	37.3	-
Nonbank Financial Institutions	1,267	1,232	1,334	1,279	1,246	1,159	1,302	1,198	1,426	1,293	1,554	1,394	22.7	13.1
Investment houses	40	13	43	12	56	12	56	12	57	12	62	12	55.0	-7.7
Finance companies	319	194	348	219	338	244	419	263	478	300	531	342	66.5	76.3
Investment companies	117	117	59	59	59	59	58	58	63	63	62	62	169.6	169.6
Securities dealers/brokers	23	23	126	126	128	128	130	130	137	137	141	141	20.5	20.5
Fund managers	194	194	178	178	9	9	9	9	9	9	12	12	-	-
Lending investors	38	38	31	30	34	33	40	39	53	50	61	57	60.5	50.0
Pawnshops	462	428	472	430	492	447	508	460	546	498	598	544	29.4	27.1
Money brokers	-	-	2	2	3	3	4	4	5	5	5	5	-	-
Nonstock SALs	67	67	68	68	70	70	71	71	71	71	72	72	7.5	7.5
Mutual RLAs	7	7	7	7	7	7	7	7	7	7	7	7	-	-
Private insurance companies /a	n.a.	149	n.a.	146	n.a.	145	n.a.	143	n.a.	141	n.a.	137	-	-
GSIS /a and SSS	n.a.	2	n.a.	2	n.a.	2	n.a.	2	-	-	-	-	-	-
Government nonbank financial institutions	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total	3,396	2,123	3,795	2,213	3,915	2,157	4,206	2,290	4,632	2,464	4,918	2,558	44.8	20.5

/a Refers to fiscal year ending June 30.

Source: Central Bank of the Philippines.

Table 2.4: ASSETS AND LIABILITIES OF COMMERCIAL BANKS: 1970-80
(% of total)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Cash & other cash items	4.6	4.6	3.4	4.8	4.3	3.9	3.7	3.1	2.6	2.8	2.4
Due from CB & other banks	9.6	9.2	12.8	14.1	13.6	13.6	10.6	9.0	9.5	12.1	13.3
Loans & discounts	65.5	66.1	64.8	57.5	62.3	61.3	64.2	64.4	64.8	65.2	64.0
Investments	12.5	11.8	9.4	13.5	10.9	11.6	12.3	13.9	12.7	11.1	9.7
Other assets /a	7.8	8.3	9.6	10.1	8.9	9.6	9.2	9.6	10.4	8.8	10.6
Liabilities											
Capital & reserves	10.4	10.4	9.9	9.8	8.9	9.7	9.8	10.2	8.9	8.0	7.7
Demand deposits	17.5	18.1	18.7	17.8	14.3	12.5	12.7	13.2	10.7	10.0	9.2
Savings deposits	26.7	27.5	23.4	23.2	19.5	16.8	18.8	19.3	19.3	18.3	16.7
Time deposits	10.4	11.8	12.8	10.3	9.5	9.7	12.9	16.7	18.6	20.8	26.6
Bills payable /b	13.9	13.9	15.4	19.7	28.9	34.3	30.5	23.7	24.2	24.6	23.7
Other liabilities /c	21.1	18.3	19.8	19.2	18.9	17.0	15.3	16.9	18.3	18.3	16.1

/a Includes premises, furniture, equipment and other real property.

/b Includes deposit substitutes.

/c Includes dues to banks and officers' and managers' checks.

Source: Central Bank of the Philippines.

Table 2.5: STRUCTURE OF DEPOSITS OF COMMERCIAL BANKS: 1970-80
(Million pesos)

End of year	Demand deposits	Savings deposits	Time deposits	Total deposits
1970	2,459	3,757	1,470	7,686
	(32.0)	(48.9)	(19.1)	(100.0)
1971	2,916	4,410	1,890	9,216
	(31.6)	(47.9)	(20.5)	(100.0)
1972	3,735	4,670	2,559	10,964
	(34.1)	(42.6)	(23.3)	(100.0)
1973	5,276	6,865	3,044	15,185
	(34.7)	(45.2)	(20.1)	(100.0)
1974	6,062	8,281	4,032	18,375
	(33.0)	(45.1)	(21.9)	(100.0)
1975	6,665	8,951	5,131	20,747
	(32.1)	(43.1)	(24.7)	(100.0)
1976	7,482	11,022	7,558	26,062
	(28.7)	(42.3)	(29.0)	(100.0)
1977	9,045	13,263	11,470	33,778
	(26.8)	(39.3)	(33.9)	(100.0)
1978	9,602	17,314	16,737	43,653
	(22.0)	(39.7)	(38.3)	(100.0)
1979	11,397	20,884	23,717	55,998
	(20.4)	(37.3)	(42.3)	(100.0)
1980	12,792	23,047	36,791	72,630
	(17.6)	(31.7)	(50.7)	(100.0)

Note: Figures in parentheses indicate percentages of the total.

Source: Central Bank of the Philippines.

Table 2.6: BREAKDOWN OF PESO TIME DEPOSIT AS TO MATURITY AND INTEREST RATE: 1975-80
(Million pesos)

	I. With Maturities of Two (2) Years and Below						II. With Maturities of Above Two (2) Years					Total
	Total	90 days 8%	180 days 9%	360 days 10%	2 yrs 12-14%	540 days 11%	Total	Above 2 yrs up to 3 yrs 12-15%	Above 3 yrs up to 4 yrs 12-16%	Above 4 yrs up to 5 yrs 14-20%	Above 5 yrs 15%	I & II
Commercial Banks												
1975	1,969.3	108.1	108.6	1,491.8	244.4	16.4	564.6	521.1	9.0	27.8	6.7	2,533.9
1976	2,939.4	215.9	193.1	1,877.7	630.1	22.6	1,763.6	1,070.6	93.8	566.4	32.8	4,703.0
1977	4,591.6	346.9	279.3	2,556.0	1,215.3	194.1	2,968.6	1,684.8	288.3	969.3	26.2	7,560.2
1978	4,643.7	324.1	308.1	2,654.1	1,161.5	195.9	4,559.7	2,115.6	612.0	1,780.0	52.1	9,203.4
1979	4,286.0	333.7	336.5	2,555.4	922.4	138.0	6,222.3	2,835.4	1,081.6	2,185.0	120.3	10,508.3
1980	3,564.1	448.2	323.6	1,742.8	1,005.7	43.8	11,526.1	4,754.1	1182.9	4,931.6	657.5	15,090.2
Savings Banks												
1975	97.7	11.6	8.3	58.1	19.7	-	149.4	149.3	0.1	-	-	247.1
1976	239.9	33.9	22.5	113.9	69.6	-	66.2	65.8	0.4	-	-	306.1
1977	467.4	58.0	72.7	220.9	112.3	3.5	190.5	188.5	0.3	1.4	0.3	657.9
1978	638.7	83.4	69.8	355.9	125.9	3.7	475.3	470.4	0.5	4.2	0.2	1,114.0
1979	828.2	100.5	189.7	447.5	84.6	5.9	817.2	770.6	19.5	27.0	0.1	1,645.4
1980	796.7	100.5	98.6	521.7	71.6	4.3	1,063.2	907.9	82.4	69.6	3.3	1,859.9
Private Development Banks												
1975	27.2	2.7	1.4	14.2	8.9	-	19.8	13.9	0.7	2.0	3.2	47.0
1976	37.7	4.0	3.4	19.2	11.1	-	46.8	37.2	1.0	6.1	2.5	84.5
1977	51.4	7.2	3.7	24.5	16.0	-	63.6	58.7	0.9	2.8	1.2	115.0
1978	64.5	7.4	6.7	32.3	18.1	-	90.5	80.2	1.2	4.2	4.9	155.0
1979	88.5	14.5	8.0	48.5	17.5	-	127.1	98.5	23.4	3.9	1.3	215.6
1980	119.6	20.1	14.0	65.3	20.2	-	207.9	159.4	5.3	43.1	0.1	327.5
Development Bank of the Phil.												
1975	295.5	2.1	5.0	280.6	7.8	-	490.3	40.2	50.1	400.0	-	785.8
1976	422.7	6.0	38.6	364.5	8.6	5.0	1,005.2	40.2	565.0	400.0	-	1,427.9
1977	987.3	8.8	18.6	379.3	575.5	5.1	425.2	425.2	-	-	-	1,412.5
1978	508.3	16.5	26.3	340.8	105.9	18.8	0.3	0.3	-	-	-	508.6
1979	581.5	29.9	55.2	387.8	95.9	13.7	5.5	5.5	-	-	-	588.0
1980	568.0	16.6	19.3	414.5	109.9	7.7	3.4	3.4	-	-	-	571.4
Land Bank of the Philippines												
1975	190.6	0.3	-	190.3	-	-	-	-	-	-	-	190.6
1976	213.2	1.0	189.2	12.6	10.1	0.3	0.3	0.2	0.1	-	-	213.5
1977	305.9	197.9	100.7	7.1	0.2	-	0.8	0.4	0.3	0.1	-	306.7
1978	235.9	2.0	144.5	78.7	10.7	-	5.8	5.5	0.2	0.1	-	241.7
1979	281.0	7.7	8.9	247.2	14.4	2.8	7.4	6.3	0.7	0.4	-	288.4
1980	335.1	14.0	9.2	288.7	18.4	4.8	4.1	0.9	0.1	3.1	-	339.2
Phil. Amanah Bank												
1975	-	-	-	-	-	-	-	-	-	-	-	-
1976	0.1	0.1	-	-	-	-	-	-	-	-	-	0.1
1977	1.2	0.6	-	0.6	-	-	-	-	-	-	-	1.2
1978	3.0	0.8	1.7	0.4	0.1	-	-	-	-	-	-	3.0
1979	4.1	2.2	1.4	0.4	0.1	-	-	-	-	-	-	4.1
1980	2.6	0.7	-	1.5	0.4	-	-	-	-	-	-	2.6

Source: Central Bank of the Philippines.

Table 2.7: LOANS OUTSTANDING OF COMMERCIAL BANKS BY MATURITY: 1977-80
(Million pesos)

End of year	Demand	Short-term	Intermediate-term	Long-term	Total
1977	7,489.8 (18.7)	26,766.9 (66.6)	4,233.6 (10.5)	1,682.6 (4.2)	40,172.9 (100.0)
1978	9,163.5 (16.9)	35,226.9 (65.1)	5,548.7 (10.3)	4,138.8 (7.7)	54,077.9 (100.0)
1979	10,636.8 (15.7)	37,601.3 (55.0)	9,388.8 (13.7)	10,637.3 (15.6)	68,264.2 (100.0)
1980	10,458.2 (13.5)	49,843.8 (64.6)	7,746.8 (10.1)	9,149.3 (11.8)	77,198.1 (100.0)

Note: Figures in parentheses indicate percentages of the total.

Source: Central Bank of the Philippines.

Table 2.8: TOTAL LOANS OUTSTANDING OF COMMERCIAL BANKS BY INDUSTRY:1977-80
(Million pesos)

End of year	Agriculture, fishery & forestry	Mining and quarrying	Manufacturing	Electricity, gas & water	Construction	Wholesale & retail trade	Transport, storage & communication	Financing insurance & business services	Real estate	Community, social & personnel services	Total
1977	5,447.6	1,577.5	13,126.4	114.8	886.8	11,830.5	797.8	2,575.7	1,810.5	2,005.3	40,172.9
	(13.6)	(3.9)	(32.7)	(0.3)	(2.2)	(29.4)	(2.0)	(6.4)	(4.5)	(5.0)	(100.0)
1978	5,770.3	3,610.1	17,490.4	314.7	1,556.1	14,155.9	1,084.1	3,299.8	2,041.5	4,755.0	54,077.9
	(10.7)	(6.7)	(32.3)	(0.6)	(2.9)	(26.2)	(2.0)	(6.1)	(3.8)	(8.8)	(100.0)
1979	8,120.2	5,507.8	22,104.6	763.6	2,043.6	14,045.6	1,746.4	6,140.5	2,620.4	5,171.5	68.264.2
	(11.9)	(8.0)	(32.4)	(1.1)	(3.0)	(20.6)	(2.6)	(9.0)	(3.8)	(7.6)	(100.0)
1980	12,009.7	7,334.3	27,053.3	644.7	2,722.7	11,210.7	1,965.9	7,914.0	2,297.9	4,044.9	77,198.1
	(15.6)	(9.5)	(35.1)	(0.8)	(3.5)	(14.5)	(2.5)	(10.3)	(3.0)	(5.2)	(100.0)

Note: Figures in parentheses indicate percentages of the total.

Source: Central Bank of the Philippines.

and 2.8). It indicates the disinclination of private financial institutions in general to engage in term transformation which has been an important factor in the lack of long-term capital in the Philippines. Profitability in short-term lending, the unwillingness of the Central Bank to discount commercial paper with maturities over one year and the interest rate risk associated with long-term lending are reasons why the commercial banks are hesitant to move into long-term markets. The financial reforms of 1980 and and the establishment of a secondary market may change this aversion (see Chapter V).

2.13 It is precisely to fill this gap that the specialized government banks were established. The credits of DBP, LBP and PAB are predominantly long term. However, their role in term-transformation is limited since deposits account for only a small portion of the total funds raised; their funds come largely from the sale of seven-year maturity securities or from government sources.

C. Other Financial Intermediaries

2.14 The lending activities of the insurance companies, like those of commercial banks are confined to the short-end of the maturity spectrum and support industrial and commercial activity. Lending to households is confined to policy loans to individual customers and mortgage loans for very expensive dwelling units. Table 2.9 shows the composition of the aggregate portfolios of both life and nonlife insurance companies over the past decade. There has been over that period a gradual reorientation of insurance company assets away from mortgages, real property and stocks toward bonds and other investments. These other investments have been predominantly short-term in nature, usually money market placements.

2.15 The loans and investments of the private non-bank financial intermediaries are, however, dwarfed by those of SSS and GSIS. These two public agencies are major institutional investors in intermediate-term government securities and play an important role in the housing finance system as well. Tables 2.10 and 2.11 display the investment portfolio of SSS and GSIS respectively over the last decade.

2.16 In the case of SSS there has been a relative shift of the portfolio toward government securities, particularly DBP/PNB notes, and away from housing loans and private securities. For example, the portfolio share of DBP/PNB notes has increased from 20% in 1970 to 44% in 1980, while housing loans droppped from 40% to 20% over the same period. The reason for this reversal are two-fold. On the one hand, rising interest rates have induced SSS to switch to government securities; on the other hand, the mortgage amount ceiling imposed by SSS has made these loans less useful as house prices have escalated and the demand for mortgage loans has fallen off (see Chapter III).

Table 2.9: CONSOLIDATED INVESTMENTS OF LIFE AND NON-LIFE INSURANCE COMPANIES OPERATING IN THE PHILIPPINES: 1970-79
(Amounts in millions of pesos)

Investment structure	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Real estate owned	229.3 (18.6)	284.9 (20.2)	294.6 (20.1)	359.2 (16.1)	326.1 (13.0)	306.3 (11.1)	323.6 (9.7)	389.9 (10.8)	404.7 (9.7)	438.3 (9.2)
Mortgage loans on real estate	170.7 (13.8)	180.9 (12.8)	184.1 (12.6)	167.0 (7.5)	218.3 (8.8)	271.2 (9.8)	288.2 (8.7)	311.2 (8.6)	329.1 (7.9)	398.9 (8.3)
Collateral loans on stocks and bonds	11.8 (1.0)	21.2 (1.5)	13.6 (0.9)	9.8 (0.4)	19.2 (0.8)	66.3 (2.4)	97.4 (2.9)	122.4 (3.4)	87.1 (2.1)	62.1 (1.3)
Policy loans	296.2 (24.0)	333.3 (23.6)	343.3 (23.4)	411.2 (18.4)	461.8 (18.5)	530.0 (19.2)	612.6 (18.4)	707.5 (19.5)	817.3 (19.6)	952.9 (19.9)
Stocks	317.8 (25.7)	285.8 (20.2)	269.0 (18.3)	545.8 (24.4)	453.7 (18.1)	461.7 (16.7)	636.1 (19.1)	553.1 (15.3)	566.1 (13.6)	651.9 (13.6)
Bonds	138.2 (11.2)	198.7 (14.1)	202.6 (13.8)	374.6 (16.7)	495.7 (19.8)	609.5 (22.1)	788.9 (23.7)	826.0 (22.9)	1,017.2 (24.4)	1,029.8 (21.5)
Fixed deposits	20.5 (1.7)	17.7 (1.2)	13.8 (0.9)	21.7 (1.0)	24.0 (1.0)	22.4 (0.8)	34.5 (1.0)	53.9 (1.5)	84.1 (2.0)	240.5 (5.0)
Other investments	50.9 (4.1)	89.1 (6.3)	145.9 (9.9)	348.3 (15.5)	501.0 (20.0)	501.0 (17.7)	549.0 (16.5)	649.7 (18.0)	865.7 (20.8)	1,012.1 (21.1)
Total	1,235.4	1,411.6	1,466.9	2,237.6	2,499.8	2,756.6	3,330.3	3,613.7	4,171.3	4,786.5

Note: Figures in parentheses are port folio shares in percentages.

Source: Insurance Commission.

Table 2.10: SSS INVESTMENT PORTFOLIO AS OF AUGUST 1981
(Amount in million pesos)

Year	PNB/DBP notes		Other government securities		Housing loans		Service loans		Private securities		Total investment	
	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total
1970	219.4	20	215.9	20	431.8	40	122.0	11	96.4	9	1,085.5	100
1971	232.9	18	279.3	22	514.5	41	140.8	11	98.3	8	1,265.8	100
1972	359.3	24	409.3	27	511.1	33	146.2	10	93.3	6	1,519.2	100
1973	564.1	30	456.1	24	562.4	30	179.6	9	128.2	7	1,890.4	100
1974	827.3	35	529.7	23	597.9	25	224.3	10	169.6	7	2,348.8	100
1975	1,099.2	38	730.7	25	667.7	23	255.4	9	162.5	5	2,915.5	100
1976	1,732.7	48	565.1	16	806.8	22	326.1	9	166.3	5	3,597.0	100
1977	2,445.0	56	367.8	8	983.9	23	390.4	9	161.0	4	4,384.1	100
1978	3,175.0	60	298.6	6	1,191.8	22	452.5	9	158.7	3	5,276.7	100
1979	2,675.3	41	1,863.8	28	1,414.4	21	548.4	8	106.7	2	6,608.6	100
1980	3,540.9	44	2,204.5	27	1,592.9	20	624.0	8	104.0	1	8,066.3	100

Source: SSS

Table 2.11: LOANS AND INVESTMENTS OF GSIS, 1970-80
(in million pesos)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Policy loans	156.3	177.9	202.5	229.2	255.3	280.9	332.8	365.6	414.3	477.8	561.6
	(8.4)	(8.8)	(8.6)	(8.9)	(9.0)	(9.6)	(8.6)	(8.5)	(8.5)	(8.6)	(8.7)
Salary loans	298.9	393.3	368.1	346.2	353.9	389.9	500.3	546.7	651.5	802.1	938.5
	(16.1)	(19.6)	(15.6)	(13.5)	(12.5)	(13.3)	(13.0)	(12.6)	(13.3)	(14.4)	(14.6)
Real estate loans	1,005.7	1,076.6	1,343.5	1,517.1	1,673.3	1,745.5	2,335.4	2,477.7	2,496.2	2,532.1	2,685.6
	(54.0)	(53.5)	(57.0)	(59.0)	(59.3)	(59.4)	(60.6)	(57.3)	(51.3)	(45.5)	(41.7)
Stocks & bonds	370.5	334.0	346.1	338.0	393.0	382.2	638.4	890.3	1,276.5	1,714.4	2,132.5
	(19.9)	(16.6)	(14.7)	(13.1)	(13.9)	(13.0)	(16.6)	(20.6)	(26.2)	(30.8)	(33.1)
Backpay certificates	7.4	7.4	2.4	2.4	2.6	1.7	1.7	1.7	0.5	0.5	0.5
	(0.4)	(0.4)	(0.1)	(0.1)	(0.1)	(-)	(-)	(-)	(-)	(-)	(-)
Miscellaneous	22.6	23.5	92.7	137.1	143.6	137.0	43.0	42.8	29.4	37.6	124.5
	(1.2)	(1.2)	(3.9)	(5.3)	(5.1)	(4.7)	(1.1)	(1.0)	(0.6)	(0.7)	(1.9)
Total	1,861.5	2,012.7	2,355.3	2,570.1	2,821.5	2,937.2	3,851.6	4,324.8	4,868.4	5,564.5	6,443.2

Note: Figures in parentheses are portfolio shares in %.

Source: GSIS Annual Report and Financial Statements.

2.17 The portfolio of GSIS shows a similar trend with the share of securities rising from 13% in 1974 to 33% in 1980 while that of real estate loans has dropped from 59% to 42% over the same period. It should be noted however that the latter figures include nonresidential real estate; the portfolio share of deeds-of-conditional sale which are essentially individual mortgage housing loans was only 11% in 1980.

D. Recent Changes

2.18 The recent changes in banking regulation allowing the formation of universal banks, and eliminating interest rate ceilings on bank deposits have generated a reorganization of the Philippine financial sector that is still continuing. These changes have begun to reduce the specialization that had developed in the banking system and are creating more general type of institutions that are engaged in financing at all levels and in a number of sectors of the economy. Similarly, the relaxation of deposit rate controls has increased the rate of return available to consumers to the point where banks may be competitive with money market instruments.

2.19 Since the system is still in a state of flux, it is too early to judge the efficacy of the reforms. Thus, while the regulatory changes have altered the manner in which most banks do business, it is not clear if they have or will result in an increase in the availability of long-term capital. For the housing finance system, this has major implications. Essentially, the affordability of housing is closely related to the financing terms for the house. In the case where mortgage loans must be repaid over a short period of time, fewer and fewer households qualify for private mortgage loans. This effect is intensified by the fact that the deregulation of interest rates and the high levels of short-term rates have pushed interest rates on private mortgages. Together, these factors have led to a declining role in housing finance for private financial institutions and a correspondingly larger role for government programs. That shift is the subject of the next chapter.

III. HOUSING FINANCE

3.01 This chapter presents a description of the housing finance system in the Philippines, including its relative size and importance in the financial sector. It provides details on the institutions and arrangements of the formal and informal primary housing finance markets /1 as well as some selected aspects of the secondary mortgage market./2 It concludes by identifying the major issues in the development of the system which are analyzed in depth in the subsequent chapters.

A. Introduction

3.02 The housing finance system in the Philippines suffers from the lack of long-term capital that is characteristic of the Philippine financial system. The vast bulk of formal financial activity in the economy is concentrated in the shorter end of the maturity spectrum. This normally favors users other than housing in the allocation of investible funds. However, a limited amount of short-term mortgages and construction period loans are available from some private financial institutions.

3.03 The combination of short-terms and high interest rates for the mortgage amortization lead to only very high income households qualifying for these loans. Similarly, only large developers have access to private construction period financing (see Chapter V). Supplementing the system of private loans are a number of government programs designed to increase the access of moderate income households to housing finance and extend development loans to smaller and less well-established contractors. These programs are characterized by long maturity loans at concessionary interest rates with low downpayments. Both mortgage and construction loans can be insured by the Government through the Home Finance Corporation (HFC).

3.04 The housing finance system in the Philippines, thus, is a highly segmented system, with the private financial intermediaries serving the high income segment of the market and government intermediaries providing subsidies for the moderate income households. Added on to this are government programs aimed at serving households whose incomes are too low to allow them to participate in the formal housing finance system.

/1 A term used to describe the overall demand for, and supply of, new mortgage funds by real estate borrowers and lenders in contrast to the secondary market in which existing mortgages are purchased and sold.

/2 This term describes transactions mostly between originators (who wish to sell mortgage loans) and investors (who wish to buy mortgage loans to hold for income), involving the sale and purchase of existing mortgages by government agencies and by private institutions and investors.

3.05 Recent initiatives by the Government have been designed to foster long-term lending in general, and to increase the flow of funds into housing finance in particular. More specifically, in the housing finance sector, the Government has attempted to establish a secondary market system that would increase the liquidity of mortgages and development loans, thus increasing the willingness of private financial institutions to lend for these purposes. Additionally, the Government has sought, through the Home Mortgage Development Fund (HMDF) to create a special circuit that would mobilize long-term savings for housing and bolster the development of the National Home Mortgage Finance Corporation (NHMFC), the principal secondary market facility.

B. Overview of the Primary Housing Finance Market

3.06 The primary housing finance market is defined here as the suppliers and demanders of funds for the purpose of financing the construction and acquisition of owner-occupied housing./1 This includes private mortgage lenders, government agencies concerned with the provision of housing finance, construction firms and developers, and households. In this market, borrowers, faced with a set of terms from lenders and a set of housing prices, choose the amount they will borrow, the term of the loan, the interest rate applicable on the loan and the fees associated with the closing of the loan.

3.07 The major characteristic of the Philippine housing finance system is its segmentation. In this system, borrowers of different income level or firm size are associated with different lenders. For the most part, this segmentation associates private lenders with high income households and large developers, and government lenders with lower income households. Yet, despite the segmentation, there still exist overlaps as well as gaps in the system, particuarly in the government sector. Under current arrangements, several government agencies /2 make funds available for construction and/or housing, with each agency lending under somewhat different terms and underwriting criteria. The result of this situation is multiple entitlement of some households to mortgage loans. This leads to the possibility of high income households combining concessionary government financing with private funds to reduce the total cost of acquiring a high-priced home.

/1 The rental market in the Philippines is smaller and in general less formally organized than the market for homeownership.

/2 These include the Social Security System (SSS), Government Service Insurance System (GSIS), Development Bank of the Philippines (DBP), National Housing Authority (NHA) and the Home Development Mutual Fund (HDMF). The operations of the first three are detailed in this chapter, of HDMF in the following chapter and NHA in Chapter VI.

3.08 One of the dominant trends in the housing finance system has been the increasing involvement of the Government. Since the establishment of the Ministry of Human Settlements (MHS) in 1978, the Government has taken a leading role in long-term resource mobilization for housing and development of the mortgage market. While this involvement is for the most part a commendable effort to correct for market failure, it appears not to have been targetted effectively.

3.09 The remainder of this chapter amplifies on this overview and describes the major participants in the housing finance system, the clientele they serve and the problems which currently exist in the system. Table 3.1 provides summary statistics on the flow of funds into housing loans since 1975./1

C. Housing Finance Activities of Private Institutions

3.10 Commercial banks are the largest group of institutions and have the largest investment in housing finance. However, this activity is predominantly for construction and development lending. For example, of the total amount of housing loans granted by commercial banks in 1980, about 22% were mortgage loans to individuals, with the remainder for development or construction purposes (Table 3.2). In other years the proportion of mortgage loans has been even lower. This is consistent with the portfolio approach of most banks, in that development or construction period loans are shortterm in nature and roll over rapidly, ensuring the bank's liquidity. This aspect is corroborated by the high ratio of loans granted to loans outstanding. In 1980, for example, this ratio was 1.05 for the commercial banks, indicating that the average maturity for a housing finance loan was less than one year.

/1 The data are based upon a sample survey of selected banks conducted by the Central Bank, and may have significant underreporting for the earlier years.

Table 3.1. HOUSING FINANCE LOANS GRANTED BY MAJOR LENDING INSTITUTIONS: 1975-80
(₱ '000)

	1975	1976	1977	1978	1979	1980
LENDER GROUP						
Private sector						
Commercial banks	10,756	21,791	92,141	195,637	504,247	767,786
Savings banks	2,204	10,370	50,513	41,069	113,866	107,535
Private development banks	997	923	791	1,282	5,506	6,505
Insurance companies	27,279	18,704	30,044	34,529	55,473	62,139
Total Private Sector	41,236	51,788	173,489	272,517	679,092	943,965
Growth rate (%)		(25.6)	(235.0)	(57.1)	(149.2)	(39.0)
Public sector						
GSIS	156,200	117,260	168,730	195,940	118,160	223,820
SSS	115,596	193,725	224,198	261,077	290,057	234,800
DBP	N/A	N/A	36,200	60,100	218,300	468,900
Land Bank	-	1,806	1,710	35,385	17,640	49,127
NHA /a	N/A	N/A	N/A	N/A	N/A	N/A
Total Public Sector	271,796	312,791	430,838	552,502	644,157	976,647
Growth rate (%)		(15.1)	(37.7)	(28.2)	(16.6)	(51.6)
Total	313,032	364,579	604,327	825,019	1,323,249	1,920,612
Growth rate (%)		(16.5)	(65.8)	(36.5)	(60.4)	(45.1)

/a Information is not available. Direct lending is a minor role of the National Housing Authority.

Source: Private Banking Institutions - Special survey of selected banks conducted by the Central Bank of the Philippines.
Insurance Companies - Insurance Commission.
Public sector - individual institutions.

Table 3.2: INDIVIDUAL MORTGAGE LOANS OF SELECTED COMMERCIAL AND SAVINGS BANKS, 1980
(in thousands of pesos and as percentage of total housing loans)

	Granted		Outstanding	
	Amount	%	Amount	%
Commercial banks	170,733	22.2	120,753	16.6
Savings banks	90,126	83.8	334,090	65.3

Source: Special survey of selected banks conducted by the Central Bank.

3.11 In contrast, the ratio for the same year for savings banks was about 0.21, indicating an average maturity of about 5 years. This is consistent with the fact that most of the housing finance activity of savings banks takes the form of mortgage loans, with only some construction and development financing. Generally, development loans have rarely exceeded 10% of the savings banks' lending. Moreover, for the most part, the mortgages acquired by savings banks were of longer duration than those acquired by commercial banks, as indicated by the smaller ratio of loans granted to loans outstanding. This is a reflection of the preference of the savings banks to mortgage lending. Private development banks play only a marginal role in the housing finance market, where their participation is almost exclusively through home mortgages.

3.12 Tables 3.3 and 3.4 show the breakdown of private sector mortgage lending by loan size and income of beneficiary. In order to facilitate comparison, the figures are expressed as percentages of mortgage lending by income and loan size classes. It is clear that both the commercial banks and the savings banks are serving a very high income clientele, by Philippine standards. In a country where the median family income for 1980 was about ₱ 12,000, only 22 and 15% of mortgage loans granted by commercial banks and savings banks, respectively, were granted to households with incomes below ₱ 100,000. In terms of loan sizes, the picture is not very different./1

/1 Although the figures show a significant percentage of relatively small loans (less than ₱ 50,000), given the income levels of the beneficiaries, these are probably not for purchase or construction of new homes. Rather they may represent financing activity for additions and improvements.

While private development banks seem to be serving a lower income and smaller borrower household, these banks are insignificant as suppliers of credit for housing.

Table 3.3: MORTGAGE LOANS GRANTED BY PRIVATE INTERMEDIARIES, BY LOAN SIZE, 1975-80
(Figures in percentages)

	Pesos			
	50,000 or below	50,000-100,000	100,000-500,000	Over 500,000
Commercial Banks				
1975	80.9	6.3	12.8	-
1976	37.5	9.1	53.4	-
1977	23.2	3.3	36.0	37.5
1978	33.1	13.3	47.0	6.6
1979	8.1	4.3	32.1	55.4
1980	22.6	10.1	38.7	28.6
Savings Banks				
1975	11.8	39.4	48.8	-
1976	6.1	14.9	57.9	21.1
1977	3.4	7.0	44.6	45.0
1978	3.3	14.9	59.3	22.6
1979	3.9	9.3	57.0	29.8
1980	3.2	5.1	48.9	42.9
Private Development Banks				
1975	100.0	-	-	-
1976	100.0	-	-	-
1977	100.0	-	-	-
1978	69.2	18.3	12.5	-
1979	43.2	10.1	46.7	-
1980	27.2	24.0	48.8	-

Source: Special survey of selected financial institutions conducted by the Central Bank.

Table 3.4: MORTGAGE LOANS GRANTED BY PRIVATE INTERMEDIARIES, BY BENEFICIARY INCOME, 1975-80
(Figures in percentages)

	Pesos				
	50,000 and below	50,001-100,000	100,001-500,000	500,001-1,000,000	More than 1 million
Commercial Banks					
1975	1.3	2.4	96.3	-	-
1976	7.5	1.3	91.2	-	-
1977	9.7	4.7	85.6	-	-
1978	35.0	5.5	59.5	-	-
1979	5.5	6.3	87.6	0.6	-
1980	17.7	4.4	37.0	40.9	-
Savings Banks					
1975	26.9	73.1	-	-	-
1976	6.0	34.7	58.2	-	1.1
1977	6.0	10.5	32.3	14.9	36.3
1978	7.5	28.9	50.2	6.5	6.8
1979	7.1	30.6	45.3	7.0	10.0
1980	4.0	11.3	53.9	14.3	16.5
Private Development Banks					
1975	90.1	9.9	-	-	-
1976	76.9	23.1	-	-	-
1977	87.2	12.8	-	-	-
1978	83.5	16.5	-	-	-
1979	24.5	14.0	61.5	-	-
1980	32.6	8.6	40.9	-	17.9

Source: Special survey of selected financial institutions conducted by the Central Bank.

3.13 These numbers are verified by the average terms and location of the mortgage loans granted by private institutions. For loans granted in 1980, savings banks and commercial banks charged, on average, interest rates of 19.64% and 16.92% respectively. Both institutions offered terms of less than 10 years on these loans and the vast majority of loans were granted inside Metro-Manila. If we assume that 19% is a representative private sector rate and that a ten-year amortization period is also typical, the monthly payment on a P 100,000 loan from a private sector institution is P 1,867. Given the standard rules of thumb employed by private lenders (amortization equal to no more than 25% of monthly income), this implies that the borrower would require an annual income of nearly ₱ 90,000. This means that less than 3% of households could afford to deal with the private sector for housing finance.

3.14 What emerges from these numbers is the picture of private sector institutions serving a very specific segment of the market, namely, upper income households who can afford to borrow short-term to finance a high-priced house. While it would be an overstatement to say that the private sector has to date completely ignored lower income households, nevertheless it is clear that private intermediaries view themselves, and are viewed, as serving a relatively high income clientele to the exclusion of other customers.

D. Government Housing Finance Activities

3.15 There are currently several governmental entities involved in the housing finance market. GSIS, SSS and DBP are direct lenders for mortgages;/1 HDMF is projected as a major source of funds for housing; NHMFC is responsible for the secondary mortgage market while HFC essentially provides a guarantee function.

3.16 It is to be expected that in view of the fact that the private sector finances the higher income groups, the government sector would serve the lower income ranges. This stems from three reasons. First, entitlement to government lending is often restricted. This is most clear in the case of GSIS which grants mortgage loans to its members and development loans to firms building homes primarily for its members. SSS is also restrictive, but its membership covers a broader section of the population than does GSIS. Since the members of the two funds tend to be lower income households, their mortgage lending applies to a lower income group than does private sector lending where entitlement is based solely on the ability to meet the terms set forth by the lender.

3.17 Second, government lenders enforce maximum loan limits. For SSS, the maximum mortgage loan size is limited to ₱ 50,000. This has become a problem for SSS lending, as house prices have risen to levels where that size mortgage covers only a small proportion of the house price. For DBP, the limit is ₱ 120,000, although an increase to ₱ 250,000 is currently under consideration. The effect of these limits, however, is to restrict government loans to a generally lower priced house and therefore a lower income clientele.

/1 NHA also provides end use financing for housing, though on a limited scale. NHA's major contribution has been in the area of slum upgrading and sites and services for low income communities, principally as the main executing agency for the three urban projects financed by the World Bank (see Appendix B).

3.18 Related to these two is the final factor, that the Government has consciously targetted these loans to the lower end of the economic housing market. The terms on government loans are a great deal more liberal than the terms available on private sector mortgages. Generally, the interest rate is a concessionary one, with SSS charging as little as 6% on a portion of its loans. The highest government rate, 14%, is that charged by DBP for its "open housing" loans. Yet even that rate is only two-thirds of the current market rate charged by banks./1 In addition, the other terms on government loans are easier. Maturities range up to 30 years and downpayments go as low as 10%. This is to be contrasted with the shorter term of private loans, which can require as much as 44% downpayment.

3.19 GSIS. The Government Service Insurance System (GSIS) exists primarily as a social security agency for government employees, but also grants housing loans to its members. The loans may be for terms up to 25 years and carry interest rates that increase with loan size. For a member taking a loan of ₱ 100,000, the effective interest rate is about 9%. For lower loan amounts the interest rate is correspondingly less, with a minimum of 6% for loans below ₱ 30,000. Underwriting standards are more liberal than those in either the private sector or in other government lending programs, as GSIS considers total family income when judging an applicant. In addition, amortization may be made on a fixed or a graduated basis in an attempt to assist as many applicants as possible.

3.20 GSIS also makes project loans for development or construction under different schemes. These loans may simply be interim financing for the builder of housing designated for GSIS employees or may be a Mass Housing loan which is, in effect, a blanket mortgage that the builder will take out to provide financing for the eventual buyers. The rate of interest on interim loans is a flat 12% compounded monthly, with terms ranging from 18 to 36 months; the loan-value ratio is 70% for collateral. Mass Housing loans carry terms similar to the individual housing loans, with higher interest rates to reflect the precommitment fee. For all these loans, GSIS derives its funds from the contributions of government employees to the pension fund.

3.21 The government employees' social insurance program has been one of the major participants in the primary housing finance market. Between 1972 and 1980, GSIS financed directly about 21,000 individual housing units. Tables 3.5 and 3.6 display summary statistics of GSIS housing finance activity over the last decade. In 1980, the average mortgage amount for these loans was about ₱ 90,000, loaned for 15 years at an average interest rate of 7.35%. Using the same assumptions employed above, these numbers imply that the average income necessary to acquire mortgage funds from GSIS

/1 This rate is expected to be raised gradually to market levels over the next two or three years.

Table 3.5. GSIS HOUSING FINANCE:1970-80
(Amount in million pesos)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	Total
Individual Loans /a												
Metro Manila												
No. of units	-	-	534	812	752	490	434	99	591	643	1,005	5,360
Amount	-	-	14.08	21.02	20.20	19.24	20.58	3.95	37.27	41.77	93.58	271.49
On Periphery of Metro Manila												
No. of units	-	-	311	231	458	1,106	923	1,780	1,509	1,192	1,006	8,516
Amount	-	-	8.24	6.49	14.20	45.06	37.90	84.77	78.73	49.61	94.28	419.28
Outside Metro Manila												
No. of units	-	-	-	191	841	1,022	1,214	1,379	1,347	764	365	7,123
Amount	-	-	-	5.37	26.09	41.64	49.85	65.67	70.28	31.80	26.4	317.10
Total												
No. of units	-	-	845	1,234	2,051	2,618	2,571	3,258	3,447	2,399	2,376	20,799
Amount	-	-	22.32	32.88	60.50	105.94	108.33	154.39	186.28	113.88	214.29	998.61
Residential Loans /b												
No. of units	2,208	3,147	3,156	1,961	2,163	1,135	108	67	37	19	30	14,031
Amount	70.55	135.09	137.89	79.49	77.09	50.26	8.93	14.34	9.66	4.28	9.53	597.11
Interim Loans												
No. of loans approved	-	15	12	18	1	n.a.	3	3	3	1	4	64
Amount	-	76.52	48.61	27.42	2.00	16.00	50.20	15.00	26.16	4.00	35.00	276.20

/a Mortgages for homes purchased in mass housing projects.

/b Mortgages for individually constructed homes.

Source: GSIS.

Table 3.6: GSIS HOUSING LOANS - TERMS AND INTEREST RATES: 1970-80
(Amount in million pesos)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Individual Loans /a											
No. of units	-	-	845	1,234	2,051	2,618	2,571	3,258	3,447	2,399	2,376
Amount	-	-	22.32	32.88	60.50	105.94	108.33	154.39	186.28	113.88	214.29
Interest rate (amounts)											
6%	-	-	22.32	32.88	59.17	78.54	77.13	97.74	103.41	71.97	71.28
9%	-	-	-	-	1.33	27.50	31.20	56.65	82.87	41.91	95.04
12%	-	-	-	-	-	-	-	-	-	-	47.97
Maturity (no. of loans)											
15 years	-	-	675	986	1,640	2,094	2,051	2,610	2,754	1,915	1,900
20 years	-	-	117	172	286	365	360	454	480	335	330
Residential Loans /b											
No. of units	2,208	3,147	3,156	1,961	2,163	1,135	108	67	37	19	30
Amount	70.55	135.09	137.89	79.49	77.09	50.26	8.93	14.34	9.66	4.28	9.53
Interest rate (amounts)											
6%	66.24	94.41	94.68	58.83	64.89	34.05	3.74	2.01	1.11	0.57	0.90
9%	4.31	40.68	43.21	20.66	12.20	16.21	4.32	2.68	1.48	0.76	1.20
12%	-	-	-	-	-	-	1.37	9.65	7.07	2.95	7.43

/a Mortgages for homes purchased in mass housing projects.

/b Mortgages for individually constructed homes.

Source: GSIS.

Table 3.7. SALARY DISTRIBUTION OF GSIS MEMBERS (Armed Forces Excluded), End 1980

Monthly basic salary ranges /a	Number of members	Percentage	Cumulative percentage
Less than 499.99	279,353	26.69	26.69
500.00 - 749.99	402,652	38.47	65.16
750.00 - 999.99	164,325	15.70	80.86
1,000.00 - 1,499.99	140,415	12.46	93.32
1,500.00 - 1,999.99	37,888	3.62	96.94
2,000.00 - 2,499.99	13,188	1.26	98.20
2,500.00 - 2,749.99	3,349	0.32	98.52
2,750.00 - 2,999.99	22,931	0.28	98.80
3,000.00 - 3,499.99	2,826	0.27	99.07
3,500.00 - 3,999.99	4,187	0.40	99.47
4,000.00 - 4,499.99	1,361	0.13	99.60
4,500.00 - 4,999.99	1,675	0.16	99.76
5,000.00 - 5,999.99	1,151	0.11	99.87
6,000.00 and over	1,361	0.13	100.00
Total	1,046,662	100.00	

/a Does not include living allowances which vary from 5% to 50% depending on whether the member is employed by the local government, the national government, the armed forces, or government-owned and/or controlled corporations.

Note: Average basic monthly salary = ₱ 788.92

Source: GSIS.

is about ₱ 40,000 per year. This is less than half the income implied by the terms prevailing in the private sector. It is however, substantially more than the average salary of GSIS members shown in Table 3.7. The numbers here for members' salaries are not a real reflection of their incomes for GSIS underwriting purposes, however. In determining loan eligibility, GSIS considers total family income, and includes the living allowances available to the member worker. In loans closed in 1980, for example, member income was on average 86% of family income.

3.22 Even with these adjustments, however, GSIS does not appear to have reached down to its target clientele. Over the 1970-80 period, its aim was to service a middle income group of households with incomes of ₱ 800 per month and up. The numbers on GSIS loans suggest that it has not reached down as far as it intended. Perhaps in recognition of this, the target clientele for the 1981-85 period for GSIS are households with incomes of ₱ 2,400 per month and up. These comprise essentially government officials though lately other buyers are being accommodated in the mass housing projects, perhaps because of difficulty in marketing the relatively high-cost units. Finally, and consistent with the above, it may be noted that most of the activity is concentrated in Metro-Manila and its periphery.

3.23 These income considerations may be insignificant if the revisions in the GSIS Law of 1977 become effective. These provisions will effectively end the housing finance activities of GSIS, and convert the fund into purely a pension and insurance system. To date, these provisions have slowed down the mortgage lending of the system, but have done little to affect the development and construction financing that GSIS has supported. Currently, development loans are being granted out of a temporary authorization which may or may not be renewed when it runs out. Through 1984, GSIS projects that it will finance the construction of over 15,000 additional housing units. Whether this activity continues or not, the withdrawal of GSIS from the mortgage market would remove a large supply of credit for middle income households.

3.24 SSS. The Social Security System (SSS) extends mortgage credit to its members of one year or more for the purchase of new primary residences. Each member of the SSS has the entitlement to one mortgage loan during the course of membership. Loans are limited to a maximum of ₱ 50,000, but can extend up to 25 years and repayment is in equal monthly installments. Like GSIS, SSS charges an interest rate that varies with loan size from 6% for the first ₱ 30,000 to 9% on the balance. For the member drawing the maximum loan, the interest rate will be about 7.2%. Prior to 1973, loans were limited to 60% of appraised value; since then, borrowers have been able to finance up to 90% of their home.

3.25 SSS membership is predominantly middle- and low-income. Table 3.8 give the income distribution of SSS members. Over 80% have incomes of less than ₱ 10,800 per year; total paying membership in 1980 was about 2.5 million workers. Table 3.9 presents the income distribution of beneficiaries of the SSS mortgage lending program for 1978-80. It is fairly clear that the vast bulk of SSS mortgage loans go to the 19% of paying members whose incomes exceed ₱ 10,800. However, the average beneficiary had an income below ₱ 20,000 per year, indicating that SSS loans reached down lower in the economic housing market than either the private sector or GSIS.

3.26 Between 1970 and 1980, SSS financed over 53,000 housing units, with average mortgage size in 1980 rising to ₱ 48,522 (see Table 3.10). For the most part, this represented the bulk of the SSS support to housing finance, although it did make some development and construction loans in the mid-1970s for projects some of which are still ongoing. Perhaps the biggest difference in the underwriting standards employed by SSS and other lenders is the fact that SSS requires that the borrower own a developed lot with no house before loan approval. SSS will then inspect the house throughout its construction and release the mortgage loan in parts as construction proceeds. Effectively, SSS is granting construction loans that are amortized over long periods of time.

3.27 Although statistics were not available, SSS officials estimated the average ratio of the loan to value of dwelling unit to be around 70%. Thus, the ₱ 50,000 limit on the loan size deserves further mention. In a period of rapidly escalating house prices, this reduces the usefulness of SSS mortgage loans for financing conventional formal housing particularly in view of the limited accumulation of savings among members. This is reflected in the decline in number of applications from 6,457 in 1978 to 4,788 in 1980; a further drop of 10-15% is anticipated in 1981.

3.28 There have been two related impacts on the housing activity of the agency. First, the geographical distribution of applications and hence loan approvals has shifted. Over the past three years, the share of applications accounted for by the Metro Manila office has dropped from about 65% to a little over 56%. During the same period the share of Cebu has risen from 5.5 to 8%, of Bacolod from 6.6 to 10.3% and of Davao from 7 to 10%.

3.29 Secondly, there has been a relative shift in the SSS portfolio from one predominantly in housing loans to one predominantly in government securities (see Table 2.10). Housing loans have shrunk from 40% of assets in 1970 to 20% in 1980; the amount disbursed in 1980 was ₱ 234.8 million, a drop of almost 20% from the preceding year's level. There are currently no plans to increase the ceiling on mortgage loans by SSS. This means that the agency will continue to diminish as a factor in the housing finance system especially as higher prices reduce the usefulness of SSS mortgages. Given the income distribution of borrowers (see Table 3.9) and the potential withdrawal of GSIS as a lender mentioned earlier (see para. 3.23), the reduced participation of SSS will be a significant negative factor in the supply of mortgage credit to low and moderate income borrowers.

Table 3.8. SALARY DISTRIBUTION OF SSS MEMBERS

Range of Salary /a (Pesos)	Monthly salary credit	Percent distribution
I - 1 - 49.99	25	1.88
II - 50 - 99.99	75	2.71
III - 100 - 149.99	125	3.27
IV - 150 - 199.99	175	3.78
V - 200 - 249.99	225	5.67
VI - 250 - 349.99	300	18.47
VII - 350 - 499.99	425	23.15
VIII - 500 - 699.99	600	14.92
IX - 700 - 899.99	800	7.11
X - 900 and over	1,000	19.04
Total		100.00

Note: The above distribution was based on:

(1) the latest contribution remitted by 2,323,000 paying members in 1980, and
(2) a maximum contribution base of ₱ 1,000.

/a SSS contribution is computed on the basis of the category within which the actual salary falls.

Source: SSS.

Table 3.9: INCOME DISTRIBUTION OF BENEFICIARIES, SSS MORTGAGE LOANS, 1978-80 (Figures in percentages)

Income ranges (Pesos)	1978	1979	1980
12,000 and below	6.87	5.05	2.15
12,001 - 14,868	15.01	9.30	6.24
14,869 - 20,988	44.12	51.11	50.38
20,989 - 26,268	17.26	14.95	17.87
26,269 - 35,508	11.23	14.02	16.83
35,509 and over	5.51	5.57	6.53

Source: SSS.

Table 3.10: SSS HOUSING LOAN PROGRAM: 1970-80

Year	Disbursement ('000 omitted)	Completed units	Average loan (P)
1970	103,794	5,235	19,827
1971	112,445	5,666	19,846
1972	24,874	1,194	20,832
1973	82,001	4,668	17,567
1974	71,940	4,258	16,895
1975	115,596	4,240	27,263
1976	193,725	5,119	37,844
1977	224,198	5,223	42,925
1978	261,077	6,419	40,672
1979	290,057	6,549	44,290
1980	234,800	4,839	48,522

Source: SSS.

Table 3.11: DBP HOUSING LOAN APPROVALS, 1971-80
(Amount in ₱ million)

Fiscal year	Number	Amount
1971	1,394	7.4
1972	1,706	9.6
1973	3,400	22.8
1974	3,798	25.7
1975	1,892	21.8
1976	5,020	56.7
1976 (Jul-Dec) /a	1,897	21.8
1977	3,019	36.2
1978	3,898	60.1
1979	6,638	218.4
1980	7,421	468.9
Total	40,078	949.4

/a Fiscal year changed to coincide with calendar years.

Note: Total amount ₱ 687.30 for 1979 and 1980 represents 72% of total loan approvals from 1971 to 1980. In number, loan approvals of 14,059 represents 35% of aggregate approved loans for the 10-year period.

Source: DBP.

3.30 DBP. The Development Bank of the Philippines (DBP) is the largest lender of long-term resources in the nation and is engaged primarily in financing industrial development. Although it has been making housing loans for a long period, it is only since 1977 that there has been a significant increase in its loans for urban housing./1 This was due, in part, to the loan ceilings being raised in steps to ₱ 120,000. DBP participates in financing both construction and mortgage loans. Its involvement in the housing sector may be categorized into four sets of programs, namely individual loans, mass housing projects, a credit line for the government's BLISS projects and loans for upgrading and expansion of dwelling units in marginal settlements./2

3.31 In the mortgage loans market DBP serves mainly as a lender through its "open housing" loan program. These loans are available for amounts up to ₱ 120,000 at interest rates of 12-14% for long-term periods. Since 1977, its first year of significant involvement in mortgage lending, DBP has emerged as a major source of mortgage credit, ranking second only to commercial banks in 1980.

3.32 Perhaps more importantly, DBP serves the middle and lower income portions of the housing market. Table 3.12 summarizes the loan amounts and income distributions of DBP mortgage borrowers over the 1976-80 period. While loan sizes are not appreciably different from other lenders, beneficiary incomes are much lower. In virtually all loans, beneficiary incomes were below ₱ 100,000 and for the majority, incomes were below ₱ 50,000. Using the 1980 average DBP loan value of about ₱ 63,000 amortized over 25 years at 14%, the required income is about ₱ 36,500 per year. This is slightly less than the required income implied by the GSIS mortgage loan terms and far less than that implied by the private mortgage market. However, even DBP loans are reaching higher-income clientele. The percentage of beneficiaries with incomes below ₱ 50,000 has declined significantly from nearly 96% in 1977 to just over 21% in 1980. This trend will continue as DBP "open housing" loans carry higher peso limits and higher interest rates in the future.

3.33 Current proposals call for the increase in the interest rate on "open housing" loans to 17 or 18% and the loan limit to ₱ 250,000. The purpose of this change would be to integrate the lending activities of DBP

/1 See Table 3.11.

/2 The last two categories are in cooperation with public corporations under MHS; they are dealt with in Chapter VI, together with the issues relating to the tie-up with NHMFC regarding some individual loan programs. DBP used to make loans for home improvement but has substantially discontinued this practice.

Table 3.12: DBP MORTGAGE LOAN ACTIVITIES, BY LOAN SIZE AND BENEFICIARY, 1976-80
(Figures in percentages)

	1976	1977	1978	1979	1980
Loan Size (Pesos)					
50,000 and below	-	95.62	98.03	53.98	21.38
50,000 - 100,000	-	0.19	-	45.55	68.40
100,000 - 500,000	13.04	1.98	1.08	0.47	10.22
Over 500,000	86.96	2.19	0.89	-	-
Beneficiary Income (Pesos)					
50,000 and below	-	95.63	98.03	53.98	21.37
50,000 - 100,000	-	0.45	-	45.47	68.44
100,000 - 500,000	-	3.92	0.65	0.55	10.19
500,000 - 1 million	-	-	1.32	-	-
Over 1 million	100.00	-	-	-	-

Source: Central Bank of the Philippines.

with those of the private market in an attempt to provide a solid base for a secondary mortage market. This is a worthwhile goal, but merging the public and private markets through an increase in DBP's mortgage lending terms would remove yet another source of credit for lower income mortgage borrowers. This is especially important, since institutional arrangements called "pari passu" allow for the combination of GSIS and DBP money to reduce the payment necessary to sustain a mortgage sufficient to purchase a house, particularly in the Metro-Manila market. The translation of DBP's open housing program into private market terms would remove that possibility and decrease the affordability of housing by moderate income borrowers.

3.34 DBP started its construction and development finance program only in 1980 for mass housing projects; in that year this constituted about 20% of its housing finance activity level. The program allows financing for sites development as well as construction of housing units. The loans are made at 18% interest rate for a maximum term of three years.

3.35 HDMF. The Home Development Mutual Fund (HDMF), popularly known as "PagIBIG," is a contractual savings scheme devised to generate long-term funds to be used for the exclusive purpose of housing development in the Philippines. Under the scheme which is mandatory for all employed persons in the formal sector of the economy, a specified percentage of the employee's salary is deducted at the source, complemented by an equal matching amount from the employer and deposited under the administration of HDMF. The funds deposited earn a minimum dividend of 7.5% compounded annually,/1 and the accumulated amount is to be returned to the employee at maturity of the membership which is normally 20 years after commencement.

3.36 HDMF was originally established as a voluntary provident system in 1978. It was reorganized and made mandatory in 1980, although implementation was delayed until July 1981. As of that time, all employees were to contribute 1% of their salary to the fund; this figure is to rise to 2% in 1982 and 3% in 1983 and thereafter and the amounts are to be matched by the employers. In addition to the benefits mentioned above, the only other benefit to HDMF members is their eligibility to apply for a 25-year mortgage loan from an accredited bank at 9% interest rate, terms which are significantly easier than the open market. The maximum loan size is limited to ₱ 100,000 per member, though up to three family members can obtain a joint loan. The mutually exclusive form of the two benefits should be noted, however; the exercise of the mortgage entitlement results in a forfeiture of the members' entitlement to fixed dividends.

/1 When a member becomes a borrower, these dividends are terminated (see the following paragraph).

3.37 NHMFC. The National Home Mortgage Finance Corporation (NHMFC) established in 1979, is responsible for the development and operation of a secondary market for residential mortgages in the Philippines. Currently the secondary market operations are carried out exclusively by the government; the system works as follows: The mortgages are originated by banks and other financial institutions which are accredited by NHMFC, in accordance with standards /1 prescribed by the corporation. NHMFC is the sole buyer of primary mortgages and makes forward purchase commitments to buy up to a specified amount of these mortgages. The NHMFC pools these mortgages under a trust administration facility with DBP. Certificates of Indebtedness called Bahayan Mortgage Participation Certificates (BMPC) are issued against the pools of mortgages to investors to raise money for acquiring additional mortgages.

3.38 HFC. The Home Financing Corporation (HFC) was the result of upgrading the Home Financing Commission in 1979 to permit an expanded level of activity. The Commission, modeled on the Federal Housing Administration (FHA) of the United States, was established in 1956 as part of the Home Financing Act to provide mortgage insurance. Under its new status as a corporation under MHS it has been charged with the additional functions of encouraging and/or initiating the organization and incorporation of homeowners' associations and promotion of home building and land ownership./2

3.39 Under its Credit Insurance and Guarantee program HFC guarantees all types of loans corresponding to various stages of the housing delivery system. However, most of HFC's guarantee activity has been confined to to development period financing, and a large proportion of its mortgage guarantee activities to government sector loans, which in many cases require mortgage insurance before they can be closed. This reflects in part the private sector penchant for short-term lending, and the need for some sort of

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/1 In addition to HDMF (PagIBIG) housing loans, NHMFC purchases two other types of residential mortgage loans, namely Open Housing Loans and Urban BLISS Loans. The Urban BLISS loans are similar to either HDMF or Open Housing Loans, and indeed in the future MHS proposes to make BLISS homes available only to PagIBIG members.

/2 Since its upgrading to corporate status, HFC has in view of its broadened mandate and powers, started operations in newer directions. These include its Investments Program which offers assistance packages to private developers, the chartering and licensing of Homeowners' Associations as well as the Materials Guarantee Program which is in the process of being developed to deal with problems related to interim financing of construction. These aspects are dealt with in Chapter VI together with major structural issues pertaining to insurance and guarantee functions.

guarantee before a bank will commit funds to housing construction. Specifically, an HFC guarantee is equivalent to an unconditional guarantee of the Philippines Government subject to an aggregate limit of ₱ 15 billion. In addition to direct risk reduction, an associated benefit results from the loan receivable being classified as a non-risk asset for regulatory purposes. An offsetting feature on the other hand is the limitation on interest rates charged by the lending institutions on the loan (8.5% tax free or 14% gross).

E. The Informal Sector in Housing Finance

3.40 The formal housing finance sector affects only a portion of the housing market. Even for SSS loans, the least costly of all formal sector alternatives, required incomes are high enough to touch only a few households. There is a large gap between the households covered by formal private and government lending arrangements and those households who are candidates for subsidized housing. This gap is filled by an informal financing sector. By its very nature, the informal sector is difficult to identify and virtually impossible to quantify. Yet, the income figures implied by the lending terms and the underwriting standards of the formal sector, together with shelter requirements of the population, suggest that the informal sector is a significant part of the Philippine housing finance system.

3.41 For the most part, this informal sector consists of transfers in cash or in kind within extended families and the gradual accumulation of capital through household savings. In the informal sector, housing is built in parts over long periods of time. As the household sets aside part of its income or receives gifts or loans from family members, it builds on to its house, expanding and improving it over time.

3.42 One piece of information available on this process comes from the study of the Tondo Foreshore Dagat-Dagatan Development Project. Here low income households were faced with the task of upgrading their homes in connection with the reblocking and improvement of what had been a major slum area. The funds for this upgrading came predominantly from savings, with significant portions being accounted for by gifts, and loans from relatives and friends. Only a small portion of the funds used were from formal loan programs. In fact, part of the funds reported as savings actually originated not in the income of the household, but as gifts from relatives and friends. Average income of these households was about ₱ 900 per month.

3.43 As found in many countries of the region and elsewhere, a specific type of arrangement in the informal sector is the "paluwagan", a neighborhood savings club./1 A group of households agrees to contribute a part of its

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/1 cf. KEI societies in Korea, partner savings systems in Jamaica or the early building societies in Great Britain.

weekly income to a general fund. At the end of each week, one family is chosen by lot to receive the entire fund for the purpose of housing improvement. The process continues until all households have received the weekly fund./1 In general, the amounts are small, with each household contributing ₱ 5 or 10 per week. When all households have had their turn, the agreement may dissolve or may continue for another round. The key here is the mutual pooling of resources to the joint benefit of all so that housing consumption can be increased.

3.44 Essentially, the informal financing system exists because of the large body of households with no access to either formal financing or subsidized housing. Most of the government programs are intended to serve this group, but fall short of expectation due to the ineffectiveness of the targetting process. This issue is elaborated further in Chapter VI.

F. Issues and Problems in the Housing Finance System

3.45 Perhaps the two major problems in the housing finance system in the Philippines are the lack of long-term funds and the ineffective targetting of government subsidies. Both of these, in turn, are related to the large problem of segmentation in the market. The private financial institutions serve upper income households exclusively; the government attempts to serve middle and lower income households.

3.46 The lack of long-term funds for housing finance stems from the reluctance of private financial institutions to commit funds for long periods of time. There exists a distinct uncertainty in financial markets in the Philipines concerning the future course of inflation and interest rates. This uncertainty has kept short-term interest rates high and resulted in a flat or inverted yield curve. Further, among the range of short-term assets, housing related loans rank below other investment opportunities. Thus, most banks are reluctant to engage in development and construction period financing unless the loans are insured by HFC. The attraction here is not the collateral of the loan or the housing relationship, but the tax and regulatory sweeteners connected with HFC-insured loans.

3.47 To some extent, the Government has been successful in mobilizing long-term funds for housing finance. For the most part, these have come through SSS and GSIS. DBP has also allocated some funds to housing and

/1 Occasionally, materials are purchased through cooperative arrangements like Freedom to Build Inc. For further description, see Keyes, W. (1980) "The Freedom to Build Project in the Philippines," in P.J. Swan (ed.), The Practice of Peoples Participation: Seven Asian Experiences in Housing the Poor. Bangkok: Asian Institute of Technology construction, but these are financed by medium-term obligations. On the other hand, the retirement contributions to the two social insurance organizations are long-term resources. But these funds are being phased out of the housing finance system. While it is unclear whether GSIS will withdraw from the field completely, its new emphasis on maximizing the rate of return to its members will certainly reduce its commitment to housing and development finance. Also, while SSS remains a mortgage lender, its low loan limit will have the effect of reducing its ability to serve as a significant actor in the housing finance system. /1

3.48 The housing finance system also suffers from a lack of consistency among the lending agencies. This includes the private sector where underwriting standards and mortgage application forms and procedures differ between institutions to the point where comparability is virtually impossible. This has major implications for the development of a secondary market which could in turn also be instrumental in increasing the level of flow of mortgage funds. There is, of course, little correlation between the public and private sectors, but even within the government sector itself, various lenders require different appraisal processes, application forms and certifications./2

3.49 To a significant extent, the lack of coordination may be ascribed to the institutional structure of the system, particularly that of the public sector. The structure is characterized by the existence of overlapping functions as well as some major gaps. Furthermore the limited coordination that exists appears to depend on individuals holding more than one position rather than on specific lines of communication and controls./3

/1 The recent initiative represented by the establishment of HDMF is investigated in the following chapter which also analyzes the broader issues pertaining to mobilization of long-term resources.

/2 The actual practices are treated in detail in Chapter V which examines the issues related to development of financial instruments and markets.

/3 Chapter VI explores the issues pertaining to the rationalization of the institutional structure.

IV. RESOURCE MOBILIZATION AND OTHER MACROECONOMIC ISSUES

4.01 The level of national investment in housing has been the subject of frequent debate among economists and planning authorities. It is not the intent of this report to argue for or against increasing the aggregate level, but to suggest that given the excess capacity in the housing industry, output of housing could be expanded by broadening the scope and operations of the formal housing finance sector without constraints on balance of payments and with the benefit of additional employment and value added. This chapter discusses issues pertaining to the expansion of housing activity in a macroeconomic context, thereby enabling some of the economy-wide implications of alternative shelter policies in the Philippines to be deduced. It must be noted at the outset, however, that due to the nature and limitations of data, the discussion is more indicative than rigorous.

A. Political Economy Context

4.02 The Philippine economy may be viewed as having done well in aggregate terms, having registered an average growth rate in GNP of 6.4% over the last decade corresponding to an increase of 3.6% in average per capita income between 1972 and 1980. During this period, especially in the late 1970s, the country's development policy has generally been conducive to sustained growth and development. This has included, as major elements, export promotion and the liberalization of the trade and financial sectors. The rapid growth in exports as well as in financial assets is viewed as a positive sign indicating the soundness of the general development strategy.

4.03 There are two interrelated areas of major concern however, namely, the distribution of benefits from economic growth and the difficulties being encountered in the structural adjustment of the economy to adverse international conditions following the oil price increases of the late 1970s, both of which have implications for housing the population. Since these two areas have been the subject of considerable investigation within the Bank and discussion with the Government, repetition is avoided by pointing out a few salient features.

4.04 Firstly, it is clear that, at best, the income distribution in the country has not worsened since the imposition of martial law. However, there is significant evidence to point to a general deterioration in the purchasing power of the lower income class and especially among those for whom the housing problem is typically the most acute. For example, Central Bank statistics indicate that the index of real wages of unskilled laborers in Metro-Manila stood at 57 in 1979 (1972 = 100) which corresponds to an average annual decline of greater than 7% in the 1970s. The effects of this have, of course, been offset somewhat by the sharp increase in the labor force participation rates which have been observed over the same period, since these would have helped family incomes keep pace with inflation. (See Chapter I, Section C.)

4.05 It is doubtful that there will be significant improvement in the distribution of income in the foreseeable future. It will be difficult, as the economy tries to sustain its export competitiveness, to maintain the share of incomes going to labor and prevent real wages falling further. Thus, to the extent that the housing problem is an income problem, one may expect a decline in shelter standards.

4.06 The current development strategy is predicated on a continuation of the high level of investment in the "productive", particularly manufacturing, sectors. Together with the efforts to redress regional imbalances through the development of the rural industrial sector and use of local natural resources, this will make it difficult to allocate a larger share of investment to social overhead capital, i.e., infrastructure including housing, except when concurrently accompanied by a significant rise in the level of savings.

4.07 However, as the national income accounts show, although the level of domestic savings in the Philippines compares favorably with middle-income oil-importing developing countries, the country is still dependent upon foreign savings to finance a significant part of its capital accumulation. It is doubtful that the foreign savings inflow will increase, and in fact, may be expected to decline. Hence it is clear that even to maintain the current levels of fixed investment at 25% of GNP, the level of domestic savings will be required to grow by 0.8 percentage points annually. This will be a difficult task because it implies a marginal savings rate greater than 35%.

4.08 Meanwhile, given the demographic trends and the pattern of economic development, there is little reason to expect any future decline in the urbanization rate. Of course, depending upon the success of the regional development efforts, there may be a change in the geographic pattern in the longer term. In any case, the need for urban housing will continue to grow and can be expected to become more acute in the short and medium terms. This has led the Government to seek innovative and effective methods for mobilization of long-term resources, which are described below.

B. Home Development Mutual Fund

4.09 As detailed in the preceding chapter, the Home Development Mutual Fund (HDMF) is a contractual savings scheme designed to generate long-term funds to be used for housing development in the Philippines. Thus, HDMF is a special circuit for housing finance, through the mechanism of a provident fund on the Singapore model, though with some important differences./1 As

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/1 Two which deserve mention are that firstly in Singapore, the housing fund is integrated into the national budget. Secondly, the accumulated savings may be used towards down payment for the loan. The introduction of this feature was apparently crucial to the growth of the fund.

designed, it is a forced saving scheme that will eventually claim resources equal to 6% of total employee compensation in the formal sector of the economy and devote those funds to housing. This has significant macroeconomic consequences that are dealt with later in this chapter. However, there are certain gaps that exist between the notion of HDMF and its actual implementation.

4.10 First, the coverage of HDMF is not as complete as its mandatory nature suggests. In practice, a firm may ask for a waiver from coverage either because it maintains a superior provident scheme that predated HDMF, or it maintains an employee housing program, or it is part of a distressed industry. Through December 1981, HDMF had over 1.5 million registered members coming from 51,600 employers. Over 624,000 employees with a payroll totalling ₱ 569.2 million per year, had been excused from the "mandatory" provident fund (see Table 4.1).

4.11 Second, the mortgage lending of the fund has been slight and is not projected to reach a large portion of its members. The assumptions that HDMF uses in running its financial projection model are that only 5% of its members will actually avail themselves of the mortgage option. If the fund is restricted to using only its receipts, member contributions and loan repayments, HDMF projects that only 3.5% of its members will have received housing loans by the third full year of operation. Finally, if all HDMF members who qualified for loans applied and were granted mortgage funds, only 11% of the membership would receive housing finance from the fund. These numbers raise questions about the nature of the fund. Clearly, HDMF cannot be seen as a housing finance special circuit aimed at low income households. It can, however, be considered a vehicle to raise low-cost funds for the development of a secondary mortgage market; the analysis of these issues is deferred to Chapter VI.

4.12 Finally, HDMF is clearly a provident fund. Members are guaranteed a return of 7.5% on twice the amount they contribute, with periodic bonus dividends to be added by the fund. The problem here is the purpose of this fund. The forced saving may detract from the supply of funds to other areas of the economy. At the same time, the utilization of HDMF resources is protected by an explicit provision in the HDMF charter which states that the funds shall be considered private and that the government cannot use it for any other governmental purpose. However, the provident fund will need to be invested, raising the question as to what these investments will be: a matter for careful and candid consideration.

/1 By February 1982, HDMF fund level had reached ₱ 132 million and it had 1.7 million registered members coming from 56,000 employers. Some 3,700 employers covering about 720,000 employees were granted waivers. It is interesting to note that seven of the waived employers opted to rejoin the HDMF and 18 integrated their existing provident funds.

Table 4.1: HDMF STATUS AS OF DECEMBER 31, 1981

Membership	Employer	Employee
Government	1,537	693,659
Private	50,055	844,840
Self-employed	-	355
Self-paying	-	271
Total	51,592	1,539,125

HDMF Fund Level ₱ 127.6 million

Waivers

Applications Received: 4,129

Applications Approved: 2,359

Total waived employees : 624,250

Basic payroll (monthly): ₱ 568.94 million

Source: HDMF

4.13 Table 4.2 presents the projected growth of HDMF to 1987. In the early years, the major growth in membership is projected in the private and government sectors. Beginning in 1982, the fund anticipates that considerable numbers of self-employed individuals will become members. Projections of receipts follow the pattern of membership, growing to ₱ 12.5 billion by 1986. This is a fairly substantial sum that will have significant macroeconomic impact (see Section E).

4.14 Perhaps more important here is the nature of the membership of HDMF. Exemption figures, and the grounds for exemption, suggest that the larger employers will be the ones to opt out of the system. For example, all of the major banks have some sort of housing or provident scheme for their employees that will furnish the grounds for exemption. This will result in small firms, and the self-employed being the major contributors of the fund. Given that the housing benefit will reach down to only a small portion of the membership and that the return to contributions is below market rates, it appears that the fund will be supported by only a small segment of the population, who will get little in return.

4.15 To summarize, the Home Development Mutual Fund with its mandatory membership and forced saving is a major government effort to mobilize long-term funds for housing. While the potential is there for this effort to provide a stable base for housing finance, the apparent ease of exemption, combined with the qualifications necessary to receive a mortgage loan, raise questions as to the eventual effectiveness of this scheme. Currently, a member of HDMF may qualify for a mortgage no greater than 33 times his fund-based salary. This standard excludes the earning of any family member not a member of the fund, and does not recognize bonuses, allowances, etc., which may be a regular part of the fund member's income. Thus, the allowable mortgage will in many cases be less than the member's household can afford to sustain, and in fact less than that necessary to finance a home. This may result in the funds mobilized through HDMF being less than anticipated and being channeled to the higher income groups who can afford the mortgage payments for the types of homes financed.

C. Public Borrowing

4.16 Another method for resource mobilization for housing would be public borrowing. Since the next chapter analyses the microeconomic and financial issues in detail, this section confines itself to a brief discussion of some macroeconomic aspects specific to borrowings for housing finance in the Philippines. The monetary authorities have approved the issuance of a debt instrument, the Bahayan Mortgage Participation Certificates (BMPCs) by the National Home Mortgage Finance Corporation (NHMFC)./1 These securities are supposed to tap long-term resources for housing development,

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/1 See Chapter V.

Table 4.2: HDMF PROJECTIONS, 1981-86

	1981	1982	1983	1984	1985	1986
Membership (in millions)						
Employed						
Private	0.950	1.650	1.950	2.250	2.550	2.850
Government	0.400	0.750	0.770	0.790	0.818	0.830
Self-employed	-	0.025	0.035	0.050	0.065	0.080
Self-paying	-	0.020	0.025	0.035	0.045	0.055
Won over from waivers	-	0.120	0.330	0.690	0.810	0.810
Total	1.350	2.565	3.110	3.815	4.280	4.625
Pag-IBIG funds (₱ million)						
Incremental contribution	127.6	776.2	1,598.4	2,366.3	3,573.1	4,072.0
Cumulative contribution	-	903.8	2,502.2	4,868.5	8,441.6	12,513.6

Note: The year-to-year projections for membership are cumulative, not incremental figures.

Source: HDMF.

specifically mortgage lending. The question that then arises is whether the BMPCs are crowding out borrowing for other investments and whether they will do so in the future.

4.17 It is fairly clear that the marketing or placement of these secuities is facing difficulties and the current level of placements reflect extra-economic factors. In any case, given the term structure of interest rates in the economy and other investment options, as well as the recent "crisis of confidence", there is an impression that BMPCs have displaced, albeit on a small scale, other government securities. This may be expected to continue under the various alternatives now being considered by the Government, and to that extent they will not crowd private investment. This will be especially true if the major buyers of BMPCs turn out to be the public pension funds, viz GSIS and SSS. As pointed out earlier, these institutional investors have a significant proportion of their portfolios in government securities. It does raise the issue of what share of public borrowing it is appropriate to earmark for housing. This will be quite explicit if the Monetary Board decides to continue managing the marketing of BMPCs and program their issue in a consolidated manner with other securities, such as DBP Countryside Bills and Central Bank Certificates of Indebtedness (CBCIs). Such a system is indeed desirable as it should stabilize major fluctuations that could occur in a completely unmanaged market. From the point of view of effective programming of housing investment, this, of course, does imply adequate medium-term planning on the part of the monetary authorities.

4.18 An associated issue concerns the proposed eligibility of BMPCs for the agricultural reform credit requirement on the portfolios of major financial institutions. It is a fact that this reserve requirement has not been very effective in terms of channeling a greater amount of resources into agricultural credit, and the great bulk of the requirement is met through investment in various eligible securities such as Treasury bills and DBP countryside bills in addition to CBCIs. It may be expected that the approval of such eligibility for BMPCs will boost their sales in the short run but may be of limited effectiveness in the long run, unless the yields are competitive. The argument can also be made that the eligibility of BMPCs for the agricultural reserve requirement would be counter to the spirit behind the recent financial sector reforms.

D. Budgetary Appropriations

4.19 The third mode for mobilization of financial resources for housing in the Philippines has been through budgetary appropriation of general government revenues. Indeed, as Table 4.3 shows, the direct government assistance for the national housing program has been significant, totaling more than ₱ 2.2 billion between 1976 and 1980, with almost 80% of the total being in the last two years. The estimated contribution in 1981 of ₱ 935 million /1 is at the same level in nominal terms as the preceding year, and is equivalent to 6% of the capital expenditures in the budget.

4.20 A significant part of the government support is in the form of equity contributions to the various public sector corporations which are supposed to provide capital services, amplified if necessary through appropriate gearing, for their operations. Thus an investment of approximately ₱ 1.1 billion implies an annual flow of ₱ 160 million of such services,/2 which should be added to direct funding for outlay expenditures to obtain a measure of aggregate government support. More practically, however, it must be recognized that in the Philippines, equity contributions may not really be very different from the latter, particularly, for the nonfinancial corporations. For example, in the case of NHA, all government funding, although termed equity contribution, represents in great part the accumulation of assets with minimal turnover.

E. Macroeconomic Implications

4.21 It is difficult to estimate accurately the macroeconomic impact, particularly on savings mobilization, of the compulsory contractual savings scheme that HDMF represents due to the absence of any meaningful data on the savings behaviour of wage earners in the Philippines. Furthermore, the novelty of the program precludes placing much reliance on the sample survey of the membership for information pertaining to their perception of the fund or their contributions. Similarly, any extrapolation of the profile of depositors/savers of the one savings bank that had this information is fraught with methodological difficulties. It is thus necessary to make some heroic deductions from the national income accounts.

4.22 Although the level of gross accumulation in the economy has been relatively constant around 25% of GNP and that of savings (i.e. excluding capital consumption allowance) at around 15% during 1978-80 (Table 4.4),

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/1 The breakdown is as follows: equity contributions of ₱ 310 million for NHA, ₱ 25 million for NHMFC, ₱ 80 million for HSDC, and ₱ 20 million for HFC together with ₱ 500 million for MHS outlays.

/2 This figure assumes an opportunity cost of capital of 15% which is the average rate reflected by the yields on various government securities.

Table 4.3: SUMMARY OF GOVERNMENT ASSISTANCE TO THE HOUSING PROGRAM, CY1976-80
(In million pesos)

Particulars	Current operating	Equity	Buildings and structure outlay	Loans outlay	Land/land improvement	Total	Purpose
National Housing Authority							
1976	10.000/a	78.645	116.287	-	-	204.932	Equity investments to finance
1977	-	111.530	2.000	-	-	113.530	various housing projects of
1978	13.400/b	106.609	-	-	-	120.009	NHA including sites and ser-
1979	30.600/b	287.560	21.500	-	-	339.660	vices upgrading, zonal im-
1980	-	214.128	-	129.168	-	343.296	provement and resettlement projects.
Total	54.000	798.472	139.787	129.168	-	1,121.427	
National Home Mortgage Finance Corporation							
1978/79	-	100.000	-	-	-	100.000	Equity investments for the
1980	-	50.000	-	-	-	50.000	National Shelter Program of NHMFC.
Total	-	150.000	-	-	-	150.000	
Human Settlements Development Corporation							
1978	-	2.337	-	-	-	2.337	Equity investments for urban
1979	-	9.358	-	-	-	9.358	development projects.
1980	-	5.00	-	-	-	5.000	
Total	-	16.695	-	-	-	16.695	
Home Financing Corporation							
1980	-.	60.000	-	-	-	60.000	Equity investments for home mortgage insurance guarantee.
Ministry of Human Settlements							
1979	-	-	376.000	-	-	376.000	For Bagong Lipunan Improve-
1980	-	100.000	400.000	-	-	500.000	ment of Sites and Services (BLISS) Program.
Total	-	100.000	776.000	-	-	876.000	
Ministry of Public Highways							
1977	-	-	-	-	4.516	4.516	Dagat-dagatan access road
1980	-	-	-	-	2.421	2.421	BLISS projects road component (access road).
Total	-	-	-	-	6.937	6.937	

/a Gratuity payments for absorbed personnel.

/b Grants.

Source: Ministry of the Budget.

Table 4.4: RELEVANT NATIONAL INCOME ACCOUNTS: 1978-80
(₱ billion) Current Prices

	1978	1979	1980/a
GNP	178.1	218.3	264.3
GDP	178.6	219.1	266.5
Personal consumption	118.8	144.1	178.0
General government consumption	16.6	18.3	21.4
GDCF	51.7	65.3	80.6
GFCF	42.5	53.9	67.5
Construction	22.4	28.7	36.4
Government	10.3	12.6	15.3
Private	12.1	16.1	21.0
Residential	6.7	8.9	11.4
GDCF Financing			
Net Borrowing	8.4	10.7	14.9
Gross Accumulation	43.3	54.6	65.7
Savings	26.6	34.1	39.4
Personal	9.6	10.4	10.4
Corporate	9.8	12.1	13.7
Government	7.2	11.7	15.3
Capital consumption allowance	16.8	20.5	26.3
Personal Income Receipts /b	134.8	163.9	197.4
Employee compensation	61.2	78.4	95.1
Entrepreneurial and property income	68.7	79.5	95.6
Personal Expenditures /b	134.8	163.9	197.4
Consumption	118.8	144.1	178.0
Savings	9.6	10.4	10.4
Direct taxes	3.1	4.0	5.1
Social security contributions	2.0	2.3	2.7

/a Preliminary estimates.
/b Totals do not add since miscellaneous items have been omitted.

Source: National Income Accounts, NEDA.
(Preliminary Estimates as of June 1, 1981).

the distribution of savings between the personal, corporate and government sectors has changed significantly. During this period, excluding capital consumption allowance, the share of personal savings dropped from 36% to 26% of the total while the Government's share rose from 27% to 39%; the corporate sector showed a marginal decline from 37% to 35%. As a percentage of personal income, the share of savings dropped from 7% in 1978 to 5% in 1980. It may be worthwhile to note at this juncture that during this period the national aggregate personal income has been evenly divided between employee compensation and entrepreneurial income as sources.

4.23 It appears reasonable from the above and the decline in real wages noted earlier, to infer a scenario whereby the squeeze on the wage earning class inhibits the accumulation of voluntary savings. An alternative hypothesis, that a larger share of income is accruing to those with a lower propensity to save, would have broadly similar implications for this analysis, but is highly improbable for a variety of reasons including the observed stability in the shares of employee compensation and entrepreneurial/property income. In either case, HDMF is likely to lead to some increased mobilization of savings.

4.24 It is nevertheless true that not all the funds generated by HDMF will be a net addition to national savings. There are several offsetting factors; a major one being that between 27% to 34% of the total essentially represents a transfer from government revenue (see para. 4.29). Even as regards employee contributions, a significant proportion of HDMF members, especially those in middle and upper income groups, save some of their income in financial institutions with a variety of motives. To the extent that they do so for purposes of housing or provident funds, there would be a substitution of these savings. Secondly, compulsory levies of this kind have the same impact as additional taxes in that they reduce disposable incomes, and as a result must also reduce gross national savings. (The HDMF will offset this effect only to the extent that its operations result in a larger net contribution to national savings.) For example, an effective average marginal propensity to save of 0.20 would mean that 10% of the aggregate funds mobilized have effectively been transferred from other savings institutions. Finally, it is possible that most employers will try to compensate for their contribution to the fund through reductions in future wage increases or other benefits. This is especially true in view of the Government's encouragement towards HDMF being treated as part of the benefits package. Again, to the extent that the reduced employee benefits pertain to savings (e.g. provident fund or housing), the net impact of HDMF shall be lower. However, in the short run this may not be a major factor since those employers who provide such benefits are being exempted anyway.

4.25 Similarly, some of the funds mobilized through BMPCs will probably be at the expense of those that would have been available for other government borrowing (see Section C above). Given the significant role of government in other sectors, particularly in regional and industrial development, the trade-off is quite explicit. One aspect of the trade-off, not mentioned above but discussed elsewhere (see Chapter VI), concerns the distributional consequences especially if the funds mobilized through BMPCs are used for high or middle income housing.

4.26 Finally, we may also note that not all of the resources mobilized as described above will be used for housing investment. Depending upon the financial strategies chosen, some fraction of the funds will have to be invested for other purposes to maintain the financial viability of the corporations. This point is dealt with further in Chapters V and VI.

4.27 In summary, it is expected that there will indeed be some net generation of additional personal savings in the economy through HDMF. A significant proportion of the total resources mobilized by the fund will, however, be an effective transfer from government revenues. Furthermore, there will be a diversion of investible funds into housing in two ways, which will lead to a higher cost of capital in the economy. First, part of the resources in HDMF represent a substitution for other forms of financial savings which would otherwise be in various private financial institutions. Secondly, borrowing through BMPCs will compete primarily with other government borrowing, thus raising market rates of interest. Thus the net macroeconomic impact will be a combination of the effects of a higher cost of capital, thereby affecting industry and other sectors in the short run, and the channeling of additional capital resources into housing. The latter should lead to some increases in output and employment (See Chapter VII).

F. Fiscal Impact

4.28 The operation of HDMF will also have a significant fiscal impact in terms of budgetary revenues forgone as well as increased government expenditures. The loss in revenue is due to employers' contributions being tax-deductible; assuming an average marginal tax rate of 35% on corporate income, for every peso credited to the account of a private sector employee, the loss in revenue equals 17.5 centavos. In the case of public sector employees the entire employer's contribution is borne by the Government.

4.29 In 1981, the fund membership was almost evenly split between private and government employees. Assuming similar distributions of basic salaries, this corresponds to at least 34% of HDMF contributions being effectively a transfer from the budget./1 Of course, as the coverage is extended in the future, a larger proportion of the fund membership will be in the private sector. Based upon a split corresponding to the current ratio of active contributors in GSIS and SSS, approximately 30% of HDMF members

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/1 The figure is a conservative estimate since a comparison of the cumulative distributions of basic salaries for GSIS and SSS members reveals the former to be well to the right (i.e. higher).

would be employed by the Government. This would still imply an effective transfer from the budget of more than 27% of the aggregate level of HDMF contributions. For example, a cumulative collection of ₱ 8 billion by 1985 would include an effective net transfer of about ₱ 2.6 billion from the budget.

4.30 In addition to the above, the exemption from taxes of interest earnings from HFC-insured mortgages and loans will lead to a further decline ceteris paribus in government revenue. Similarly, in the secondary mortgage market, series A of BMPC's represent an investment with tax-free yields. Depending upon the nature of securities they displace as well as the investing institutions, these may well have a net budgetary impact.

G. Financial Policy Implications

4.31 The interest rate of 9% on PagIBIG loans as well as the rates on mortgage loans by other lenders such as SSS and GSIS (See Chapter III) are significantly below the levels in the open market, or even the opportunity cost of capital as indicated by the return on alternative uses of capital resources. Thus, for example, the present value at a discount rate of 15%, of the repayments /1 made over 25 years on a ₱ 100,000 loan, amount to only about ₱ 70,000. In aggregate terms, an HDMF lending program by 1985 of P2 billion annually represents an implicit transfer of ₱ 600 million to the borrowers. Although, strictly speaking this transfer is actually distributed over the whole life of the loan, it is nevertheless instructive to compare it with the aggregate subsidies in the national income accounts which were ₱ 760 million in 1980.

4.32 The interest rate subsidy represents a transfer from the general membership to the borrowing members. In addition, as mentioned above in the preceding sections, there are other transfers as well, primarily from government revenues either to HDMF members, or to the residential construction industry, including the associated financial institutions through the various tax incentives. The high absolute and relative magnitude of these transfers raises a variety of issues pertaining to both the efficiency and equity aspects, and have significant operational implications for resource allocation at the national level and economic development policy. Thus, it is imperative for the Government to make an explicit consideration of the full costs and benefits of various government interventions to achieve socio-economic goals in an economy-wide context as well as recognize the importance of targetting assistance for housing with respect to income group.

/1 Repayment stream calculated for a 25-year term at 9% and including an additional 10% contribution to the Housing Contributory Fund (HCF) from the 4th year onwards. Without the 10% contribution the present value is only ₱ 66,000.

4.33 Approaching these issues from another perspective, it should be noted that the basic thrust of the financial sector reforms being undertaken since 1980 was a significant decontrol and deregulation of the financial sector, especially vis-a-vis the interest rates in the system. Thus, two interrelated questions arise with respect to the housing finance initiatives of the Government. The first relates to the low level of the mortgage rates for housing loans, while the second pertains to whether such rates should be fixed or flexible.

4.34 The establishment of an interest rate below market level on mortgage loans is meant to address the affordability problem. It should enable a significant segment of the population, which could not meet repayment schedules otherwise, to purchase their homes. The alternative modes to meeting the housing needs of these groups would be a straight front-end purchase subsidy or a public housing rental program, which have their own problems including, among others, the heavy requirements on administrative effort. However, a major drawback of the present interest-rate subsidy is that it is regressive in nature since the amount varies in direct proportion with the loan size. Hence, to achieve the Government's objective, it becomes imperative to maintain greater control to ensure nonregressive use of the funds. Indeed, this is the rationale behind the limits on loan sizes stipulated by the various agencies. However, given the relatively wide band in the income distribution that is desired to be aided and the group that contributes to HDMF, this may not be enough, especially since the effective limits are quite high. Instead, it may be more useful to specify a distribution on the output mix, i.e. types of homes fincanced (See Chapter VI).

4.35 Maintaining flexibility on the interest rate would have obvious advantages, and would be in line with the general thrust of the recent interest rate reforms. Some caveats are, however, in order. First, too much variation may weaken the market consolidating function of the fund. Second, if the integrity of HDMF as a trust fund of its members is to be maintained, a relative balance between the borrowing and lending rates, as well as in the amounts raised through contributions and benefits to members should be maintained. Finally, it should be noted that at least in the short run, the "marketing" of the fund may be quite dependent on the highly publicized 9% rate.

V. DEVELOPMENT OF FINANCIAL INSTITUTIONS AND INSTRUMENTS

A. Introduction

5.01 Having examined the macroeconomic implications of the current housing finance system, this chapter focuses on the degree to which the institutions and instruments of the system have developed toward the goal of increasing access to housing finance and channelling investible funds into housing. After reviewing the financial instruments and terms, and tracing the evolution of the secondary mortgage market, it discusses some aspects of interim financing and concludes with an analysis of the issues pertaining to the development of appropriate financial instruments.

5.02 A distinctive feature of the approach to institutional development in this sector in the Philippines is that it does not follow the conventional path typical of many nations, particularly the industrialized countries. Specifically, they have avoided the establishment of specialized financial institutions for home financing such as savings and loans associations in the US. This may help circumvent some of the problems such institutions have been facing, which are due in great part to their high degree of specialization.

5.03 Instead, the Government has focussed on the creation of a secondary market institution, namely, the National Home Mortgage Finance Corporation (NHMFC). The establishment of NHMFC, as well as the operations of HDMF outlined earlier, appear to be in consonance with the recent financial sector reforms. In particular, these developments obviate the need for special housing finance institutions at the primary or retail level, and any financial institution with retail operations may enter the business with minimal effort. On an ancillary note, the introduction of the fee-based banking concept, as opposed to margin-based banking, may also foster desirable incentive effects towards increased competition.

B. Financial Instruments and Terms

5.04 For the most part, the fixed interest rate, fixed maturity, equal payment mortgage is the prevailing instrument for formal housing finance in the Philippines. For development and construction lending, the instrument is the same, although the very short maturity of these loans makes the fixed interest rate provision less significant. GSIS has done some experimentation with graduated payment mortgages, but these have been infrequent and make up no noticeable part of the housing finance system.

5.05 Recently, private financial institutions have begun some experimentation with floating rate loans for housing. These loans carry interest rates six percentage points above the Manila Reference Rate (MRR), an average of the deposit costs of the five largest banks in the Metro Manila region. Recently, the MRR was at about 16%, implying a mortgage rate of about 22%. Although these loans carry floating rates, they are still of short maturity, often as short as three years. In general, bankers are not satisfied with this type of loan, since the MRR is sluggish relative to market rates, even though deposit rates have been decontrolled.

5.06 The HDMF projects that its loans will contain a one-step graduated payment. In the fourth year of a mortgage loan granted through HDMF, amortization payments will jump by 10%, with the incremental collections devoted to a Housing Contributory Fund (HCF) which will be used to sustain the lending operations of HDMF. This raises the effective interest rate on HDMF loans.

5.07 The terms for mortgage loans originated by private firms and government entitites are shown in Table 5.1, while the effective rates based on the fees are shown in Table 5.2. Clearly, these show a wide variation. In general, the fees charged by SSS are the lowest. When combined with the concessionary interest rates on these loans, the effective rates on SSS loans are the lowest of all lenders. Within the government sector, the highest fees are connected with the HDMF loans. The major element here is the 5% origination fee granted to the originating institution. This fee, and the 2% servicing fee appear to be above market levels and are imposed in part to induce private financial institutions to deal in long-term loans. Together with the HCF contribution, the net impact is to increase the nominal 9% rate by about 93 basis points, to an effective rate of 9.93%.

5.08 While private sector interest rates are high and loan terms short, fees are negligible. The differences which exist between the nominal rate and the effective rate for private sector mortgages are due to the relatively high downpayment requirements. GSIS fees are high relative to SSS, but in general do not increase the nominal interest rate to any great extent.

Table 5.1: MORTGAGE RATES AND TERMS

Term	GSIS	SSS	DBP Individual housing	DBP Open housing	DBP PARI-PASU with DBP	HDMF /a	Private financial institutions
Interest rate	15-20 yrs 6% - 1st 30,000 9% - next 40,000 12% - over 70,000 ₱ 90 K average	5 yrs in incre- ments of 5-25 yrs 6% - 1st 30,000 9% - over 30,000 Max = ₱ 50,000	25 yrs 12-15% Max ₱ 100,000	15 yrs 14%/a Max ₱ 120,000	- 14% -	10-25 yrs 9% Max ₱ 100,000	10-15 yrs 22 % No max (₱ 350,000)
Origination and processing fees	1% of loan	₱ 1.00/₱ 1,000 of loan ₱ 15 minimum ₱ 50 maximum	------- ₱ 750 ---------			₱ 500 for loans to ₱ 100,000	(a) 1/2%-1-1/2% of loan amount (b) ₱ 100/₱ 1,000 loan amount Min. Min. ₱ 100. Max. ₱ 1,000 Refundable if loan is approved
Commitment fee	n.a.	n.a.	-- 1/8 of 1% of unreleased -- balance			n.a.	n.a.
Inspection fee	n.a.	₱ 50		n.a.		n.a.	n.a.
Documention & notary fees	₱ 1.00/₱ 1,000 amount of loan	n.a.		n.a.		n.a.	n.a.
Service charges Members Nonmembers	 1% of loan 2% of loan	n.a.		n.a.		2% of unpaid balance	n.a.

/a HDMF requires an additional contribution to the Housing Contributory Fund eqal to 10% of the mortgage payments from the 4th year onwards.

Source: Data obtained from respective financial institutions.

Table 5.2 EFFECTIVE AND NOMINAL MORTGAGE RATES
(In percent)

	Nominal rate /a	Effective rate
GSIS		
- 10-year term	8.66	8.84
- 20-year term		8.81
SSS	7.20	7.20
DBP	13.00	13.19
HDMF	9.00	9.93
Private loans		
- 5 years	21.00	21.48
- 10 years		21.30
- 15 years		21.25

/a Weighted average based on average loan amounts.

Source: Data obtained from respective financial institutions.

C. The Secondary Mortgage Market: The Evolution and Activities of NHMFC

5.09 The secondary mortgage market in the Philippines is in a very early stage of development, with its beginning marked by the establishment in 1979 of the National Home Mortgage Finance Corporation (NHMFC) under the Ministry of Human Settlements. Essentially, NHMFC was intended to provide liquidity to long-term paper by providing a market for mortgage loans. This would encourage private financial institutions to originate long-term loans by giving them a hedge against adverse interest rate movements. If rates were to rise during the course of the commitment period (12-18 months), the loans would be sold to NHMFC and the proceeds reinvested at higher market rates. If interest rates fell, the loan could be retained in portfolio.

5.10 In the secondary market system, NHMFC is the sole buyer of home mortgages originated by accredited banking institutions in accordance with standard underwriting guidelines. Thus, a secondary function of NHMFC, if it succeeds in establishing a real market for mortgage loans, would be the homogenization of rates, terms and underwriting criteria among different mortgage lenders. Private financial institutions would continue to be a major source of mortgage credit, but would also serve NHMFC as agents, investors and dealers for the corporation's debt instruments. There would be a close linkage between the primary and secondary markets.

5.11 As of June 1981, NHMFC had purchased mortgages from DBP and ten other financial institutions worth a little over ₱ 250 million (see Table 5.3). The vast majority (over 70%) of these loans were existing mortgages originated either by DBP or NHA. Of the new mortgages purchased, the majority were originated under the DBP "open housing" program. A small part of total NHMFC purchases (13.5%) were loans granted to HDMF members./1 Table 5.4 displays the size breakdown of the loans purchased by NHMFC. For the most part, the HDMF and BLISS /2 loans were for amounts below ₱ 90,000, while the open housing loans were at the ₱ 120,000 maximum loan limit. Given the terms of HDMF loans, the average income implied by NHMFC purchases was about ₱ 34,000 per year, comparable to the clientele served by the GSIS loans. For all NHMFC purchases, the average loan amount is about ₱ 96,000.

5.12 With the inception of HDMF, NHMFC took on another function, the management of the HDMF investment portfolio. NHMFC effectively borrowed the HDMF funds at a rate of 12%, and invested these funds in a manner consistent with prudence and profitability. Ostensibly, the major part of those investments would be mortgages originated by accredited financial institutions for HDMF members. This relationship raises certain policy problems which are explored in chapter VI.

/1 By the end of February 1982, NHMFC mortgage purchases were worth about ₱ 375 million; the proportion of existing mortgages had fallen to 40% while that of loans granted to HDMF members had increased to about 40%.

/2 BLISS is an integrated community development effort under the auspices of the Ministry of Human Settlements.

Table 5.3: NHMFC MORTGAGE PURCHASES, from March 1980 to June 1981

Financial institutions	BLISS	New primary mortgages (NPM) Pag-IBIC	Open housing	Total of NPM	Existing mortgages	Total
DBP	14,351,971.00	18,675,900.00	20,895,900.00	53,923,771.00	25,000,000.00	78,923,771.00
Banco Filipino	-	7,652,559.20	220,000.00	7,872,559.20	19,999,755.91	27,872,351.00
First Summa	-	5,173,000.00	4,308,500.00	9,481,500.00	-	9,481,500.00
Solid Homes Savings Bank	-	530,000.00	580,000.00	1,110,000.00	-	1,110,000.00
Citibank	-	-	-	-	25,000,000.00	25,000,000.00
Philippine Veterans Bank	-	1,061,463.00	-	1,061,463.00	-	1,061,463.00
BF - NHA /a	-	-	-	-	92,545,927.00	92,545,927.00
Royal Savings Bank	-	-	-	-	1,605,368.12	1,605,368.12
Manila Bank	-	-	-	-	10,000,000.00	10,000,000.00
Maunlad Savings Bank	-	880,000.00	505,000.00	1,385,000.00	-	1,385,000.00
Perpetual Savings and Loan	-	80,000.00	365,000.00	465,000.00	-	465,000.00
Misc. building and loan associations	-	-	-	-	1,970,000.00	1,970,000.00
Total	14,351,971.00	34,052,922.20	26,894,400.00	75,299,293.20	176,121,051.03	251,420,344.23

/a Loans closed under NHA programs.

Note: BLISS is the only group housing program, while Pag-IBIG and open housing pertains to individual programs.

Source: NHMFC

Table 5.4: DISTRIBUTION OF LOAN VALUE OF PRIMARY MORTGAGES ABSORBED BY NHMFC (as of June 1981)

Size (₱)	Program	BLISS	Pag-IBIG	Open housing	Total
Below	50,000	-	18	11	29
50,000 -	59,999	-	6	0	6
60,000 -	69,999	-	16	2	18
70,000 -	79,999	-	28	7	35
80,000 -	89,999	148	292	6	446
90,000 -	99,999	-	1	4	5
100,000 -	109,000	-	5	9	14
110,000 -	119,999	-	0	1	1
120,000 -	129,999	-	4	215	219
Above	129,999	-	1	7	8
Total		148	371	262	781

Source: NHMFC.

5.13 NHMFC is funded through both equity contributions and debt issues. The corporation has an authorized capital stock of ₱ 500 million consisting of 500,000 shares each with a par value of ₱ 1,000, fully subscribed and paid for by the Government. Additional funds are raised through the sale of Bahayan Mortgage Participation Certificates (BMPC). These, despite their title, are debt instruments which are sold on a tax-exempt (Series A--8.5% interest rate) and a taxable (Series B--14%) basis to financial institutions. BMPC's are collateralized by the mortgages held by NHMFC although they are obligations of the Government. They are eligible as nonrisk assets for banks since the collateral mortgages are all insured by HFC, and may satisfy the reserve asset requirements of insurance companies. These features are supposed to compensate for the fact that the interest rate attached to them is below that of alternative investments available to the institutions.

5.14 As at the end of 1981, approximately ₱ 256 million of BMPCs had been sold. Of these 61% were sold on a tax-exempt basis. The major holder of these securities is the largest savings bank in the Philippines with about ₱ 100 million. In general, the Series A securities have been more attractive to savings banks. The BMPCs have a term of 6 years, so the acquisition of these securities represents a lengthening of the portfolios of most private financial institutions.

5.15 The amount of BMPCs sold has been below the projections made by NHMFC. For 1981, for example, BMPC sales are projected at ₱ 1 billion, a figure that is unlikely to be reached. This suggests that the estimates for subsequent years may also be too high. If this is the case, then NHMFC will need to rely on more costly sources of funds in the future, hampering its ability to serve effectively the development of a secondary market (paras. 5.25-27).

5.16 As currently structured, NHMFC operations are predicated on the existence of a market for BMPCs. The securities serve as the major vehicle for recycling private institution funds through the mortgage market. NHMFC sells the securities to various private financial institutions and, in doing so, increases the supply of funds through mortgage financing. By matching mortgage purchases with the BMPC sales, NHMFC may be able to redistribute the available pool of mortgage funds and alleviate the chronic excess demand that exists within the Philippine housing finance system. The problem here is that BMPCs face a limited market. They do not carry competitive market rates and are of somewhat longer maturity than would be preferred by financial institutions. They are purchased for tax and regulatory considerations. Thus, BMPCs will not provide a long-term stable source of funds to NHMFC unless they are able to compete with other securities on a rate of return basis.

5.17 On the other hand, if BMPCs carry interest rates that are competitive with other securities, NHMFC will need to hold a portfolio of market rate mortgages or be faced with a negative spread. It cannot borrow through BMPCs at 16% or 17% to invest in HDMF or DBP mortgages which yield 9% or 14%. A movement to the purchase of market-rate mortgages originated by private financial institutions should strengthen the development of the secondary mortgage market, but will weaken the connection between NHMFC and HDMF that has been so carefully developed. This question deserves fuller treatment and is considered in the next chapter.

D. Interim Finance

5.18 There are two distinct features of the financing system for the construction of houses that merit attentión. The first concerns the more conventional bridge financing /1 for developers and contractors, while the second pertains to the financing (actually, the lack thereof) of sites and services where the completion of the dwelling units are the reponsibility of the final homeowners. For the most part, both these sets of issues stem from the current practice in the formal housing finance sector which focusses essentially on credit only for completed houses/2 and, as outlined below, the resolution of both may lie at least partially in similar measures.

5.19 One of the major aspects of the segmentation of the Philippine housing finance system (see Chapter III) is the inability of small developers to secure interim financing for residential construction projects. Large developers are indeed able to secure credit from commercial and savings banks, but such developers are often not the most efficient producers of housing especially for lower income groups. Although the loans are usually guaranteed by HFC, this does not appear to appreciably increase the accessibility for small developers. Since the banks have to hold the property in the case of default and because financial institutions are not in the business of holding property, they choose only the best risks when considering interim financing, namely the well-established enterprises./3

/1 Short-term financing between the termination of one loan and the commencement of another, or between the acquisition of a property and its improvement or rehabilitation to make it eligible for a permanent mortgage, or between the maturity of a construction loan and the negotiation of permanent financing.

/2 The limited residential construction loans granted to individuals by private and some public (e.g. GSIS) financial institutions, appear to be confined to very high income individuals. SSS does make such loans to its members but has several reservations about underwriting sites and services dwelling units. GSIS and DBP provide development and construction finance for their mass housing projects but mainly to large developers. See the following para.

/3 Similar behavior is exhibited by various public agencies (GSIS & DBP) involved in construction and development finance of mass housing projects.

5.20 Another major gap in the housing finance system is the unavailability of financing for sites and services residential projects or for slum upgrading./1 While it is difficult to envisage a leading role for private financial institutions in the latter, viz. upgrading, due to the complex institutional processes involved, this need not hold true for sites and services projects which are no different in the financial structure sense than conventional residential developments. The only deviation occurs in the timing of when the interim loan is converted into a long-term mortgage. The primary reasons for lack of financing of sites and services projects appears to be the perceived softness of the market and the reservations of the various financial institutions concerning the appropriate underwriting standards.

5.21 The above problems may be alleviated to a significant extent through guaranteed take-out mortgage financing. This would make it easier for developers to raise construction funds more easily from the various financal institutions, since a major source of hesitation on the part of potential lenders is the uncertainty of the timing and value of the sale of the product they finance. Such takeout commitments may also be used to steer the industry towards financing and thus development of sites and services projects (see following chapters) since they address the twin issues of market firmness and underwriting standards. In addition to spreading the available funds wider, sites and services projects also serve to mobilize a greater amount of resources through the personal savings of the borrowers and the informal mechanisms, which are used for expansion of the basic core units. Thus, these developments would provide an essential link to connect the formal and informal housing finance sectors.

5.22 There are other direct ways of attacking the bridge financing problem. The first of these is to improve the guarantee system and extend it to smaller developers. This would increase the access to housing finance for producers of housing and thus the supply of housing for the population at large. Alternatively, DBP could enter the market by making direct loans for bridge financing to small developers. This increase in access for developers, it should be noted, would have its greatest impact outside the Metro Manila area. It is outside Manila that small builders and developers are most significant in the supply of housing. Increasing their ability to produce housing would cause a geographical homogenization of the housing market.

/1 Such activities are confined to the National Housing Authority (NHA), a government corporation, primarily as part of World Bank supported urban projects.

E. Major Issues

5.23 The discussion above, together with that in Chapter III, raises an interrelated set of issues. These include those pertaining to the development of alternative mortgage instruments, the secondary mortgage market, and mechanisms for tapping a larger share of investible funds of private financial institutions for housing development. These are analyzed below.

Alternative Mortgage Instruments

5.24 There has been very limited use of alternative mortgage instruments in the Philippines. Private financial institutions have experimented with a variable rate mortgage tied to the index of interest rates paid by savings banks, but this has proven to be too static to really appeal to lenders. GSIS has implemented graduated payment mortgages, but these have been quite limited and not sufficiently advertised to become widespread. In the planning documents used by NHMFC, there are descriptions of a number of alternative instruments, presumably as models for mortgage purchases in the future.

5.25 Graduated payment mortgages appear to be the best alternative instrument for addressing the access problem that seems to be endemic in the Philippine system. The most attractive feature of these instruments is that they reduce amortization payments in the early years of the mortgage and thus reduce the household income needed to qualify for a loan. For example, in the case where payments are graduated over a ten-year period at five percent per year, the initial payment can be reduced by about one-third. This means that the household income needed for a GSIS loan would be reduced from about P 40,000 per year to about P 27,000 per year.

5.26 There are drawbacks here. From the borrower's point of view, income must rise as mortgage payments rise or the payment will become an increasing burden. Thus the graduated mortgage is not suitable for all households. It is, rather, an instrument designed for those with good earning prospects but lacking the income to qualify for a mortgage loan under current conditions. From the lender's point of view, the graduation of payments means shrinking borrower equity in the early years of mortgage. Hence the risk of default increases. With government insurance, however, this problem can be mitigated.

5.27 Variable rate mortgages are preferred by lenders. As payments increase with increases in market interest rates, the lender's return keeps pace with the market. Thus, what may on paper be a long-term instrument has the yield characterisics of a short-term instrument. The use of variable rate mortgages in the Philippines, tied to a rate that lenders felt reflected market movements, would increase the willingness of private lenders to enter the mortgage market and thus increase the supply of funds to housing. For borrowers, the effect of variable rate mortgages is quite the opposite. Whereas previously the burden of bearing the interest rate risk fell on the lender, it would now fall on the borrower. This would increase the risk of default during periods of rapidly rising interest rates. The prospect of mass default and the resulting political pressure to keep interest rates low would make variable rate mortgages difficult to use on a wide scale.

The Secondary Market

5.28 The operations of NHMFC have not included any significant private sector participation, are dependent on a thin source of funds and at present are closely tied to the Home Development Mutual Fund. While the ingredients for an effective secondary market agency are present in the organization of NHMFC, the direction of the institution needs to be adjusted if it is to develop into an effective mortgage trader.

5.29 One of the major purposes of a secondary market for mortgages is to reduce the risk of mortgage lending by assuring a liquid market for mortgage paper. That assurance will induce private lenders to commit funds to housing. But to be effective, the purchases by the secondary market agency must be at prices that will reflect market rates of interest. To date, NHMFC has concentrated its purchase activity on concessionary rate government loans. Of the total of NHMFC purchases through June 1981, over 76% have been concessionary rate mortgages. Additionally, the close relationship of NHMFC with HDMF implies that future purchase will be concentrated in government subsidized mortgages as well.

5.30 Currently, NHMFC is contemplating a gradual increase in the rates of its "open housing" loans, until they are on a par with private institution loans. This will force NHMFC to become financially capable of acquiring a portfolio of private sector paper, but still restricts the secondary market to government paper.

5.31 Some private sector involvement will come through the HDMF program as banks originate the loans for sale to NHMFC and purchase BMPCs. But the origination process is merely a service, for which the banks receive a generous fee, and represents no real portfolio commitment. Further, the purchase of BMPCs by private financial institutions is limited and dependent on non-yield features.

Marketing of BMPCs

5.32 NHMFC sees its real connection with the private sector coming through the sale of BMPCs. Currently these are debt instruments, but NHMFC projects that they will eventually be converted into real participation certificates./1 They are also projected to become the largest source of funds

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/1 In a mortgage participation certificate the investor has an equity interest in the pool of mortgages backing the issue.

to NHMFC. The yields are low relative to the market: the effective yield is 15.12% for the taxable series and 9.23% for the tax-exempt, the latter being equivalent to a pre-tax yield of 15.4% to the corporate taxpayer. The securities are purchased because of the regulatory benefits that are attached to them./1 In addition, NHMFC is lobbying to qualify BMPCs for the 25% agri-credit requirement imposed on financial institutions./2

5.33 Even with all the qualifications attached to the BMPCs, their market will remain thin, unless they are offered at yields competitive with other market securities. While some banks have made a major commitment to purchase the securities as a sign of their commitment to housing, for the most part, BMPCs have limited attractiveness to financial institutions. For private investors paying high marginal tax rates, BMPCs may be attractive. However, when the Philippine tax system changes next year and marginal rates are reduced, they will lose this attractiveness relative to alternative market opportunities./3

5.34 There are two alternatives to promote BMPCs as a stable source of funds for NHMFC. The first of these is to collateralize the issue of BMPCs with market rate mortgages. This allows NHMFC to offer competitive yields on BMPCs and yet cover its required operating spread. However, doing this would require that NHMFC hold a portfolio that was dominated by market rate mortgages. This would involve the decoupling of NHMFC and HDMF so that each exists on its own merits. Such a strategy has not been the inclination of NHMFC to date; it is, however, one worth considering (see Chapter VI).

5.35 The second possible scheme which is now in effect is to upgrade BMPCs is to have them issued on the same basis as other government debt through the control of the Monetary Board. In this case, BMPCs have access to the same market as government debt and the allocation of funds to housing could be considered on a centralized basis and compared with other claims on the government's borrowing capacity. The drawback here is that the flow of funds to the secondary mortgage market would be beyond the complete control of NHMFC and its position as the secondary market maker will be weakened. This would also imply holding a larger proportion of higher-rate mortgages.

/1 These include their being classed as nonrisk assets for the purpose of computation of risk-asset ratio. It fulfills reserve requirements for insurance companies.

/2 Financial institutions are required to devote 25% of their portfolios to agriculture or agrarian reform. In practice, there is a wide range of eligible assets, many of which have little connection with agriculture (See Chapter IV).

/3 In 1982, the system of itemized deductions will end and, in compensation, tax rates will be reduced drastically. The highest marginal rate will be halved to 35%.

VI. RATIONALIZATION OF THE INSTITUTIONAL STRUCTURE

6.01 This chapter includes, first, a brief identification of the problems faced in the public delivery of housing services, followed by an equally brief section on planned government activity. The third part provides a summary discussion of various programs constituting supply-side interventions, and together with the first two sections, sets the stage for the concluding section, which comprises an analysis of the institutional structure and some aspects of its rationalization.

A. Introduction

6.02 The institutional structure of public sector involvement in housing in the Philippines has seen several changes since the mid-1970s as the Government has tried to determine an effective mode of intervention in the housing sector. The process has not been strictly evolutionary, given the general tendency of the Government to react to problems and structural deficiencies in all sectors by the *ad hoc* creation of new institutions./1 For example, the Ministry of Human Settlements (MHS) was established in 1978 and charged with the tasks of shelter system development and environmental management as well as land use and town planning. Thus, all governmental functions relating to housing were placed under the jurisdiction of the Ministry, in a sense repeating the process which surrounded the creation of the National Housing Authority (NHA) in 1975.

6.03 It may thus be instructive to note several problems with the policies and operating procedures of NHA, many of which derive from the complex external environment but are also representative of the issues involved in the sector in general. The problems include those connected with new concepts, fragmented activities and coordination, together with land acquisition and finance which are outside its control. These are compounded by recent changes in structure and policies of MHS, as well as political infighting between MHS corporations. Structural problems concern cost recovery and inadequate return on investments (the margins on low-income oriented activities do not leave much room for maneuver), difficulties with cross-subsidization attempts and the accumulation of unproductive assets. The last includes a growing inventory of properties with no buyers.

6.04 Partly as a result of these problems, the Government announced in October 1981 its intention of merging NHA into its sister agency HSDC.

/1 For a discussion of this with respect to the financial sector, see "The Philippines: Aspects of the Financial Sector," IBRD, May 1980.

However the latter, also an executing arm of MHS, has several problems of its own, especially regarding the BLISS /1 projects. Its relatively short track record provides a limited basis for future plans. For example, the urban BLISS projects have been heavily subsidized even when land was made available at no cost; in any case it is doubtful that these units would be appropriate for any but the upper-middle income groups.

6.05 Given the political economy of housing in the Philippines, it is perhaps inevitable that the Government undertook the programs that it did. However, based upon the realization that direct government construction can only be limited in extent, the nature of intervention is undergoing a qualitative change. Specifically, there is greater emphasis now on private sector involvement through various market mechanisms, particularly in the areas of housing finance as well as upstream in the housing delivery system.

B. Planned Government Activity

6.06 MHS has embarked on an ambitious national shelter development program for the next five years. It envisages the delivery of 30,000 units for housing in the first year,/2 of which 17,000 units are to be provided as part of the countryside housing program in the various regions, while 13,000 are to be constructed in urban areas. The latter would be similar to Urban BLISS, i.e. "low-cost" single-detached or medium-rise walk-up units with an average cost estimated to be between ₱ 80,000 and ₱ 100,000, thereby making them affordable for HDMF membership./3 The new approach to be taken by HSDC involves a significant proportion of joint venture arrangements with private developers together with a scheme for standardization, procurement and supply of construction materials with the objective of reducing costs and speeding up construction. Although the program details are still being planned, the annual value of construction and development is expected to be of the order of ₱ 1 billion.

6.07 The plans of NHA, as they stood at the time of its announced merger with HSDC, envisage a continuation of its current program comprising a mix of activities which include the construction of new units, upgrading

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/1 See Appendix B.

/2 The annual level is supposed to rise to 100,000 units by the end of the five-year plan period 1982-87.

/3 In fact, all of the housing would cater exclusively to HDMF members.

of slum and marginal settlements, sites and services projects, land assembly and titling. The merger should lead to some changes in policy direction, though no sharp discontinuities are expected in the near term since it is to be phased in gradually. The average unit costs are estimated to be ₱ 80,000 for new units and between ₱ 15-17,000 for upgrading and sites and services projects (assuming one dwelling per lot). The projected fund requirements total approximately ₱ 1.4 billion in 1982.

6.08 The housing program of the Government appears over-ambitious, and it is doubtful that the accomplishment will come anywhere near the targets. This is probably self-evident for NHA which, for example, had completed less than 3,000 new units at the end of 1980./2 In the case of HSDC, it should be noted that although it is a newly formed institution, it is similar in organization and staffing to what existed under MHS. Secondly, there appears to be a significant level of over-optimism regarding the construction materials supply program and the elimination of the bottlenecks currently appearing on the supply side of the market. However, the program may have some desirable structural features; thus close monitoring, together with feedback adjustment, may be a reasonable strategy, subject of course to the prior resolution of some of the major issues analyzed later in this chapter (Section D).

6.09 In addition to the programs of MHS, the other public sector agencies, namely GSIS, SSS and DBP, plan to continue their housing finance operations. Except in the case of DBP, which commenced its construction and development finance program in 1980 and is closely involved with NHMFC and HDMF, there have been no major changes in policy recently; nor were any contemplated by these agencies as of October 1981. Thus, GSIS plans to continue lending for middle-income housing, viz. to households with gross incomes above ₱ 24,000 annually, though the number of units is expected to drop from 4,400 in 1982 to around 3,000 annually in 1983 and 1984. SSS, with its low loan limits also expects the decline in numbers of applications and approvals to continue. DBP expects to finance around 3,000 units annually, but projects an increasing proportion to fall under its tie-up with NHMFC (See Chapter III).

/2 Of course NHA has been involved in several activities, most notably upgrading, where it has had a noticeable impact.

C. Initiatives on the Supply Side

6.10 In view of the ambitious targets and the significant level of private sector involvement envisaged, the Government has initiated a variety of measures to stimulate activity on the supply side./1 This includes regulatory reforms, supply of construction materials, credit for materials, take-out finance and project management assistance. However, as will be evident from the description below, there may be some duplication or redundancy. Also, some of the programs have been in place with mixed results, while others have yet to be implemented.

Regulatory Reform

6.11 The major regulatory reform concerns PD 957, the primary law governing subdivisions for residential development. Since the requirements of this decree have proved to be very stringent and a significant barrier to cost reduction, HSRC has recently finalized and approved measures to allow greater flexibility. These include the introduction of three grades of regulatory standards with the lowest one, for example, allowing narrower roads and significantly cheaper drainage systems, as well as smaller lot sizes. HSRC has also taken new initiatives to shorten processing time by allowing the use of affidavits by developers and contractors for some purposes, delegation of authority to the Bureau of Lands for approval of "simple" subdivisions, and an agreement with the Ministry of Trade concerning registration of traders. Another innovation with particular implication for financing is the option to the developer of obtaining a government guarantee (e.g. HFC) as an alternative to posting a development bond equal to 20% of development costs.

6.12 Judged from the initial response of some developers, it appears that there has indeed been some streamlining of the regulatory process; approval of applications may be taking less than half as much time as before. The variable standards should also allow housing development appropriate to income levels. Whether the reduction in costs is passed on to the final homeowners is unclear at this stage.

/1 The Philippine Council for Planning and Housing (PCPH), established recently with membership comprising all the major private sector participants in housing-related activities and with the MHS Deputy Minister as president, is very active in planning and policy design.

Construction Materials

6.13 The new approach formulated by HSDC for the "May BLISS sa PagIBIG" program may also be characterized as a supply-side intervention since a major proportion of the units constructed will be through joint ventures with private developers. HSDC proposes to reduce costs through assuming the responsibility for procurement and supply of all construction materials whence it may negotiate bulk purchases at lower prices and also stimulate greater efficiency, through a guaranteed market, among the producers. Furthermore, by streamlining the supply of such materials it hopes to accelerate the development and construction phases, thereby reducing the "soft" costs. It also seeks further reductions in construction costs through standardization of various components.

6.14 It is still too early to pass any judgement on the above program. However, some factors which may limit the effectiveness of the program are worth noting. First, the estimated 30-40% reduction in costs may be optimistic. Second, it is not clear that construction materials are or have been a significant bottleneck; thus, even though there may be some cost reduction through bulk procurement, it is not clear if construction schedules will necessarily be speeded up. Third, cost reduction would appear even more doubtful, given the limited administrative resources and capability of the government agencies, particularly in programming and planning. Fourth, it is not at all clear if newer developers and contractors, especially smaller ones, will be in any better position to respond. This is related to the fifth and last factor which is that bridge financing, which has been the binding constraint in the past, may continue to be so.

Materials Credit

6.15 To some extent, the construction financing constraint may be alleviated through an appropriate credit mechanism. For example, DBP has had a credit line for the MHS BLISS program. The revolving credit line of ₱ 100 million provides funds for construction materials requirements of the contractors with DBP essentially functioning as a bookkeeper for the aggregate fund. It has a life of five years with drawdown levels projected at ₱ 37 million annually, corresponding to the requirements of seven BLISS projects, all of them within Metro-Manila.

6.16 DBP has another related activity, which is particularly relevant for low-income self-help or self-managed housing, namely the Materials Loan Program which it is administering on behalf of NHA. The program was started in 1978 to provide small in-kind loans (₱ 3,500 maximum), i.e., construction materials on credit, for upgrading of dwelling units in the Tondo area. For a variety of reasons, including the small size, noncompetitive prices and quality, and poor marketing, the program has not been very successful, and as of October 1981, the total number of borrowers stood at only 1,355, compared to around 27,000 affected families.

6.17 In any case, the scope of the above programs has been small and limited, since construction materials constitute only one part of the total requirements for development finance (see Chapter I). Furthermore, they have been instituted only for government-administered housing programs, with DBP actually only functioning as an onlender of government funds and as a bookkeeper. Lastly, the geographical coverage has been limited to Metro-Manila. A national housing program on a much larger scale will require a significant expansion of bridge financing in terms of levels, purpose, geographical coverage and significant participation by private financial institutions as well.

6.18 For private developers, the HFC is in the process of developing the Materials Guaranty Program, and initiatives to deal with problems related to interim financing of construction. These policies seek to service "home-seeking lot owners" organized into homeowners' associations, by arranging interim funding for development and construction and tapping nontraditional sources of credit for the purpose, e.g., 90-day suppliers' credits. In addition to increased financing levels, it is hoped that the system would help streamline the whole delivery system for the projects.

Take-out Finance

6.19 The operations of HDMF display a major linkage between the financial and development/construction parts of the system. In its direct form, this manifests itself in the large (approximately half) proportion of the applications filed and the fact that 30% of the PagIBIG loans granted have been for BLISS units (as of July 1981). In the future, the MHS intends to provide BLISS units exclusively to HDMF members. More importantly, HDMF appears to be serving a market consolidating function and the private sector is responding to service the identified market composed of the potential borrowers from the fund. Thus it is clear that the nature of financing provided by HDMF will determine to a great extent the types of houses that will be built; this fact can be usefully employed by the Government to steer the industry in socially desirable directions.

6.20 The management of NHMFC interprets its corporate mission in a broad manner. Thus, in addition to the various financial subsystems supporting the secondary mortgage market directly, NHMFC has tried to devise its programs to facilitate integration with those of the MHS National Shelter Program. The most significant aspect, of course, is its close relationship with HDMF (see Section D below). In addition, its "open-housing loans" serve a similar function, viz. market identification and consolidation, though indirectly by directing the mortgage origination activities of private financial institutions. It should also be noted that guaranteed take-out mortgage financing alleviates the problem of development finance to a significant extent since it enables the developers to raise construction funds more easily from various private financial institutions.

Management and Technical Assisatnce

6.21 Another set of measures aim at providing assistance to developers and homeowner associations. For example, in its May BLISS sa PagIBIG Program, HSDC would provide architectural and engineering services in addition to land. While marketing would be the responsibility of the private developers in joint-ventures, for ministry-initiated projects this would be handled by HSDC.

6.22 Since its upgrading to a corporate status, HFC has begun operations in new directions in view of its broadened mandate. These include assistance packages to private developers as part of its Investments Program. The most commonly availed option in this category is the Project Management Program whereby HFC is retained as project manager on a fee basis by the landowner-developer with responsibility for credit supervision, funds sourcing, mortgage guarantee and NHMFC take-out commitment, project planning, design, construction and marketing of housing units.

6.23 HFC is, somewhat anomalously, also empowered to charter and license homeowners' associations and to initiate the organization and registration of buildings and loan associations. Homeowners' associations are cooperative-like entities which may be organized even before the development and construction of a particular residential community. They appear to form a major part of the general strategy of MHS (for example, all BLISS projects have such associations) with the underlying rationale of obtaining economies of scale during development, reduction of credit risks, better maintenance of the physical plant, as well as general social stability.

D. Institutional Reform Issues

6.24 It should be clear from the description above as well as from the earlier chapters that there is a pressing need for reexamination and rationalization of the institutional framework. Indeed, the Government has recognized this and initiated some measures already, such as the consolidation of NHA with HSDC, as well as efforts within various corporations (e.g. HFC) to streamline their operations./1 This section seeks to elaborate issues which require further deliberation and action, focusing especially on the financial functions. Specifically these include the targetting of benefits of government programs and the leading role of HDMF, the structural relationships between HDMF, NHMFC and HFC, and the provision of the insurance function.

/1 In early 1982, the MHS created a National Shelter Development Program Secretariat to coordinate the operations of various agencies and implementation of all housing projects. The intention is to eliminate the duplication and overlapping of functions and activities of various government institutions.

Targetting Benefits

6.25 The first major issue concerns the targetting of benefits of the several programs providing end-use finance to prospective homeowners. At present, housing finance is provided through SSS, GSIS, DBP and NHA, and will eventually also go through HDMF. Each of these programs is intended to serve middle and low-income groups. An individual whose income exceeds ₱ 800 per month has the choice of applying for mortgage financing form either SSS, GSIS, HDMF or DBP, depending on his particular job and other circumstances. Moreover, through so-called "pari passu" arrangements, he can combine funds from any one of the first three agencies with funds from DBP.

6.26 Thus, all the government lenders cater to the same income groups. This creates a three-fold problem. First, there is considerable duplication of effort. Second, it introduces both vertical and horizontal inequities into the system. The HDMF member has a greater access to mortgage finance than does a nonmember with the same income. Lower income households (below ₱ 10,000 p.a.) have virtually no access to the formal housing finance system, while households of somewhat higher incomes have a variety of choices. Finally, the dearth of housing finance causes builders to target their activity to the households who can get mortgage money. This means that the targetting by the Government in effect dictates construction activity. Since that targetting focusses on households with incomes of ₱ 800 per month and up, the housing that gets built is what these households can afford. Lower income households find that their lack of access to housing finance results in a lack of available, affordable housing.

6.27 Since HDMF is envisaged as playing the dominant role in the provision of mortgage loans, the problem is rendered all the more acute when one considers the income distribution of its membership. While there has been an examination and analysis of the financial viability of the fund, an issue of concern is the fund's politico-economic viability, specifically the relative balance and distribution of the burden and benefits to the members. According to the projections made by the management, even with a conservatively estimated average loan size of ₱ 50,000, there will be only one borrower per forty eligible members of the fund by 1985. It is doubtful that even this ratio will be achieved in the absence of major redirection, since the current trends in the sector indicate that the loan amounts are and may be expected to continue to be much larger./1

6.28 It is apparent that HDMF is indeed serving a consolidating function in the market (para. 6.19). Hence, it would appear desirable that the fund be used to direct the composition or mix of homes financed so as to ensure a housing policy that is more responsive to social needs. One way of doing

/1 As of June 1981, the average PAGIBIG loan was ₱ 90,000 approximately.

this would be through a more direct lending facility to its members instead of maintaining its sole current role as a supporter of the secondary mortgage function of NHMFC. The fund could continue to use the current system of originating banks with essentially the same procedures as at present but would specify the distribution mix of loan sizes in its take-out commitments.

6.29 In terms of added administrative costs, the burden of the above scheme would be negligible. In fact, the monitoring effort entailed would be even less if the underwriting and qualifying procedures are changed as suggested elsewhere (see Chapter VII), whereby instead of affordability limits, the system restricts loan sizes to achieve the desired credit rationing. Furthermore, this should alleviate, albeit to a limited extent, the first two problems related to targetting cited above (para. 6.26), namely, duplication and inequities, since the specification of the distribution could be flexible and aimed towards this purpose. Of course, the adoption of similar and uniform underwriting criteria by the other lending agencies would facilitate coordination with HDMF which in turn would rationalize the distribution of benefits nationwide.

NHMFC-HDMF Relationship

6.30 Another issue of concern relates to the close relationship between HDMF and NHMFC./1 Current arrangements bind the two in a trust relationship for a five-year period, as summarized in Figure 6.1. HDMF members apply for housing loans to accredited financial institutions who process, approve and release the loan. The bank then sells the loan to NHMFC. The funds for the purchase of the loan are derived from the savings generated by fund members together with the proceeds of the sale of BMPCs (see Chapter V). NHMFC on its part invests the funds of HDMF in such a way as to generate a return of 12% after expenses to be returned to HDMF which uses them to cover its costs and the promised 7.5% dividend to members who are not borrowers.

6.31 For NHMFC, the cost of funds is estimated to average 13%. This cost includes both HDMF money and the interest costs on BMPC borrowings. Against this, it generates income through the purchase of mortgages, either through the HDMF program or through loans to HDMF members. These data on costs and returns for NHMFC and HDMF are displayed in Table 6.1. Under the current system, NHMFC can cover its cost of funds and costs of operations only if it holds a portfolio consisting of no less than 75% open housing loans and 25% HDMF mortgages. Such a portfolio at current market rates would yield a return of 14.75%, leaving an operating margin of 1.75% above the 13% cost of funds. Should the required operating margin be as high as

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/1 Some aspects of this have been considered or alluded to in Chapter V.

3%, not an unreasonably high figure, NHMFC could hold on to HDMF mortgages. On the other hand, if the open housing rates are raised to 17%, the yield from a portfolio, 75% of which is held in such mortgages, would rise sufficiently to cover a 3% operating margin. The point here is that under current arrangements, the existence of a substantial NHMFC holding of HDMF mortgages is unlikely. However, the fact that the NHMFC is committed to support HDMF means that it must rely on low cost sources of funds like the BMPC.

Figure 6.1: HDMF-NHMFC INTERLINKAGE

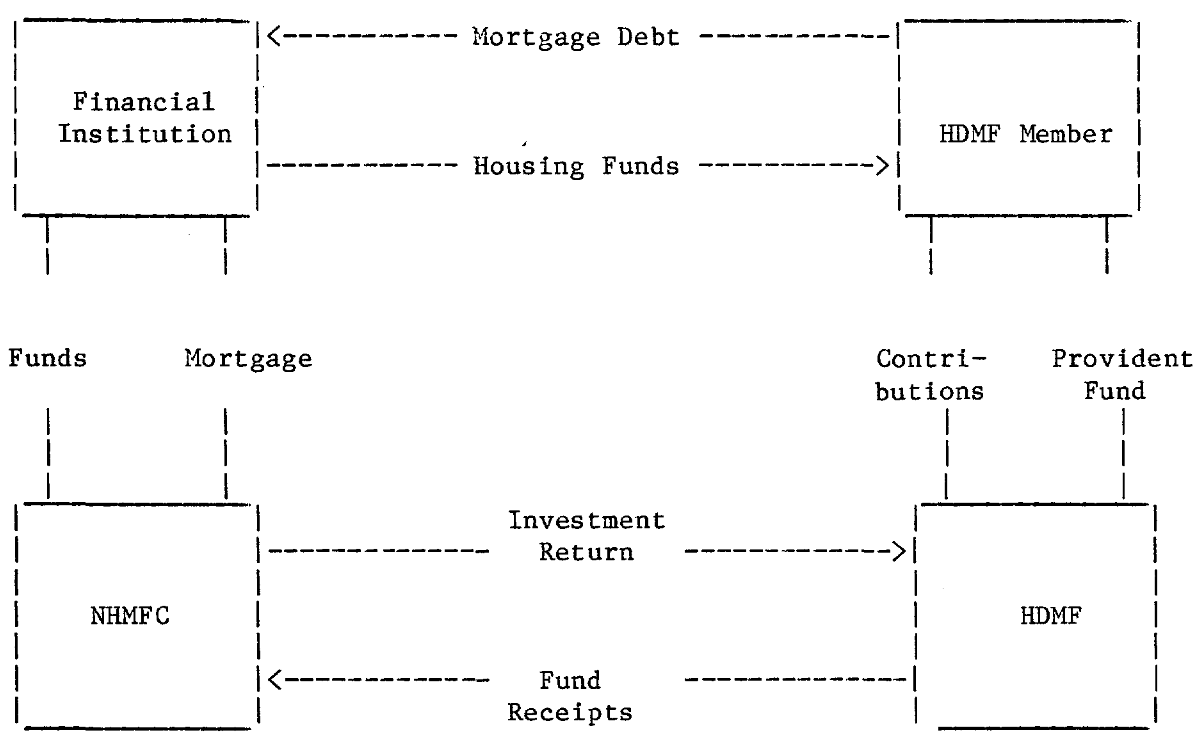

Table 6.1: HDMF AND NHMFC COST AND RETURN DATA

	Cost of funds	Portfolio return
Current System		
HDMF	7.5% + bonus return to members	12% (from NHMFC)
NHMFC	13%	Variable depending on portfolio composition
With Disengagement		
HDMF	7.5% + bonus return to members	Variable depending on portfolio composition
NHMFC	15-16% (BMPC at government securities rate)	21% (market rate loans)

6.32 This arrangement may not be very efficient in the long run and may be improved as follows. If HDMF and NHMFC were disengaged both would benefit, especially in the long run, when they could focus separately on their respective mandates. HDMF, by becoming a direct lender, could cover its required rate of return by holding a portfolio consisting of 80% loans to its members and 20% other investments such as DBP "open housing" loans./1 In fact, if its operating expenses were held to 3% of assets, it could provide a 9% dividend (instead of 7.5%) to its members or alternatively carry a larger proportion of PagIBIG loans. NHMFC could then operate a separate mechanism for the purchase of market rate mortgages by selling commitments to purchase mortgages from private institutions at face value. To the extent that private lenders took up these commitments, they would have entered the long-term financing market. NHMFC would finance the acquisition of these mortgages by issuing bonds (which may or may not be called BMPCs) that could be auctioned on the same basis as other government paper.

6.33 The advantages to disengagement are several. First, the mortgage benefit of HDMF membership would be available to more members, and could

/1 See Chapter VII.

thus be targetted down the income scale. Second, NHMFC would be dealing with private lenders on both sides of its portfolio in a meaningful way, a prerequisite for real secondary market development. Third, the inefficiencies created by loading the expenses of two different programs on top of each other would be eliminated and the flow of funds to housing finance increased. Finally, such a system would separate out the respective functions, thereby facilitating the analysis and design of further government initiatives in support of them and preventing leakages or diversion.

Role of HFC

6.34 Two interrelated issues concern the functional division between NHMFC and HFC and the operation of the insurance function in the system. Both NHMFC and HFC share the common goal of increasing the flow of investible funds into housing through their liquidity and guarantee functions respectively. Although a case may be made for an actuarially sound independent insurance system, such is not the case with HFC at present.

6.35 It is necessary for a true insuring function to be developed within the housing finance system of the Philippines. Such a function serves three purposes. First, it eases the way for the entrance of private sector lenders into the long-term housing finance market. Second, it can provide evidence on the riskiness of lending to lower income households and small developers by maintaining special risk lending programs. Third, by enforcing clear underwriting standards, it can create a homogenous mortgage instrument and provide the basis for a successful secondary market.

6.36 The insurance function, however, must be separated from the secondary market function. To be successful initially, secondary market paper must be perceived as safe paper and hence requires insurance. Moreover, the insurance must be the responsibility of an independent agency for the market to view the insurance as effective. The combination of the insurance function and the secondary market function will introduce scepticism about the quality of the insurance criteria enforced and will weaken the secondary market. Similarly, the attachment of the insurance function to the secondary market will eliminate the capacity of the insurance system to undertake any risk which is not related to marketable paper.

6.37 As regards the guarantee function there may be some overlap and redundancy between HFC and NHMFC, since the latter is a wholly-owned government agency as well. Since the banks remit the monthly payments to NHMFC for those mortgages "taken-out" by the latter, this amounts to HFC guaranteeing NHMFC which may not be a very useful function. In the case of development finance also, the major source of hesitation on the part of the lenders stems from the uncertainty as regards the take-out commitment by NHMFC of the resultant mortgage loans when the houses are sold to the buyers. Thus, given the closely allied nature of their operations, the need for similar underwriting and marketing skills, and the generally expressed preference of the private sector to deal with the minimum number of government agencies, an argument could be made to consolidate the operations of NHMFC and the Guarantee operations of HFC (as they exist today) into one organization. This could serve to streamline their functioning, provide better coordination and facilitate rapid processing, thereby obviating some of the bottlenecks currently appearing on the supply side.

6.38 In fact, the various programs of intervention on the supply side by HFC as well as other MHS corporations, may well be suffering from overlap and congestion of activities. There appears to be some redundancy, for example, in the areas of management and technical assistance between HFC and HSDC. Similarly the division of functional responsibilities and promotion of the materials program is unclear between the two agencies, and are in obvious and urgent need of rationalization. Finally, HFC is hardly a suitable agency for its regulatory role vis-a-vis the homeowners' associations; HSRC may be a more appropriate body.

Related Issues

6.39 A potential implication of the issues analyzed above pertains to the possible etablishment of a lead institution for housing finance. Such an institution may be worthy of consideration in case the Government decides to rationalize its intervention in the system through the use of general subsidies from revenues. Under such an institutional framework, HDMF would be the most suitable institution since it would have a system of accredited originating and servicing banks, appropriately standardized instruments for mortgages, and most importantly, procedures devised for targetting various segments of the population. Conjointly, as part of the same program, HFC could establish an experimental risk fund for insuring mortgages for those who would otherwise be excluded from access to formal housing finance due to their high risk. Furthermore, such a role for HFC would also make it suitable for being a monitoring agency for the program as well.

6.40 As noted earlier, HDMF lending operations can be made more relevant for a larger part of its membership and can reach further down the income scale through an appropriate targetting effort. It is nevertheless true that unless the general economic situation, and the distribution of income in particular, improves significantly, a large number of Filipinos will continue to lack adequate shelter. Thus, streamlining of the financial market for owner-occupied housing cannot be a substitute for government policies aimed at increasing the supply of low income housing.

6.41 One important issue which is not analyzed in complete detail relates to the fact that the advantages of the corporate mode of organization, especially with respect to its efficiency and effectiveness, are not obvious. Although it may seem that the constitution of organizational units as legally independent corporations would obviate the problems usually associated with the bureaucratic procedures of government and increase accountability and efficiency, this may not hold true in the context of the housing sector in the Philippines. The corporations are dependent on government budgetary allocations for current expenditures, as well as for periodic capital replenishment; given the political economy of the housing problem they will probably continue to be so. Secondly, there is the issue of control: autonomous corporations may be too pliable and responsive to special interests and moods of the moment. Given the scale of the problem and of the operations, it may be desirable to have a significant level of control by the Ministries of Finance (MOF) or Budget (MOB). This is not to argue in favor of bureaus, nor to accord pre-eminance to MOB or MOF; rather it is a suggestion that, while recognizing the limitations, there is a case for re-examination and, if necessary, for restructuring.

VII. STRATEGIES FOR HOUSING FINANCE

7.01 Having discussed the context of the Philippine housing finance system and the issues that affect its performance, this chapter, brings together the issues in order to develop scenarios about the future of the Philippine housing finance system under a number of alternative changes. The first section summarizes major issues. In the next section, criteria are established for evaluating the impact of changes, and the implications of the status quo are analyzed. The final section introduces a number of possible developments and assesses their consequences for access to housing, the size and condition of the housing stock, and the macroeconomy.

A. Summary of Major Issues

7.02 The issues identified in the housing finance sector in the Philippines are:

(a) increasing the supply of affordable housing units;

(b) increasing access to housing finance for a larger section of the population;

(c) increasing the mobilization of long-term funds;

(d) development of appropriate financial institutions and instruments; and

(e) rationalization of the institutional framework for housing finance.

7.03 The central issue would appear to be the need to increase the supply of affordable housing units and to extend the availability of housing finance lower down the income scale. The supply of more modest, and hence less expensive, housing appears to have been restricted by two factors: the profitability of the higher-income residential housing, as well as commercial and industrial ventures for the established developers and contractors who are able to secure development period financing from banks and thrift institutions; and the inability to obtain this type of financing by the less established firms who might aggressively service this segment of the market./1

7.04 The availability of housing to a larger segment of the population may be increased through greater access to housing finance. An issue of concern is the relatively strict and inflexible underwriting standards employed in evaluating mortage applications. In particular, more lenient

/1 However, several isolated instances of significantly more modest housing have been noted.

underwriting, consistent with acceptable risk criteria, could result in higher loan-to-value ratios and higher allowable expense burdens which would enfranchise more households. This is a possible component of a new housing finance strategy. The lack of fully documented experience with mortgages to different income groups under alternative underwriting criteria naturally makes mortgagees hesitant to relax their standards. A possible solution is that HFC should establish a special-risk program (with attendant government-contributed reserves) to pioneer the use of the more lenient terms and to monitor carefully the experience as it unfolds over the first several years.

7.05 One of the continuing financial sector problems in the Philippines is the scarcity of long-term capital. This is symptomatic of structural and institutional features of the economy. It is only partly due to the lack of a liquidity mechanism for long-term paper, but rests on uncertainty about interest rate levels and the future pattern of inflation. Recent government measures, such as deregulation of interest rates and graduated gross receipts taxation for financial institutions, are aimed at improving the situation.

7.06 However, the long-term capital market remains characterized by excess demand and high interest rates. Within this market, housing finance experiences particularly severe problems. As compared to alternative long-term investments, housing loans are usually small and there is less publicly available information about the borrowers. The resultant higher servicing and underwriting costs make mortgage lending of little interest to private financial institutions. Thus, the housing finance activity of the financial intermediaries in the Philippines has been confined to relatively riskless and high-yielding development finance, and to mortgages for upper-income households. In the last five years, more than 70% of all private bank mortgage loans went to households with annual incomes above ₱ 100,000.

7.07 The private financial institutions have displayed a remarkable adpatability in the past, but financial institutions and instruments for housing did not emerge as natural developments. The financial reforms of 1980 were aimed at reducing the specialization in the financial system by allowing the formation of universal banks. Hence, the need for suitable financial instruments to induce the required market response. Possible modifications could be: restructuring of the secondary mortgage market instruments to make them more attractive to investors; modification of the HDMF to enable contributions to be set against housing investments; use of HDMF resources outside the NHMFC's secondary market operations in order to create a balanced portfolio and increased yield; providing appropriate monetary and fiscal incentives for promotion of mortgage instruments.

B. Continuing the Present Structure

7.08 To analyze the implications of various possible changes in the housing finance system, it is essential to understand clearly the consequences of the status quo. This section provides a prognosis. Prior to doing this, it will be useful to set out the standards against which the present systems, as well as any revised systems, should be evaluated.

Criteria

7.09 Three broad criteria are employed: the degree to which the system provides access to housing in the formal sector for households with differing incomes; the effects on the quantity and quality of units in the housing stock, and the macroeconomic impacts of the system.

7.10 Access to Housing in the Formal Sector. It is taken to be desirable that families as far down the income distribution as possible should be able to participate in the formal segment of the housing market, with or without subsidies. Certainly, this depends on the type of housing offered in the formal sector, as well as on the effective demand of the family in question. It may well require some rationing of resources to achieve this objective; hence, relative success on this score may mean that some higher income households are temporarily rationed out of the home purchase market, either through high interest rates or fund unavailability. Certain indirect effects are conceivable here; for example, high levels of production for moderate and upper income households could eventually affect the availability of housing to lower income households. The achievement of such effects, however, would require relatively stable population and a homogenization of housing finance. These seem doubtful in light of the rate of urbanization and the extent of market segmentation.

7.11 Impacts on the housing stock. The criterion is geared to the quantity and quality of housing in the active stock over the next decade. It explicitly includes improvements in the stock resulting from the construction of new dwellings, the upgrading of existing units, and the preservation of good quality existing units. The broadness of these criteria implies that many possible changes in the housing finance sytem, as well as shifts in public policies in other areas (e.g., regional development), could have important indirect and direct effects in this area. This criterion also explicitly covers the ability of the financial system to generate long-term loanable funds for the housing sector needed to permit the regional levels of building activity./1

/1 One can go a step further, and attach different weight to improvements realized in the quality of housing occupied by various income groups. This refinement has not been introduced here, but it could well shift the relative desirability of undertaking the various changes considered in the next section.

7.12 Macroeconomic Impacts. How will the growth or decline of the housing industry affect the economy more generally? There are actually three separate aspects of a complete response that may merit attention. The first of these pertains to the fact that channelling additional loanable funds into the housing sector could not be done without affecting other sectors of the economy. One expects a higher cost of funds in the balance of the economy, how much higher depending on the extent of the diversion of funds to housing. Moreover, the least competitive industries will presumably be more seriously affected, as they will be the least able to bear the additional costs of funds. One distinct strategy for increasing the loanable funds available to housing is to adopt policies that shift deposits to institutions for which housing is a comparatively major element in their asset portfolios. An extreme version of this--the mandatory savings provisions of the HDMF--was discussed earlier. Any such shifting of funds raises two questions: the first concerns the changes in the uses of loanable funds just discussed; the second concerns the likelihood of any increase in aggregate savings that may result. The answer to the second depends heavily on the interest rates paid, the sensitivity of savings to real interest rates, and the savings habits and purposes of the target population.

7.13 The second macroeconomic impact to be highlighted is that on the national budget. All possible forms are included: direct appropriations, tax expenditures, higher interest rates on government's borrowing because of the "crowding" of excessive offerings of government and government-backed paper, and revenue collections. The description in the previous chapters has shown the housing finance system to be tattooed with taxes and tax breaks designed to do such things as encourage the purchase of BMPCs and to foster a longer-term loan structure.

7.14 The third is the amount of employment (and value added) generated by the industry. Given the relatively low skill requirements of most residential construction jobs and the highly elastic nature of the available labor supply, increased residential construction should produce net increases in employment, incomes, output and savings.

Implications of the Current System

7.15 The current system is defined as the combination of programs and institutions described in previous chapters: these include private lenders, government agencies and providers of low-cost housing. It also anticipates the growth of NHMFC and HDMF as they are currently projected.

7.16 Access to Housing Finance. Table 7.1 displays the relationships between borrowers and lenders under current mortgage market arrangements, and indicates that the formal housing finance system is concentrated on only a thin slice of the income distribution. If we ignore the providers of low-cost housing (NHA largely through IBRD funding), the formal system is open

Table 7.1: HOUSING FINANCE UNDER THE CURRENT SYSTEM

Income Class (₱)	Philippines: % of housholds	Philippines: % of total income	National Capital Region: % of housholds	National Capital Region: % of total income	Lenders Serving Income Class and Relevant Mortgage Terms
Under 1,000	5.0	0.2	0.2	0.0	
1,000-1,999	7.9	1.0	0.7	0.0	
2,000-3,999	16.5	4.0	3.5	0.4	
4,000-5,999	14.1	5.7	7.1	1.3	
6,000-7,999	11.4	6.5	9.7	2.5	
8,000-9,999	9.2	6.8	8.0	2.7	
10,000-11,999	6.1	5.4	5.9	2.4	
12,000-13,999	5.3	5.6	8.5	4.0	
14,000-15,999	4.5	5.5	7.2	4.0	
16,000-19,999	5.7	8.4	9.4	6.3	SSS (7.2%, 25 year loans)
20,000-29,999	6.8	13.3	15.4	14.0	SSS
30,000-39,999	3.3	9.4	8.8	11.1	SSS, HDMF (9.0%, 25 year)
40,000 and above	4.2	28.1	15.6	51.2	(GSIS (9.0%, 20 year loans) (DBP (13.0%, 15 year loans) (Private Sector (21%, 10 year loans)
Mean Income (₱)	12,716		26,724		

Assumptions: Loan Size = ₱100,000 or maximum allowable, whichever is lower.
Income measurement consistent across lenders.
25% housing expense to income ratio.

Source: Data provided by the authorities.

to only 20% of the population nationwide and about 49% of the population of the national capital area. These households are concentrated in the upper income levels of the population. The average family nationwide has little or no access to the formal housing finance system and, in Metro-Manila, can gain access only to the lending facilities of SSS.

7.17 In fact, these numbers may overstate the access to housing finance by households. In the first place, the major government sources of concessionary finance (SSS, GSIS and HDMF) pertain to only a small segment of the population, namely the members of these systems. Second, loan limits may preclude access to the system. SSS is a major case in point here. Currently, SSS mortgage loans are restricted to ₱ 50,000 with no plans for future increases. House prices are such that such a limit will provide effective housing finance only if the household has considerable resources of its own or can obtain supplementary finance. In either case, the effective cost of housing finance is higher than would appear from examination of the SSS loan terms. Thus, access is restricted to higher income groups.

7.18 The major government initiative to increase the access to housing finance is the HDMF. Projections indicate that the fund will have well over ₱ 12 billion available to support mortgage lending by 1986. While it is believed that these projections are overstated significantly, the potential impact of the fund on access to housing finances is nevertheless unclear, for three reasons. First, the fund determines member borrowing capacity on the basis of "fund income," an artificial standard that ignores allowances, bonuses and casual income, as well as the part of the household's income accounted for by nonmember workers. This restricts the allowable loan amount to levels which understate the household's borrowing capacity. Second, the terms of HDMF loans, while concessionary relative to the private market, are sustainable only for higher income households. A loan of ₱00,000, for example, can be carried only with an income of ₱33,000 per year. This income is earned by 7.5% of households nationwide and 23% in Metro-Manila. Finally, access to HDMF funds requires membership in the plan. Projected membership is high, but current membership and the pattern of waivers granted thus far lead us to expect that enrollment will fall short of projection. Even then, members who already own homes will be unable to avail themselves of the housing benefit of HDMF. By its own estimates, HDMF will provide housing finance for only 2.5% of its members.

7.19 Thus, the ability of HDMF to increase access to housing finance is quite limited. Also, given the disinclination of NHMFC to deal in mortgages originated at market rates and the increase in DBP interest rates and loan limits, it appears that in the future, government programs will do little to increase the access of lower income groups to housing finance. It can thus be concluded that under the current system, access to housing finance by income groups not currently in the system will certainly not increase, and may in fact diminish.

7.20 Impact on the Housing Stock. The housing finance system will have little direct impact on the quality of the housing stock, but lending policies, particularly those of the government for development and construction loans, will have an effect on the quantity of housing available. Currently, development and construction loans are confined to large-scale firms. While this reduces the risk of these loans, it is not necessarily the most efficient method of providing housing. In many cases, small contractors, not burdened with a great deal of overhead, are able to produce housing competitively with the larger firms. Yet, under present institutional arrangements, the allocation of development funds to larger contractors will continue.

7.21 The problems of large-scale developers stem from their inability to sustain large inventories of materials due to sporadic housing demand. While the uncertainty of demand is linked quite closely to the problems of the housing finance system, recent government initiatives may have the effect of directly reducing the costs incurred by developers. Essentially, the Government proposes to institute a materials purchase program through the Ministry of Human Settlements. This will entail the stockpiling of building materials by the government and the subsequent provision of these supplies to builders (see para. 6.16). By ensuring a steady market to suppliers of construction materials, the Government hopes to foster economies of large-scale production in the materials industry, and thus reduce building costs and house prices. The Government would absorb the risks connected with the cyclical nature of the housing industry. While still embryonic, this measure holds the prospect of increasing the housing stock, particularly in the lower cost end of the price spectrum.

7.22 In most developed countries, the quality of housing consumed by lower income groups is increased through a process whereby units previously occupied by upper income families become vacant as these families trade up. This process, called "filtering" is not evident in the Philippines. While homeownership is an important cultural goal, mobility of households is limited. Thus a household that wishes to increase its housing consumption will improve or add on to its current dwelling, rather than sell and buy a larger one. The present arrangements of the housing finance system are not suited to the encouragement of the filtering process and thus will do little to affect the quality of the housing stock in this manner. More importantly, the system does not currently lend itself for rehabilitation or upgrading and will be unable to increase the housing stock through these methods.

7.23 Given the present housing finance system, there is little prospect of extraordinary change in either the quality or the quantity of the housing stock. The growing problem of affordability generated by the lack of access to housing finance, moreover, suggests that the increase in the quality of the stock will be less than it would otherwise. The recent government initiative in the building materials area, if successful, will moderate the increase in house prices that has been characteristic of the market.

7.24 Macroeconomic Impact. The current housing finance system is predicated on the heavy involvement of the government sector through a set of subsidies attached to the mortgage market. These subsidies for the most part take the form of below market interest rates on housing loans, the provision of insurance for private lenders and exemption of insured instruments from taxation, and the allocation of a pool of forced savings to housing through the HDMF. All these subsidies reflect a decision, whether deliberate or accidental, to place an emphasis on the funding of housing within the Government's overall development srategy. In turn, this allocation has certain macroeconomic consequences.

7.25 For macroeconomic purposes, the operations of the HDMF are of major interest. The salary contribution by employer and employee represents a diversion of resources into the housing sector. Further, the deductability of the employer's contribution means that a portion of the fund will be contributed by the Government in the form of foregone tax revenue. There are two effects here. Savings for housing are being substituted for either other savings or consumption, and a portion of the Government's fiscal capacity is being transferred to the housing sector. If the new materials purchase program is considered, a further portion of the Government's fiscal effort is being allocated to the housing sector.

7.26 The macroeconomic impact of these diversions is uncertain. It seems fairly clear that contributions to the HDMF will constitute some net additions to savings, as at least some workers enrolled in the plan would not have saved otherwise. If these savings are devoted to housing finance, they ought to increase the access to housing finance and thus increase activity in the construction sector with its attendant benefit for national income.

7.27 On the other hand, one can readily envision a scenario in which HDMF funds are targetted to borrowers who are already well served by other institutions. In that case, they will substitute for the housing activities of these institutions with little or no net gain for the housing sector. In turn these institutions may invest in other sectors. Then, the effect of the increase in forced savings on national income is ambiguous, depending on the impact of the alternative investments on national income. Whether the HDMF housing activity is expansionary or dampening, however, it seems fairly clear that it will benefit only a narrow segment of the population.

7.28 There is another potential outcome of the current system. It is entirely possible, given the current and projected operations of HDMF, that the fund will be unable to lend a large portion of its receipts for housing purposes. In that event, there would be a great temptation to use part of the receipts to hold DBP paper in the portfolio. This would, in effect, transfer the forced savings for the housing sector to the economy in general. This is a tradeoff which the Government will doubtless consider as it evaluates the success of HDMF.

7.29 Finally, there is another tradeoff presented by the current housing finance system. The building materials purchase program currently being initiated by MHS will divert government resources to the housing sector. It thus represents a choice of housing over some other development goal. The macroeconomic consequences of this diversion are unclear, but need to be analyzed and monitored within the decision-making process.

7.30 In sum, then, the present arrangements of the housing finance system offer a series of macroeconomic tradeoffs. The Government's role in the housing finance system has grown to the point where a substantial amount of resources is being devoted to housing. With no change in the system, this will grow in the future. Whether this growth is desirable and whether housing ought to command a growing share of government resources, are matters that require explicit consideration and review within any development planning process.

C. The Implications of Potential Changes in the Housing Finance System

7.31 In this section, nine specific alterations in the present system are identified. These are evaluated under four categories, grouping the changes that affect the same markets, or which affect the economy in the same direction. The four groups considered are:

(a) The consolidation and improvement of the primary mortgage market:

  (i) homogenization of mortgage lending practices; and

  (ii) introduction of alternative mortgage instruments.

(b) The strengthening and expansion of the secondary mortgage market:

  (i) the provision of a true mortgage insurance function;

  (ii) market rate purchase program for NHMFC; and

  (iii) secondary market program for sites and services loans.

(c) The use of HDMF to organize the mortgage market:

(d) Facilitating homeownership:

  (i) the use of HDMF contribution as downpayment;

  (ii) the reduction of underwriting standards; and

  (iii) the establishment of a special risk insurance fund.

The section concludes with a general summary and evaluation of all nine measures.

The Consolidation and Improvement of the Primary Mortgage Market

7.32 Current lending practices differ across mortgage lenders in a number of ways unrelated to the specific terms of the mortgage loan. From the most mundane differences in the forms to be filled out by borrower and lender, to the definition of income used in evaluating the creditworthiness of the borrower, instruments are noncomparable between lenders in the same market. At the same time, the mortgage instrument is inflexible. The standard instrument in the Philippines is a fixed interest rate, level mortgage that requires a fairly major downpayment and carries a relatively short term. Several entities have experimented with alternative forms, most notably the graduated payment mortgage of GSIS and the floating rate mortgage used by some private institutions. These have, by and large, been isolated examples.

7.33 Each of these factors is a target for potential change, and each carries implications for the housing market. In the case of the mortgage instrument, the introduction of alternatives could increase the access to housing finance in two ways. Variable rate mortgages would allow the lender's return to fluctuate with the market. This turns the mortgage into what is essentially a short-term instrument and makes it competitive with the other short-term use of funds. To the extent that mortgage loans now carry a premium, this reduction in the effective duration of the mortgage loan could decrease the mortgage interest rate. Graduated payment mortgages reduce the payment necessary to carry a mortgage in its early years at the expense of higher payments later on. The lower initial payments would qualify more households for mortgage loans and thus increase the access to housing finance for lower income groups. Thus, graduated payment mortgages would initially be the province of government lending programs before they could filter into the private sector.

7.34 In macroeconomic terms, alternative mortgage instruments, particularly floating rate mortgages, generate conflicting impacts. On the one hand, they reduce the uncertainty about the effects of future inflation and thus could bring about behavior that dampens prices. On the other hand, by linking mortgage payments to an explicit index of inflation, they create political pressure to enforce macroeconomic controls aimed at retarding the growth of that index. Finally, the adoption of graduated mortgages into government finance programs implies a greater cost and risk exposure for these programs that will necessitate higher government subsidies. The consequences of government involvement in alternative mortgage instruments need to be clearly understood and analyzed prior to the inception of any programs in this area.

7.35 The standardization of procedures and flexibility of instruments ought to increase access to housing finance through the interactions among the lenders in the mortgage market. Part of the costs of mortgage lending are the cost of gathering information about market participants and terms. The improvements in lending practices will reduce that cost to lending institutions and could result in a reduction of mortgage interest rates. A particular element of this, the adoption of uniform income definitions across lenders, is especially important. Currently, a household may qualify for a loan from some lenders but not from others because the definition of the household's income is not the same. With a uniform definition of income the qualified household will reduce its search time, and avail of housing finance smoothly.

The Strengthening and Expansion of the Secondary Market

7.36 The secondary market for mortgages in the Philippines is in a very rudimentary stage of development. As it now exists, it consists of a purchasing agency (NHMFC) and an insuring agency (HFC). There is no significant private sector involvement on either the purchase side or the sale side of the secondary mortgage process. Changes in this area should be aimed at increasing that private involvement. In addition, the secondary market services a relatively high income segment of the mortgage market. The secondary market has the potential to reach lower income groups through its encouragement of housing lending programs that affect these households.

7.37 Currently, there seems to be no real insurance function for mortgages in the Philippines. Although HFC is nominally a mortgage insurer, its reserve behavior and default practices are not fully consistent with that role. Yet, such a function is necessary in a developed housing finance system. From the viewpoint of the secondary market, mortgage insurance facilitates the trading of mortgages by reducing the uncertainty that surrounds the collateral for the loan and the creditability of the borrower. With the security of an actuarially sound insurance system and the liquidity of a functioning secondary market agency, lenders will be more willing to lend for longer terms on the basis of housing collateral. This will expand the availability of housing finance. This development should lead to the creation of special funds to insure mortgages of lower income households which will further increase access to housing finance.

7.38 The establishment of a true insuring function in the mortgage market will, of itself, have little macroeconomic impact. If the change occurs relative to the current system, and HFC-insured mortgage income is no longer tax-exempt, there will be an increase in government revenues. Additionally, with the advent of actuarially sound mortgage insurance, risk will be reduced and mortgage interest rates reduced somewhat.

7.39 NHMFC deals in government-sponsored mortgage loans, either those of DBP or those granted by private institutions to members of HDMF. It currently purchases no market rate mortgages. As already explained, the reason for this gap in the secondary market lies in the method by which NHMFC finances its mortgage purchases. By relying on BMPCs and HDMF funds, NHMFC restricts itself to the government sector of the market. In their efforts to approach market rates, the authorities are considering the possibility of allowing the interest rate and loan limits on DBP mortgages to be increased gradually to market levels. But there are no plans for NHMFC to operate a purchase program for market rate loans.

7.40 NHMFC could remain in the business of supporting HDMF, but at the same time operate a separate fund for the purchase of market rate mortgages. It could do this by selling commitments to purchase long-term market rate mortgages from private financial institutions. These commitments would be valid for a certain period of time during which the purchase price of the mortgage would be fixed. To the extent that these mortgage commitments were used, private institutions would have entered (at least partially) the long-term housing finance market. NHMFC could finance the acquisition of these mortgages by issuing bonds that would be sold through the Monetary Board on the same basis as other government paper.

7.41 This particular change would have little immediate impact on the access to housing finance by lower income groups. Private market rates and terms are such that only very high income households can afford to use this borrowing method. However, as more and more private firms choose to use the secondary market and are assured of the liquidity of mortgages, the terms under which NHMFC will purchase mortgages become important in setting the terms under which mortgage funds are loaned.

7.42 This particular change has some significant policy implications. On the one hand, there is a real question as to whether the Government's borrowing authority should be used to subsidize housing for the wealthy. On the other hand, the issuance of NHMFC debt through the Monetary Board allows centralized control of all the demands on the Government's credit and allows a more explicit consideration of the role of housing in the overall development plan than is possible now, given NHMFC's independence in debt issuance. The establishment of an efficient secondary market will attract capital into housing.

7.43 A final secondary market change affects the other end of the scale. One of the reasons that the formal housing finance system reaches only a small slice of the income distribution has been its persistent attention to the financing of completed houses. No lender, either private or government-sponsored, has financed sites and services, slum upgrading, or improvements. The secondary market can serve as a vehicle for encouraging this activity through the institution of purchase programs for sites and services loans.

7.44 The impact of this type of program on housing finance access and the housing stock could be dramatic. All customers served under this program would be new entrants to the housing finance system, as no lender is currently servicing this clientele. The provision of sites and services would extend basic housing infrastructure down the income scale and improve the quality of lower income household dwellings. From these would flow the macroeconomic benefits of increased housing construction activity and income generation. The secondary market purchase of sites and services loans would be a change of great potential in the Philippine system.

Organizing the Market

7.45 It was noted earlier that the developers of residential properties had responded to the anticipated high volume of mortgage funds to be made available through the joint operations of HDMF and NHMFC. In particular, developers and contractors are targetting new homes at the ₱ 100,000 mortgage limit of the PagIBIG fund. Hence, homes costing from ₱90,000 to ₱ 150,000 are being targetted to this market. This response is certainly rational, given the general dearth of mortgage funds at "affordable rates", and the large volume of funds that PagIBIG has forecast will be available for lending. Developers have generally targetted at the high end of the mortgage range because this means a clientele and a type of housing that is more familiar to them and because the higher priced housing is more profitable.

7.46 A change from current practice might be to use the market power of PagIBIG mortgages to shift developers into lower cost complete core (CC) units, and more basic core units on serviced sites (CSS), the latter being the unroofed frame and completed sanitary core like that financed by the World Bank in Dagat-Dagatan. The CC is of somewhat higher quality and size than is the CSS unit. In any event, PagIBIG funds would be allocated to classes of dwellings according to price ranges. So perhaps 30% of PagIBIG financed mortgages would be for units (home and lot) priced at ₱ 40,000 or less, and another 20% in the ₱ 40,000 to ₱ 60,000 range, and so forth.

7.47 The use of the purchase price instead of the mortgage amount is important since it pushes developers to build low-cost housing; a restriction on the mortgage amount might well only change loan-to-value ratios. Several contractors and bankers interviewed in the Philippines asserted confidently that if a market were present for ₱ 50,000 homes, i.e., if take-out financing were available, developers would produce the units./1

/1 See, however, potential constraints outlined in Chapter I.

7.48 Examining this possibility against the criteria set forth earlier, the clearest change would be to dramatically improve access to housing by lower income households. A household would need a monthly income of about P 3,270 to service a 25-year term, 10% mortgage for P 90,000 using 25% of its income; clearly, it would need only half that much for a P 45,000 loan. Families in Metro-Manila in the 50th income percentile would qualify. Understandably, the sites for these projects might be quite distant and the total cost of living in one of these units significantly higher than housing costs alone; but, the potential demand appears large indeed.

7.49 The effect on the housing stock is less emphatic. Assuming that aggregate mortgage credit continues to be constrained, adoption of this change would result in more homes, although they will be initially small and possibly of lower quality than those that would have been built. All of these homes, however, are in the formal sector, and this probably means a net increase in the number of families occupying units in the sector. Since security of tenure positively influences upgrading, more total investment may take place than would have otherwise.

7.50 The corresponding macroeconomic impact is that the savings rate is likely to rise because of homeowners equity build-up, although for those who receive mortgages little will be invested outside of the housing sector. On the other hand, the "disappointed" higher income would-be purchasers presumably would be rationed out of the market. For these households savings may decrease. However, what savings that did occur would be channelled out of the housing sector. The effects on the aggregate level (value) of building activity and the impacts on the budget would appear to be negligible.

Facilitating Home Purchase

7.51 Home purchase is one of the two primary ways to gain entry to the formal housing sector; the second is obtaining clear title to land on which the family has squatted or has rented./1 With the low turn-over of existing units in the formal sector, home purchase typically means acquisition of a new dwelling or core unit.

7.52 There are numerous ways in which government might facilitate home purchase, i.e., make homeownership more accessible to all but the highest income households. One action would be to allow contributors to HDMF to use their contributions plus those of their employer as part of the downpayment on the unit they wish to purchase. A family with a contributor's HDMF salary of P 1,000 per month, would have accumulated approximately the entire 10% downpayment on a P 50,000 unit at the end of five years.

/1 Renting a dwelling unit in the sector is a third way.

7.53 One argument against this proposal is that the provident fund is to be kept wholly separate from the housing aspect of HDMF. Actually, the two have already been linked by the rule that when a fund member takes out a mortgage loan, he stops receiving interest payments on his accumulated savings in the fund. The rationale here is that this moves the real interest rate to the mortgager closer to the market rate, and thus reduces the size of the transfer within the fund. Permitting a member to use his savings for a downpayment tightens this relationship further.

7.54 The second action would be the adoption of underwriting standards for mortgage applications which are more liberal but still consistent with acceptable risk criteria. Counting all of the family's income--in-kind, as well as cash, and of all secondary as well as primary earner's incomes--and allowing higher ratios of housing expenses to income would both make dwellings of a given price affordable to more households. A major problem with going to more liberal terms is the lack of well-documented experience on mortgage defaults. This void is especially unfortunate for the GSIS mortgage portfolio since the GSIS has apparently used the most liberal underwriting standards in the Philippines. Hence, to convince mortgagees that using such underwriting standards would not be irresponsible, it may well be necessary to establish a special insurance risk fund or mortgage guarantee program; either would require that the Government appropriate sufficient reserves to HFC or other agencies, so that mortgagees would be confident that claims exceeding reserves based on the insurance fees could be paid.

7.55 How much difference might these provisions make? Take as the initial case that 80% of the household's ₱ 1,500 per month income is included for mortgage purposes, because the other 20% is in-kind income and money the wife earns from a sari-sari store which is viewed as unreliable. Also assume that 25% of income is defined as the maximum that should go to debt servicing. This means that the bank will lend this household funds for a mortgage that can be serviced for ₱ 300 per month: ₱ 33,000. With all income counted and 30% of income going to debt service, ₱ 450 is available--an increase of 50%.

7.56 The effects on housing access of such changes in the underwriting standards would be substantial, especially if coupled with the availability of more low priced units in the market. The impact on access of members being able to use their accumulated PagIBIG savings as the downpayment on a home is clearly positive, but its magnitude is difficult to judge. This difficulty arises due to lack of information on the extent to which downpayment requirements have been a genuine deterrent to home purchase in the past, especially in light of the substantial intra-family support for such purchases.

7.57 The long-term effects on the housing stock are very similar to those discussed earlier (para. 7.50), depending significantly on the extent to which aggregate investment is increased by more households owning homes with secure title. Likewise, the macroeconomic effects are very similar, except for the possible effect of use of PagIBIG funds for downpayments. The reduction in total savings may cause the amount of PagIBIG funds available for investment outside of the housing sector to decline. Since these outside investments may carry a higher interest rate than mortgages to PagIBIG members, this might ultimately require an increase in the mortgage interest rate to sustain the needed rate of return to the funds, although this is far from certain./1 Residential construction employment and budget impacts appear again to be negligible.

Summary

7.58 A succinct summary of the impacts of the changes discussed is provided in Table 7.2. The changes are rated relative to the current system along the criteria developed above. It is fairly clear from the table that relative to the current system, there are a number of potential changes that will improve the access to housing on the part of lower income families. In particular, they include the use of alternative mortgage instruments, the secondary market purchase of sites and services loans and the more liberal use of HDMF. The last refers to a situation where HDMF would be used to accumulate downpayments and to organize the primary mortgage market. Still beneficial, but somewhat less so, would be the provision of a true mortgage insurance function and a purchase program for market-rate mortgages. Both these affect the secondary market directly and only have indirect impacts on access to housing finance.

7.59 Most of these measures are likely to increase savings. Those who are recently enfranchised in the formal housing sector will increase their savings in the form of equity in owner-occupied housing, while those crowded out of the sector will probably divert their savings to other forms. The sole exception to this is the use of HDMF to accumulate downpayments. Here HDMF contributions would substitute in part for other savings, with the result that a lesser flow of funds would result than under the current program. Most of the changes are neutral with respect to the housing stock; however, some would result in either an expansion or improvement of that stock.

/1 Withdrawal of funds for the downpayment, of course, also reduces the pool of funds on which interest has to be paid.

Table 7.2: SUMMARY OF IMPACTS OF SELECTED CHANGES

Possible changes	Impacts: Access to housing	The stock of housing	Savings	Nonhousing Investment	Budget
Consolidation of primary mortgage market					
Homogenization of practices and instruments	+	0	0	0	0
Alternative mortgage instruments	++	+	–	–	–
Strengthening the secondary mortgage market					
Providing true mortgage insurance function	+	0	0	0	+
Purchases of market rate mortgages	+	0	+	–	–
Secondary market to finance sites and services	++	+	+	–	–
Using HDMF to organize the market	++	+	+	0	0
Facilitating homeownership					
Use of HDMDF contributions as downpayment	++	+	–	–	0
Reduction in underwriting standards) Establishment of special risk insurance fund)	++	+	+	0	0

++ = strong beneficial impact
+ = beneficial impact
0 - neutral
– = negative impact

7.60 These benefits however, are achieved only at a cost to the budget or to investment in sectors other than housing. Each of the changes requires that more resources be devoted to housing, thereby removing them from other sectors. Alternative mortgage instruments and secondary market expansion, for instance, generate increased access to housing finance only with an increased intput of government budget resources. This can be accomplished either through an increase in government spending, increased borrowing, taxation or monetary expansion, or a reduction in government development efforts in other areas of the economy. Thus, the implementation of any of the above changes in housing policy will require some reallocation of resources and consequently a change in development policy. A careful consideration of the full costs and benefits of strengthening housing finance must therefore be undertaken by the Govenment before any of these options are pursued.

APPENDIX A. MICROECONOMICS OF URBAN HOUSING AND HOUSING FINANCE

The Market

1. An outline of the urban housing market in the Philippines can help elucidate how housing finance affects the actual housing situation. As suggested already, the market is complex since it is segmented in demand and in sources of supply. It is most useful to approach this model at the micro level, and largely from the perspective of the individual household or producer. To start, the household is viewed as forming its demand in each period and satisfying it from the array of suppliers, given the price per unit of services in the market. Later, some "transition paths," i.e., the ways in which the household may move from one segment of the market to another are discussed.

2. Housing demand has four distinct elements: tenure, housing services and the derived demands for land and structure assets. The household selects among options - all containing these four elements. First, we need to describe these elements more thoroughly; then, the available options can be clarified. Four tenure situations (t_i) should be distinguished: renting a room or apartment; owning the structure located on a site over which the household has no economic or legal control (squatting); owning the structure but renting the site; and, owning both the structure and the lot. The demand for housing services (S) is one of the two primary determinants of the demand for land and structure assets, the other being the investment motive. For convenience, we will take housing services to be an undifferentiated, highly divisible and homogenous commodity which includes the services provided by the structure (e.g., shelter, cooking and sanitary facilities), and those provided by the site (e.g., recreation and gardening space, work location, etc.). For owners, there is a derived demand for land (L) and structure (H) assets.

3. As noted earlier, the demand for T_i, S, L, and H are determined simultaneously. Perhaps most critical is the tenure decision. The choice among tenures depends on the household's income (Y), the size of the household (HS), the financial assets accumulated by the household, including gifts available from friends or relatives (A), the price per unit of housing services under each tenure form (P_i), and the minimum quantity of land and structure assets that must be purchased under each tenure form ($L_m inj'$ $H_m inj$). The minimum quantities are an essential idea as they combine with prices per unit to restrict entry into some tenure situations: for renters, of course, no purchase of assets is required; but owning both home and lot may require a substantial initial investment. The full set of demand functions can be written succinctly as follows, where T_i is the pure rental tenure.

(1) $T_i = f(Y, HS, A, P_i, Z, L_{minj}, H_{minj}, F, r)$

(2) $S = f(Y, HS, P_i, Z)$

for $i > 1$

(3) $L = f(Y, A\ P_L, P_H, F, H, ST)$

(4) $H = f(Y, A, P_L, P_H, F, L, ST)$

where z is the price per unit of nonhousing goods and services, ST is the security of tenure, F is a vector of variables describing the availability and price of mortgage financing, and r is the rate of return on housing compared to other investments.

4. All households explicitly consider the tenure choice and housing consumption decisions. The price of housing services (P_i) for homeowners depends (in part) on P_L and P_H. F will affect strongly the choice among T_i and interacts powerfully with asset accumulation (A). As discussed further below, F varies systematically among households depending on for whom the wage earners work and whether or not they contribute to the Social Security or the government insurance system.

5. While we have included the rate of return on housing in the tenure function the investment motive appears to be weak in the Philippines compared to many other countries. Two factors are associated with this pattern. First, there is a strong tradition of retaining residential property in the family, so that the household that is the initial purchaser of a dwelling is unlikely to realize the capital gain. Second, the transactions cost of changing dwellings is high. There is a capital gains tax of 10% on gains of less than ₱ 100,000 and 20% on gains over that amount. Additionally, there are some restrictions on a household obtaining multiple loans at concessionary rates, at least from some sources (e.g., GSIS)./1 These factors together restrict the amount of turnover and "trading up" ongoing in the market; and thus undermines any sort of "filtering" strategy to raise the housing quality of the poor.

6. Households other than those in the pure rental state consider the quantity of land and structure asset decisions in addition to the quantity of services decision The demand for each depends on the prices of both the household choosing higher ratios of H to L as the ratio PL/PH increases:

/1 It may be possible, though, for the household to use one concessionary source for one loan and another for a second loan.

there is a limit to the degree of substitution, since minimum quantities of H and L are required for production. The quantity of asset demanded also depends on the security of tenure and on the terms and absolute availability of mortgage financing. The lower the price of financing and the greater its availability, the larger the quantity of asset demanded. Note that security of tenure frequently does not have a simple correspondence to the legal status of the title.

7. Turning now to the supply side, the fundamental distinction for structures is between the provision of services from the existing housing stock and additional services provided by increments to the stock. Our primary concern is with increments to the housing stock. So we will simply note that landlords and current homeowners provide housing services, combining labor with services from the existing stock.

8. Increments to the stock come either from the construction of new units or from expanding or upgrading dwellings already in the stock. In the Philippines context, four types of suppliers can be isolated: (a) a household itself, depending on the skills and available time of the members; (b) a carpenter or other skilled person working alone or with a few helpers; (c) the smaller contractor with a permanent crew, working for individual homeowners or as subcontractors on larger developments; and (d) large contractors, some even with their own plants for producing prefabricated units./1 There appears to be a fair degree of specialization among these four suppliers (B_a . . . B_d) between new construction and upgrading. This is demonstrated in the following chart, where an "X" indicates substantial activity by a type of supplier. In essence, the larger suppliers concentrate on new building, while the smaller ones do new construction and upgrading.

	B_a	B_b	B_c	B_d
New construction		X	X	X
Upgrading	X	X		

/1 This final category includes, for ease of exposition, the two larger groups distinguished in the discussion of the formal construction industry.

9. The price of the composite housing asset from each of these sources depends on the wage rates paid, the extent of the firm's overhead, the scale economies available to it, its costs of materials, and the cost of development period financing. Prices are also affected by the availability of interim financing, even if the borrowing cost is equivalent to the opportunity cost of the developer's equity, because lack of such financing raises transactions costs - finding purchasers who can provide the interim financing (by definition, prior to the take-out mortgage) or the developer raising risk capital from individuals - and lowers technical efficiency available from large-scale and more consistent operations.

10. Supplier activities are segmented both between new construction and expansion/upgrading and by the quantity of the stock demanded, i.e., the value of the property and/or the total scale of the project defined in number of structures to be constructed. Hence, an individual household faces a set of prices (per unit of the asset), only some of which are relevant to it, depending on the type and quantity of the asset demanded.

11. Four suppliers of land exist: government, owners of parcels who make direct sales to end users, developers, and "owner expropriation" or squatting. The price of government-supplied land is determined outside of the market process, although in some cases such as the Zonal Improvement Program, the price is set in relation to that of nearby parcels. The price of raw land from developers or individual owners should be the same, if the market is functioning smoothly. The price of squatter land is more difficult to ascertain because of the multiplicity of arrangements that, in fact, exist under which the squatters make some payments to nominal owners. In any event, there is segmentation in the supply of land./1

12. The coupling of the segmentation in the supply of land and in the supply of structures with segmentation in demand by tenure and by income group suggests the complexity of the urban housing market in the Philippines. Despite its complexity however, the necessary (and large) array of prices appears to work to clear the market. Probably the greatest sources of inefficiency in decision-making, though, arise with respect to demand from uncertainty about land ownership and with respect to supply from the shortage of development period financing.

/1 A further complication ignored here for simplicity, is the site development process and the demand for utility services - electricity, water (piped into the house, community stand pipe), and sanitary sewerage. Also, one could distinguish between the purchase of the site separately from the structure or as part of a land-structure package. This is a nontrivial distinction because of the importance of lot ownership as collateral for obtaining a mortgage for the dwelling unit.

13. It is essential, however, that one must go beyond this static representation of demand to understand the workings of the market. Housing demand, especially for lower and middle-income families, is characterized by a stock adjustment process: each period the household reevaluates its demand for the whole array of housing elements in light of its income, savings, household size, and financing possibilities. It may shift from room renter to squatter, from owner of a structure and site renter to owner of both, or expand or upgrade the quality of the structure it has been occupying. That such processes exist has been documented through the Bank's research on Tondo. Much less well-documented is the timing and incidence of such adjustments throughout the market as a whole.

APPENDIX B. NONFINANCIAL CORPORATIONS UNDER MHS

1. The Ministry of Human Settlements (MHS) was established in 1978 and charged with the tasks of shelter system development, land use and town planning, and environmental management. All governmental functions relating to housing were placed under the jurisdiction of the Ministry, in a sense repeating the process which surrounded the creation of the National Housing Authority in 1975. MHS is now organized in a "corporate" structure with the ministry proper assuming primarily a central planning and coordinating role, the substantive functions being delegated to ostensibly autonomous corporate entities. Of the seven such corporations related to housing, three are financial, namely the National Home Mortgage Finance Corporation (NHMFC), the Home Development Mutual Fund (HDMF) and the Home Financing Corporation (HFC); their activities have been described in the main text of the report (Chapter III).

2. The non-financial corporations under MHS include two executing arms, namely the National Housing Authority (NHA) which formulates and implements a variety of shelter programs, and the Human Settlements Development Corporation (HSDC) which was established more recently for a broadly similar purpose. The Government announced the merger of these two organizations in October 1981, and the program to phase this transition is still in the process of being formulated. MHS is also the parent ministry for the Human Settlements Regulatory Commission (HSRC), the regulatory body for housing and urban development, and for the National Housing Corporation (NHC) which is involved in the production of construction materials.

3. NHA was established in 1975 as a wholly-owned government corporation to consolidate planning, programming and implementation of a wide range of housing policies and programs in the Philippines. Its broad mandate included construction, financing, and management, as well as regulation of housing; subsequently, slum upgrading was also brought in as an explicit expansion of its responsibilities. Since the inception of MHS, however, these have been narrowed down (see para. 9) and NHA now functions as another department of government although its corporate status exempts it from some bureaucratic procedures.

4. NHA is currently involved in a variety of activities which include the construction of new units, upgrading of slum and marginal settlements, sites and services projects, land assembly and titling. There are actually four different programs within the activity classified as construction of new units. The Pambansang Bagong Nayon and the Joint Venture Program are joint venture projects with local government and private developers respectively. The average costs of these units are estimated to be around ₱ 80,000. The Apartment Housing Program essentially involves the finance and construction of privately owned apartment buildings, while the last category comprises properties which are retained in ownership by NHA.

5. During the last few years, NHA s responsibilities have focussed on slum upgrading and sites and services for low income communities, principally as the main executing agency for the three urban projects financed by the World Bank In fact, NHA appears to be the only agency with any programs of relevance to low-income households; however, costs for upgrading and basic sites are still estimated at around ₱ 15-17,000. The slum improvement program is now established in five regional cities and Metro-Manila where it is termed the Zonal Improvement Program (ZIP). New sites and services projects are underway in Manila (Dagat Dagatan) and in three regional cities

6. HSDC was established as a corporation in 1979 to function as a "constructio arm" of MHS. As announced in October 1981, it shall be taking over the operations of NHA, whose functions are broadly similar. HSDC currently has thre main operating divisions corresponding to its three sets of activities, viz. Urban BLISS, Rural BLISS and Special Projects, which includes construction of markets and new town development.

7. The Bagong Lipunan Improvement of Sites and Services (BLISS) program was launched in February 1979 and has been the keystone of the MHS development program. The principal concept is the development of mixed income communities with emphasis on employment and a degree of self-sufficiency; however its early focus was primarily on housing and community development The program has two major components: "rural BLISS" for small settlements in regional cities involving a demonstration project commencing with ten hectare developments in each settlement, and "urban BLISS" for central and inner-ring sites in Metro Manila. The "rura LISS" program is similar in service standards and costs to the higher ra of NHA's and middle income people. The Metro-Manila BLISS presently ts of four-storey walk up apartments costing ₱ 75-90,000 per unit ng land and infrastructure and affordable to low income families onl he basis of substantial subsidies.

8. A variety of implementation problems with BLISS ther with the fundamental problem of affordability has led the Government to restructure its efforts away from a primary emphasis on housing towards local employment generation and livelihood activities. The authorities penchant for drama and "bold" new initiatives is reflected once again in the much publicized new program called Kilusang Kabuhayan at Kaunlaran (KKK) which translates as Movement for Livelihood and Progress. It is not clear at this stage where, if at all, shelter development would fit into this.

9. HSRC was created in 1979 and the regulatory functions of NHA were transferred to it subsequently. The Commission's responsibilities now encompass all regulation pertaining to land use and physical planning

including subdivision, zoning and building rules. It issues locational clearances and development permits while building permits are issued by the appropriate local authority. As the name suggests, the commission is indeed a quasi-judicial body as well.

10. NHC is the last nonfinancial corporate entity connected with housing under MHS. It was placed under the policy direction of the NHA board when the latter was created in 1975 and until recently the general manager of NHA was also the executive vice president of NHC. NHC produces construction materials which it supplies to NHA and some private suppliers. The economic efficiency of these operations is open to question as NHC has had problems competing in the open market, for instance, in the case of particle board. NHC has in the past also contraced for core units in NHA projects and the latter has helped finance a loan to NHC for purposes of retooling some plant. The Government has initiated a series of measures aimed at reorganization, including a change in top management. The exact role and its extent in the materials program is still in the process of evolution.

APPENDIX C. COMPARISON OF NHMFC WITH FNMA AND FHLMC /1

Specifications	National Home Mortgage Finance Corporation (NHMFC) Philippines	Federal National Mortgage Association (FNMA) United States	Federal Home Loan Mortgage Corporation (FHLMC) United States
Purpose	To develop and provide for a secondary market for home mortgages granted by public and/or private financing institutions.	To supplement the secondary market for residential mortgages thereby providing additional liquidity to the mortgage market and improving the distribution of investment capital available for the construction and sale of housing.	To increase the availability of residential mortgage credit by developing and maintaining a nationwide secondary market for residential mortgages.
Government stand by	Central Bank of the Philippines up to P 200 million.	U.S. Treasury Department up to $2.25 billion.	None
Eligibility	Institutions must be accredited by NHMFC to participate under the corporation's home financing program.	Institutions must apply and qualify under FNMA policies.	Automatic for Federal Home Loan Bank System members, i.e., federally chartered thrift institutions and/or issued by FSLIC.
Purchase whole loans	Yes, including Pag-IBIG loans, DBP Open Housing and Urban BLISS loans.	Yes, primarily conventional loans.	Yes, conventional and government insured loans.
Purchase participations	No.	Yes, under special "urban" purchase program only.	Yes, from 50% to 95% participation.
Allocation of funds	Direct commitments to qualified participating institutions.	Auction method-bi-weekly.	Auction method - weekly.
Delivery requirements	Mandatory	Non-mandatory.	Mandatory.
Delivery period	Not exceeding 18 months.	120 days.	60 days.
Maximum loan term	Up to twenty-five years.	Up to thirty years.	Up to thirty years.
Maximum loan-to-value	Not more than 90% for PagIBIG and 80% for Open Housing where no less than 75% of the loan value pertain directly to the collateral value of the unit.	80% without mortgage insurance; up to 95% with mortgage insurance on amounts over 80%.	80% without mortgage insurances; up to 95% with mortgage insurance on amounts over 75%.
Mortgage purchase programs	Single family HDMF or Pag-IBIG housing loans; DBP Open Housing Loans and Urban BLISS Housing Loans.	Single-family conventional and government mortgages, mobile homes, adjustable rate mortgages, rehabilitation loans, PUDs, condominiums, participations and project mortgages.	Single-family conventional home mortgages including condominiums, planned unit development (PUDs), whole loans, participations and multi-family mortgages.
Rates	Concessionary rates.	Market rates.	Market rates.
Financing of mortgage purchases (Sources of funds)	Sale of Bahayan Mortgage Participation Certificate (BMPCs); liquidity fund up to 20% of outstanding BMPCs, HDMF.	Income from portfolio, fees, stock subscriptions, FNMA short-term discount notes and debentures.	Sale of mortgage-backed pass-throughs or Participation Certificates, Sales of Guaranteed Mortgage Certificates (GMC); Sale of FHLMC short- and long-term debt.
Asset size	-	$58.5 billion (1980).	$5.5 billion (1980)
Outstanding debt	-	$55.2 billion (1980)	$4.7 billion (1980)
Service fees	2% of the amortized payments of the mortgage.	0.375% on whole loans.	.375% on whole loans; for participations, the difference between the coupon r..te and FHLMC yield on participations.
Mortgage purchase Commitment fees	2% fee (1% upon signing of commitment and 1% upon delivery).	2% of the commitment amount upon receipt of the acceptance statement and 1/100% of processing fee.	None for members of the Federal Home Loan Bank System (i.e., Federally chartered and/or insured thrift institutions); 0.5% fee for others.
Stock subscription requirements	None	One share or fractions at market for each $10,000 of mortgages serviced for FNMA.	None.
Standard forms	Yes	Yes; institution's own form is allowed under Urban Programs.	Yes.
Loan amounts and down payments	Up to P 100,000 for PagIBIG loans, up to P 120,000 for Open Housing; 10% down payment for PagIBIG and 20% down payment for Open Housing.	$98,000 with as low as 5% down payment.	$93,750 with 10% or more down payment; $75,000 with down payment between 5% and 10%.
Mortgage insurance	All mortgages purchased are insured by HFC.	Based on loan-to-value ratios for conventionals, and FHA or VA for government loans.	Based on loan-to-value ratios for conventionals and FHA or VA for government loans.

/1 This comparison chart is based on NHMFC's purchase programs, FHLMC's over-the-counter purchase programs and FNMA's four-month standby program for conventional single-family loans. These three organizations have other programs and this chart will not be meaningful for evaluating those programs.

APPENDIX D. FUNCTIONAL FLOW CHART OF HDMF