Yandraduth Googoolye: The role of central banks in encouraging investment in housing

Address by Mr Yandraduth Googoolye, First Deputy Governor of the Bank of Mauritius, at the annual conference of the African Union for Housing Finance, Flic en Flac, 11 September 2013.

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Ladies and Gentlemen

A very good morning to you all.

It gives me great pleasure to participate this morning in this Annual Conference of the African Union for Housing Finance (AUHF), being organised in collaboration with the Mauritius Housing Company Ltd (MHC).

Home ownership is one of the major aspirations of an individual. Today, owning a house not only means having a shelter for the family. The house is a real asset that probably represents the largest investment undertaken by an individual during his lifetime. Such a large sum of money may not initially be readily available for the average individual. It is primarily in this context that housing finance has been linked to the grant of credit facilities by banks and other mortgage institutions.

Investment in housing can be seen from different viewpoints. For a Government interested in fulfilling its social mandate of facilitating access to decent housing for low- to middle- income families, the problem is finding the necessary resources to carry out public housing programs. Let me set an aside here to dwell for a minute on the experience of Mauritius where the Government set up as early as 1963 an organism geared towards the provision of social housing. This organism evolved into the Mauritius Housing Corporation (MHC), which is today the only finance institution – both in Mauritius and Rodrigues – that caters exclusively for the promotion of home ownership and the provision of housing finance. Since July 2001, the MHC has been authorised to conduct deposit-taking business to finance its activities and is accordingly under the regulatory purview of the Bank of Mauritius. Over the years, the MHC has been innovative. In addition to credit granted for housing projects, the company also provides architectural, technical, legal, insurance services, and accept deposits primarily for the purpose engaging the general public in savings for home-ownership. More of this will be provided by the Managing Director of MHC.

Coming back to my main point, investment in housing, from the perspective of the household, is very often linked to the possibility of obtaining a loan at affordable terms. For the bank manager considering whether to grant a loan, the problem is how to expand the scope of financial services while managing risks appropriately. Finally, from the viewpoint of central banks, the problem is to prevent financial instability and to maintain confidence in the financial system.

Today, I should like to take this opportunity to share with you the viewpoint of the central bank and some thoughts on our role in encouraging investment in housing while taking into account the risks that such investment may pose to financial stability. Hopefully, I will be able to contribute towards a deeper awareness and understanding of these risks and other issues linked to housing financing.

At least two factors make this a highly topical subject. First, the 2008 global financial crisis has shed the spotlight directly on the housing market, prompting many questions to be raised about practices in housing finance. These questions have challenged traditional assumptions that lending for housing purposes is generally a safe and low-risk activity, and highlighted potential dangers that central banks and banks need to be concerned about. Secondly, the current accommodative stance of monetary policy coupled with the increased competition in the housing market calls for greater vigilance by banks in monitoring risks linked with housing loans.

In Mauritius, credit for housing purposes has always constituted a large share of total credit to households. Currently, advances granted by banks for housing purposes account for around 62 per cent of total household credit. As a percentage of GDP, housing loans have increased from 7.1 per cent at end-March 2008 to 12.1 per cent in the first quarter of 2013. Latest data show that investment in residential building posted a robust growth rate of 26.9 per cent in the first quarter of 2013, and it is expected that growth in this segment will hover around 10 per cent in 2013. At the end of the first quarter, the volume of residential building permits increased to 1,724 compared to 1,367 a year earlier. Comparatively, according to the Housing Survey conducted by Statistics Mauritius in 2011, the housing stock grew by 19.9% from 297,700 to 356,900 housing units over the past decade, with the number of private households increasing by 14.5% from 297,900 in 2000 to 341,000 in 2011. While growth in the housing market is expected to be sustained, there is increasing evidence that the rise of investment property has also been important.

Housing loans remain relatively sound. However, while house financing is a profitable business for most banks, competition has intensified considerably. Today banks compete aggressively for borrowers by offering highly competitive home loan packages to meet different needs of borrowers. Banks need to be aware of the risks posed by a rapidly expanding housing credit portfolio. The financial crisis of 2008 and its consequences for the world economy serve as a useful reminder of this need.

Part of the central bank mandate is to ascertain that, notwithstanding competition and the need to make profits, banks maintain a prudent approach in granting housing loans. At the same time, the regulatory framework set up by the Bank of Mauritius is such that it encourages investment in housing, particularly with regard to first-time buyers.

In line with international standards prescribed by the Basel Committee for Banking Supervision, credit extended for residential purposes is classified in the preferential bucket of 35 per cent of risk-weighted assets in the computation of capital adequacy ratio requirement. Accordingly, banks are implicitly encouraged to increase the quantum of their portfolio for housing credit given that they maintain lower regulatory capital for holding these assets in their books.

In 2004, a Commission of Inquiry was set up by the Government on the Sale by Levy system in the light of several cases of foreclosures and rising number of lawsuits being filed in court against borrowers whose loans had become non-performing. Subsequently, the promulgation of the Borrowers Protection Act in 2007 came to the rescue and clearly set out the obligations of lenders in providing clear information on the terms and conditions governing the grant of any credit facility, including financing of the acquisition of immovable property. Several measures were taken by the Bank of Mauritius: banks were requested to abide by the provisions of the said Act for all loans, specifically with respect to facilities below the amount of Rs2 million; in view of a closer monitoring of cases being lodged in courts against borrowers, banks were requested to provide information on all cases of Sale by Levy on a periodical basis to the Bank of Mauritius.

Presently, the Bank of Mauritius is working on several initiatives that aim at promoting investment by first-home buyers. Macroprudential measures shall shortly become applicable to credit extended by the banking sector for residential purposes, and these policy measures shall include guidelines towards demarcating credit granted for housing purposes and property investment based on speculation and commercial purposes. There is no doubt that making a clear distinction in the terms and conditions applicable for first-house buyers would facilitate the granting of loans.

It is also perceived that buying a first house represents a low-risk investment as the collateral for mortgage financing is usually secured by fixed charge on both land and building. However, the Bank of Mauritius has adopted the stance that banks have to maintain sound lending standards in granting credit facilities to the housing sector. While having due regard to the level of household indebtedness at the macro level, the Bank of Mauritius has underlined the need for all financial institutions to undertake proper assessment of borrowers' repayment capacity. This would prevent households from becoming overleveraged. The Bank of Mauritius further ensures that accurate information is conveyed through advertisements issued by financial institutions to attract borrowers. In this regard, while "teaser rates" for home loans can be conspicuously displayed, the Bank of Mauritius requires that other information, including the Annual Percentage Rate (APR), be displayed as well so that the potential borrower is clearly made aware of the implied interest rate applicable on an annual basis.

Conclusion

Housing finance contributes significantly in raising living standards of people, be it either in Africa or any part of the world. Viewed at the macro level, housing finance generates economic growth via job creation, entrepreneurship, and economic linkages to other sectors. However, one cannot ignore the fact that the recent financial crisis that rocked the global economy is closely related to a crash in subprime mortgage lending in the United States, the so-called CDS or credit default swap.

While taking lessons from the global financial turmoil, the Bank of Mauritius remains committed to its goal of maintaining the soundness and stability of the financial system in Mauritius. Stakeholders should therefore aim at ways to improve access to housing finance in a sustainable way.

Ladies and gentlemen, you will concur that affordability remains a major challenge in housing markets in Africa. Several constraining factors such as poverty, lack of long-term financing, reform in land management system, and the rising cost of building materials are issues that remain to be tackled by all delegates present at this conference. However, it is reassuring to note that lenders are becoming more proactive and experimenting with new products, and that housing microfinance is complementing conventional financing methods.

Work being undertaken by the African Union for Housing Finance is laudable while aiming to promote housing credit as part of financial inclusion in Africa. I am sure all delegates present here from Africa mainland will benefit from the fruitful deliberations over the next three days and will reach concrete resolutions that shall foster sharing of knowledge and cooperation among members of the African Union for Housing Finance in mobilising funds for shelter and housing on the African continent.

I thank you for your attention.