

Challenges of Financing Affordable Housing in Afghanistan

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Road map of presentation

- ❑ Housing market development as a catalyst for economic prosperity;
- ❑ Housing market conditions in Afghanistan;
- ❑ Macroeconomic fundamentals as the foundation for a vibrant mortgage market;
- ❑ Financial sector indicators;
- ❑ Policies to tackle constraints to traditional mortgage finance;
- ❑ Incremental and microfinance solutions to affordable housing in Afghanistan

A vibrant housing market is a catalyst for economic prosperity...

- The housing market has significant backward and forward linkages in the economy:
 - Supports job creation in construction and manufacturing ;
 - Improves living conditions and basic infrastructure
 - Provides motivation to save and invest
- Housing demand creates a virtuous cycle:
 - Housing demand → housing finance → financial sector development → economic growth → prosperity → housing demand

But the current housing situation is dire; after over two decades of conflict...

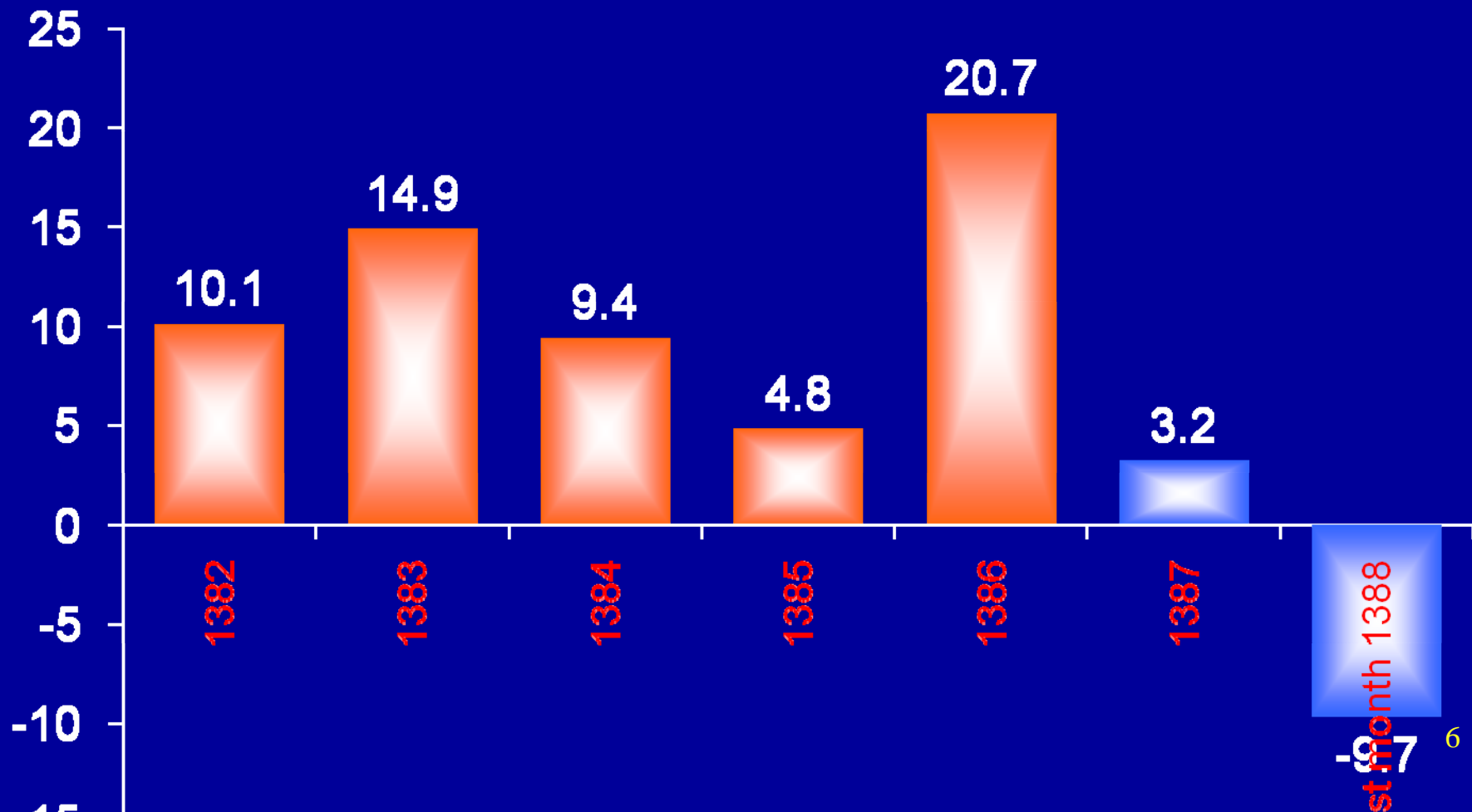
- Many of the six million refugees that left the country during the conflict have returned, putting upward pressure on demand for housing
- Housing demand far outstrips supply with a projected deficit of 1.5 million units by 2014
- 80% of population in Kabul live in informal/slum settlements without access to basic services
- Access to credit is limited with Afghanistan ranked 159th out of 178 countries in ease of getting credit according to World Bank “Doing Business Survey” 2008

However macroeconomic stability, the foundation of a vibrant mortgage market has been largely achieved....

Inflation is in single digits after a sharp spike in 2008 due to global price shock...

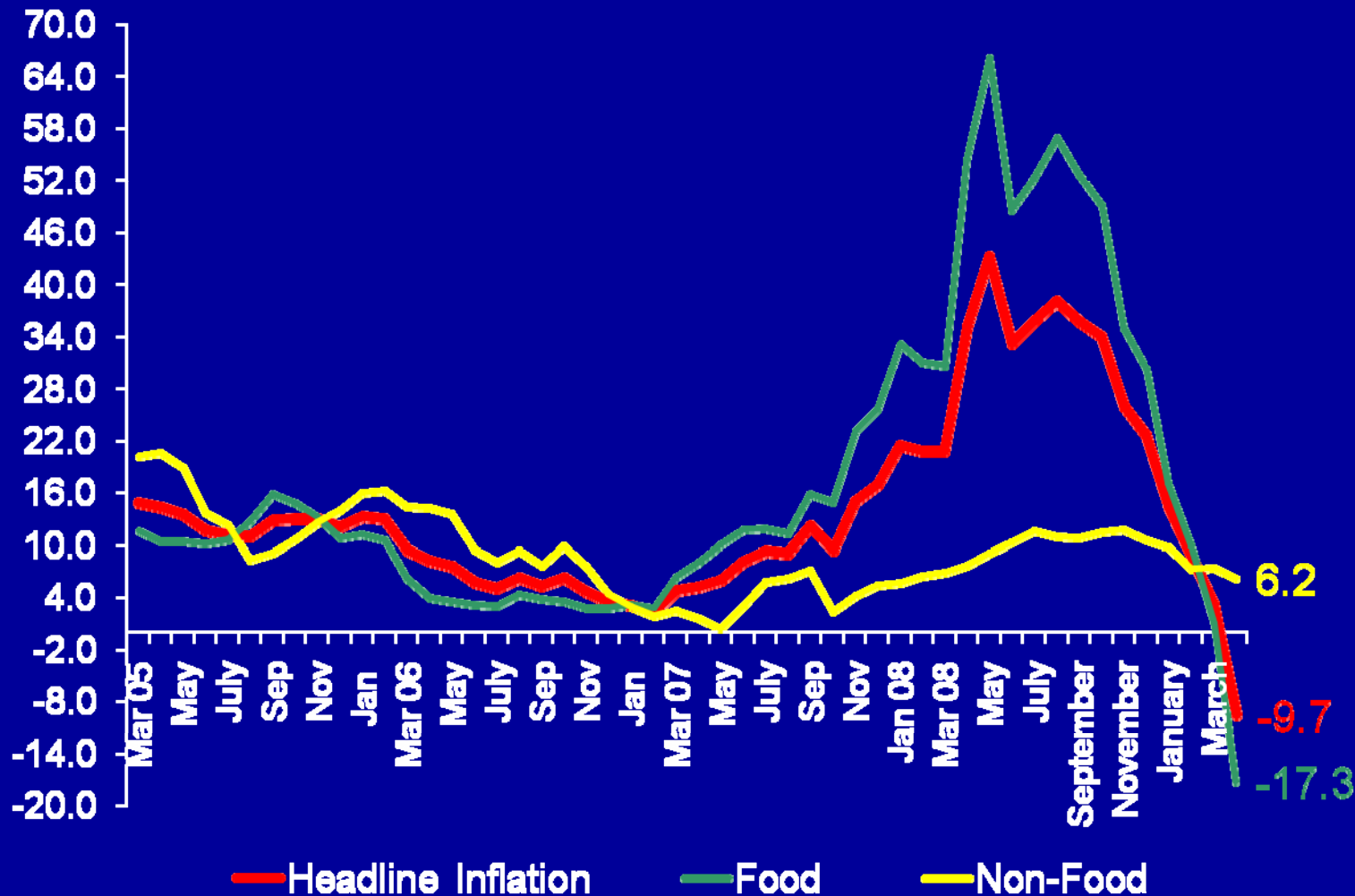
(%)

Headline Inflation: Year-on-Year



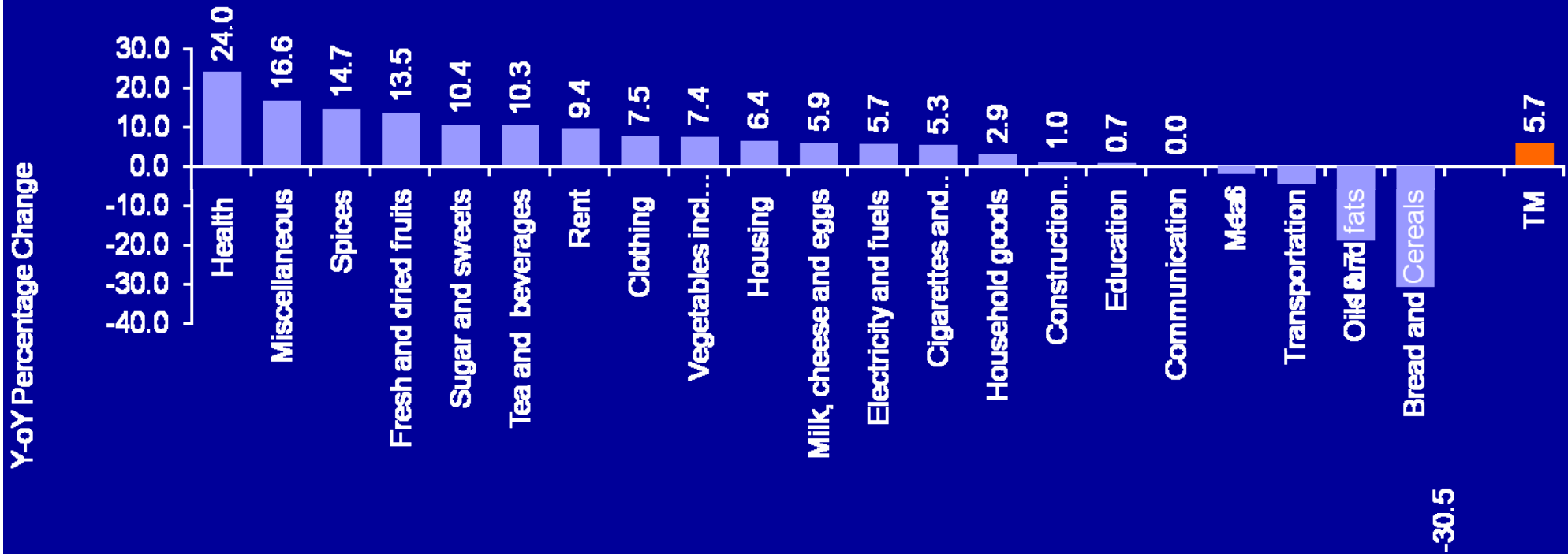
Non-food prices are in positive territory (6.2%) while food prices were negative -17.3%

Kabul CPI



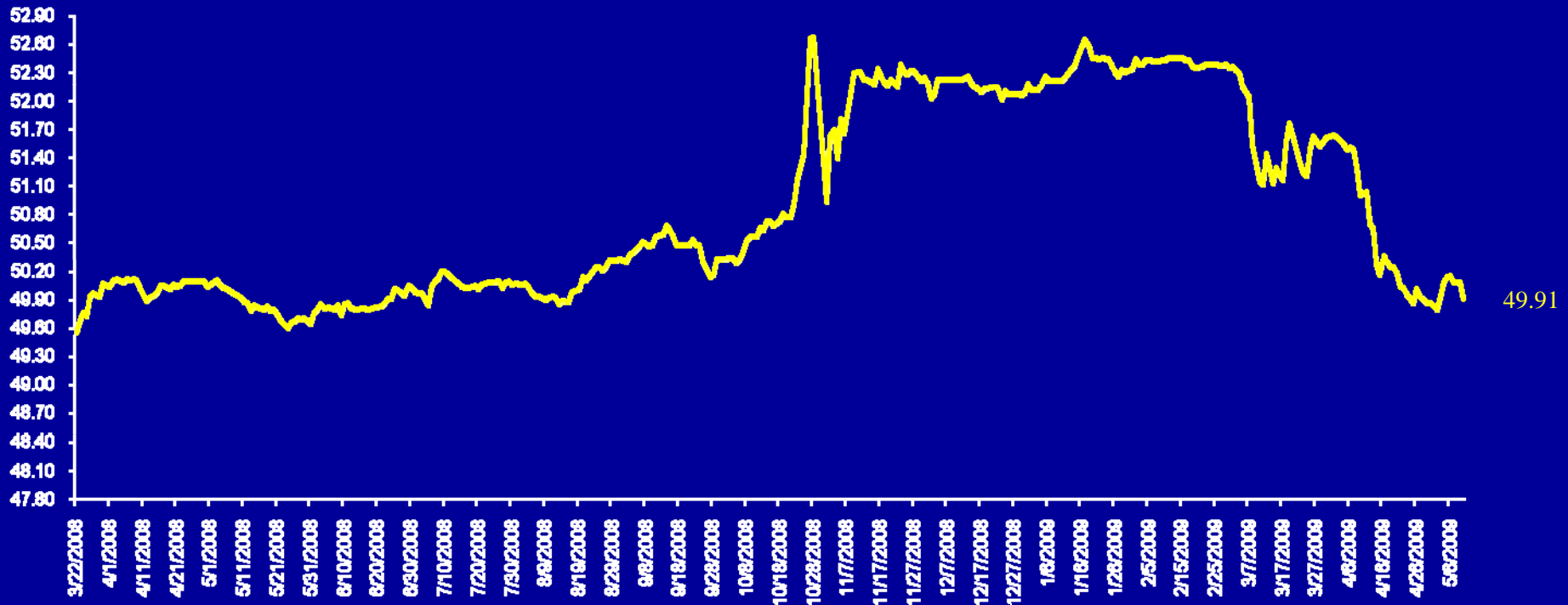
Deflation risk is of little concern because core inflation (5.7%) is within target range

25% Trimmed Mean Inflation (March 2009)



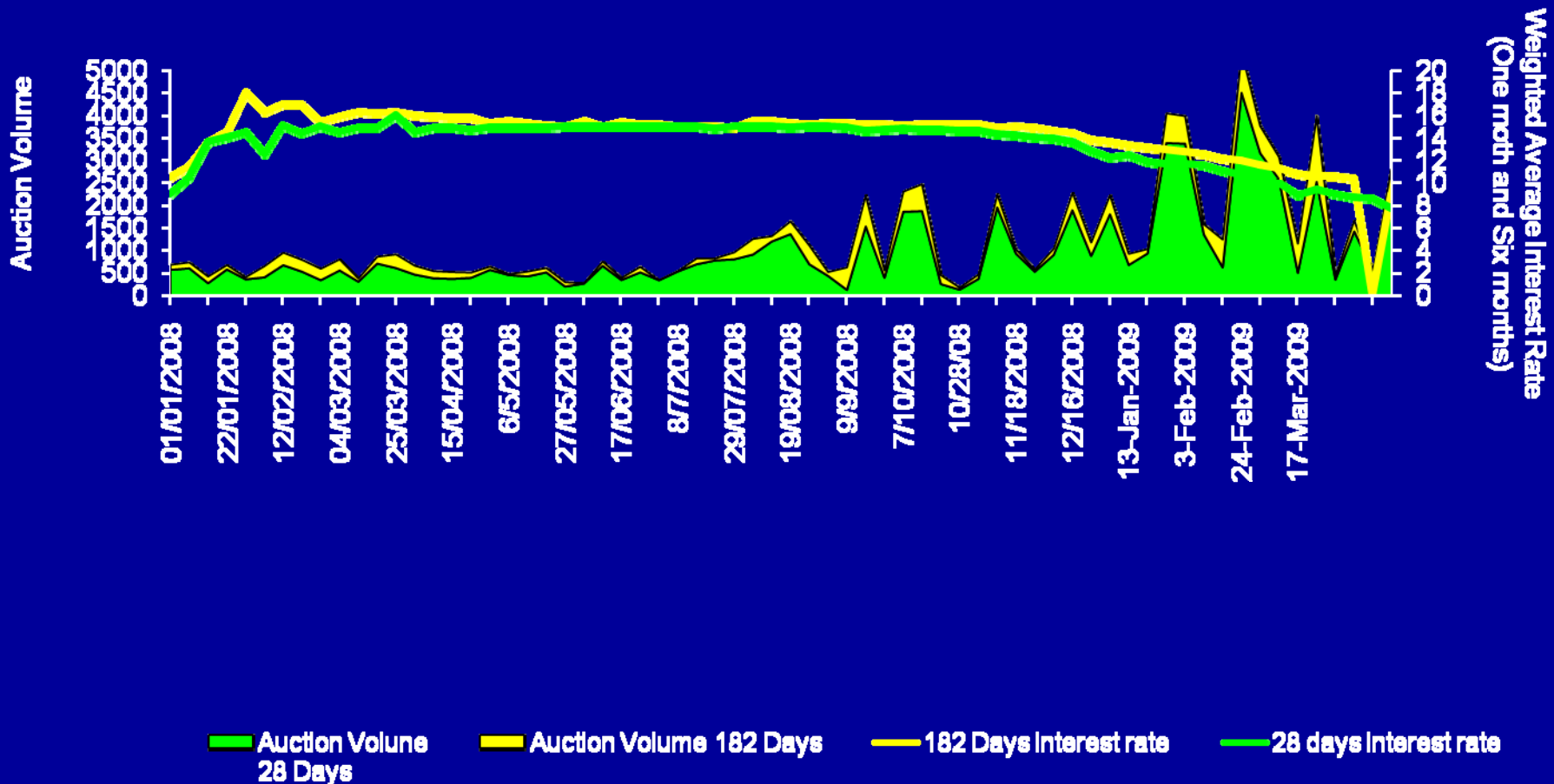
Exchange rate fluctuates in a narrow band...

Daily Avg. Exchange Rate
Mar 22, 2008, to May 10, 2009

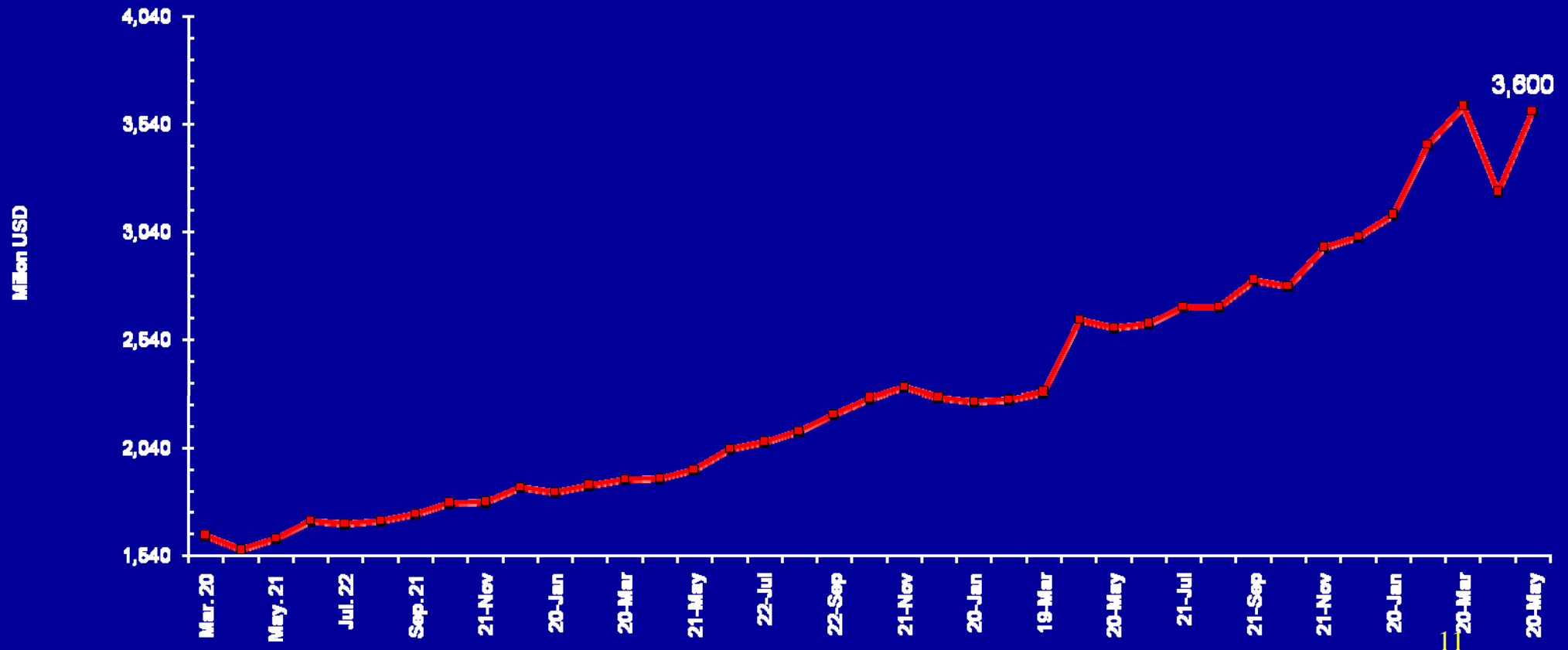


Interest rates on central bank securities are in single digits (7.5%) and positive in real terms

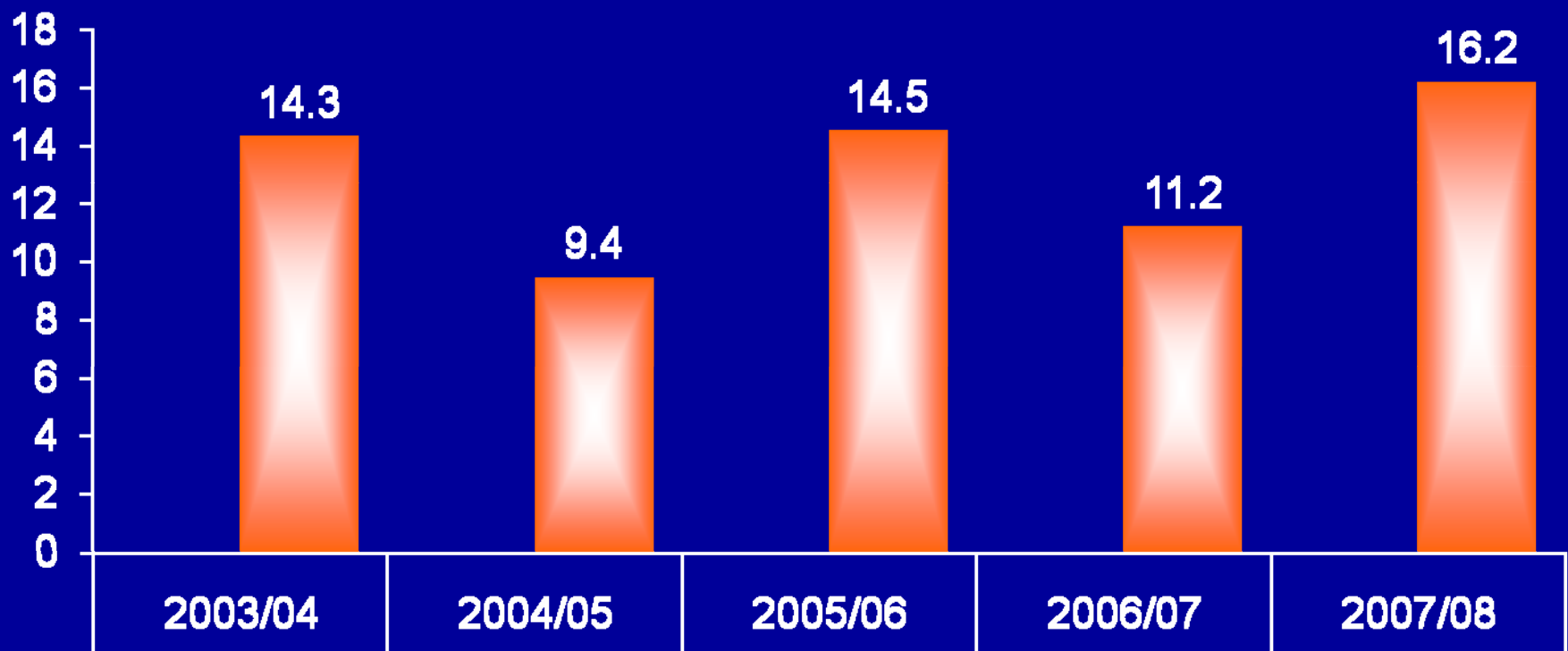
Interest Rates and Volume of Capital Notes



Foreign reserves provide a comfortable cushion of over 11 months of imports



Growth of nominal GDP (including opium) has been high but volatile....

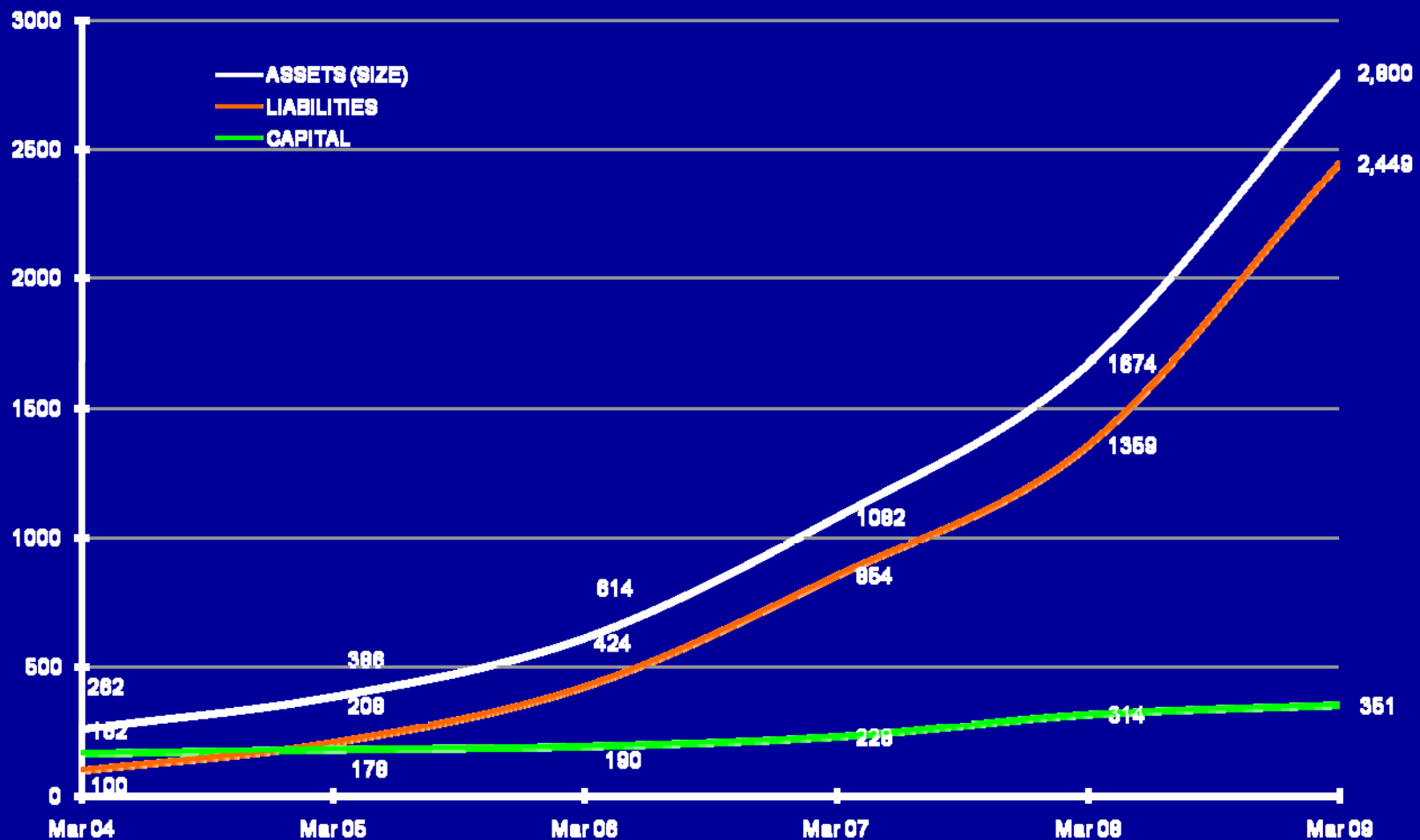


Source: Central Statistics Office

Financial sector has grown rapidly..

- Licensed Financial Institutions
 - In 2002 there were only 3 state-owned banks
 - In 2009 there are now 17 licensed banks (2 re-licensed state-owned, 10 full-fledged private, 5 branches of foreign banks), MISFA has 15 Microfinance institutions
 - 111 Money Service Providers and 374 Foreign Exchange Dealers are licensed.

Banking sector has US \$2.8 billion in assets, up from \$262 million in 2004...



However access to finance is limited...

INDICATOR	AFGHANISTAN	NEPAL	PAKISTAN	SRI LANKA
1. Demographic branch penetration (branches per 100,000 people)	0.6	6	15	29
2. Demographic ATM penetration (ATM's per 100,000 people)	0.09	13	16	30
3. Deposit accounts per 1,000 people	26	6	12	30
4. Loan accounts per 1,000 people	2	7	11	30
4. Geographic branch penetration (branches per 1,000 km ²)	0.031	6	12	18
5. Geographic ATM penetration (ATMs per 1,000 km ²)	0.04	12	12	30

Performance and efficiency indicators are weak...

INDICATOR	AFGHANISTAN	NEPAL	PAKISTAN	SRI LANKA
Return on equity	10	6	15	29
Return on assets	2	14	25	20

Though financial stability indicators are strong.....

INDICATOR	AFGHANISTAN	NEPAL	PAKISTAN	SRI LANKA
Capital adequacy ratio	32	6	25	20
Non performing loans	0.7	7	23	19
Liquid Assets Ratio	25	6	25	13

Housing finance industry is nascent...

- Two state-owned banks provide small mortgage loans generally for 2 years and ranging from \$400 to \$10,000
- A few other banks provide cash for home purchases structured as an Islamic lease buy-back (*Murabaha*)
- Only one micro-finance institution has extended loans to approximately 100 slum dwellers
- The single private insurance company in Afghanistan does not yet provide mortgage/homeowners insurance

Bank liquidity is not the major constraint...

- While the availability of long-term funding remains a challenge the main constraint is not availability of financing—banks have excess liquidity (see Slide 17).
- The main constraints are legal and regulatory:
 - Land insecurity due to lack of appropriate land-titling mechanisms
 - Absence of efficient foreclosure and eviction procedures
 - Absence of reliable property valuation/appraisals
 - Lack of well functioning collateral system

Home affordability in comparator countries...

INDICATOR	Afghanistan	Bolivia	Venezuela	Suriname
Cost of a 40 m2 house	\$5,000	\$6,000	\$5,000	\$13,000
Typical amount borrowed	\$4,000	\$4,800	\$4,000	\$10,400
Annual interest rate	10%	14.5%	33%	39%
Average term	20 years	9 years	10 years	15 years
Monthly payment	\$49	\$78	\$111	\$328
Typical monthly earnings of low-income households	\$30	\$75	\$225	\$200
Payment to income ratio	163%	\$104	49%	164%

Home affordability is a major problem...

- The ratio of mortgage payment to income (Row 7 previous slide) for low income households in Afghanistan is 164 % which is well above the maximum 25-30 percent that is required for traditional mortgages internationally.
- Home affordability in Afghanistan is similar to low-income country like Suriname (164%) .

Legal and regulatory reforms are critical for affordable housing finance...

- While the availability of long-term funding remains a challenge the main constraint is not availability of financing—banks have excess liquidity (see Slide 17).
- The main constraints are legal and regulatory:
 - Lack of appropriate land-titling mechanisms
 - Absence of efficient foreclosure and eviction procedures
 - Absence of reliable property valuation/appraisal
 - Lack of well functioning collateral system
 - Lack of trained judiciary

Policies to tackle constraints to *ONGOING ✓* traditional mortgages

- Credit information bureau.
- A premium-based deposit insurance scheme.
- Collateral registry
- Mortgage Law (already enacted), Leasing Law, Agency Law , Secured Transaction law, Islamic Banking Law (already drafted)
- Afghanistan Institute of Banking and Finance to train banking professional in mortgage origination, title searches

Fiscal policy (taxation and fees) must also be appropriate...

- Low loan origination fees
- Reasonable transaction, registration and notary fees
- No deduction or credit for interest paid on loans
- Interest on savings and dividends taxed
 - In general, good fiscal policy is required, but carefully targeted incentives might be considered to encourage long term deposits, investment in central bank securities, or to increase financial intermediation among underserved sectors of population

Afghanistan needs mortgage products tailored to its unique conditions..

- Traditional mortgage finance poorly suit Afghan conditions because it requires payments every month for long periods. Most low income households are self-employed and incomes vary greatly.
- Traditional mortgages require full legal title but most low-income households have “para-legal” or no titles at all.
- Mortgage lending requires standard documentation like salary—banks cannot verify self-employed incomes
- Small loans to low-income households are less profitable and stunt the equity and asset growth of banks.

...Mortgage products tailored to its unique conditions..(contd)

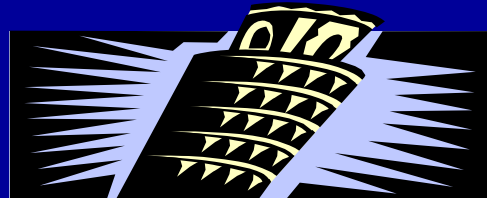
- Banks have little interest in making small loans to many low-income households because the term –risk problem (the funding of long term assets with short-term liabilities) is exacerbated.
- Amortization schedules in traditional mortgages require “tilting” real payments towards the first years of a loan—a serious problem for low-income households
- Traditional mortgage finance will only reach a modest fraction of households even when all reforms are in place

Incremental financing and micro-finance provides a solution ..

- Many homes are dilapidated ; huge demand for small loans (>\$5000) for home upgrades
- Many households build homes over many years starting with buying land making incremental improvements
- Micro-finance institutions can provide small, incremental loans without perfecting a lien or using collateral
- Micro-finance can provide mechanisms to underwrite credit risk for informal sector applicants through group-lending.
- Governments can provide smart targeted subsidies

Conclusion: affordable housing finance requires a comprehensive approach...

Donors provide
Technical
Assistance



Liquidity and
Long Term
Capital
from OPIC etc

**Building Vibrant Mortgage Markets in
Afghanistan**

Judicial sector provides
secure property rights

Government maintains
Fiscal prudence , tax treatment and
Issue Treasury Bills/Bonds .

Financial Sector provides
innovative mortgage
Products

Central Bank maintains low
inflation, interest rates and
stable exchange rate

References

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- May, Ernesto; Bell, Simon and Reazul Islam “Housing Finance in Afghanistan: Challenges and Opportunities” World Bank Working Paper No. 33683 (Washington DC: World Bank).
- USAID, 2006, “ Legal Issues Pertaining to Land Titling and Registration in Afghanistan” (LTERA Project: Kabul, Afghanistan).

Thank you