

Executive Summary

Cagamas & World Bank Group “Constructing and Financing Affordable Housing across Asia” conference, 2nd – 3rd April 2019



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Rapid urbanisation coupled with population explosion have created a pressing need for affordable housing across the world. The United Nations estimates that by 2030, 300 million new housing units are needed – a mind-boggling 50 homes every minute for the next 11 years.

While this is a global problem, it is of particular concern in emerging markets, where the majority of the workforce is informally employed and does not have access to financing. It is well reflected in negligible mortgage penetration thereby exacerbating the problem further. With this in mind, Cagamas Berhad (Cagamas) and the World Bank Group co-hosted the “Constructing and Financing Affordable Housing across Asia” conference with the theme “Solutions for Safe, Adequate and Affordable Housing for All” on April 2 – 3, 2019 in Kuala Lumpur to provide a platform for sharing challenges and solutions. The key takeaways are discussed below.

1. Rental housing is not only a missing piece in housing policy across Asia, but it can also be an important pillar of affordable housing

In Asia, where there is a strong culture of home ownership, rental is an often overlooked component of the policy toolkit. Closer scrutiny of the facts, however, would warrant a reappraisal of rental in facing the affordable housing challenge. For example, while the rate of home ownership (based on 2010 census) is relatively high in Indonesia and Malaysia at 78 and 73 percent, respectively, the situation changes drastically in their capital cities. In Jakarta, this rate falls to 45 percent, and in Kuala Lumpur, 54 percent.

The main reason for the higher rental rates in urban areas is because land prices are becoming prohibitively expensive. This, in turn, forces developers to concentrate on the high-end market in order to make a reasonable rate of return. There are many models, however, to incentivise commercial developers to build rental housing, such as co-investments by governments to ensure sufficient supply within core urban centres. Large institutional investors can also play a role by warehousing rental housing to mirror fixed income instruments like annuities. Non-profit organisations can also promote community driven rental properties.

For rental housing to be scaled successfully, governments need to play an active role in bringing together lenders, community groups, developers, and other stakeholders. Housing is complicated and cannot be easily resolved by a single agency to meet the huge affordable housing needs of the people. One important factor in securing the rental proposition is to address the security of tenancy for tenants. Countries that have higher rental rates normally have rental tenancies that give a high level of security and the protection against rapid rental price escalations.

The Malaysian National Housing Department has taken a positive step in this regard by proposing laws including the Residential Tenancy Act to protect both tenants and owners in the rental relationship. These laws are based on standards and benchmarks used in Australia, and will be tailored to suit the local context.

2. Using Big Data to analyse supply and demand to improve the allocation of resources

One of the main causes of the affordable housing problem is the mismatch between supply and demand in property markets. Most of the supply is concentrated in high-end housing, while most of the demand, however, is for middle- and lower-end properties. This should come as no surprise, as not only are margins better at the top end, but credit is usually more forthcoming. Furthermore, as the Malaysian property market matures, competition increases, and buyers become more discerning. While location still plays the primary role in determining the choice of residence, other factors such as infrastructure (e.g. proximity to public transportation) and living standards (e.g. availability of parks and similar recreational amenities) are becoming more important. The same holds true even in the affordable housing segment.

Although a relative success in promoting widespread home ownership, Malaysia is not immune to these problems. To assist the local property industry to meet these challenges, Housing and Local Government Minister, Zuraida Kamaruddin, announced that, as part of its National Housing Policy (2018-2025), her ministry was planning to develop an Integrated Housing Database that incorporated Big Data technology.

By consolidating data, property players will be able to more accurately analyse the supply and demand of housing. This will help to determine what kind of products to build, and the timing for project launches. The industry can move beyond the traditional static view of the supply of housing in a given market, and overlay that with data on consumer behaviour, providing a much richer view of hotspots for demand. In short, the Malaysian property industry will be better equipped to manage the property overhang issue.

Delivering a Big Data solution, however, is not without its challenges. The most prevalent, and one that plagues many emerging markets, is that the data has to be normalised across several disparate platforms. For example, in Malaysia, this data is spread out over three layers of government (i.e. federal, state and local), each with its own definitions and formats, making it difficult to consolidate and analyse.

3. Innovative financing solutions alongside the role of the Government: Rent-To-Own, Shared Equity, and Waqf

As the intended beneficiaries of affordable housing are usually either in the informal employment sector or the urban poor, mortgages are usually not an option on the path to home ownership. Stated bluntly, banks do not lend to those who cannot provide evidence of their creditworthiness, or do not have the funds necessary to pay the down payment on a home. Therefore, several innovative solutions have taken root across the world, and bear discussing.

- a) Rent-To-Own (RTO) schemes are becoming a viable alternative to traditional financing as a means of making housing affordable. In RTO, homes are rented for a fixed term (e.g. five years) with the option to buy at pre-determined prices when the leases expire. During that fixed term, a portion of the rental payments go towards the purchase deposit. At the same time, tenants build up credit histories through regular rental payments. It is then hoped at the end of the fixed term, tenants are then able to qualify for a mortgage to buy the home.

- b) The Shared Equity (SE) scheme pioneered by Keystart, an agency of the Western Australia (WA) government, caters to buyers who lack sufficient funds to meet the required purchase deposit. Under the SE scheme, the capital cost of purchasing the home is shared with an equity partner (in this case, the WA government, through its Housing Authority). In WA, commercial lenders typically require 20 percent of the cost of the home to be paid as a deposit. With Keystart, however, a home buyer only needs to pay two percent.

The way it works is whatever amount put down by home buyers is turned into equity in the property. The remainder of the purchase price is then taken up by the Housing Authority in the form of a loan that is also turned into equity in the property.

The Housing Authority does not charge any rent or interest on its equity shares, but it is the responsibility of the home buyers to maintain the properties and all outgoings, such as council taxes. If home buyers wish to sell their properties, both they and the Housing Authority will benefit from any capital gains obtained, which are determined when the homes are sold, in proportion to the value of the shares.

Critically, Keystart encourages home buyers to purchase additional equity in their homes when their incomes increase by conducting annual income checks. This is important to ensure liquidity in the system, and to limit government intervention in the housing market. Once the borrowing capacities of the home buyers increase, they are encouraged to transition to commercial lenders.

- c) Private Public Partnerships (PPP) allow governments to assume roles that are critical to the delivery of affordable housing without being a strain on public funds. Examples include designating sites that are close to the place of work for most of the intended beneficiaries of a particular affordable housing project, and granting private sector permits in a shorter timeframe. These are critical components that often determine the success of a project yet are not constraints on government finances.
- d) A green bond is like any other regular bond, but with one key difference: funds raised by the issuer are earmarked towards financing that supports the drive for socially responsible investments or green projects. For the affordable housing challenge, these would be classified as green housing loans. Green bonds or sukuk would attract new types of investments, and a unique group of investors. Currently, in Malaysia there are no loans that are classified as “green”. Hence, a clear definition or standardised classification on green loans would need to be established where the loans are needed to make up a portfolio that allows for the issuance of green bonds or sukuk. These definitions would encompass areas such as whether the property or building in question is environmentally friendly. In this respect, a globally-recognised organisation such as the World Bank could assist with an internationally accepted definition.
- e) While the consensus is that Islamic Social Finance has adequate products to address affordable housing, it still faces the problem of tapping the capital market to raise funds for this sector. One method is to make use of waqf (endowment) land. In many countries with sizeable Muslim populations, much of this land is not productive. In Indonesia, for example, they are mostly used for cemeteries.

Some private sector developers, notably in Malaysia, have begun to form joint development partnerships with the holders of waqf land (i.e. the state Islamic Councils). In essence, the Islamic Councils provide this land, while developers build. Development financing is provided by raising funds either

as pure sukuk, or through the issuance of waqf certificates. This, in turn, lowers construction costs and thus increases the available stock of affordable housing.

Regardless of the model, there is universal agreement that the role of the government is crucial in delivering affordable housing. In Malaysia, the Government aims to look into promoting RTO models to promote Affordable Housing. Minister Zuraida said Cagamas could act as a conduit by undertaking the administration and distribution of such programmes by facilitating investment flow from other countries.

4. Role of Mortgage Refinance Corporation to connect capital markets and Affordable Housing delivery

Countries around the world has established Mortgage Refinance Corporations (MRCs) to help mobilise longer term financing from the capital market (predominantly the fixed income market) to help fund affordable housing.

For the affordable housing sector, it would be beneficial to homeowners to obtain fixed rate mortgages from financial institutions as this would elude the homeowners from any risk in interest rate volatility, hence allowing homeowners to be in control of their monthly commitments and afford their homes. Homeowners will be protected from sudden and potentially significant increases in monthly mortgage payments if benchmark interest rates rises. In order for financial institutions to hedge the long-term fixed rates exposures, they can obtain fixed rate funding or sell those fixed rate loans to Mortgage Refinance Corporations like Korea Housing Finance and Cagamas.

In Korea, in the case of affordable housing, financial institutions offered the housing loans at fixed rates and are compelled to sell the fixed rate housing loans to the Korean Housing Finance for securitisation. In essence, the risk arising from interest rate and liquidity mismatch are removed from the banking system. Korea Housing Finance has also issued social covered bonds to fund affordable housing targeting at discerning sustainability inclined investors.

In Malaysia, Cagamas provides mortgage guarantee to assist first time house buyers to buy their first home. With such assistance, young individuals and households are able to get full financing from financial institutions.

Moving forward, MRCs could tap the capital market to fund Rent-To-Own or Shared Equity schemes, not just in the form of conventional bonds and sukuk but also securitisation, covered bonds and sukuk, sustainability bonds and

sukuk as well as residential property REITS, mortgage REITS or even crowdfunding.

5. Emergence of non-bank institutions to fill the gaps in financing affordable housing programs

While the supply and demand mismatch lies at the heart of the affordable housing dilemma, an even bigger challenge is when there is no documentation whatsoever to prove creditworthiness. This plagues large swathes of the emerging markets, as up to 70 percent of the workforce is informally employed. Without a paper trail, these people are simply excluded from the formal banking sector, making mortgage penetration woefully inadequate. For example, mortgage penetration is less than 0.1 percent in Pakistan, and only up to seven percent in India. Quite simply, decent housing for poor people is already unaffordable; when you then question their creditworthiness, it becomes impossible.

Since risk management is not about to radically change anytime soon, several non-bank entities have developed FinTech solutions to tackle this problem. Software can now efficiently reach informally employed people. This, in turn, allows lenders to understand how somebody without a documented income can demonstrate their capacity – and willingness – to pay a twenty year mortgage.

The power of the Internet has also been harnessed to reduce the asymmetry of information to provide peer-to-peer, Shariah-compliant lending. As a platform for bringing people together, the web is peerless in its breadth and scope. Therefore, search costs are reduced, resulting in cheaper credit. While still relatively new to the Islamic banking world, this method has already been used to successfully fund an affordable housing project in Indonesia.

While FinTech grabs the headlines, we should not forget the role played by traditional government-backed agencies like Keystart. They have managed to alleviate the demand for public housing in Western Australia by opening up the housing market to 95 percent of the population – simply, in a sense, by partnering with their people.

As many of the participants to the conference can attest, lending to the very bottom of the income pyramid is not only socially responsible and financially sustainable, it is also commercially viable. While people in this sector are poor, they are often times very reliable borrowers. And there lies the crux of the

matter. Financing must not make housing appear affordable, house and rent prices must be affordable first. The supply of decent affordable housing will then be supported by accessible finance.

6. The role of government, and a holistic urban planning approach incorporating affordable housing policy for effective utilisation of land and funding

At the heart of the affordable housing problem is insufficient data in the housing market, which causes a supply and demand mismatch. To paraphrase, “to intervene or not to intervene, that is the question”. Whilst most economist would agree that government subsidies should go directly to consumers (demand) rather than producers (supply), it is the myopic application of subsidy at the wrong product prices that created the rapid price escalations, leading to affordability eventually becoming an issue. Government regulations has led to price competition that prevails in the ‘free-market’. The Competition Act, for example, would act as a deterrent on the existence of monopolies in the market. Must we be reminded that, unfettered capitalism leads to market collapse, less we forget the sub-prime crisis.

Therefore, the housing policies should be formulated holistically. They should not be narrowly confined to the supply and demand for both the homeownership and rental housing markets, but also to incorporate various contexts of health, employment, transport, environment, legal framework, crime prevention, and infrastructure. Effective housing policies promote homeownership, while giving recipients the freedom to use additional income optimally. They should contain guidelines to dictate the construction of housing, or the provision of land, where it would accelerate the building of homes. These guidelines would also ensure quality and affordability to address housing shortage.

Finding opportunities for the lower-income segment to gain access to housing is critical. Despite having the ability to pay for simple affordable housing, there is often insufficient supply. Therefore, one suggestion is for housing policies to target whole communities to generate the required volume to make such projects commercially viable

Another suggestion is for governments to use technology to provide quality housing at affordable prices through digital Industrial Building Systems (IBS).

Lower labor costs, together with a shortened value chain, translates into affordability for homebuyers. There are now virtual reality design platforms where buyers can design their own homes, and have it manufactured through digital IBS for delivery within 30 days for assembling.

7. Community-led development, and equipping women with skillsets to drive sustainable affordable housing programs

Insecure and poor housing conditions lead to a lower standard of living for a significant population of low-income families. They create unhealthy living conditions, which adversely impact the social and physical conditions of these households. This has led to community-led housing solutions where agencies or governments become enablers and provide support and technical assistance.

For example, affordable housing does not need to always translate into investment in new buildings. In fact, urban renewal programs are often times more popular, as they do not require current residents to be relocated (“evicted” is usually how the people being relocated see it). Such renewal efforts may only require repairs of public amenities and upgrading of infrastructure, which are usually less costly and can be done faster than new developments.

Even if relocation is necessary, community-based efforts centered on negotiation often result in stakeholder buy-in which, in today’s 24-hour news cycle, is increasingly important. A good example is the 600-acre redevelopment of the Dharavi slum outside of Mumbai. The project has only recently made progress because the state government allowed its residents to be relocated to an area nearby. The reason for the 20-year delay? The residents feared that they were going to be relocated too far from their places of work.

Once built, affordable housing often loses its value due to poor maintenance, which results in dilapidation. To avoid this common pitfall, housing projects should firstly be located near where their residents work. By doing so, they stop being housing projects, and start being communities, which stand a better chance of proper maintenance and price appreciation.

Secondly, educating the residents on the importance of proper maintenance – not just of the housing units themselves, but the surrounding infrastructure like public transportation – will also promote community spirit. It shouldn’t surprise anyone that these tasks become infinitely easier when there is community support.

Understanding the social norm in communities is crucial to ensure adequate improvements in living conditions for low-income households. In certain parts of the world, it is a social norm for women to play an important role as the decision maker on matters related to their home. Take for example, India. Although the men are the head of the households, it is the women who usually take the lead in identifying the need for any home improvements. Similarly, in Peru, the women play the role of the “originator”; they plan and begin the construction of their home, which only then will the men take over and continue until completion.

It is therefore imperative for governments to consider the local factors when formulating solutions and realize the need to educate women on construction technology. By doing so, they are being equipped with the skillsets required to drive sustainable, disaster resilient, and affordable housing programs.

Combined, these community-based initiatives ensure that well-prepared housing plans are in place that benefits the community at large. They leverage on the efforts of members of the particular community to improve the condition of substandard homes through home improvements and construction. It is therefore fundamental that collaboration exists between the government and community

Conclusion:

Housing are not random acts of building. A holistic approach to formulate housing policies is pivotal to achieving an equilibrium between demand and supply mismatches whilst catalysing the fulfilment of affordable housing for the population at large. Urban economic migration resulted in rental housing rapidly becoming an important aspect in government housing policies in Asia. Policies to dictate building construction, land utilisation and affordable home financing are key for successful implementation to achieve affordable housing goals.

The arrival of big data has been imminent. Aggregating pools of both linear and non-linear data enables deep analytics to accurately define the policy landscape for effective deployment of private and public resources. New perspectives arising from informed decisions drawn from Big Data will define the shape of communities spreading across geographies by adequately fitting supply snugly into the housing needs of the population.

Innovative financing solutions beyond the shores of traditional financing are mushrooming to fill the funding void left behind by financial institutions, thus allowing first time homebuyers to own homes or have access to housing sooner.

The informal sector and urban poor are not deprived of their housing needs, with the advent of micro-financing crystallising homeownership by catering to their unique financial disposition. The emergence of FinTech allows for rapid deployment of funding solutions by covering vast swathes of the population in a cost-effective manner.

Affordable housing initiatives warrant different types of interventions across countries in Asia depending on the levels of housing market maturity, domestic income, financial landscape and institutional strength in each country. A supportive Government is paramount to the success of affordable housing schemes. The most important piece of the affordable housing puzzle rest on the need to equip communities with financial literacy to revolutionise their lives to gain access to quality housing for all across Asia.

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April 2019