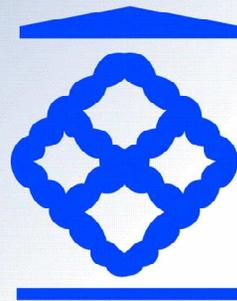


# CHALLENGES & OPPORTUNITIES FOR DEVELOPING MORTGAGE MARKETS

(The Ghanaian Experience)



**HFC BANK**

Date: June 19<sup>th</sup>, 2007

# INTRODUCTION



**Housing is one of man's basic needs. Of the 3 most basic needs; food, clothing and housing, housing is the most tangible and enduring**



**Housing Finance and Construction have been described as the bedrock of economic growth. The process itself is a catalyst for wealth creation and noted for its multiplier effect.**

# INTRODUCTION (2)



**One house constructed creates job opportunities for a host of unskilled labourers and many other skilled labour including; masonry, carpentry, painters, plumbers, architects, structured engineers, lawyers, Bankers, etc.**



**The formation of new communities also leads to new opportunities for the expansion of the service industry.**

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Banking institution offering a full  
range of financial services in  
Commercial banking, Investment  
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# MISSION

***To create wealth and a better life  
for our customers***

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# VISION

***To become a leading universal Banking institution in the West African sub-region, providing world-class financial services***

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# BACKGROUND



Upon attaining Independence in 1957, Government of Ghana (GOG) adopted a policy of direct intervention in the housing delivery process with the establishment of



The State Housing Corporation



The Tema Development Corporation.



The Bank for Housing & Construction.



The State Insurance Corporation



# BACKGROUND



Over the years all of the government housing initiatives which have tended to be ad-hoc and not products of a comprehensive housing policy have failed to effectively address the national housing problem in a sustainable way.



In the circumstances, self financed housing construction mechanisms evolved which today accounts for about 80% of new housing developments in Ghana.



# HOUSING STATISTICS (1)



**It is estimated that there is about 500,000 housing unit deficit in Ghana ( Source: GOG national Shelter Policy, 2000)**



**Only 5% of Ghanaians who want to own houses can do so from their own resources.**



**About 60% of Ghanaians who want to own houses will need financial assistance.**



**About 35% are not capable of owning or building a house in their lifetime (Source: IFC Housing Finance in Ghana Study)**



## HOUSING STATISTICS (2)



**Annual housing output estimates for 2005 was 40,000 housing units ( Source: Building & Road research Inst (BRRl), Kumasi)**



**Out of the 40,000 units, 95.5% were supplied/ constructed by private individuals.**



**Ghana Real Estate Developers (GREDA) supplied the next highest housing units of 750, representing 1.9%**



# HOUSING STATISTICS (3)



**The foregoing data shows that there is a significant housing deficits, just like many other African countries.**



**These deficits have been compounded by rapid population growth and increasing urbanization.**



**It is further complicated by Housing Market Distortions.**

# MARKET DISTORTIONS (1)



**In a 1990 World Bank Survey on Ghana, it was determined that years of misguided public policy had:**



**made housing costs relative to income among the highest in the world even though housing quality was low and deteriorating.**



**Paralyzed the 2 housing sector parastatals (SHC and TDC) which between them controlled assets equal more than 2% of GDP.**



## MARKET DISTORTIONS (2)



**Bankrupted domestic input producers and contributed to the collapse of Bank for Housing & Construction.**



**Resulted in many employers relying on very large and inefficient in-kind salary compensation in the form of housing allowances and subsidized housing loans.**



**Left the government with over 15,000 housing units that yielded rents significantly less than the cost of maintenance.**



# LEGAL CHALLENGES (1)



**In 1973, GOG introduced the Mortgages Decree that took away the mortgagees right of sale and foreclosure without reference to the courts.**



**This decree did not only change the essentials of the mortgage but significantly changed the process of recovery of mortgage loans to the detriment of lenders.**



**The decree also emphasized that a mortgage contract constitutes only a charge over the property and shall not effect any change in the ownership except as provided under the provisions of the decree.**



## LEGAL CHALLENGES (2)



The question, whether a transaction is a mortgage or not, is determined by the substance and not the form of the agreement. It is virtually impossible, therefore, to write mortgages in the form of any innovative instrument, so as to avoid the provisions of the decree.



(Similarly, a decree in 1972 on Hire Purchase and Conditional sales took away the incentive for investors to undertake these businesses). It was not surprising that the collapsed Bank for Housing and Construction (BHC), First Ghana Building Society (FGBS) and a few other institutions dealing in housing and construction either became dormant or redirected their resources to other sectors of the economy, such as commercial banking and trade finance.

# LEGAL CHALLENGES (3)



Meanwhile judicial processes have substantially deteriorated since the 1970's such that it can take more than five years to process a case to recover possession or sell a house.



Furthermore, the judges are known to give injunctions on land without establishing the title of the claimant. Injunctions are typically for long periods such as two (2) years.



Borrowers and their lawyers took advantage of this system to more or less force lending institutions to write-off large sums of accrued interest charges just to be able to manage their portfolios and reduce regulatory provisioning requirements that are more suited to short-term lending than long-term mortgages.



# FINANCIAL DISTORTIONS (1)



**High inflation, averaging almost 50% per annum over 1980-87 and peaking at 70% in 1995.**



**Extensive direction of credit to unsuccessful parastatals resulted in a financial system that provides little or no incentive to save, and which correspondingly has little depth or buoyancy.**



**A banking system, unable to mobilize adequate resources; and a small, unsustainable supply of mortgage credit that carried with it large implicit inflation taxes on suppliers.**



# FINANCIAL DISTORTIONS (2)



**In countries where the macro-economic situation is high and volatile interest rates, it is difficult to involve the banks in lending or investing long-term, no matter the rewards.**



**Treasury bills and profitable trade finance became so attractive for the banks that it crowded out customers needing medium- to long-term capital.**



**Such financial policies made inflation hedges, such as land, more attractive to savers and, as a result, more expensive for those who need shelter.**



# OTHER CHALLENGES (1)



**Lack of long-term funds required to match the duration of mortgage loans.**



**Relative low incomes in comparison with house prices, hence a high affordability threshold.**



**Low savings culture due to the absence of suitable savings mobilization mechanisms.**



**Low access to construction financing.**



## OTHER CHALLENGES (2)



**Absence of well established real estate developers and low skill level in project management.**



**Land tenure and administration bottlenecks.**



**Cumbersome and long foreclosure processes.**



**Lack of consistent fiscal and regulatory incentives to promote the development of housing finance.**



# HFC BANK



**HFC was created** in an attempt to address these distortions and challenges.



**Home Finance Company Limited (HFC)**, initially a special purpose vehicle, was promoted by HFC/GOG/MBG and SSNIT in 1990 to implement a pilot housing finance scheme component of the IDA-funded Urban II infrastructural development project.



# INITIAL FUNDING



IDA

Financing for sub-loans	=	<b>US\$7.2 Million</b>
<b>Technical Assistance</b>	=	<b>US\$1.0 Million</b>

<b>SSNIT</b>	=	<b>US\$16.2Million</b>
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<b>Total</b>	=	<b>US\$24.4 Million</b>
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# BRIEF BACKGROUND OF HFC

-  **DEC 1991 – HFC COMMENCED BUSINESS AS HOME FINANCE COMPANY LTD**
-  **AUG 1994 – LICENSED BY BOG AS A NON-BANK FINANCIAL INSTITUTION**
-  **OCT 1994 – BECAME A PUBLIC COMPANY**
-  **MAR 1995 – LISTED ON G.S.E.**
-  **1996 – FIRST AND ONLY COMPANY TO ISSUE CORPORATE BONDS IN GHANA**
-  **2000 – DEPOSIT TAKING PERMIT ISSU**

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# HISTORY OF HFC BANK



Currently, the largest shareholders include Union Bank of Nigeria, plc, Union Homes Savings and Loans, SSNIT (the National Pension Fund), the Ghana Union Assurance (GUA), a private insurance company, and several large insurance companies.



98% of the shares are held by corporates.



GOG (the Government) no longer has an equity stake in the company.



# *Incentives (Enabling environment) Provided by Govt*



## ***Tax Incentives for the Housing Sector (1)***

### ***Developers***

New enterprises enjoyed five (5) year tax holidays.

Exemption from custom duties on plant and equipment.

Capital allowance of 50% in year of investment and 25% in subsequent years



# *Incentives (Enabling environment) Provided by Govt*



**For Homeowners**

**Allowed to deduct mortgage interest from rent income.**



**Investments in either the HFC-Unit Trust or the HFC-REIT are tax exempt.**

**Through investments in these two (2) Collective Investment Schemes, households and corporates have built up resources to purchase residential accommodation either through outright purchase or as down-payments for mortgages. Through the REIT, land has been acquired and serviced for sale or housing development.**

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# OPPORTUNITIES (1)



**HFC introduced 2 Mortgage Repayment methods:**



**The Conventional Reducing Balance Repayment Method.**



**The Graduated payment method, now referred to as Flexible Repayment Method (Flex).**

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# CONVENTIONAL REDUCING BALANCE



**This type of loan has a fixed periodic repayment amount consisting of two variable components of principal and interest.**



**The repayment amount is calculated at the start of the contract so that the loan amount will be fully repaid after the required number of repayments.**



# CONVENTIONAL REDUCING BALANCE



**Regular monthly payments reduce both the interest and principal components of the mortgage.**



**The monthly repayment remains the same over the term of the loan, assuming interest rates are unchanged.**



**Mainly used by high net worth customers.**



# FLEXIBLE REPAYMENT METHOD (Flex)

 The idea behind this type of mortgage is to address the needs of low income households by allowing middle-to-low income earners to access mortgage loan amounts which they would not normally qualify for under conventional loan terms.

 We start the borrowers with smaller repayment amounts.

 Allow borrower's to make initial installments of 30 - 35% of their net monthly income to service the loan granted.

# FLEXIBLE REPAYMENT METHOD (Flex)



Loan balance may initially increase since the stipulated repayment only contributes towards the interest.



There is therefore an annual increments in installments to cover the principal and interest payments so that the loan can fully amortize at its maturity date.



However, when wages begin to rise borrowers on Flex mortgages are expected to accelerate their monthly repayments to cover interest and principal.



# AFFORDABLE HOME SOLUTION

 **Price of 2 bedroom semi detached : GHC 250,000,000.  
(USD26,900)**

 **Min down payment (20%):** **GHC 50,000,000.  
(USD5,380)**

 **Loan Amount** **GHC 200,000,000  
(USD 21,520)**

 **The above example is an average home constructed by State Housing Corporation (SHC)**

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# FLEX SCHEME



To qualify for **GHC250m (USD21,520)** , an individual or couple with joint income must earn a minimum of **GHC4.2 m (USD452)** per month.



The term is for a period of **20 years**.



Initial monthly installment will be **GHC1,260,000 (USD136)**.



# REACTION OF BORROWERS



Those paying minimal amounts had growing balances resulting in bad PR and a 'Stigma' for the company, (***"You never finish paying HFC loans"***).



**We had to explain the concept.**



**The facts on the ground show a different picture.**



**HFC is the largest provider of home loans in Ghana.**

# ACHIEVEMENTS (1)



**In spite of high interest rates and relative low incomes, our mortgage loan programs have demonstrated that it is still possible to implement unsubsidized loans for housing in inflationary environment.**



**Even though loan balances, in cedi terms, have grown over the years of operations, the same figures in US dollar terms shows declining balances, and the build up of equity by our mortgagors.**



**Some mortgagors have traded their built up equity in order to move up the housing ladder.**



## ACHIEVEMENTS (2)



**Improvement in foreclosure process by the passing of the Home Mortgage Finance Law PNDCL 329 (1993).**



**Establishment by HFC, of the HFC Unit trust and HFC Real Estate Investment Trust (REIT) as collective investment schemes, to promote the savings habit and facilitate home ownership.**



**The drop in inflation and interest rates (if sustained) will enable the issuance of longer dated bonds required for mortgage finance.**



# ACHIEVEMENTS (3)



HFC has established other sources of funding from the capital market.



Approximately, US\$22 million have been raised from the Ghana Stock Exchange (GSE) through the issuance of Housbonds to refinance dollar denominated mortgages for NRG mortgages.



HFC and its wholly-owned subsidiary company HFC Investment Services Limited (HFC-ISL), manage the first two collective investment schemes in Ghana. These are the HFC Unit Trust and HFC Real Estate Investment Trust (HFC-REIT).



Both funds have provided investors real returns over the years.

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# ACHIEVEMENTS (4)

 Demand - For modest housing is still very high.

 HFC finances homes that are certified by qualified valuers to be of good quality in areas which have basic infrastructure and good legal title, usually leaseholds of 50 to 99 years duration.

 Bulk of the market is for two (2) bedroom houses.

 HFC has provided construction financing to real estate developers, but it is clear that the Developers prefer a more comprehensive banking



# THE WAY FORWARD (1)



To Create an efficient land titling and administration process.



The need for the establishment of a National Housing Fund to fund and facilitate access to housing by moderate and low income earners.



Clear policies on the role of Government and the private sector in the provision of infrastructure to support housing development. I.e recovery of infrastructure financing must be made over a longer term as against the current practice where it is fully recoverable through the selling prices of houses.



Required change in regulations of the Bank of Ghana and the Insurance Commission, to include allowing investment in housing bonds by Banks and Insurance companies to be included in the computation of reserve ratios. This will greatly encourage financial institutions to invest in housing bonds.



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## THE WAY FORWARD (2)



The regulatory framework such as provisioning rules for mortgage loans must take into consideration the specialized and long term nature of the loans and not to be applied on the same conditions as normal short term loans.



Tax holiday to Real Estate developers must be made conditional upon the construction of a minimum number of moderate income houses per annum per estate developer. Such houses are currently in very short supply.



# THE WAY FORWARD (3)



**Often housing finance issues in developing economies, are treated in isolation, without serious consideration of linkages to the general well-being of the national economy. Often housing is an election issue, but afterwards there is little commitment to housing.**



**The potential for housing finance to serve as the engine for creating national wealth has not been fully understood by our politicians and regulators who are charged with the responsibility of facilitating the development of the industry. Housing policies articulated by housing ministers and not economic planners, have often failed to address the positive contribution housing can make towards economic development.**



# THE WAY FORWARD (4)



**In order that housing finance schemes may be sustainable, the housing finance and construction process must themselves serve as means for creating internal wealth.**



**In a continent where savings rate is very low, housing finance is a good motivation for consistent household savings. Traditionally, collective savings schemes such as the 'susu' system are well known.**



**We need a secondary mortgage finance system, but it must emerge. HFC tried to jump-start a two-tiered system but did not work because of the banks' negative attitude and the refusal of the Central Bank to institute incentives to create a secondary mortgage finance system.**



# CONCLUSION



**Housing finance can be profitable even under difficult economic situation.**



**Our experience is that moderate-income earners are better in paying back loans than the so called high net worth individuals.**



**Each country must evolve its own type of suitable housing finance system.**



**You cannot easily replicate successful schemes in Africa.**

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