

## EXECUTIVE SUMMARY

**Objectives.** The purpose of this study is to 1) provide a brief overview of existing housing finance systems in Bangladesh, including those available to the urban and rural low-income households, and, 2) to make suggestions for the improvement of housing finance mechanisms for lower-middle and lower income groups suitable to the conditions in Bangladesh.

**Population and Economy.** Bangladesh is one of the poorest countries in the world with a per capita GNP of \$260. Bangladesh has a population of approximately 124 million people. Population growth decreased over the past decades and was 1.6 percent per year during the 1990-1996 period, while the urban growth rate is estimated at approximately 4.2 percent per annum. Over that same period, GNP at constant market prices increased at an average rate of 4.8 percent and economic growth for 1998 was estimated at 5.5 percent. These economic growth figures have, however, had only a modest influence on the proportion of people living in poverty which was estimated at 35.6 percent in 1995/96. Inflation is modest, although it increased from past low figures of below 5 percent to a year-on-year rate of 8.1 percent in February 1998.

**Housing conditions.** The poverty of the population is reflected in the housing conditions. It was estimated that close to half of all housing units were made of temporary materials. Estimates of the requirements for housing in urban areas vary from 300,000 units to 550,000 annually for the next twenty years depending on the number of backlog and replacement units incorporated in the estimates. The main constraint in housing production is the high cost of housing in relation to incomes, particularly in urban areas, where land prices are high. This gap between income and house prices has some major consequences: 1) It forces new developments for moderate income households further out of the center, while most employment opportunities are still located in inner city areas. 2) Only a small proportion of all required houses is built in the formal sector, 3) High land prices in urban areas have caused multi-family units to become the predominant house-type. This type of housing makes it difficult for urban middle and lower-income households to use traditional incremental house-acquisition methods. In rural areas and in informal urban areas incremental single-family house-construction is the prevalent way of house building.

The lack of housing finance exacerbates the problem. The private development sector is interested in building houses for middle income households, which have been under-served until now. NGOs are beginning to make plans for the development of new lower income housing projects in peri-urban areas. Without access to finance, however, a down-market move in the formal housing sector (particularly for multi-family housing) is virtually impossible. In the meantime, informal housing solutions prevail in urban areas, both in the rental and ownership sector.

**The financial sector.** The overall size of the financial sector relative to GDP remains smaller than that for other countries in the region and has some critical weaknesses related to poor financial management practices. The housing sector, which is highly finance dependent, is particularly affected. The banking system is troubled by bad debt and cannot provide wholesale or individual long-term funds at an efficient rate for housing finance. Debt markets are not developed and are dominated by government, eliminating another potential source of housing

funds. Cleaning up the commercial banking system, strengthening the regulatory and supervisory system for the financial sector and improving and expanding debt markets are of particular concern for the housing finance sector.

**Housing finance.** The present housing finance system in Bangladesh is underdeveloped and highly segmented:

- *The formal mortgage finance system* 1) is small relative to new housing construction, 2) only serves the highest income groups; households with incomes above Tk.25,000 per month, well above the 10<sup>th</sup> percentile of the urban income distribution, 3) is restricted to selected high-income housing sub-markets in Dhaka, 4) has weak underwriting, loan administration and risk management practices, and, 5) has a segregated structure that provides advantages to the government owned BHBFC, which operates in the same higher income market. The present establishment of new specialized private housing finance institutions is a hopeful sign for a more healthy development of the mortgage market. However, these HFI have difficulty mobilizing adequate resources because of the lack of financial market development, the weak banking system and the competition with government savings schemes. Interest rates for fixed rate mortgages vary from 13 to 16.5 percent for periods of 10 to 15 years.
- *Non-collateral-based credit for house-construction* is provided by three of the four largest micro-finance institutions in Bangladesh (Grameen Bank, BRAC and Proshika. Loans are made on the bases of established membership in lending programs and a sound track record of repayments on previous loans. Housing loans form only a small proportion of the MFIs total loan portfolio (never more than a few percent), and have only been available to rural landless borrowers, mostly women. A total of approximately 700,000 housing loans have been issued since the programs started in the 1970s and 1980s. No urban housing lending programs exist.

Housing loans carry flat interest rates ranging from 5 to 10 percent. The term varies from 6 years for Proshika to 15 years with the Grameen Bank. The housing loans have simple application and approval procedures and assistance is provided with the design and purchase of cheap and appropriate building materials. All housing loans have a lower rate than income-generating loans (which carry an interest of approximately 20 percent) and are internally cross-subsidized within the MFI. This is done for the following reasons : 1) housing is considered a social good and a basic need worthy of subsidization; 2) without subsidization the rural poor would not be able to afford a housing loan.

While Bangladesh is unique in having several large MFIs operating a housing credit and construction program in the rural areas, the following characteristics of these programs constrain their extension: 1) the targeting to the poorest rural households who are recipients of income-generating credit, 2) the lack of housing improvement and extension loans, 3) the high internal cross-subsidy provided for housing loans, 4) the vulnerability of the programs to systemic default risks, and, 5) the lack of a savings cushion to deal with these risks. The problem of extending the housing programs to urban areas is tied to the high costs of land and the perceived difficulty to run longer-term credit programs for the urban poor. The larger MFIs agree that under specific conditions the extension of credit for urban housing may be considered.

***Improving access to housing credit by moderate income households.*** *The challenges facing the housing finance sector in Bangladesh is to narrow the extraordinary gap in access to housing credit.* Three types of strategies are discussed: First, increasing the number of households that have access to formal construction and mortgage finance to build or purchase a home in the formal urban housing sector, second, extending credit to lower-income urban households that already own a house in the informal sector or could, with special assistance, acquire an apartment or plot but would not qualify for formal mortgage programs, and, third, enhancing and expanding rural housing lending programs.

***Down-market expansion of formal mortgage lending.*** Several reforms are suggested that could achieve a more vigorous formal housing finance sector:

- *Expanding financial resources available to the private housing finance sector through:*
  - Changes in the Trust laws and Insurance Act in order to allow long-term investors to participate more freely in the housing finance sector.
  - Assistance in the development of a debt market that would facilitate the link between housing finance institutions and long-term investors.
  - Enforcement of the rules guiding participation in the GOB special savings schemes to those lower income individuals for whom these were intended.
  - Encouragement to the larger and professionally run MFIs to set up banks or non-bank financial institutions in order to create a more vigorous domestic financial sector environment that can provide support for the emerging housing finance sector and its move towards middle-income lending.
  - Stimulation of foreign investment in, and foreign lending and guarantees to the new HFIs by carefully selected parties.
- *Leveling the housing finance playing field.*
  - Deciding on the role of BHBFC and detailing an implementation strategy. If it is perceived that it is unlikely for BHBFC to change to an efficient and innovative middle and lower-income mortgage lender, its borrowing / debt raising privileges could be adjusted in order to discourage its competition with the newly developing private HFIs for the same customers.
- *Increasing access to formal mortgage finance by middle-income households*
  - Introducing alternative subsidy instruments for presently under-served lower and middle-income households in specific housing markets.
  - Decreasing the administrative costs related to mortgage lending.
- *Improving the efficiency of the primary mortgage market*
  - Training in state-of-the-art mortgage lending and servicing operations for those actively involved in changing the mortgage industry in the country.
  - Improving the regulatory system for new HFIs which is now divided among various agencies, none of which have experience with mortgage lending operations and risks.

#### ***Expanding Access to Micro-Finance for Housing in Urban and Rural Areas***

- *Improving the sustainability of micro-finance housing programs*
  - Limiting cross-subsidization of housing loans.
  - Expanding programs to borrower groups that can afford larger and longer-term loans.
  - Requiring savings accounts, that would be available in case of delinquencies.

- Assessing housing quality and location for disaster vulnerability.
- *Extending micro-finance for housing to urban households*
  - Extending housing rehabilitation and extension options in housing credit programs. A housing improvement loan program for owners of informal housing may be a starting point for the extension of micro-credit to urban households, for example, in conjunction with existing services improvement projects (UNDP/UNCHS Urban Poverty Alleviation Project) in bustees.
  - Analyzing lending options with joint land ownership forms for low-income urban housing projects.
  - Establishing more professional micro- and mortgage lending conditions, procedures and instruments for urban housing. Subsidies may have to shift more towards land cost than the cost of finance.
- *Creating an apex funding and monitoring window for micro-finance for housing through PKSF<sup>1</sup>*
  - Expanding and professionalizing the housing loan programs by interested MFIs, will require a more reliable source of finance earmarked for housing. An apex fund managed by PKSF could be established. Such a fund should have the capacity to carefully monitor the housing loan programs implemented by participating MFIs and provide technical assistance in the specialized field of housing lending where necessary.

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<sup>1</sup> PKSF was established in 1990 by GOB and was initially wholly funded by the government. It is registered, however, as a non-profit private limited company, governed by a general board of 7 people of whom three are appointed by the government.

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US\$1 = Tk.47