COMPARATIVE ANALYSIS OF DEVELOPED AND DEVELOPING COUNTRIES ON MORTGAGE FINANCE: LESSONS FOR NIGERIA

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Abstract

Homeownership, according to Tiwari and Moriizumi (2001), is the most desired form of housing tenure around the world for reasons of security and certainty. Despite this, owning a house presents a struggle for families virtually everywhere because many families can not purchase a house with equity yet there is phenomenal increase in the population, number and size of cities all over the world. The Nigerian government on her part had adopted many measures to achieve near self-sufficiency in residential housing production over the years but did not achieve much.

This study examined the extent to which mortgage financing institutions in developed and developing countries have been able to meet the housing needs of savings' contributors. The study noted that Harker and Zenios (2000) in their study realised that the financial services sector employs more people than manufacturing, automobiles, computers, pharmaceuticals and steel combined in more advanced countries. The financial services sector is also expected to encourage savings and allocate credit across space and time thereby allowing households to cope with economic uncertainties by hedging, pooling, sharing and pricing risks. Abiodun (1999) observed that a similar scheme has been used successfully to transform the housing sector in Korea.

This study found out that economic stability in any nation is the panacea that would guaranty availability of long term loans since it is difficult for a mortgage finance company to operate in an unstable and volatile economic environment.

Introduction

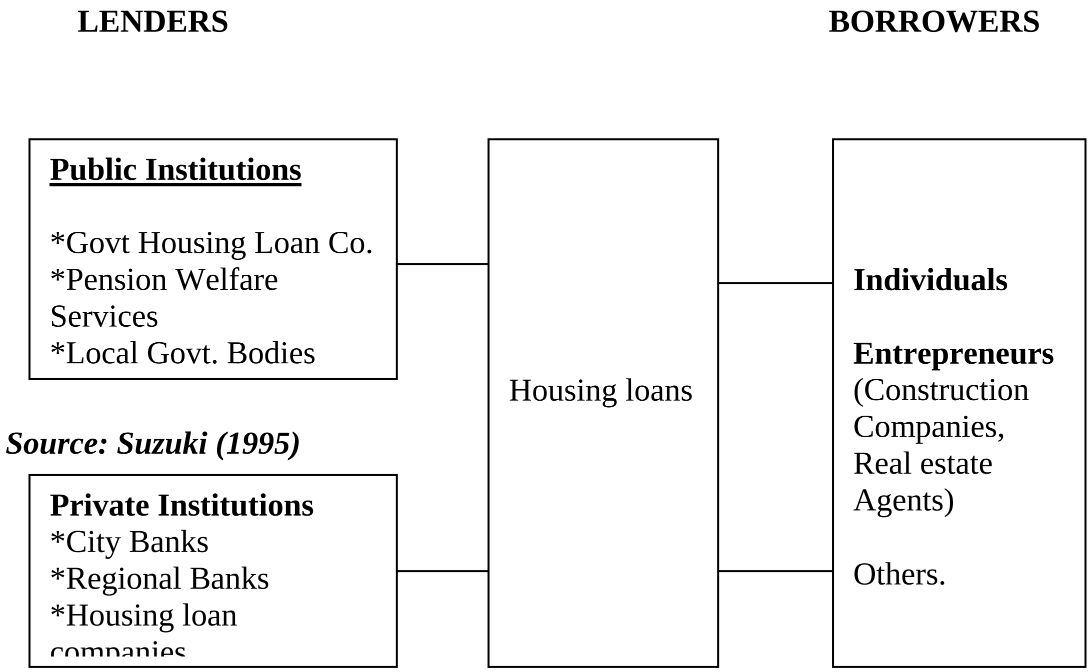
Real estate and its finance are essential elements of economic development, economic growth and capital formation. The availability of adequate housing finance to would be purchasers, would definitely reduce the developers' financial pressures which would have been imposed by unsold stock of housing and, at the same time, help channel profits into new housing projects. However, housing finance in many developing countries has been limited to state-owned specialized housing banks, which in many instances is a sector that is primitive and under-developed. These banks thereby constituted a burden on government budgets through heavy reliance on subsidized finance and accumulation of contingent liabilities. They also suffered chronic mismatch between assets and liabilities' markets were distorted by the operations of these banks which provide subsidized loans in a way that discouraged market-based institutions from providing housing finance services. Policies, such as interest ceilings and protection for households, adopted by many developing countries, were aimed at expanding the housing finance but they eventually had adverse effects. Lending was only restricted to few borrowers and consequently the real estate market remained under-developed and incapable of serving the needs and requirements of low and medium income households. According to Adesina and Urgikar (1980), there is no country in the world which is devoid of housing problems but these problems are more acute in the developing countries than in the advanced industrial nations. There is therefore the need to examine the situation in these developing and advanced countries across the world for comparison.

Some Finance Systems across the World

Several authors have examined the nature and success of mortgage finance systems in countries across the World. These finance systems differ from each other in source of funds, mortgage products and in the role of government (Stephen, 2000; Tiwari and Moriizumi, 2001 and Lea, 2001). Housing finance systems in Germany and Denmark, as reported by the above authors, are characterised by specialised mortgage banks with mortgage bonds backed by collateral pool as the principal source of funding. U.K. has a depository type of housing finance system with commercial banks and savings banks as mortgage lenders while the government insures deposits. The housing system in U.S.A. is linked to the secondary mortgage market. Banks and mortgage companies are principal lenders and mortgages are sold to investors in secondary markets as mortgage backed securities constituting the major source of funding. In Japan, housing finance system is based on direct credit system with government playing a major role with fixed or adjustable rate of interest.

Saunders and Walter (1994) studied finance systems in Switzerland and found that banks are permitted to have broad powers and also that in the two countries there was little banking instability. In contrast, Benston and Kaufman (1995) noted that Spain experienced serious banking problems because financial institutions were over protected from competition. They observed however, that such instability may have come from the cost of monopoly profits and inefficiency of the financial system. Political manipulations also came from politicians and government officials who defined what they considered as safe assets that banks may hold for political, social or prudential reasons. The studies also showed that government encouraged, subsidized or mandated financing institutions to allocate credit to targeted groups/sectors or to provide services below market prices to targeted groups. Narrow banking proposals are designed to minimize the sources of the perceived fragility of financing institutions. Financial institutions are restricted to only high credit quality debt of short duration to eliminate potential losses associated with credit and interest rate risk. Suzuki (1995) studied finance systems in Japan, and discovered that home finances fall under three categories, namely loans for individuals, developers and urban renewal projects Individuals took up to 88% of the available funds. The finance of home purchases was provided by Commercial Banks, Finance Companies, Government Housing Loan Corporation, Pension Welfare Services, Public Corporation and Local Government bodies and funding was from public and private institutions. Their paper pointed out that in Japan, both public and private institutions grant mortgage loans to individuals, construction companies and real estate agents, and funding is both from public and private institutions. The housing structure and policy in operation in Japan are slightly in line with that of Nigeria as can be seen in Figure 1.

Fig. 1: Housing Finance System in Japan



Edey and Gray (1996) in their study of finance systems in Australia observed that during the past three decades, there had been rapid structural changes in the financial system. They noted that there has been a shift from the traditional financial services suppliers by banks to the establishment of specialist mortgage suppliers on a stand-alone basis.

The Finance System in Nigeria

A financial system is a composition of various institutions, markets, instruments and operators that interact within an economy to provide financial services. It can also be seen in the context of sets of rules and regulations, and heap of financial arrangements within the financial sector. Such services may include resource mobilization and allocation; financial intermediation; and foreign exchange transaction to enhance international trade, among others. The financial system thus plays an important role in the process of economic growth and development in a country (Uffort, 2003)

Various studies (The World Bank, 1982; Renaud 1986; Olufemi 1993, etc) have shown that the main role of government in the financial system should revolve round a regulatory responsibility of encouraging the development of viable housing institutions and/or maintaining direct and indirect approaches as in Tunisia and Philippines where the government served as developer, lender and stabilizer. Christian (1980) has documented that the emerging view is that the public sector should restrict itself to providing an enabling environment so that the private sector, (including firms, cooperatives and community groups), can expand shelter supply. The financial sector of an economy consists of institutions, markets and regulators that deal in financial instruments under a legal framework within which the activities of the various participants are regulated.

The financial sector in Nigeria has four vital components namely financial institutions, financial markets, the regulatory/supervisory authorities and financial instruments (CBN, 1999). Over the years, the country's financial system has undergone remarkable changes in terms of ownership structure, the depth and breadth of instruments employed, the number of institutions established and the regulatory framework within which the system operates. From an examination of publications of the CBN (1999), it is gathered that the Nigerian financial system is regulated by the following institutions: the Federal Ministry of Finance, the Central Bank of Nigeria, the Nigerian Deposit Insurance Corporation, Security and Exchange Commission, the National Insurance Commission, Federal Mortgage Bank of Nigeria, and the National Board for Community Banks (NBCB). A descriptive review of papers on these finance systems would provide some foundational understanding for the subsequent sections.

The Federal Mortgage Bank of Nigeria (FMBN) took over the assets and liabilities of the Nigerian Building Society (NBS). FMBN provides banking and advisory services and undertakes research activities pertaining to housing. Following the adoption of the National Housing Policy in 1990, FMBN was empowered to license and regulate Primary Mortgage Institutions (PMI) in Nigeria and act as the Apex regulatory body for the mortgage finance industry. The retail mortgage financing functions of FMBN were transferred to the Federal Mortgage Finance Limited (FMFL) in 1992 while the FMBN retains its regulatory role. FMBN was then put under the control of the Central Bank of Nigeria (CBN). With the advent of the National Housing Policy, the Federal Mortgage was mandated to act as the Apex Mortgage Bank with the licensing and accreditation of PMIs to carry on with retail mortgage activities in Nigeria in addition t FMFL.

The structure of mortgage finance in the country has been discussed in many papers along two major headings, namely, traditional (primary) mortgage system and the secondary mortgage market that the country is yet to fully attain to. In the secondary mortgage system, the whole process of mortgage finance activities and practices are unbundled thereby lowering the risk of mortgage lending to originators and providing them with new funding outlets. (Lea, 2000; Lee and Lee, 2000; Nubi, 2000, 2003) The other mortgage system, which is currently in operation, and which is the focus of this study, is the classical or traditional real estate finance system. It is referred to as direct or bundled home/mortgage delivery system (Lea, 2000) and is usually in form of loans secured by a pledge or equivalent security. In this type of arrangement, one class of institution, usually the Primary Mortgage Institution frequently provides housing finance activities. The Primary Mortgage Institutions serve as mortgage originators, service providers, managers of risk and funds within the system. In other words, housing finance relies solely on Primary Mortgage Institutions as organizations providing services for originating finance, underwriting and risk management. While this system is easily understood and operated by the participants, the over concentration of mortgage activities on PMIs has contributed to the reasons why the system is under criticisms. For example, in this system, mortgage interest rate to be charged by a Primary Mortgage Institution is related to interest rates on other non-mortgage loans originated by banks or to the cost of deposits unlike in the secondary mortgage structure (Nubi, 2002). As a result of this, mortgage interest rates scare homeowners and investors. Moreover, Primary Mortgage Institutions have been mainly criticized for their inability to satisfy the existing demand for housing credit especially in urban areas. This has been due to the small size of the resources they control. Also PMIs are faced with constraints, which include difficulties in loan administration (screening, monitoring, information asymmetry, affordability and poor foreclosure mechanisms). PMIs are fragmented and different segments serve clients with distinct characteristics. In fact the World Bank (2000) observed in relation to the nation's housing finance that:-

> *"the National Housing fund was expected to refinance affordable mortgages originated by PMIs to eligible contributors at slightly below commercial rates. Under this plan, PMIs assume all credit risk and the FMBN refinances 80% of PMI mortgage credit balances at 5% interest with PMI's lending rates capped at 9% (with terms up to 25 years)…..But these initiatives have largely failed. PMIs have proven largely non viable and few survived the 1990s for reasons including: improper status and regulatory status as specialized institutions; high inflation; mistrust of PMIs by households due to various malpractices; and a persistent lack of appropriate funding. PMIS made very few mortgage loans. Meanwhile, the NHF also financed an insignificant volume of housing loans utilizing the collected savings for FMBN's administrative structure and expansion costs."*

Comparative Analysis

According to Lea and Diamond (1992), the United States mortgage finance benchmark contract is the fixed-rate mortgage. There are few individuals or institutions willing to lend for 30 years at a fixed rate and hold the mortgage as a portfolio asset. What has emerged is a system of institutions that back this benchmark mortgage, with derivative securities, secondary market agencies, and staggered maturities that permit lenders and investors to reallocate the risk of holding mortgages with a term of up to 30 years.

In the United Kingdom, mortgage contract is a combination of an interest-only non-amortizing loan and life insurance policy for which the borrower pays an annuity. The lender is protected against the premature death of the borrower by being the beneficiary of the insurance policy. If the borrower survives the term of the loan (usually 25 years), the proceeds of the policy are used to pay off the loan. United Kingdom contract does not have a fixed rate. Instead, the rate is set by the institution and tied to a base lending rate that serves a function similar to the U.S. prime rate. When interest rates rise, all borrowers face increased payments, and below-market-rate financing is not locked in. A tight monetary policy therefore affects all homeowners. A fixed-rate mortgage usually cannot survive in a non-regulated regime. There is no market for resale of the interest rate risk, and lenders shift all the risk to the borrower. If there were a secondary market, a fixed-rate contract could be offered, and the risk would be tradable. A completely adjustable interest rate regime shifts the risk back to borrowers who cannot diversify it away from themselves and leads to social costs.

Germans are not homeowners: fewer than half of the house-holds own their homes; down payments are high (well in excess of 20 percent), and the median age of a purchaser is several years higher than in the United States. The mortgage contract is a three-way arrangement. A potential homeowner opens a contract savings account and deposits funds for a prescribed time and rate. When the funds have accumulated, the same institution usually lends a first mortgage, with the deposit account providing all or most of the down payment. A second mortgage at a favorable interest rate completes the purchase and rewards continued savings.

The mortgage finance system in France is similarly arranged. These contract savings plans in France and Germany certainly help to explain the high savings ratios in these two countries, as well as account for the lack of such activity in the United States. When down payments are set at relatively high levels, homeownership declines, and savings accounts to purchase homes increase in number.

Perhaps there is a lesson to be learned here for the United States. A lender could introduce a contract savings plan, with the reward being a lower-than-market interest rate once the funds were accumulated. There is another side to the issue, however; homeownership is a reward in itself and may provide an incentive for work, effort, and thrift in other activities. Also, where homeownership is restricted, as it is in Germany, the result may be a reduction of incentives for productive effort.

Options and Recommendations for Nigeria

In an attempt to reduce the problems involved in the traditional mortgage system as operated in Nigeria, the suggestions of authors such as Suzuki (1995) and Tiwari and Moriizumi (2001) are noteworthy. These authors have suggested a modification of the system whereby both the public and private institutions provide housing loans and manage the fund with government playing a major role by pronouncing a fixed or adjustable rate of interest as a means of ensuring that risk of the mortgage originator is reduced. It is difficult for a mortgage finance company to operate in an unstable and volatile economic environment. A sustainable system crucial for market participants to give some confidence and certainty that no major change is going to take place that would have adverse effect on their operations. Economic stability would guaranty availability of long term loans of 20 years or more from a group of competing institutions provided requirements are met.

Interest rates charged should be at market rates sufficient to cover the cost of funds and administration in addition to cost of risk and profit. In developed countries, the margin between cost of funds and the mortgage rates is two percentage points. Mortgage lending institutions are in a better position to address obstacles that impede the development of mortgage finance and, at the same time, influence government policy.

There is the need for a generally accepted method of valuation so that properties are accurately valued on the basis of the price that could be obtained in the open market. The valuation must be based on sound principles which would require seasoned estate surveyors and valuers.

Government should not impose social obligations on lenders and developers. Where subsidy is encouraged, such should be financed through taxation and not by imposing arbitrary subsidies on mortgage finance institutions. The functions of mortgage finance should be separated from funding low-income housing since according to a study by Eldin, Mohieldin and Nasr (2004), the mortgage finance system is a very inefficient and inequitable tool for delivering subsidies.

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