Executive Summary of Evaluation

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Background

This note summarizes a larger literature review that looked at empirical evidence regarding the relationship between housing finance and economic growth & poverty. The review finds that the strongest link between them is through financial deepening through development of mortgage markets, and consequent access to cheaper credit in general. Housing finance may also positively influence economic growth through increased savings and tax revenues. There is also significant evidence that low income housing construction creates jobs and results in increased investment in education. The strength of these relationships however has been found to vary across country and over time. Further, due to limited data and other limitations, there is scope for much more research that could be done to determine the causality between housing finance and poverty reduction.

Objectives

This note summarizes a literature review conducted by IFC on identifying the transmission links of housing finance to poverty and economic growth. This exercise was undertaken as part of IFC's Poverty Action Plan, to better understand how IFC operations in specific sectors across its investment and advisory operations result in eradicating poverty and boosting shared prosperity.

As of March FY13, IFC's Housing Finance Portfolio consisted of 167 projects with 93 clients in 46 countries, with a committed exposure of $1.1 billion. A majority of the projects (66 projects) were in LAC; however current trends are towards South Asia, CEU and Sub-Saharan Africa.

The review looks at housing finance per se, and also links between housing and economic growth and poverty, to the extent that housing finance increases or facilitates housing activity in an economy.

[1] This note has been summarized from the poverty literature review conducted by Dr. Sonya Williams-Stanton for IFC. The main document is available on the IFC poverty website: http://ifcnet.ifc.org/ifcint/deveffectiveness.nsf/Content/home

Analysis

Impact of Housing Finance on Economic Growth

Reducing Cost of Capital: Housing finance impacts economic growth through several ways. One way is to reduce the loan interest rates which in turn results in increased affordability of housing. A model proposed by Dubel in 2007 studies the relationship of Housing Finance and Affordability. According to this model, the role of housing finance is to reduce the cost of capital and as that cost is lowered housing prices fall and affordability of housing increases. This increase in housing activity in turn has a potential positive impact on economic growth. Some studies on this relationship suggest that housing investment has an impact on economic growth, especially short-run growth (Hongyu, Park and Siqi, 2002). There have also been several estimates of the *multiplier effects* of construction. For example, a United Nations study in 1995 indicated that in most developing countries construction of low-income housing is labor intensive and has a high multiplier effect of between 2 and 3 times the initial investment on GDP. This potentially arises due to the additional investment required on infrastructure and utilities around housing development.

Further, a study by Quigley (2008) on rural versus urban effects finds that a housing investment in an urban area may produce greater economic growth than in rural area. This is related to the phenomenon of growth increasingly being centered around urban areas in developing countries and can be an important factor in directing housing policy and finance. The link to economic growth is through urbanization promoting productivity due to increases in specialization, centralization of knowledge and economies of scale and scope.

Increasing savings: Further, improved housing finance may also lead to increased savings in the economy. A study by Buckley in 1996 shows that the availability of affordable housing finance may lead to increased savings as potential homeowners save to make the required down payment and to maintain the asset. However, there have not been enough empirical documentation of the benefits arising from those increased savings and this is an area for further exploration.

Increasing Tax Revenues: There have proven to be strong links between housing activity and government revenues, which in turn can contribute to redistributive activity to reduce poverty. Revenue sources during the construction phase include sales taxes on building materials, corporate taxes on builders' profits, income taxes on construction workers, and fees for zoning, inspections, etc. Hangen and Northrup (2010) estimated that for a $25 million housing bond project in Rhode Island, the income and taxes increased state revenues by about $16.7 million. In addition to immediate fiscal benefits, housing construction also provides on- going benefits to the local economy. These include residential property taxes, property taxes from the businesses supported by the residents, and utility user fees. A residential development project will have a net positive fiscal impact only if taxes exceed the cost. While evidence on net effect of affordable low income housing is inconclusive, there is evidence that market-rate housing provides net positive fiscal impact (National Association of Home Builders, 2009).

Increasing investment on education: Some studies have also documented a link between education and housing and suggest that having a house as an asset improves homeowners' borrowing capacity and so housing finance could lead to more investment in human capital. And to the extent that housing finance improves housing

affordability for the poor, it may improve the probability of education opportunities for the poor. Jacoby & Skoufias (1997) find that without access to finance, shocks to income cause poor families to discontinue schooling for children. Housing provides an asset that can be used to smooth such shocks and thereby reduce the vulnerability among the poor.

Increasing financial deepening: One of the strongest ways in which housing finance may impact economic growth is through contributing to deepening of financial markets. The development of mortgage markets and creation of mortgage bonds or instruments can be viewed as part of an overall financial deepening of the capital markets in the developing countries. For instance, Malpezzi (1999) suggests that much of the world is shifting from the perspective that housing finance is mainly concerned about mobilizing short-term household deposits for long-term mortgages to a perspective that housing finance is closely integrated with broader capital markets. While there has been no research on the development of mortgage markets and poverty specifically, a review of the relationship between financial deepening and poverty may tell something about the potential impact of mortgage market development and poverty.

Some research finds a positive correlation between the share of housing market in GDP and the financial and real estate related services share in GDP. A study (Dubel, 2007) shows that a doubling of housing market share in the 1980's and early 1990's in Hong Kong led to a tripling of share of financial insurance, real estate and business services as % GDP.

Further, the reverse relationship is also relevant to poverty reduction. Some research finds that holding all else constant countries with deeper financial markets invest more in housing and that financial development reduces income inequality by raising the incomes of the poor.

Impact of Housing Finance on Employment and Job Creation

Jobs are one of the most critical paths out of poverty. Therefore, a sector's ability to create jobs among the poor is an important component in the dialogue on the transmission links between the sector and poverty reduction.

Increasing employment from low income housing activity: In the case of housing finance and the consequent housing activity that follows, there are a number of studies which have looked at employment effects. In the case of the United States, it is found that the development of affordable housing increases spending and employment in the local economy (Wardrip, Williams and Hague, 2011). A model by the National Association of Home Builders predicts that an investment of building 100 new low-income housing will create 80 jobs from the direct and indirect effects of construction and 42 jobs from the induced effects of increased spending. The study also highlights that since a majority of these jobs are construction jobs (70%), the model results will depend significantly on the availability of skilled labor for the construction work and would likely vary across countries. Other studies (Erbas and Nothaft,2002) show that low income housing has higher labor intensity and therefore activity in this sector will lead to greater employment. The employment effects of housing activity depend on the level of capital intensity and import content in the construction process, with an inverse relationship being found between the two. Further, evidence does not support the fact that housing activity in emerging markets is less capital or import intensive.

In terms of jobs created per unit of investment, a number of statistics are available. In Argentia (Freire, Hassler et all, 2006) estimate that a million peso investment in construction creates about 40 direct jobs and 20 indirect jobs. The National Building Organization in India (Tipple, 1994) estimates that a $1 million investment in building construction leads to 600 direct and 1000 indirect jobs. This does not include employment generation that might get created further in the backward and forward linkages.

Conclusions and Recommendations

While academic literature and empirical evidence exists that discusses causality between housing finance, housing activity and economic growth, this exercise reveals the large gaps in evidence linking housing finance to poverty in general. Furthermore, the strength of the relationships is found to be highly contextual across countries and over time. These gaps could be partly driven by lack of necessary data, specifically in low income countries and the lack of robust techniques to test the direction of causality in these relationships. To the extent that housing finance is an important product offered by IFC to its clients, it might be worthwhile to investigate and test some of the hypothesis that the review highlights, which can further assist in refining IFC's strategy in this sector.