

Fiscal costs of subsidies for socialized housing programs: an update

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This *Policy Notes* provides an update of housing subsidies in the Philippines and the fiscal costs of their application. It addresses the issue on whether the subsidies for housing programs could have been put into more efficient use by the government.

Housing subsidies in retrospect

The Philippine socialized housing program consists of a combination of explicit and implicit subsidies intended to improve the affordability levels of low-income families. Explicit subsidies involve documented transfers that are on budget. In particular, these are: (1) upfront grants to reduce the cost of housing or serviced lots under the resettlement program; and (2) government direct funding for the housing loan program for low-income households. On the other hand, implicit subsidies involve transfers at a price lower than

the market rate. These subsidies include: (1) low interest mortgages; (2) exemptions from taxes or levies; and (3) underpriced and tax-exempt guarantees or risk insurance. Implicit subsidies are off budget but for government, they represent both forgone income and contingent liabilities associated with potential default and stock losses.

A study of housing-related subsidies in the Philippines estimates that a total of PHP 25.4 billion in explicit and implicit subsidies was provided to the housing sector over the period 1993–95.¹ About 90 percent (PHP 23 billion) of these subsidies consist of interest subsidies channeled through home mortgage programs and developmental loan programs. The other

¹ G. Llanto and A. Orbeta 2001.

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subsidies are cash transfers and forgone income from tax exemptions. In addition, and even more of a concern than interest subsidy flows, there are the fiscal costs associated with potential stock losses. During the period 1993–1995, government-subsidized housing finance programs were mainly administered by the National Home Mortgage Finance Corporation or NHMFC. The NHMFC managed four major low-income housing finance programs, namely, (1) the Unified Home Lending Program (UHLP), a financing program funded by pooled funds from NHMFC, Home Development Mutual Fund (HDMF), Social Security System (SSS), and Government Service Insurance System (GSIS) that offers subsidized credit to borrowers of lowest loan packages (PHP 150,000 to PHP 375,000); (2) the Community Mortgage Program (CMP), a government-funded loan program that provides subsidized loans to community associations in blighted areas; (3) the Abot Kaya Pabahay Funds, a loan program funded by government to finance the development of low-cost housing and provide outright amortization support to poor households in the first five years of loan amortization; and (4) the Social Housing Development Loan Program (SHDLP), a housing program funded by internally generated funds of NHMFC that aims to complement the UHLP through financial assistance to private

developers, nongovernment organizations (NGOs), landowners, and local government units (LGUs) in undertaking social housing projects.

In 1996, the NHMFC was considered “technically insolvent and irreversibly illiquid.”² The Corporation incurred net losses of PHP 64.07 million in 1993, which increased six-fold by end of 1995 to PHP 340 million. The fiscal impact of these losses is huge. Rough estimate of the amount of funding needed to bring NHMFC up to liquidity and capital adequacy standards and to provide for interest shortfalls for the UHLP and SHDLP is about PHP 23 billion (or slightly over 1% of GNP in March 1996) under fairly conservative scenarios.³

On the other hand, these costs did not significantly impact on the poor and low-income sector. Llanto and Orbeta (2001) showed that the actual incidence of subsidies is highly regressive. For instance, the bulk of subsidies are low-interest mortgages channeled through the UHLP scheme, which, by its design, primarily serviced borrowers in the middle- and high-income deciles. The World Bank study also reported that a large proportion of the resources used in making homeownership available had been wasted. This is because the interest subsidy, which was provided to largely middle-income clients, spans over 25 years whereas the real burden of amortization declines over time with inflation and increase in homebuyer’s income over the life span of the loan. Had a shorter period for interest subsidy been provided, government could have deployed resources elsewhere or reached a larger set of beneficiaries. Moreover, the scheme of providing guaranteed take-outs to developers has led to

² See Bueno and Sugitan 1997. The Report builds on previous examinations done by the Landbank’s Management and Operations review of the NHMFC (May 1995), the BSP Examination of the NHMFC (July 1995), and the 1995 COA Audit Report.

³ Bueno and Sugitan 1997. The estimate includes cost of collection, write-off for loan loss provision, government guarantee on interest shortfall on loans to funders (HDMF, SSS, GSIS), and assumption of additional capital needed based on Bangko Sentral ng Pilipinas (BSP) capital adequacy ratio.

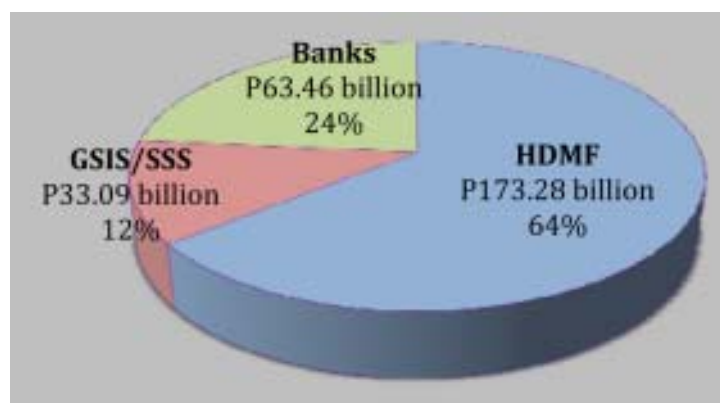
distorted incentives. With the developer's objective for rapid turnover of capital, there is less incentive to find creditworthy buyers or to meet satisfactory development standards. In some cases, said scheme had even opened the system to fraud and anomalous transactions.

Current structure of housing subsidies

Despite the allocative and distributive inefficiencies of the design of socialized housing programs as noted above, the forms of housing subsidies have not changed at all. Government, however, has reorganized the process of program implementation to reduce losses. The institutional and policy changes in the last ten years or so are as follows:

- HDMF has taken over the primary role of providing housing loans to low- and middle-income families, with about 64 percent of home lending being provided by HDMF (Figure 1). HDMF continues to implement below market rates for socialized and low-cost housing. The value of socialized housing or loan packages had been increased from PHP 150,000 to PHP 400,000 while that of low-cost housing, from above PHP 150,000 to PHP 375,000 to above PHP 400,000 to PHP 2.5 million. The loan term has also been extended from 25 to 30 years at a fixed interest rate of 6 percent for socialized housing and 7 to 11.5 percent for low-cost housing. Except for loan packages below PHP 1.0 million, interest rates are being repriced every two years.⁴ The distribution across loan packages and repricing for higher loan packages allow the HDMF to operate a cross-subsidization scheme where borrowers of the higher loan packages would subsidize borrowers of the lowest loan packages.

Figure 1. Releases for the primary mortgage/contract receivables market (2001–2009)



Sources: BSP, HDMF/GSIS/SSS Annual Reports

- NHMFC has moved out of the primary housing finance market; instead, its subsidiary corporation, the Social Housing Finance Corporation (SHFC), took over in developing and administering social housing programs, particularly the CMP and the Abot-Kaya Pabahay Fund (AKPF) Program, specifically the amortization support and development financing programs.⁵ Both UHLP and SHDLP were abolished and NHMFC disposed of its highly delinquent and nonperforming accounts with a principal value of PHP 12.8 billion. The nonperforming loans (NPLs) were transferred to a special purpose corporation, the Balikatan Housing Finance, Inc., which is 56 percent privately owned.⁶ The AKPF for development financing is

⁴ Interest rates are adjusted to, at most, 2 percent every two years based on prevailing market rates.

⁵ SHFC was created through issuance of Executive Order 272 (January 2004).

⁶ The NPL sale was through a joint venture agreement between the buyer DB Global Opportunities Group (DBGO) and the NHMFC. The Special Purpose Corporation named Balikatan Housing Finance, Inc. (BHFI) is 51 percent owned by DBGO, 44 percent by NHMFC and 5 percent owned by the International Finance Corporation (IFC).

also under restructuring due to high default rates. NHMFC's current operation is focused on the collection of past due accounts from its various programs since it has to meet loan obligations with its funders, the SSS, GSIS, and HDMF. The Corporation is also strengthening its primary mandate of establishing a secondary mortgage market (SMM) for the development of securitization in the country. Its SMM operation was launched in 2009 and is still at an infancy stage.

- The Home Guarantee Corporation (HGC) has been strengthened through increased capitalization under the HGC Act of 2000. The New HGC Charter approved a capitalization of PHP 12 billion, providing the agency a guaranty capacity of about PHP 130 billion or 20 times its equity. More than 60 percent of HGC outstanding regular guarantees are socialized housing packages (i.e., loan packages of PHP 400,000 and below) and low-income housing (i.e., loan packages above PHP 400,000 to PHP 3.0 million). However, the share of this sector has declined over time, specifically socialized housing which represented only 6 percent of

⁷ One explanation from the HGC is that borrowers are taking up higher loan packages. The combined pressure of high land prices, high land development costs, and construction costs has in reality moved the socialized housing ceiling to PHP 750,000.

⁸ There is no premium fee charged on enrollments under the Abot Kaya program; however, guarantee capacity is only one times the equity of PHP 2.5 billion. HDMF, SSS, GSIS can also enroll in the regular guarantee program.

⁹ Guarantee fee varies from 1.5 to 2.5 percent depending on the type of guarantee coverage and type of loan packages. Retail guaranty is charged lower fees than developmental guaranty. Socialized housing packages have lower guarantee fees than open market housing.

¹⁰ HGC floated zero coupon bonds to service 16 billion of guarantee claims from bad accounts. It intends to sell assets or undertake asset swap scheme to cover other claims.

total guarantee in 2010, way below the 40 percent allocation required under the HGC Charter.⁷ Most socialized housing packages are covered under the Abot Kaya Cash Flow guarantee, a special guarantee fund administered by the HGC for socialized housing loans originated by HDMF, SSS, GSIS, and their accredited institutions.⁸

- To date, HGC has not adopted risk-based premiums. Clients continue to pay guarantee premiums of 1.5 to 2.5 percent which is much lower than the tax breaks of 9.5 to 11 percent on income tax of guaranteed loans.⁹ HGC has been operating at loss as it continues to service claims from guaranteed accounts resulting from high default rates of 17 to 20 percent which was incurred by the Corporation from 1999 to 2001. Most of the defaulting accounts are development loans, specifically big ticket projects such as the Smokey Mountain and Pabahay sa Riles. Finance charges alone from the HGC borrowings to service claims amount to an annual average of PHP 1.1 billion for the period 2006–2009. Comparatively, retail guaranty accounts from banks and developers showed good performance. Guarantee claims for retail accounts have been reduced to only 0.05 percent in 2007 to almost nil (0.003%) in 2010. Apparently, most lenders do not claim on guaranty but enroll their accounts anyway for the tax incentive. Due to HGC's attempt to improve its financial position, the Corporation has focused its operation on retail guaranty and increased the share of nonsocialized loan packages in its guarantee portfolio. These actions alone, however, are not sufficient to cover for approximately PHP 28 billion of guarantee claims from past accounts.¹⁰

- The National Housing Authority (NHA) continues to manage public production of

housing primarily for the resettlement of residents affected by national government infrastructure projects and those households occupying danger areas. NHA also provides resettlement assistance to LGUs usually under a joint venture arrangement. Aside from resettlement projects, NHA also undertakes other programs (i.e., sites and services, medium rise, local housing) using funds provided under the Comprehensive Shelter Finance Act (CISFA) as capital. While the private sector is producing socialized housing with prices ranging from PHP 400,000 to PHP 750,000 per unit, NHA housing packages cost PHP 160,000 to PHP 300,000 per unit. The lower cost housing packages translate into subsidy in the form of budgetary appropriations, free or low-cost government lands, and corporate fiscal incentives.

- The Housing and Urban Development Coordinating Council (HUDCC) has been tasked to harmonize the release of public lands for socialized housing use. In an effort to provide access to lands and tenure security to low-income families, government proclaims certain public lands for private ownership by virtue of presidential proclamations and other legal instruments. These lands are either turned over to NHA or LGUs to be developed into housing subdivisions and for disposition to qualified beneficiaries. In particular, this program has regularized informal settler families occupying public lands as well as provided lands for other marginalized sectors.

Fiscal costs of socialized housing

Table 1 gives an account of the major subsidies provided as per the institutional and policy changes cited earlier. The bulk of annual subsidies for housing still consists of interest

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subsidy provided mainly through HDMF home mortgages. This amount is comparatively lower than that of the UHLP due to the lower market interest rate in the current period.¹¹ In the 1990s, mortgage rate was a high of 23 percent which implied an interest rate difference of 14 percent between the market and the mandated interest rate for socialized housing. The current market interest rate, on the average, is 11.5 percent, a difference of at most 5.5 percent from the mandated rate.

Aside from lower market rates, there is also evidence of limited exposure to the socialized sector. In 1995 alone, the total loan portfolio from UHLP for socialized housing (up to PHP 375,000) amounted to PHP 57.7 billion. In 2009, the socialized loan portfolio (< PHP 400,000) amounts to about PHP 7.0 billion while low-income housing portfolio (> PHP 400,000 to PHP 2.5 M) amounted to PHP 38 billion. The increase in ceilings of housing packages does not benefit the poor and those in the low-income deciles at all, primarily because the ratio of housing price to income has also increased. This implies that the higher prices further crowd out the low-income borrowers and

¹¹ In 1995, the annual interest subsidy was in the range of PHP 3.0 to PHP 5.4 billion. See Benjamin and Dubel 1997.

Table 1. Cost of housing subsidies in 2009

Housing Subsidy	Value (PHP million)
<i>Home Development Mutual Fund</i>	
Interest subsidy	1,837.79
Socialized (up to PHP 400,000)	389.84
Low cost (> PHP 400,000 to PHP 2.5M) ^a	1,447.95
<i>Social Security System/ Government Service Insurance System</i>	
Interest subsidy ^b	10.41
<i>Community Mortgage Program</i>	162.02
Interest subsidy	33.42
Loan losses ^c	1.29
<i>National Housing Authority Resettlement</i>	3,409.97
Resettlement subsidy ^d	1,073.18
Budget appropriations ^e	2,126.82
<i>Home Guarantee Corporation</i>	1,442.14
Tax exemption (retail) ^f	277.37
Tax exemption (developmental) ^f	0.98
Losses ^g	1,163.78
<i>Housing and Urban Development Coordinating Council Tenure Security Program^h</i>	
Subdivision cost of proclaimed Lands	12.98
Budget appropriation (urban asset reform)	17.75
Grand total	6,765.74
% to GDP (2009)	0.088
Summary by type	
Interest subsidy	PHP million (% to total)
Tax exemption	2,091.58 (31)
Cash/cash transfer	278.36 (4)
Losses	1,073.18 (16)
Administrative and other cost ⁱ	1,292.38 (17)
	2,157.55 (32)

Notes:

^a Interest subsidy in 2009 is the difference between interest payments based on market rates and interest payments based on below market rates. For low-income packages, interest rates vary depending on amount.

^b SSS/GSIS assumes that 20 percent of loans granted are socialized loan packages.

^c Use BSP guidelines of 20 percent as write off for loan loss provision. Applied 3 percent for loan loss provision on nonperforming loans.

^d NHA resettlement subsidy based on 2009 resettlement projects (North and South rail). Each affected family is entitled to PHP 160,000. Resettlement subsidy includes grant component (PHP 25,000/unit) and interest subsidy on loan portion (PHP 135,000/unit). Includes cash assistance to households under the "balik-probinsya" scheme.

^e Other resettlement costs (administrative and other program support).

^f HGC tax exemption on interest income net of guarantee payments. Based on 2009 new enrollments for guaranty.

^g Losses from impaired assets and loss in sale of disposed assets.

^h Budgetary appropriation for administration of pre- and post-proclamation activities.

ⁱ Includes subdivision cost of land which is part of government subsidy on land cost.

the interest subsidy is captured primarily by the middle- and high-income sectors.

On the other hand, requiring the financial system to take out or guarantee subprime loans implies that government assumes 100 percent of the risk and the resulting nonperforming loans translate to impaired assets and losses from sale of these assets. The costs arising from the associated defaults of these loans amounted to over PHP 1.0 billion in 2009 alone. The true fiscal cost of the risks assumed by the government is a cause for concern since this adds up to the contingent liabilities of the government.

The bulk of direct subsidy or cash transfers are channeled to the NHA for the production of low-cost housing. Although NHA housing programs are targeted for low-income households, resettlement in areas far from places of work and town centers can be costly to government since this would also require government to provide basic facilities such as schools and livelihood programs for the displaced families. Several studies also point to the ineffectiveness of the program since many beneficiaries return back to urban centers. Moreover, international evidence suggests that public housing provision crowds out private developers. A study conducted in the US found that each new additional unit of publicly subsidized housing was associated with a decrease in private housing production of about 0.85 units.¹² While no similar study has been done in the Philippines, the crowding-out effect may likely be a problem given that NHA enjoys government equity injections, access to free land, and corporate fiscal incentives.

¹² M. Murray 1983.

Fiscal costs from tax exemption through the guarantee program are lowest among other forms of subsidy. Government loss amounted to PHP 278 million in 2009. However, this forgone income may not be necessary at all. Tax breaks are most likely captured by the intermediaries rather than the beneficiaries. It is also difficult to determine how these subsidies result in lower cost of housing for the beneficiaries.

Conclusions and recommendation

Overall, direct subsidy to the low-income housing sector has been limited. The bulk of fiscal costs are indirect subsidies from low interest rate and losses from impaired assets. In an effort to reduce losses from financial transactions, government has further restricted financing to the low-income sector through lower exposure of funders and the higher loan ceilings on socialized and low-income packages. Recent data show that housing needs have ballooned to 5.7 million for 2011–2016 or over 1 million housing annually, with the need highest at the low end of the market. Clearly, the current subsidy system does not address the objectives of the National Shelter Program.

International experience shows that effective housing subsidies have precise objectives and are able to directly respond to the identified problem. A major housing issue in the Philippines is affordability. This issue can be addressed in the real sector as well as in the financial sector. In the real sector, policy changes in land management and property rights systems could be very efficient options but effective housing finance is also critical to addressing affordability issues. Housing is a major investment and the cost of the cheapest

house in the formal market is typically six to eight times the annual incomes in the country. Housing finance impacts on affordability in two ways—one, through the availability of long-term mortgage financing that would allow payments to be spread over time; and two, through the provision of subsidies to lower housing cost, specifically as an interim measure.

The issue of access and availability of long-term finance should be addressed through capital market development, improvement in underwriting and securitization, and improvement in ancillary financial services (e.g., credit information bureaus, insurance, property appraisals, etc.) instead of mandating institutions to lend to socialized housing. On the other hand, lowering the cost of housing should be done outside of the financial intermediation process. Government should avoid large potential future fiscal liabilities such as unfunded pension liabilities or bailouts of failed housing finance institutions. The current housing subsidy arrangements such as the use of contractual savings for below-market interest rates, guaranteed take-outs of developers, and tax exemptions may stimulate private sector investment in low-cost housing but would not address the issues of access and affordability for the low-income sector.

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Subsidy interventions in the financial system should be focused on low- to middle-income households or those who are able to fulfill obligations resulting from small loans. Subsidy can be provided through a point system that rewards the need for housing and savings effort.

And finally, if the objective is to improve affordability levels, direct or upfront subsidies would have greater impact. Latin American countries moved away from similar low-cost contractual savings lending schemes to a demand subsidy mechanism.¹³ Among the key lessons that are worth considering for the Philippines are:

- The housing finance subsidy should be a transparent amount that may be budgeted and with government commitment in terms of amount and continuity of resources. Chile, Colombia, and Costa Rica dedicated more than 1 percent of government budget in maintaining temporal continuity in the long term.
- Subsidy interventions in the financial system should be focused on low- to middle-income households or those who are able to fulfill obligations resulting from small loans.¹⁴ Subsidy can be provided through a point system that rewards the need for housing and savings effort.

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- The demand subsidies should be portable, allowing families to select their housing in terms of type of property, location, and other characteristics. The subsidy is given to the household, not to the developer or financial entity.
- The poor with incomes below minimum wage and those with incomes that are 1.5 to 3.5 times the minimum wage require other types of intervention. Most likely, these are through different types of public housing arrangements such as NHA housing and rental arrangements, among others. 📄

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¹³ See Bruce Ferguson 2004.

¹⁴ In Latin America, these are households with incomes of 3.5 to 6 times the minimum wage.