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Socioeconomic Development and Housing Finance's Roles and Positioning in China

1. Socioeconomic Development and Housing Finance's Roles and Positioning in China

1.1. Promotion of Housing Development in the Process of Social Development in China Is the Symbol of Enhancement of the Quality of National Life

1.1.1. Acquisition of Housing of Fine Quality As a National Goal

In 2000, Shanghai had a population of 16.74 million. In the same year Beijing's population reached 13.82 million. Urban residents (455.94 million in total) accounted for 36 percent of the total population of the country--consisting of provinces (31 in total), autonomous regions, and cities under the direct control of the central government. (The Fifth Census). To provide the huge urban population with housing is one of China's very important socioeconomic problems.

The country's gross domestic product for 2000 was 8.9404 trillion RMB, which was an 8 percent increase over the previous year. Consumer expenditure for the purchase of commercial housing increased by 50.6 percent, and sales of commercial housing to individuals accounted for 84.8 percent of total sales of commercial housing. Furthermore, the average per capita dwelling floor area for the urban areas reached 10 square meters ("National Economy and the Progress of the Social Development Program in Fiscal 2000" made public at the National People's Congress held in March 2001).

Since the early 1990s, China has been promoting its economy 's shift toward a market economy. Although food and clothing are now in ample supply, the supply of housing of fine quality is not. Consumers feel that the quality of life has really been improved and that they really live in affluent circumstances only when they become capable of acquiring housing of fine quality.

The guiding principle shown in the "Outline" of the Tenth Five-Year Plan, which has socioeconomic development as its main theme, says that the enhancement of the quality of national life should promote socioeconomic development in the country. The "Outline" adopted the enhancement of the quality of national life as its main goal for the first time. The "Outline" also says that the average per capita building area for the urban areas of 22 square meters should be realized, and that the average per capita disposable income for the urban areas should exceed the 8,000 RMB level by the time the Tenth Five-Year Plan comes to an end.

1.1.2. Due Consideration Should Be Given to the Needs of the Low-Income Group in the Process of Monetization of Housing

The ongoing reforms of the country's housing system emphasize the central

government's "monetization of housing" policy in which direct supply of housing is ruled out. The monetization of housing is part of the central government's policy measures to promote the Chinese economy's shift toward a market economy. Basically, it is aimed at lightening the financial burden related to supply of housing of the central government and private businesses and also to increasing the transparency of the process of the supply of housing. On the other hand, however, it will make it harder for consumers belonging to the low-income group, who have been able to acquire housing easily under the direct housing supply system, to acquire housing.

Generally speaking, the central government's policy to promote the Chinese economy's shift toward a market economy will lead to higher income levels, which in turn will promote private home ownership. In Japan, when the workers' incomes remained at low levels, private businesses supplied their employees with company-owned houses. As workers' incomes increased, private businesses gradually reduced the number of company-owned houses, to encourage their employees to acquire housing. At that stage, private businesses gave financial assistance to employees who owned housing in an effort to be fair to both occupants of company-owned and homeowners. At the next stage, private businesses provided financial assistance to employees only those who have been transferred to company-owned houses and abolished financial assistance to homeowners.

As stated above, the monetization of housing is basically aimed at lightening the financial burden related to supply of housing of the central government and private businesses. It will therefore not be effective in solving the low-income group's housing problem. The number of consumers who can acquire housing at prices of not more than five times their annual income is still limited.

1.1.3. Cost Bearing by the People and Financial Support Require Comprehensive Policy Measures and Policy Adjustment

When the country's economy was a planned economy, state-owned corporations took care of the people from the cradle to the grave. These corporations provided social security services on behalf of the central government. However, if such corporations continue to be responsible for social security when an open door policy is adopted, (a shift toward a market economy is promoted and the country's entry into the WTO is just around the corner,) such corporations' international competitiveness is reduced. There is no choice but to divide the responsibility for social security among the consumers, business corporations and the central government.

Consumers now have to bear a heavier personal income tax burden. It is necessary,

however, to formulate a comprehensive tax policy that will take into account, which income group should bear how heavy a tax burden, and identify how the income groups find it very difficult to bear their tax burden, and decide those which are incapable of bearing any tax burden.

It is also necessary to develop a mechanism which will enable the National Development Planning Committee or any organization operating under the direct control of the State Council, (not individual central government agencies,) to formulate and implement such comprehensive tax policy in coordination with central government agencies.

Those income groups which are still incapable of acquiring housing despite the central government's financial assistance, tax incentives, interest subsidies, and other subsidies, are to be excluded from the housing finance system. The local governments should provide low-rent housing or free-of-charge facilities.

Local governments that have sufficient financial base could provide qualified housing loan users with interest subsidies, or exempt them from local taxes. In addition to the central government's housing policy, local governments should formulate and implement diverse housing policies.

1.1.4. System of Economical Housing for the Low- to Medium-Income Group and Its Problems

It is very important that consumers belonging to the low- to medium-income group be able to acquire housing easily. One of the policy measures aimed at achieving this goal is the economical housing system. The system, which is aimed at supplying low-priced housing through public financial assistance, is an effective housing policy measure. However, in reality, some setbacks to this system can be observed. For instance, those who have plenty funds for the acquisition of housing choose to purchase economical housing. Although, the problem may find a solution by putting a cap on the income level of the qualified applicants, the option is difficult to implement.

The Ministry of Construction is well aware of such a problem. The ministry served an official notice as an attempt to make it easier for consumers of low-to medium-income to acquire economical housing.

“To promote the spread of economical housing is an important constituent of the central government's plan to establish a housing supply system suited for a socialist market economy. It is also an important policy measure to promote consumer spending for acquisition of housing by promoting the growth of the country's housing market.”

Under the plan, the ratio between the number of economical housing units to the total number of housing units is to be determined on the basis of regional housing prices, and the

financial ability of consumers of low- to medium-income.

Policy measures, such as provisions for the sale of lands in lots, tax cost reduction, and cost/profit restraint, should be taken so that the prices of economical housing may be kept at a level beneficial to the households of low- to medium-income.

The selling of economical housing is to be regulated. Likewise, an economical housing selling control law, an economical housing selling supervision law, and a relevant listing and stock transaction law are to be enacted.

Quantitative controls on economical housing construction should be stepped up. The way to design and construct economical housing should be organized, (a long-term economical housing supply plan should be worked out,) and economical housing stockpile projects should be promoted.

Quality control of economical housing construction (including control of the quality of planning, construction process and real estate management) should be stepped-up. Economical housing construction by tender should be promoted and recognized, competent large-scale developers' entry in the economical housing market should be promoted.

Source: "Economic Daily" article with a dateline of September 19, 2000 (summarized by JICA Envestigative Commission)

The contents of the above-mentioned public notice of the Ministry of Construction are reasonable, but whether local governments can act on the public notice and how they will act on it are more important. But there remain other problems. Among them are the problems of sale of existing economical housing. Under what condition can existing economical housing be sold off? More specifically, are there different markets for ordinary housing and economical housing? Is there a single market for the two types of housing? In order to promote the development of economical housing in earnest, it is necessary to work out specific guidelines to deal with such delicate problems.

1.1.5. Challenges Facing the Central Government's Housing Development Promotion Policy

How to encourage consumers of low- to medium-income to acquire housing is one of the most important challenges facing the central government in the area of housing development. But there are other challenges, as stated below.

(1) State-owned Corporation Reform and Promotion of Housing Development

The State-owned Corporation Reform is one of the most important challenges facing the central government. If the reform is to be successful, it is necessary to establish a viable social security system, which is to deal with the housing problems.

In 2000, China's per capita GDP at approximately US\$800, implies that food and clothing are now in ample supply. In this context, the work to establish a system which enables most of the people to acquire housing (in which they can live in peace) is the best way for the success of state-owned corporation reform, and enable the Chinese economy to achieve stable and relatively high growth.

2) Promotion of Development of Agriculture/Agricultural Districts and Promotion of Housing Development

The problem which require special attention in the process of promotion of housing development, include the need to minimize the pace of reduction in cultivated acreage. In keeping with the socioeconomic development, the rate of possession of land has been gradually increasing, consequently, this is applying greater pressure on cultivated land.

As Outlined in the Tenth Five-Year Plan, it is imperative to actively promote the relocation of surplus workers in the rural areas (approximately 40 million surplus workers over a five year period) so that more and more farmers may engage in non-agricultural businesses. The promotion of housing development is closely related to the problem of farmers' relocation to the urban areas.

3) Aging of the Country's Population and Promotion of Housing Development

China is also becoming an aging society. It is imperative, therefore, to formulate and implement policy measures to meet the needs of the elderly in the area of promotion of housing development.

According to the report, "Housing and Other Related Facilities for the Elderly" (made public by the Architectural Technology Council of China), in 1999 the total number of persons aged 65 or older was 97 million. This accounted for 8.58 percent of the country's population. Moreover, it is expected that the number will exceed 130 million, increasing the population to more than 10 percent. By the middle of the 21st century, the number is expected to further increase to 420 million, accounting for as much as 25 percent of the total population aged 65 or older.

In China, little attention is paid to the needs of the elderly in preparing architectural designs. For example, most of the 5 to 6 storied buildings are not equipped with elevators. Likewise, privacy in bead houses and other similar facilities is not protected sufficiently. The concept of housing for the elderly has not yet been introduced in the country. The above-mentioned report proposes that the central government establish a standard on housing for the elderly as soon as possible, and determine the ratio of condominiums for the elderly,

and step up research on the theory of architectural design of housing for the elderly.

1.2. Promotion of the Growth of the Housing Industry Shoulders Long-term Responsibilities for the Expansion of Domestic Demand and Economic Growth in China

1.2.1. Promotion of the Growth of the Housing Industry Is Going to Play a Very Important Role in Stimulating Investment and Domestic Demand for a Long Period of Time

Maintenance of high economic growth is the most important challenge facing the Chinese government. The Outline of the Tenth Five-Year Plan projects that the country's GDP to double in 10 years and that the rate of growth of the country's economy during the same period will be approximately 7 percent. Of the three main factors contributing to the high growth of the Chinese economy (export, investment, and domestic demand), the ratio of foreign demand (export) is increasing in the country than in any other economic superpowers. Since there are many uncertainties in the world economy, the Chinese government must implement a positive fiscal policy, and at the same time promote private investment. It must also try hard to curb consumption, and expand domestic demand. It is expected that promotion of housing development will play a very important role over a long period of time in relation to investment and domestic demand.

A breakdown of the per capita consumer spending for 2000 shows that 454.8 RMB (a 7.6 percent increase over the preceding year) was for purchase or construction of housing, and 500.5 RMB (a 10.2 percent increase over the previous year) for occupancy of housing. Urban residents' spending for housing is rapidly increasing. The rate of private home ownership increased to as much as 77.1 percent (an increase of 8.4 percentage points), the percentage of the number of persons living in houses with a per capita dwelling floor area of more than 14 square meters reached 38.6 percent. (The National Statistic's Bureau Urban Research Division, April 4, 2001)

During the period of implementation of the Ninth Five-Year Plan (1996 to 2000), housing investment amounted to 2.51 trillion RMB, while consumer spending for residence reaching 1.69 trillion RMB. Consumer spending for housing accounted for 10.6 percent of the country's cumulative nominal GDP for the same period (39.68 trillion RMB). (Figures for nominal GDP and housing investment are based on completed work. Estimation was made by JICA Investigator Commission based on the contents of "China Statistic's Yearbook".)

1.2.2. Housing Investment Has Great Ripple Effects on Industrial Development

Housing investment's effects on promotion of industrial development is very

important. If the Chinese economy is to continue to grow rapidly over a long period of time, then housing investment must be effective in stimulating the domestic demand. Therefore, the supply of housing of fine quality must likewise be promoted within the framework of the housing finance system.

According to “China Housing Construction Market Yearbook” (1999/2000), urban housing construction accounted for 14 percent of steel consumption, 20 percent of lumber consumption, 47 percent of cement consumption, and 40 percent of glass consumption.

Housing investment’s ripple effects on industrial development are not limited to such temporary ripple effect. Housing investment’s effects on industry as a whole can be estimated by using the full consumption factor. Note that the, “China Input/Output Table (1997)” does not include a classification of housing construction companies. More so, the ratio of total housing construction accounts for 70 percent of the construction industry’s total production in value terms. Using the full consumption factor for the construction industry as an expedient, shows that the ripple effect of housing investment on industry as a whole is worth twice as much as the total amount of housing investment.

It can be said that the cumulative total amount of housing investment during the period of implementation of the Ninth Five-Year Plan (1996 to 2000), which was 2.51 trillion RMB, had a ripple effect worth 5.02 trillion RMB. During the two-year period from 1998 to 2000 housing investment increased at an average annual rate of 10.4 percent. If its ripple effect on industry as a whole is taken into account, then this will accounts for 1.98 percent of the average annual growth rate of 6.3 percent of the nominal GDP during the same period. That means that housing construction greatly contributed to the growth of the Chinese economy during the same period.

It is thus clear that housing construction greatly contributes to the growth of the Chinese economy. The fiscal policy measures for the promotion of housing construction provides significant guidance policy investment to promote the growth of the Chinese economy.

1.2.3. Growth of the Housing Industry Has Great Ripple Effects on Job Creation

The growth of the housing industry has a great effect on employment. During the two-year period from 1998 to 2000, the working population of the real estate industry increased by 2.25 million, accounting for 18.7 percent of the country’s total working population. (The real estate industry’s working population is cited because it is impossible to pick out the housing industry’s working population.)

Employment in the real estate industry is characterized by a high percentage of

workers relocated from farm villages. Of the real estate industry's working population of 35.22 million, 76 percent were workers relocated from farm villages. The real estate industry and the housing industry are the two major industries that absorb workers relocated from farm villages. ("China Statistics Yearbook", "China Construction Industry Yearbook" and "China Construction Industry Statistics Yearbook")

Furthermore, the growth of the real estate construction industry, notably the housing construction industry, is promoting the growth of the real estate interior decoration industry and the real estate service industry. Between 1999 and 2000, the working population of the real estate interior decoration industry increased by approximately 1 million. ("China Building Interior Decoration Association Statistics")As stated earlier, housing construction's ripple effects on industry as a whole is worth twice as much as the total amount of housing investment. If the employment index (the number of works relative to production in value terms) for housing investment is the same as housing construction, it is estimated that housing investment's effect on employment is equally great. During the two-year period from 1998 to 2000, the real estate industry's working population increased by 1.9 million. That means that during the same period housing investment contributed to the creation of approximately 3.8 million jobs in all other industries. The creation of approximately 3.8 million jobs translated into an approximately 47 percent increase in the country's total working population during the same period.

It is thus clear that promotion of housing development's effect on job creation is great. The housing industry is positioned as a major industry that absorbs workers relocated from the rural areas. From the standpoint of employment policy, promotion of housing development by government policy is of great significance.

1.3. Housing Finance Contributes to the Drastic Reforms of the Financial System

1.3.1. Banks Take a Positive Attitude Toward Loan Business and There Are No Fears of Fund Shortage

It was the China Construction Bank that first started the personal housing loan business in the country. And it launched the personal housing loan business in 1992. But it was in the spring of 1999 that the People's Bank of China announced its guidance opinion about the need to promote the growth of the consumer loan business. It was in November 1999 that the Central Financial Policy Measure Council advanced a similar opinion. In actuality, however, consumer finance was not yet clearly defined, personal housing loans being regarded as consumer finance. Since the second half of 1999 the housing loan business has

been growing rapidly.

Although banks are not against consumer finance, they find it quite time-consuming. As the banks become more and more in favor of consumer finance, banks must actively be involved in making inroads to accommodate consumer finance. The China Construction Bank and the Industrial and Commercial Bank of China, in particular, are very enthusiastic about the personal housing loan business. The results from personal housing loan business for FY2000 were far better than planned.

According to the two banks, their personal housing loan business is growing faster than planned, and there are no fears of fund shortage. They say that if a fund shortage should occur, such shortfall can be covered by funds of the other loan departments. For the time being, it seems very unlikely that private commercial banks will suffer from a shortage of funds for personal housing finance.

1.3.2. One of the Financial Challenges Is Collection of Bad Loans

It seems that the personal housing loan business has made a good start in China. For Chinese banks, the personal housing business means more than just making it easier for individual consumers to acquire housing. In July 1997, a slump in the baht's value triggered the devastating Asian financial crisis. In a meeting of the Central Financial Policy Measure Council, which was held at the end of 1997, the Chinese government decided to further promote the ongoing reforms of the financial system. The decision was made in an attempt to prevent and overcome financial risks, and thereby ensuring the security of the country's financial circles and national security as well. The year 1998 saw the most dramatic progress of the reforms of the financial system in the country. Nevertheless, it cannot be said that the ongoing reforms of the financial system have made sufficient progress.

In December, China became a signatory to the IMF Article 8. Faced with the Asian financial crisis, China felt relieved that the Renminbi Yuan had not yet been made exchangeable in capital transactions. But the Chinese government adopted a positive public finance policy while implementing a moderate monetary policy on grounds that the effects of the Asian financial crisis were being felt in the country. The Chinese government is to continue with a positive fiscal policy.

However, China is faced with a wide variety of monetary problems. The most serious is the problem of bad loans. Following the example of Resolution Trust Corporation (RTC) in the United States, and Resolution and Collection Bank in Japan, the Chinese government directed the country's four major state-owned banks to establish Asset Management Corporation in 1999. The Chinese government had the four major banks' bad

loans totaling 1.3 trillion RMB separated at book values, and transferred to Asset Management Corporation.

The four major banks will deal with approximately 27 percent of the bad loans after segregating the loans that have been accumulated up to the end of 1995. However, it is very likely that most of the loans will remain outstanding. The bigger problem is how to prevent the banks from accumulating new bad loans. Eventually, the Chinese government should step up supervision and management of the financial institutions.

1.3.3. It Is Necessary to Enhance the Quality of Claimable Assets Arising from Loans

The personal housing loan business is rapidly expanding on a nationwide scale. The four major commercial banks' total outstanding housing loans increased by 190.1 billion RMB in 2000 alone. At the end of 2000, it was 2.5 times as much compared to 1999.

In the case of the Industrial and Commercial Bank of China, housing loans accounted for 30 percent of the total amount of new loans provided in 2000, and two-thirds of the housing loans were personal housing loans. Why do the China Construction Bank and the Industrial and Commercial Bank of China, (both of which have abundant financial resources,) attach so much importance to the personal housing loan business? In the case of the Industrial and Commercial Bank of China, personal housing loans serve as a very important means to enhance the quality of claimable assets arising from loans, since the bank's default rate for personal housing loans is very low--approximately 0.3 percent. It is said that the coastal cities (with a non-farm population of more than 1 million) account for more than 80 percent of the bank's total amount of personal housing loans provided. This implies that in recent years the personal housing loans have been extended mainly to the affluent.

Even in the case of the People's Bank of China, which is in a position to direct and supervise other financial institutions, the housing loan business is an important means to promote the growth of the country's economy. The bank also thinks that the housing loan business is a means to enhance the quality of commercial banks' claimable assets arising from loans as well as their profitability. There is no denying that the Central Bank is taking a keen interest in housing loans.

There are no significant policy-related setbacks for the reform of the stock systems of state-owned commercial banks. But these banks are faced with such problems as resolution of bad loans and the need to improve their profitability. It is expected that these banks will expand their consumer finance business, which is centered around personal housing loans.

1.3.4. China's Entry into the WTO and the Challenges Facing China's Financial

Circles

China became a member of the WTO in 2001. Foreign financial institutions can enter China's consumer finance market five years thereafter. It is expected that foreign financial institutions, notably U.S. banks, will introduce new financial products in the country. In this context, Chinese financial institutions have to strengthen their corporate structure and capability within the next five years.

The People's Bank of China is optimistic about China's entry into the WTO. The bank says that it expects funds, new products, management models and services from foreign banks. It realizes that foreign banks are far ahead of their Chinese counterpart institutions in the areas of international settlement and consumer finance, and therefore thinks that it has to learn foreign banks' know-how as soon as possible. It is necessary that the reforms of Chinese financial institutions (including the reform of their internal management systems and the improvement of their product development capability) be further promoted.

The stated-owned commercial banks are in the process of actively promoting reforms of their respective organizations and operations under the guidance of the People's Bank of China. But smaller local financial institutions seem to be faced with a lot of problems. For example, the case of village credit companies which number more than 40,000, are increasingly experiencing difficult in effectively coping with drastic changes in the financial community due to their size. Their efforts to establish prefectural joint ventures to remedy the problem is not adequate.

The Chinese financial institutions' recently established a number of personal credit information systems. In two or three years, it will be likely and viable that more personal credit information systems will be developed nationwide. In Shanghai, such a system is already in operation. Some other regions are following suit. It is encouraging to observe that a concrete plan is being considered at the central level. Such movement should be accelerated.

It is expected that the state-owned commercial banks' plans to computerize their respective operations will make rapid progress. Unfortunately, the smaller local financial institutions lack financial resources to follow suit. This will most likely result to an increase in the inability for commercial banks and small financial institutions to connect their information systems. The marketization of interest rates will also be disadvantageous to smaller financial institutions. Since it is expected that the ratio of financing for smaller business and consumer finance will increase. It will become imperative for smaller financial institutions to promote shared use of computers and funds, and likewise, create and strengthen subsidiary organizations. They may also have to consider mergers. Since it is already a fact

that computerization is by far more effective than manual work in reducing costs substantially, it is essential that smaller financial institutions streamline their respective operations by pulling together all available resources.

1.3.5. Importance of Development of Operational Manuals of Coordination and Collaboration Among Banks in China

It is highly desirable that Chinese financial institutions develop a variety of financial products that fit in with the local market condition in order to establish viable risk management systems, as experienced by other foreign countries, including Japan.

As Chinese banks have many branches as well as their respective regional characteristics, it seems desirable that they cooperate effectively with one another to some extent in order to be able to compete with foreign banks. This is important if they are to secure housing loans in the future.

In the United States, Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) have standardized the housing finance application form, the report on assets and liabilities, the real estate appraisal report, and the promissory note. This enables financial institutions to streamline their debtor scoring and orchestration of credit accommodation operations.

From the standpoint of increased operational efficiency and risk management, it is also important that Chinese banks promote the creation of operational manuals.

1.4. Guidance Policy Housing Finance Accelerates a Good Circular Flow of the Economy

1.4.1. Guidance Policy Housing Enhances Consumers' Motivation to Acquire Housing

In China, housing prices are still too high relative to the average income level. If housing prices remain at high levels, it is likely that housing investment will decrease as the housing market approaches maturity.

A survey of consumers' willingness to purchase housing, which was conducted on randomly selected Beijing residents shows that approximately 70 percent of respondents preferred low- to modest-priced housing, and that only 5 percent of respondents thought they could afford to purchase high-priced housing.

If the lowest housing price in Beijing 4,000 RMB per square meter, and if a Beijing resident plans to purchase housing with a total floor area of 60 square meters, such resident will have to pay 240,000 RMB, which is approximately 9 times the average annual income of 27,000 RMB (twice as much as 13,500 RMB, which is the average annual income for workers in Beijing).

On the basis of consumers' ability to pay for housing, the central government's housing policies have to be formulated for the purpose of rational supply of commercial housing, economical housing, and low-rent housing.

Housing finance by government policy is an incentive for increasing the number of persons who can afford to acquire housing. It is also aimed at enhancing consumers' motivation to acquire housing on their own. It is necessary, therefore, that a guidance policy housing finance system characterized by low-interest guidance policy housing finance, interest subsidies, and government guarantee be developed, and that the private housing finance and the guidance policy on housing finance are coexistent.

1.4.2. Government Spending as a Cost of Reforms of the Economic System

The Chinese government's fiscal revenues for fiscal 2000 accounted for approximately 15 percent of the GDP. It cannot be said that the Chinese government is in good financial condition. Under such circumstances, the central government has to make budgetary appropriations for social security and the resolution of bad loans. China is in the process of carrying out drastic economic reforms, notably its economy's shift from a planned economy to a market economy. So the Chinese government must pay the "costs of reforms" by all means in its power.

Included in the "costs of reforms" is a resolution of bad loans by the country's four major banks. The system in which state-owned corporations took care of employees and their families "from the cradle to the grave" is to be abolished, and the central government's defrayment of costs of social security should be a part of the "cost of reforms."

Similarly, the direct housing supply system is to be abolished and housing is to be monetized. The central government's efforts to make it easy for those who cannot purchase housing under the new system are also included in the "costs of reforms".

To what extent is the central government to defray "costs of reforms"? It will be impossible for the central government to bear the "costs of reforms" disregarding the conditions of the country, more specifically its financial condition. It is necessary to minimize the costs of reforms" as much as possible.

In the area of housing, the central government need not defray the "costs of reforms" of those consumers who are already swimming with the tide of the market economy system, and therefore can afford to own housing on their own using commercial housing loans and the like.

Many people of low- to medium-income (whom banks refuse to deal with) were eligible for the direct supply of housing when the country's economy was a planned economy.

In the case of those consumers who find it difficult to acquire housing as a result of monetization of housing, the central government must defray their “costs of reforms”. China is still a socialist nation and therefore it is impossible to solve the housing problem with commercial housing loans alone. The problem should not be solved with commercial housing alone.

1.4.3. To Minimize the Central Government’s Cost Payments

A good circular flow of economy should be accelerated through the central government’s financial support which matches the present condition of the country, and which can generate multiplier effects.

Good local public financial management seeks a harmonious balance between revenues and expenditures. However, the central and western regions of the country, in particular, are characterized by insufficient local public finance. If the ability to acquire housing of residents of these regions are enhanced through effective use of financial fund in the form of, (for example, guidance policy finance and/or tax incentives,) it will lead to a reduction in the “costs of reforms” which the central government has to pay.

It is necessary to consider various measures to lighten housing loan users’ financial burden. From the standpoint of housing loan users, it is desirable to introduce a housing loan system in which housing loans are provided at long-term and low fixed interest rates.

Banks are unable to reduce their interest rates substantially due to their need to cover risks attributable to the inconsistency between procurement and management of housing loan funds. It would therefore be advisable for banks to procure housing loan funds through government-guaranteed bonds or securitized housing loans. It would be appropriate that government-guaranteed bonds be issued by housing finance organizations as guidance policy finance organizations. Since liberation of capital transactions is to be phased in, it will be possible to infuse foreign capital into the housing finance market in this way.

What was described above is only a part of the whole story of the “costs of reforms”. In order to minimize the payment of the actual costs of reforms, it is important to develop a wide variety of financial products and systems.

Government guarantee for personal borrowing is impractical because it will overburden the central government’s present financial obligations. Government guarantee should take the form of guarantee that enhances borrowers’ creditworthiness with minimal or zero risk. When government guarantee runs counter to the mortgage law, perhaps international organizations or foreign government should be allowed to act as guarantor in exceptional cases.

1.4.4. The Central Government's Policy Support Promotes Private Housing Construction and Reduces Adjustment Costs During a Transitional Period

The questionnaire survey regarding the demand for housing, which was conducted as part of this study shows that commercial housing construction is not dependent on commercial banks' housing loans, and that its growth depends on the central government's housing policy.

The questionnaire survey shows that the respondents' motivation to acquire housing is enhanced by such factors as "affluence", "substantial government assistance or prospect of substantial government assistance", "decline in prices of housing built for sale" and "lower interest rates". It also shows that the problems respondents are faced with when they implement their housing acquisition plan include: "lower income due to the inflation", "job instability", "insufficient own funds", "uneasiness about applying for a long-term housing loan", and "uneasiness about rising interest rates". It can be concluded that many consumers are uncertain about their ability to repay housing loans for a long period of time because in China (where reforms of the economic system are being carried out) many consumers' incomes are unlikely to remain stable for a long period of time.

The average Chinese has few assets other than financial assets. In the case of homeowners, their homes are mostly public houses disposed-off by the government. Such houses generally do not have high asset value. With regards to the future discounted current value of earned income, many workers are likely to lose their job (as a result of state-owned corporations' restructuring at a time when the country's economy is in a period of transition from a planned economy to a market economy). With the exception of young workers, workers who have lost their job find it difficult to regain the past salary level even if they can find a new job because of the mis-match between employment and employment opportunity.

In a period of transition from a planned to market economy in China, the central government should not be totally dependent on market mechanisms in order to reduce the adjustment costs. Although facing financial difficulties, the government should consider introducing a system for supporting personal housing loans through interest subsidies, government guarantee and the like, putting a cap on period of time or amount.

1.4.5. Use of Fixed Property Tax Revenues as Fund to Give Relief to the Weak Is Worth Considering

When the country's economy was a planned economy, state-owned corporations took care of employees and their families from the cradle to the grave. All costs defrayed by state-owned corporations. In the age of globalization of the economy, corporations doing business in such a manner will eventually lose its ability to compete. When the government is in difficult financial condition, and business corporations are unable to take good care of

employees and their families, the only alternative is to improve the government's financial condition by increasing the people's tax burden ratio. For example, in Japan, the tax burden ratio (amount of taxes/national income) was 24.5 percent in 1998. As for local taxes, municipal tax consists of municipal inhabitants tax and fixed property tax. The amount of municipal tax is nearly equal to that of fixed property tax. On the other hand, the amount of public welfare costs included in expenditures from ordinary local account is a little larger than that of fixed property tax.

Imposing fixed property tax on individuals and business corporations that possess sufficient assets, and covering public welfare costs by collecting fixed property tax revenues, is worth considering as a means to secure financial resources for giving relief to the weak.

China's current tax system is supported mainly by circulation tax revenues. Circulation tax consists of multiplication tax, consumption tax, business tax, and customs duty. These four taxes account for more than 70 percent of the central government's total amount of tax revenues. Income tax is divided into corporate income tax, foreign investment company/foreign company income tax, and personal income tax. These three types of income taxes account for 15 percent of the central government's total amount of tax revenues.

Property tax and other related taxes include land use tax, cultivated land occupancy tax, house duty, city real estate tax, city protection construction tax, fixed property investment adjustment tax and land multiplication tax. Despite their diversity, these taxes account for a very small percentage of the total amount of tax revenues because many persons and companies are exempted from these taxes.

As a whole, a wide variety of real estate-related taxes are collected, and the cost of collection of these taxes is enormous. It seems desirable that these taxes be reclassified and that these taxes be collected from homeowners (who own their home as asset) to secure financial resources for giving relief to the weak.

In China, house duty was once imposed at a rate of 1.2 percent after deduction of 10 to 30 percent of the acquisition price of housing. At present, however, it is imposed on the appraised value of housing at a rate of 1 percent. The appraised value of housing is determined by real estate appraisal organizations recognized by local governments. Real estate appraisal is conducted every three to five years. For China whose economy is in the process of being shifted from a planned economy to a market economy, it seems desirable, that to ensure increased tax revenues, the appraised value of housing is reviewed every year and that the tax rate is increased gradually. It should be noted, however, that in a market economy people of high income, those who own sufficient assets have to bear a higher tax burden.

1.5. Ultimate Goal of Reforms of the Housing Finance System--Creation of

the Framework for Supporting Consumers' Asset Formation, Enhancing Consumers' Motivation to Acquire Private Home, and Accelerating a Good Circular Flow of the Economy

1.5.1. Limitations of Private Housing Finance--Experiences in Japan

In Japan, the Housing Loan Corporation was solely responsible for housing finance from the late 1950s to the early 1960s. No other private financial institutions provided any form of housing loans. During the late 60s, however, the private housing finance business grew rapidly. As consumers' demand for funds for acquiring housing increased, private financial institutions met such demand on the strength of monetary relaxation.

The total amount of private housing loans, was ¥70 billion, or 0.3 percent of the total amount of debit balance by the end of fiscal 1965. It increased to ¥ 4.3 trillion (4 percent of the total amount of debit balance) by the end of fiscal 1972. The total amount of private housing loans increased by a factor of sixty during the seven-year period.

It is said that when the amount of per capita national income exceeds the \$1,000 mark, demand for housing increases rapidly. Japan's Economy exceeded the \$1,000 per capita national income within the seven year period.

An analysis of the annual growth of the private housing finance business shows a close relationship to the trend of the demand for industrial fund. The private housing finance business grew rapidly during the 1966 to 1968. In 1972, the growth in demand for industrial fund leveled off. Conversely, the rate of increase in demand for private housing finance decreased from 1969 to 1970. The corporate businesses' demand for money was strong.

In the case of private financial institutions, then clients are mostly business corporations with outstanding loans and need a continued supply of loans. In terms of housing finance, clients are new loan customers, most however rank low in the order of priority as far as private financial institutions are concerned. As a consequence, the growth in housing finance slowed down when business corporations' demand for money is strong.

When housing loan interest rates are kept at relatively low levels compared to other interest rates, the incentives to private housing finance are likely to become weak. Conversely, when housing loan interests are kept at relatively high levels, consumers have to pay high interest rates.

Private housing finance is basically very responsive to business fluctuations. It is very difficult, therefore, to ensure stable promotion of housing development which is free from the effects of business fluctuations with private housing finance alone.

If various types of consumers are to acquire housing according to their capability and upgrade their living environment through replacement purchases of housing, it is important,

from a long-range standpoint, that new housing finance products be developed and supplied on the basis of a combination of private housing finance and guidance policy housing finance and a variety of fund raising routes.

In this context, it will be exceedingly helpful for the Chinese government to develop a guidance policy housing finance system that fits in with the conditions of the country similar to Japan's experiences after the war, when housing finance was developed through the creation of the Housing Loan Corporation.

1.5.2. Policies to Promote Private Home Ownership in Western Industrialized Nations

In promoting private home ownership, major Western industrialized nations provide their consumers with a variety of private home ownership promotion programs based on the consumers' ability to acquire housing.

In the United States, where much emphasis is placed on tax incentives, a "deduction of interest income from taxable income" program and some other tax incentives are offered. In order to make it easy to obtain housing loans at the time of purchase of housing, consumers can utilize the insurance/guarantee services of the Federal Housing Agency (FHA) and the Veterans Administration (VA). Furthermore, other federal government agencies, such as Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), support financial institutions that provide housing loans.

Britain has the "Housing Loan Interest Subsidy System"(MIRAS), in which the central government pays part of interest on the loans that consumers obtain for the purpose of acquiring housing. As from April 1998, the interest subsidy rate is 10 percent of the interest cost.

Germany has the "Housing Acquisition Subsidy System" (established in 1996) and a savings encouraging system aimed at promoting acquisition of housing and a social housing system which people of low to medium income can get low-interest housing loans.

In France, a central government-directed housing finance system is playing an important role. At present, "zero percent" loans are offered under the agreement between the central government and financial institutions. In this housing finance system no interest is charged on housing loans in the amount of up to 20 percent of the housing price. Financial institutions that offer such housing loans receive subsidies that cover the interest on such loans from the government. In addition, those financial institutions which have concluded the agreement with the government offer low-interest "agreed loans" (PC). These housing loans, for which no government subsidies are granted, are provided low deposit interest rates in accordance with the central government's relevant guideline.

As is clear from the above descriptions, Western industrialized nations are promoting private home ownership through tax incentives, interest subsidies, and other subsidies. Needless to say, the policy to promote private ownership is a considerably heavy financial burden on the governments of these countries. It is a fact that these countries have taken measures to lighten their respective central governments' financial burden through a review of their respective housing finance systems. Accordingly, the Chinese government, (which is in difficult financial condition,) they should implement its policy to private ownership within the limits of its financial condition.

1.5.3. Three Pillars of the Chinese Government's Housing Policy and "New Urban Housing System"

Included in the Outline of the Tenth Five-Year Plan is the following statement: "There is a strong need to improve consumers' living environment. In this connection, it is necessary to bring the Housing Provident Fund System to perfection, promote housing construction with emphasis on economical housing, and establish a system to guarantee the supply of low-rent housing." And the central government announced the three pillars of its housing policy--the Housing Provident Fund System, economical housing, and low-rent housing as.

A limited number of people of high income can afford to acquire housing using commercial banks' housing loans or their own funds, and therefore have no need to be provided with housing finance services. In the case of people of low to medium income, who are the main beneficiaries of public housing finance, on the other hand, it is necessary to procure funds for acquisition of housing through the Housing Provident Fund System, and develop a system to enable them to acquire housing through construction of economical housing and the guidance policy housing finance system. In this case, tax incentives will prove to be effective. The basic concept of such system is giving such people encouragement to acquire housing with the support of the government's housing-related policy measures.

The Ministry of Construction cites the following as its main duties for the establishment of a new urban housing system during the next five years.

Establishment of a housing money distribution system that fits in with the current employee salary system.

Determination of a reasonable ratio among commercial housing, economical housing, and low-rent housing.

Establishment of a viable housing supply policy, a viable tax cost policy, and a viable tax cost management system.

Establishment of a housing market system for the harmonious coexistence and

growth of existing house transaction and new housing transaction as well as for the harmonious coexistence and growth housing transaction and housing lease.

Development of policy measures to promote guidance policy housing finance through improvement of the Housing Provident Fund System, loan interest subsidies and government guarantee.

Development of a housing finance system which allows of coexistence of commercial housing finance and guidance policy housing finance.

Establishment of a real estate management system that fits in with the diversity of real estate owners.

Establishment of a system in which the central government is to manage the housing market within the framework of such indirect management instruments as the fiscal tax system, the monetary system, the legal system, development plans, land supply, and industrial policy.

Establishment of a system of housing industry policies which includes strategies for saving water, energy and land, prevention of environmental pollution and overall enhancement of the quality of housing construction and the standards for the improvement of the housing industry.

Establishment of a system of laws and regulations which helps protect consumers' housing as property, is convenient for consumers' housing transactions, and meets the requirements of the central government's economic and social policies.

(“Economic Daily” dated February 6, 2001)

As a matter of course, it is desirable that policies for the people of China to reinvigorate the housing market through the fullest possible use of their own funds be formulated in a manner that minimizes the financial burden on central government finance and local government finance.

It should be noted here that the ratio of owner-occupied homes and the rate of partly-owned, owner-occupied homes is 77.1 percent (8.4 percent increase over the previous year). It is never easy for the average Chinese to acquire housing. No attempt should be made to solve the housing problem hastily. This problem should be solved in a manner that suits the conditions of the country and at the same time is in consistency with regional characteristics. In this sense, the new urban housing system which the Ministry of Construction plans to develop over the next five years can be said to cover all problems concerning promotion of housing development.

1.5.4. Creation of a Comprehensive Housing Market System

Thus far China has concentrated its energies on the creation of a housing market on a

base like development of economical housing where there is no likelihood that a viable housing market will be created. One of the important future challenges will be the establishment of a housing market system which is to cover the secondary market (existing housing market) and the rental housing market. This is also to be covered by the above-mentioned “new urban housing system”.

Supply of rental housing will be effective in solving the problem of “shelter” facing the country’s floating population and college students. Tax incentives to be appropriated to the supply of rental housing should be examined carefully.

The ratio of students who go on to college education was 7.6 percent in 1997. According to the Outline of the Tenth Five-Year Plan, the ratio is to be increased to 15 percent by 2005, if possible. It is therefore expected that college students’ demand for “shelter” will increase rapidly. It is likely that the fixed number of new college students will be increased. Since there is a limit to construction of dormitories, the number of construction projects to convert existing housing into rental housing for college students will likely increase.

1.5.5. Provision of Housing Loans by Public and Private Organizations Is Worth Considering

Housing finance is one of the main instruments to promote housing construction. The number of people who can use housing finance services is limited. The Housing Provident Fund System, which was initiated with the aim of making it easy for consumers to acquire housing, is utilized only by those who have the ability to repay provident fund loans. The fact is that the system is utilized mainly by the affluent.

From the standpoint of banks, guarantee to ensure repayment of housing loans is an important issue. Judging from the conditions of the country, it is difficult to dispose of collateral in compliance with the relevant laws. In Shanghai, for example, mortgages are held on housing and at the same time housing is insured against disasters.

The system of direct supply of housing by business corporations and government agencies has been abolished, and the government’s financial assistance for acquisition of housing in the form of monetization of housing is yet to be initiated. Consumers who desire to obtain housing loans are hesitant to actually apply for housing loans unless they have the ability to repay housing loans over a long period of time. As a matter of course, financial institutions are also hesitant to offer housing loans to consumers whose ability to repay them is not verified. The present consumption level can be determined by i) nonhuman assets included in family finances (housing, financial assets, etc.), ii) human assets (the discounted present value of future earned incomes) and iii) present disposable income.

It is the employers of borrowers and government agencies that have a thorough

knowledge of borrowers' present and future ability to repay housing loans. A plan to provide housing loans to officers of qualified business corporations and government agencies by holding mortgages on their lifetime salaries and retirement allowances seems to be worth considering.

1.5.6. Lessons to Be Learned from the United States for the Future Securitization of Housing Loans

In China, there are two types of interest on personal housing loans--interest on loans with a repayment period of up to 5 years, and interest on loans with a repayment period of 5 to 30 years. The interest rate is a half-year preferential low interest rate, and is adjusted on January 1 every year on the basis of the current level of interest rates. In actuality, it is not a fixed interest rate. It is likely that China's interest rate market will be liberalized in five years or so. If borrowers are able to choose between a fixed interest rate and a floating interest rate, both in the true sense of the word, it is necessary to develop a fund procurement and management system in which financial institutions' fund procurement is consistent with their fund management.

In the United States, the securitization of housing loans is well under way. In China, on the other hand, it will not be easy to securitize housing loans in a short period of time. It should be noted, however, that the progress of securitization of housing loans in the United States has helped solve important problems faced in promoting the housing loan business.

First, the securitization of housing loans has led to distribution of risks. It can be said that the securitization of housing loans represents a system to distribute risks among federal government agencies, government-supported organizations, private financial institutions and investors. In the United States, the housing finance market is supported by government-supported organizations, such as Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), and public organizations, such as Government National Mortgage Association (GNMA), the Federal Housing Agency (FHA) and the Veterans Administration (VA). The federal government established a system to extend credit using the insurance and guarantee of the FHA and the VA and have Fannie Mae and Freddie Mac purchase housing loan claims, securitize these claims, and then sell securitized claims to investors.

Second, the securitization of housing loans has led to development of advanced analytical and financing techniques concerning interest rate risk and credit risk. In securitizing housing loans, it was very important to develop advanced analytical and financing techniques concerning interest rate risk and credit risk that arise concerning debtors, such as redemption before due date and arrear, as well as a viable information system infrastructure.

Third, the housing loan application form, the report on assets and liabilities, the real estate appraisal report and the promissory note were standardized by Fannie Mae and Freddie Mac. The standardization of such documents and forms makes possible the rational scoring of debtors and orchestration of credit accommodation operations.

Such consistent method of reform leads to reductions of costs of reforms. As mentioned later, the establishment of an organization to specialize in housing finance as a guidance policy financial institution is a concrete measure through which the Chinese government may learn lessons from the past experience of the United States with consideration to the conditions of China. Such more will serve as an impetus to promote the smooth securitization of housing loans in the country.

1.5.7. The Housing Provident Fund System Should Be More Supportive of Consumers' Asset Formation

The above-mentioned questionnaire survey shows that more than 80 percent of users of the provident fund find the provident fund system acceptable. Nearly half of respondents want the system improved. As to what aspects of the current system they want improved, most of them cited "raising of the rate of interest on the provident fund" and "reduction of the rate of interest on provident fund loans". It can be concluded that the provident fund system is acceptable with some areas of the system needing to be improved.

From a long-range standpoint, the provident fund cannot be said to have attained its original goal.

If it is a means to promote asset formation, it must be managed at the depositors' best interest. The management by persons who are not experts in financial practices should be rectified as soon as possible. Accounts are concentrated in certain banks, with the result that such accounts are used as the sources of low-interest deposits. This should also be rectified as soon as possible if it does not work for the benefit of depositors.

Many aspects of the provident fund, such as liquidity risk involved in reduction financing, and its inconsistency with the government's housing policy, must be improved.

If its management at the local level is the cause of problems, such situation must also be rectified.

1.5.8. Improvement of the Housing Provident Fund and Establishment of Guidance Policy Finance Organizations

What to do with the provident fund system, and what to do with guarantee organizations are matters of the utmost urgency. Provident fund management centers, which number as much as 2,300, should not be allowed to operate in isolation. An umbrella

provident fund management center should be established in Beijing or Shanghai, and local provident fund management centers should be integrated into a limited number of regional provident fund management centers, which are to be affiliated to the umbrella provident fund management center. It is desirable that the umbrella provident fund management center and the affiliated regional provident fund management centers are to jointly form the nucleus of the housing finance organization which is to be established as a guidance policy financial institution. Guarantee organizations are to be established as affiliates of the housing finance organizations. It is necessary to establish these organizations as soon as possible.

The housing finance organization to be established as a guidance policy financial organizations is to operate under the supervision and management of the People's Bank of China, and is to fall under the jurisdiction of the Ministry of Construction.

What operations is this organization to carry out? First, it is to manage the provident fund. It should try hard to manage the provident fund safely and to depositors' best advantage. The fund should be managed in the market, and open bids should be accepted to ensure transparency, profitability, safety and promotion of public good. The provident fund should not be concentrated in certain banks.

As a guidance policy financial institution, it should be authorized to issue government-guaranteed bonds, including foreign bonds. It should be so arranged that funds procured through issuance of government-guaranteed bonds, including foreign bonds, can be supplied as housing loans offered by commercial banks, notably the four major banks.

The organization should be able to offer loans for construction of economical housing, housing for the elderly and dormitories. In the future, the organization should be able to purchase securitized housing loans as if to carry out buying operations.

The organization should be able to implement the government's housing policy and stimulate domestic demand on the basis of its diverse fund procurement/fund management authority. If the Ministry of Construction implements concrete policies through this organization in keeping with the intent of the State Council, it will determine the direction of the government's housing policy.

It will be impossible to solve almost all of the housing finance problems as a result of implementation of concrete policies through the housing finance organization alone. But such implementation of concrete policies could be effective in producing multiplier effects and financially supporting commercial banks that offer housing loans. It should be noted that the organization's financial support to commercial banks does not mean the abolition of the current system for the central bank's further advance to meet demand for housing loan funds at commercial banks and other financial institutions.

Since in China circumstances differ from one region to another, it is desirable that institutions be diverse and flexible. To what extent can financial funds be invested? Judging from the government's present financial condition, such funds can be invested only in a manner that fits in with the actual situation in the country. However, financial support is not to be given through the housing finance organization as a guidance policy organization alone. Since tax incentives are provided by the National Tax Administration Agency and a number of regional tax bureau, it seems appropriate that interest subsidies and other subsidies be provided by the central government or local governments. When financial resources for housing-related subsidization are insufficient, the shortfall could be covered by proceeds from sale of state-owned assets.

In conclusion, the whole housing finance system should be developed as the framework for promoting consumers' asset formation, enhancing consumers' motivation to own housing, and accelerating a good circular flow of the economy.

II-2.

Housing Policy, Legislation, and Housing Finance: Directions

2. Housing Policy, Legislation, and Housing Finance: Directions

2.1. Housing Policy and Legislation: Objectives and Challenges

2.1.1. Housing Policy and Legislation: Current Issues

(1) Housing Policy: Current Issues

Below are the main issues of the current Chinese housing policies (including the housing policies of Shanghai, Wuhan and Chengdu, model cities of this research study) identified from this research project:

- 1) Schemes and methodologies of market-leading housing policy, which will help enhance the allocation of housing resources through market are not established.
- 2) The supply system of housing does not match the changes in the demand for housing, market transformations such as in the balance between supply and demand, and purchasing power of people in various income levels.
- 3) Policy structure pertaining to housing finance system is yet to be established, and its overall framework and approach are not determined. Housing Provident Fund System (HPF System), a core of the current housing finance system still have numerous issues in the program design and operation. As a result, HPF System is not fulfilling its role in political finance.
- 4) System infrastructure of the Chinese government to boost and manage housing market is still underdeveloped. Accurate housing planning and policy development are difficult, due to poor housing statistics infrastructure and statistical analysis methodologies.
- 5) The overall quality of housing is still low. Quality of services in construction, distribution and property management is also low.
- 6) Housing legislations are not fully established, particularly in regards to purchasing and trading houses. Housing legislations in the areas of property, debenture, and mortgage are also underdeveloped.

(2) Housing Legislation: Current Issues

Legislation-related aspects of the issues discussed above, are identified below:

- 1) In the course of bringing drastic reforms to the urban housing system, housing should be considered as the center of comprehensive legislation system, not as a part of property and real estate legislations.
- 2) As the private ownership of urban residences increases, housing legislation should also regulate an individual homeowner's rights and duties. Thus, legislations in the areas of property (rights), credit (debt), mortgage (collateral), (not only the administration law), should be established.

- 3) Local legislation currently mainly consists of the administration law and regulations serves as housing legislation. Therefore, a comprehensive legislation structure, which regulates and governs local legislations, should be established while considering the national housing legislation plans.
- 4) As the total number of housing properties available to the public increases, the renewal of properties and the overall city planning will be required due to the decaying of the existing houses and housing-related infrastructure. Various new legislations should be established in order to cope with “flow issues” related to new development/construction, and also with “stock issues” related to filtering and refurbishment.
- 5) Considering China’s membership in WTO, legislations and operation infrastructures should be established in the areas of housing brokerage services, property management services, development of housing information system and information services.
- 6) Legislations pertaining to housing administration, positioning/development process of housing plans, certification system and education of housing professionals will be necessary.¹

(3) Housing Provident Fund System as Housing System: Current Issues

Current Housing Provident Fund System (HPF System) is a critical component of the Chinese Housing System Reform. At the same time, HPF System can be identified as the only housing finance system in China, which was developed in order to implement the country’s housing policies (promotion of privately owned housing). However, when HPF System is viewed as one form of political housing finance system, it is not fulfilling its role because of the numerous problems that exist in the program design and operation. Main issues of the current HPF system are summarized below:²

1) Overall Program Design

A large number of HPF System participants have a relatively high housing purchasing power.³ The political effectiveness of HPF System is currently limited since it is not meeting its original objective in increasing the housing purchasing power of low-to-mid income level people. Also, HPF System is not utilizing its financing functions in full.

2) Loans

- a. Lack of incentives to increase the demand for housing
- b. Lack of loan function
- c. Inflexible loans
- d. Shortage of loan fund

¹ Collateral and guarantee system is discussed in detail in II-5.

² HPF system is discussed in detail in II-3.

- e. A large number of HPF System participants belong to a high-income group. This suggests that HPF System is not meeting its original objective in increasing the housing purchasing abilities of low-to-mid income level people.

3) Finance Management

- a. Finance management is not autonomous.
- b. Finance management is not thorough.
- c. Information disclosure is not complete.

2.1.2. Objective of Housing Policy

The fundamental objective of housing policy is to improve living standard and to re-allocate wealth. Overall, it is aimed to solve housing-related problems. The main goal of the housing policy and legislation is to enhance the standards of living environment, and therefore upgrade the social assets at a national level. Three major tasks should be performed to achieve this goal:

- 1) To provide the opportunity to purchase a house with a wide set of choices to people in the different economic conditions and age,
- 2) To improve the living environment and develop a good housing stock in order to enhance the overall social asset value (public and personal), and
- 3) To guide with appropriate political means and complement the housing market that will establish and maintain an effective housing development mechanism.

The first task implies the following political acts:

- 1) In promoting housing for people of different economic conditions, specially for those with a low purchasing power, the government should require a study of the relevant financial and monetary measures.
- 2) By offering a wide range of choices the government should create a political balance among them. This requires a study of the relevant financial and monetary measures.
- 3) The government should develop a fair, equitable and transparent scheme to provide various opportunities to the people.

The second task implies the following political acts:

³ Based on the survey in three cities, Shanghai, Chengdu, and Wuhan, conducted by JICA research group.

- 1) Due to the fact that in a short term period, the people's housing purchasing power and the housing market mechanism are not developed enough, the government should provide quality housing by establishing and implementing a middle and long-term political target.
- 2) To assist people to buy quality housing easily, the government should support the people's efforts through effective housing policies. This requires a study of the relevant financial and monetary measures.
- 3) The purchase of a house represents the most important fixed asset and monetary asset activity for an individual. Moreover, people should perceive its maintenance and evaluation as an asset value. Therefore the government should develop quality assurance, assessment, mortgage, and insurance systems for housing asset and implement policies base on them. Dissemination of information on these systems is also important.

The third task implies the following political acts:

- 1) To develop conditions wherein the move to a new house can be possible or easily performed. This requires a study of the relevant system infrastructure and financial measures.
- 2) To encourage, guide and adequately support not only the buyers but also all the other players in the housing market. This requires a study of adequate financial and monetary measures to guide and complement the housing market.

2.2. Housing Policy: Basic Concepts

2.2.1. Housing Policy: Basic Concepts

An important role of the housing policy is to achieve political objectives through housing market. There are mainly two types of housing policy: 1) a policy that will affect the supply side of housing, and 2) a policy that will affect the demand side of housing. Specific examples of housing policies are: public housing policy; income allocation policy; rent policy; policy to regulate the usage of properties and buildings; tax policy; and housing fund assistance policy. Most of these policies are closely connected to, and supported by housing finance policy.

(1) Public Housing Policy

The objective of this policy is to provide low-rent housing for low-income earners and political housing such as housing for elders and handicapped people. In principle, it is considered as a part of social security system.

(2) Income Allocation Policy

The objective of this policy is to upgrade the income level of low-income people by allocation, which will increase the demand for housing and to support the promotion of housing through private housing sector. There are direct allocation such as China's provision of housing allowance, and indirect allocation such as employer reserve in housing provident fund.

Effectiveness of income allocation policy will be minimum for low-income individuals since housing-related spending consists only a small portion of their household budget. Therefore, possibility for low-income people to obtain high quality residences with long-term durability will be small, even if income allocation policy is introduced.

(3) Rent Policy

The objective of rent policy is to control and to provide rent subsidy.

Rent subsidy is designed to secure stable housing for low-income individuals. On the other hand, rent control is designed to boost rental-housing market and to protect tenants.

(4) Tax Policy

Various tax deduction measures such as housing saving deduction, income tax deduction, partial deduction of property purchase tax and fixed property tax, can be utilized to promote private home ownership.

It is true that income tax deduction for homebuyers will not benefit individuals who are leasing houses. However, overall equality will be maintained through fixed property tax, since it will not be applicable to individuals with leased houses. Property tax will not affect housing consumption negatively, since appraised value of housing tends to be lower than the market price in any countries.

(5) Housing Finance Policy

The objective of this policy is to provide fund for building and purchasing houses at the possible lowest cost and at greater convenience. Specific measures include long-term, low interest loans to private sector's housing construction and to individual homeowners; interest rate subsidy; and provision of public credit (collateral, guarantee, insurance) for default risks.

In order to maximize the effectiveness of housing fund policy, it is important to introduce public political housing fund led by the government (i.e. structures of housing policy finance).

2.2.2. Housing Policy with Effective Political Housing Finance

The basic concepts of housing policy, which utilizes financing for housing policies in China should be the following:

- 1) Housing distribution and monetization system to be started in 2000. The supply side measure of ensuring supply of housing by public bodies should be considered along the demand side measure, the relevant housing policies and the concerned laws formulated to encourage private bodies to induce people to buy housing or move into a new house.
- 2) To drive the demand side measures, the entire housing market should be studied and incentives of various types should be given to the different players.
- 3) The government should achieve its political purpose to rely on the housing market, guide and complement the market by providing incentives to the players in various ways.
- 4) Suitable conditions should be established to activate the housing market promoting the moving to a new house and allowing a smooth functioning of the market. To guide and complement the housing market, a system infrastructure should accompany a physical foundation.
- 5) A political housing fund system should be in place to develop the system infrastructure. To pursue the housing policy over a long time period, housing policy and the related statutory system should be linked to housing fund. Coordination between the housing policy and the political housing fund is determinant.
- 6) A political housing fund scheme should be developed. The scheme should clarify the roles of the public housing fund organs (e.g. Housing Provident Fund Center that is functionally reorganized) and private financial institutions (e.g. four big commercial banks). The scheme should provide defined measures of support. In this way, a combination of public and private housing fund system can be established to support the long-term housing policy.

2.3. Basic Direction of Housing Policy with Effective Financing for Housing Policy

2.3.1. Filtering Policy and Financing for housing policy

(1) Filtering Policy: Concept

Filtering is an effective means to upgrade the housing standard for the entire society using the existing house stock.

Filtering means that the intermediate earners move to a higher level house and the low-income people fill the vacancy. People can enhance their housing standard according to their economic capability in a continuous changing life style environment.

Filtering does not simply encourage the intermediate earners to purchase a new house. It contributes to improve the overall housing standard through an increased liquidity of the housing stock. Intended as a government policy, filtering drives people to move to a new house of higher standards.

In China, the majority of the houses have been constructed as a means of payment in kind, and the quality of the nationwide housing stock is not high in general. The housing policy should enhance the quality of the housing stock by encouraging the moving to a new house with filtering and supported by a housing financial policy.

(2) Introduction of Filtering to China and Tasks

The introduction of filtering in China and the relevant tasks have been studied from three viewpoints: housing stock, housing buyer, and government policy. Table 2-1 shows the feasibility and tasks of introduction of filtering.

Table 2-1 Application of Concept of Filtering in China

	Current Status and Feasibility of Introduction	Tasks
Housing stock viewpoint	Approximately 60% of public-owned houses have been sold to individuals through the disposal measure of the government (for the three investigated cities). Filtering stock already exists so far as stock in its simple sense is concerned.	Hard: There are few houses that are of good quality and available over a long time period. Soft: Housing diversity is directed to cope with the increasingly diversified user needs.

	Current Status and Feasibility of Introduction	Tasks
Housing buyer viewpoint	Earnings differentials are increasing among salaried workers in the urban areas in China. As a result of the historical “average emphasis”, the intermediate earners represent the more conspicuous group. Any policy is greatly felt from this group of intermediate earners	Maturity of the existing house market differs from one city to another. Generally, however, market liquidity is low except in the special big cities such as Shanghai. Information transmission routes and contents are also limited.
Housing policy viewpoint	Filtering will promote an affordable housing policy. The policy is also compatible with the current and middle- and long-term policy to promote private home ownership.	The housing finance policy is not sufficiently supported and the intention of the policy is not well communicated.

Source: JICA Study Team

(3) Conditions for Filtering

1) Diverse Housing Types and Offers

Brisk moving to a new house by filtering does not occur naturally. A housing market that is partly mature and has a certain level of liquidity should be in place and offers new houses, existing houses (disposed houses, etc.) and houses for rent.

The basic requirements of the housing market are to offer diverse housing types and forms to meet the demand at various levels.

Table 2-2 shows the housing types and the corresponding demand elements (individuals and households) as well as the tasks related to the supply of the required housing type.

Table 2-2 Housing Type, Demand and Supply Problems

Housing type	Demand (individual and household)	Major problems
<p><u>Inexpensive rent houses</u></p> <ul style="list-style-type: none"> • <u>New</u> • <u>Disposed house purchased</u> • <u>Disposed house rented</u> 	<ul style="list-style-type: none"> • House with an extremely low living environment (living area is approximately 3 to 4 square meters per person) • With urban family register 	<ul style="list-style-type: none"> • Unstable supply due to the limited government funds available. • Consistent supply system is not in place. • The properties offered are basically disposed-off houses that were purchased or rented, and do not much contribute to improving quality.
<p>Existing house rented</p> <ul style="list-style-type: none"> • General rent house • Renting of disposed-off houses that were purchased • Renting of existing commercial house • sublet of general rent house 	<ul style="list-style-type: none"> • General renting: A wide range of living bodies exist including, for example, government body staff and corporate employees. High possibility of purchasing depending on conditions. • Renting of purchased house that was disposed-off, and sublet of general rent house: students, and general workers in the mobile population. • Renting of existing commercial houses (including near-new): Middle and upper bracket earners in the mobile population. 	<ul style="list-style-type: none"> • House renting market has not been developed. • Insufficient support for brokers • A reform support system is missing to guarantee a certain level of quality of rent house.
<p>High-class rent house</p> <ul style="list-style-type: none"> • Service apartment • High-class apartment 	<ul style="list-style-type: none"> • Corporations • High-income mobile population • High-income foreigners 	<p>None in particular</p>
<p>General rent house (new)</p>	<p>Applicable to a wide range of people, including, for example, singles immediately after household separation and new households, or new-generation people who are not given a disposed of house.</p>	<ul style="list-style-type: none"> • Very few offerings. • Developers bear a heavy burden and high risk due to prolonged investment recovery period, yet the government provides very little political support. • No commodities are available in the market to meet the needs of the mobile population.
<p>8) Welfare rent house</p>	<ul style="list-style-type: none"> • Aged people with stable income and welfare benefits. • Special people 	<ul style="list-style-type: none"> • Very few offerings for general aged people. • Very poor political support in spite of the anticipated aged society in the near future.

Housing type	Demand (individual and household)	Major problems
<u>Economical housing</u> <ul style="list-style-type: none"> • <u>Conventional government subsidized housing</u> • <u>General economical housing</u> 	<ul style="list-style-type: none"> • Most users comprise low to medium income households with an urban family register in principle. • Except for the government subsidized housing, the users are substantially identical to those of general commercial housing according to the city. 	<ul style="list-style-type: none"> • <u>The</u> current economical housing initiative lacks clear definition of applicants' qualification and house construction criteria. • The current economical housing initiative is not fully supportive of purchase of a house by middle and low earners.
General commercial housing	<ul style="list-style-type: none"> • Houses with a stable income. Forms a very large user group. 	<ul style="list-style-type: none"> • The average price is generally 8 to 10 times the annual average household income. • Generally left to the market mechanism. Very few government induced offerings with political intention based on certain technical standards. • Lack of a consistent quality evaluation and performance guarantee system.
Disposed of housing	People with a variety of vested rights as a result of housing system innovation.	<ul style="list-style-type: none"> • Poor maintenance and reform system to maintain housing quality at a certain level. • Lack of a consistent quality evaluation and performance guarantee system.
Other special housing	Out of the question.	Out of the question.

Note: The underlined items are government specified political housing that is not traded in the market in principle.

Source: JICA Study Team

2) Policy to Promote Filtering while Utilizing Financing for Housing Policy

Moving to a new house presumes the availability of houses. The owners of a house sell the current house or rent it to enter the money market. People may move to a new house due to household separation or formation of a new household. Moving to a new house occurs due to three main reasons:

- a. Rent a higher-quality house (quality of a house, size, floor plan, location, environment, etc.).

Example: from an inexpensive rent house to a new rent house of higher status.

- b. From a rent house to a privately owned house

Example: a house to be disposed, or purchase of a commercial house.

c. From a low- to a high-quality privately owned house.

Example: From a disposed house to a commercial house, or to a higher-quality commercial house.

As mentioned earlier, the availability of diverse housing types and forms is indispensable to moving to a new house. Therefore it is necessary to offer good facilities, develop a housing market to attract the potential buyers, formulate a supportive housing policy, build a system of infrastructures, and develop a housing finance system to sustain the housing policy and the system of infrastructures. Without this system, the market mechanism will not function as should be reasonably expected.

In the case of sale of an existing house, for example, if the existing house is a disposed house, the user has already gained resale profits and thus no problem should exist. If, however, a general commercial house is going to be sold with a loss, the user may hesitate selling the house and moving to a new house. When operating the asset value of an existing house without selling, the user may need a policy, a system, or a technology to protect and promote his or her asset operation. In the absence of a safeguard, the user would not select the asset operation option and the possibility of moving to a new house is decreased. The need for moving to a new house (step-up to a higher-quality house) is a latent need, lacking urgency in general. Political incentives are important to actualize this latent need.

Table 2-3 shows various incentives given to the players in the housing market for the purpose of achieving the political purpose in the housing market.

Table 2-3 Incentives for Players in the Housing Market

Political target	Measures	Subjects to be supported	Incentives
Development of a good housing stock	Supply quality housing	<ul style="list-style-type: none"> • Housing developers • Housing buyer 	Preferential interest and tax (see Note 1) for development and purchase of housing satisfying certain quality standards (see Note 2).
	Maintain and improve housing stock	<ul style="list-style-type: none"> • Mainly existing house developers • Housing buyer 	Preferential interest and tax for development and purchase of reformed existing houses satisfying certain quality standards (see Note 3).
	Develop various lead model houses (see Note 4)	Mainly housing developers	Offering of land Preferential interest and tax

Political target	Measures	Subjects to be supported	Incentives
Development of a housing distribution market and promotion of moving to a new house activities	Develop rent houses	<ul style="list-style-type: none"> • New and general rent housing developers • Rent housing developers who effectively use existing houses • Those living in a rent house 	<ul style="list-style-type: none"> • Preferential interest and tax for developers who respond to political guidance. • Rent subsidy for specified dwellers.
	Effectively use quality stock (promote distribution of existing houses)	Mainly those who sell or buy an existing house	Preferential interest and tax (see Note 5) for sale and purchase of high-grade existing houses.
	Improve housing purchasing ability through reduced housing price and rent	Mainly housing developers	Preferential interest and tax (see Note 6) for development of housing complying with construction cost reduction program with political intention.
Future-oriented housing	Be ready for the aged society	<ul style="list-style-type: none"> • Housing developers • Housing buyers 	Preferential interest and tax for development and purchase of silver housing, two-generation housing, etc. satisfying certain political technical standards (see Note 7).
	Protect environment	<ul style="list-style-type: none"> • Housing components manufacturers • Housing developers • Housing buyers 	Preferential interest and tax for development and purchase of energy-saving housing.

Note 1: Different interest rates apply depending on the level.

Note 2: Not the minimum but the guidance standard with political intention.

Note 3: Reform guidance standard.

Note 4: Intelligent house, etc.

Note 5: Includes a series of taxes paid for the property previously.

Note 6: Cost reduction model project, etc.

Note 7: Barrier-free and two-generation housing standard.

Source: JICA Study Team

3) Legal systems reflecting promotional policies for sustainable house-moving

In order to promote house-moving as a central and long-term policy of housing promotional policies, it is important to first prepare a Housing Authority Law (Basic Law) and establish the positioning of house-moving policies within this law. This will enable a wide variety of housing patterns and provision styles to exist in the housing market, and it will also enable government to give the incentives necessary to achieve the goals of its policies.

In China, a deliberation on the enactment of the “People’s Republic of China Housing Law” has already begun in June 2000. By March 2001, the basic outline of the law was created and in April the bill was raised to the enactment stage.

The concepts (principles) of the enactment of the law comprise the following three points:

- Securing citizens’ residential rights
- Securing legal interests of both residential owners and users
- Securing normative activities in the housing market

Each of these points is a basic and fundamental aspect of China’s housing promotion policy in the future.

Also, the overall structure of the bill that is by and large already determined, is comprised of the following eleven items (as of March 2001, unreleased): general provisions, residential land, housing construction, housing supply, housing finance, rights and obligations of resident owners and users, utilization and maintenance of residents, property management, remodeling of old houses, legal responsibilities, and supplementary provisions. It is assumed that the course of action for creating a system that will give shape to the house-moving policy and its necessary functions can be reflected in the outline of the bill.

2.3.2. Political Housing and Financing for Housing Policy

(1) Concept of Housing Security

The government should achieve the settled political goal using the housing market to allow as many urban citizens as possible to buy quality housing. For those unable to purchase a house in the market by themselves, the political housing system should be enhanced and public housing offered.

In the major Western countries, the central government provides subsidies to reduce housing cost incurred by middle and low income tenants. In the United States, the subsidies to reduce the burden of low earners are specified in Section 8 (1974) and the Voucher System (1983). In the United Kingdom, the Housing Benefit (1972) system was introduced for low earners who cannot purchase a house. Germany introduced housing allowances (Wohngeld) in 1960, with several later revisions. Subsidies are also paid to certain qualifying house owners. In France, housing allowances (AL) were introduced soon after WWII in line with the living and welfare policy (1948). The new housing allowance system (APL) was introduced in 1977 to promote construction of houses and enhance the living standard.

The low-income people for whom it is difficult to buy a house should receive the benefits of an efficient and fair political housing service. From this viewpoint, the qualifying

applicants should be identified according to the regional conditions. It is also important to identify the applicable houses based on necessity and indispensability.

Housing security for the poverty layer is described as follows: When the houses in stock for the entire society are scarce, and the ratio of the absolutely low-income people is high, uniform and special relief measures as government initiatives, are effective. To whom it is still difficult to purchase a house even when tax concessions, interest subsidies, grants-in-aid, and other policies are granted, the government may offer low-rent houses, and exempt temporarily these people from the operation of the housing finance system. When the housing stock grows and the national income increases steadily, (to separate the public houses for the poverty layer from the overall housing market) treating them as a special case is a necessity that should lessen gradually.

To assist those wanting to purchase a house, the major Western governments use a variety of political housing finance-linked systems to complement the individuals' purchasing capability. The U.S. government uses preferential tax incentives and applies loan interest income deduction. This is just one of many ways to provide tax concessions. When a housing loan is obtained, the applicant can use the insurance and warranty system run by Federal Housing Administration (FHA) and Department of Veterans Affairs (VA). In addition, some government support organs including Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), sustain the housing loan handling financial organs through liquidation of claims. In the United Kingdom, a part of the interests is subsidized by the government through the mortgage interest relief at source (MIRAS) system when borrowing from a financial organ to purchase a house. Since April 1988, the interest relief rate was 10% of the interests paid. Germany operates the housing purchasing subsidy system (1996) and preferential housing purchasing savings system. The social housing system provides special low-interest bearing loans for the middle and low-income people. In France, the loan system where government is involved plays an important role in the housing sector. The government offers 0% loans in cooperation with financial organs. Up to 20% of the housing price is loaned with 0% interest. The financial organ will then receive subsidies equal to the interest due from the government. Financial organs with contract with the government also handle relatively low-interest bearing cooperating loan (PC). No subsidies are paid, but low-interest bearing deposits and savings are used to fund low-interest bearing loans according to the national guideline.

Loan qualification, loan limit, and repayment burden limit in the various systems are shown in the table below. Some systems emphasize the objective of the policy by detailing qualification of the applicants; some another attempt to control repayment risk by specifying the repayment burden ratio; and some others limit the loan amount relative to the annual income of

the applicant. Those systems that limit the qualification of the applicants may be said to be more public in nature.

Table 2-4 Limitation on Applicants' Qualification for Public Housing Loans in Foreign Countries

Country	Public system, etc.	Qualification	Loan limit and loan repayment burden limit
U.S.	Privately owned housing loan guideline for securities conversion		Repayment burden rate 28% ~ 30%
U.K.	Public house disposal loan	Dwell at least two years	Loan ceiling is 2.5 times the annual income
Germany	Public-assisted housing	Annual income limit by the number of people in a household	
France	0% loan	Annual income limit by the number of people in a household	
	Social housing purchasing loan	Annual income limit by the number of people in a household	
	Privately owned housing purchasing assist loan	Annual income limit by the number of people in a household	
Japan	The Government Housing Loan Corporation		Repayment burden rate is 20% or less

Source: Prepared by JICA Study Team based on the materials from The Government Housing Loan Corporation

In the system operated by The Government Housing Loan Corporation, Japan, floor area and construction cost are specified to articulate the purpose of the system to improve the living environment of average households.

Table 2-5 Important Loan Conditions in Foreign Countries

Country	Systems, etc.		Loan conditions, etc.
Japan	The Government Housing Loan Corporation	Floor area	80 to 280 square meters, both inclusive
		Construction cost	Upper limit for construction cost is set
Germany	Public-assisted housing		Upper and lower limit for housing area are set
France	0% loan		Upper limit for construction unit cost is set
	Social housing purchasing loan		Upper limit for construction unit cost is set
	Privately owned housing purchasing assist loan		Upper limit for construction cost is set. Upper and lower limit for housing area by the number of people in a household are set

Source: Prepared by JICA Study Team based on various materials

The above measures translates to significant costs for each government. Some governments are considering reducing the national financial burden through a review of the system.

To develop a fair housing market, the government should guide the housing market to secure housing for the poverty layer. The government should not simply save the low earners. It should assist them in their own efforts, and on a long-term basis by establishing sound political programs. If left only in the hand of the private financial organs, the burden would be unsustainable for the middle and low earners, especially for the latter. Political housing measures including housing security should be pursued using the political housing finance at the possible extent.

(2) Political Housing and Financing for Housing Policy

The Chinese government currently operates two main political housing security systems: Inexpensive Rent House and Economical Housing system.

1) Inexpensive Rent House System

The inexpensive rent house system applies to those who are in absolute need of a house. It meets the minimum housing demand of urban citizens. The people who qualify have a small share in the total population in all cities and are decreasing rapidly. The government do not necessarily have to build new inexpensive rent houses under the system, but checks the existing stock for availability of such houses. This shows that the use the housing market mechanism is already at work.

2) Economical Housing System

The economical housing system provides political houses for middle and low earners in cities. The two major objectives are to develop an environment where the middle and low earners find it easy to own a house, and to promote the demand for privately owned houses in the entire society by enhancing the capability of the middle and low earners to buy a house. The government will guide on quality enhancement as a condition for offering incentives to the economical housing building. This assists in the development of a quality housing stock. Ministry of Construction of People's Republic of China, being the supervising department, has declared the following promotion policy regarding the economical housing system:

- a. The objective is to foster the existing housing market and stimulate housing consumption.
- b. The price is set at the level of the middle and low-income houses.

- c. The system implementation procedures will concretely specify the income level of the middle and low-income houses, condition of purchasing, purchasing process, and price standard.
- d. Control the total volume and set up a long-term funding plan.
- e. Quality improvement.

The economical housing system is a welcomed political instrument in light of the condition of China. However, as the implementation of the system in the three model cities was checked, many people who could actually choose a better house purchased the economical housing. It is difficult to actually determine how the system works, and how to determine the income level of the purchaser, and later set appropriate restrictions. Moreover the conditions differ for each city to some extent. As a result, the economical housing system does not assist completely the middle and low-income people to buy a house at the policy implementation stage.

It is necessary in the future to clearly identify to what extent the housing system should be politically positioned, and to what extent should promote the development of a quality housing stock, and/or offer public houses to the poor, low income earners.

3) Private and Public Finance

A housing loan support system covering commercial houses should be developed. Table 2-6 shows the housing finance systems in China and foreign countries. According to the table, the housing loan system in China is limited to the Housing Provident Fund for reduction loans and joint loans by commercial banks. It is necessary to enrich housing finance in China by introducing direct loans offered by public housing finance organs, credit complement, liquidation of claims and other support. The introduction of specialized housing finance organs should be promoted once examined their potential contribution.

Table 2-6 Housing Finance Systems in China and Major Western Countries

Country	Private finance organ		Public finance organ		
	Housing-exclusive	Others	Direct loan	Credit complement	Claims liquidation
U.S.	Savings and loan associations Savings banks	Commercial banks	Local public bodies	Federal Housing Administration Department of Veterans Affairs	Federal Housing Administration Federal National Mortgage Association Federal Home Loan Mortgage Corporation
U.K.	Housing finance associations	Commercial banks	Local public bodies	-	-
Germany	Construction savings banks	Savings banks Mortgage banks	Savings banks Mortgage banks Construction savings banks Local public bodies	State governments	-
France	-	Banks Ordinary savings banks	National savings banks	-	Credit Common Fund
Japan	Specialized housing finance organs	Banks Credit associations Credit unions	The Government Housing Loan Corporation Housing and Urban Development Corporation Local municipalities	Housing Loan Guarantee Association	-
China	-	Commercial banks	-	-	-
Tasks	Strict loan application range and loan conditions	Public support for promotion of housing finance	Adequate financial burden	Adequate financial burden Enhancement of user consciousness of insurance and guarantee	Development of capital market and institutional investors

Sources: Prepared by JICA Study Team based on materials from The Government Housing Loan Corporation, Japan

2.3.3. Development of System Infrastructure to Promote Housing Policy

(1) Market-oriented System Infrastructure

The housing policy and the relevant legislation should focus on demand side measures rather than the supply side. Housing development initiated by the private sector should be given preference over the construction of houses distributed by the public bodies. Excluding the allocation of political resources to the development of physical infrastructures would be difficult to undertake. The development of a system infrastructure should be promoted to allow individuals and businesses to act effectively in the market.

The market function (supply of political and privately owned housing, distribution of housing stock, etc.) should be fully utilized if the government wants to offer efficiently adequate housing service and satisfy the diverse needs of the urban inhabitants.

In particular the government should promote supply of quality housing so that the consumers at various levels can purchase the house desired from the housing market. It should promote the moving to a new house establishing a housing performance assessment, display system, and other housing distribution infrastructure. Besides, it should create or improve the current mortgage, guarantee and insurance system to support the consumers in a stronger way.

(2) Development of System Infrastructure to Support Housing Distribution Market

The availability of houses, assessed and selected by consumers, is essential if the government wants to foster new activities in the housing market and utilizes quality housing stock. Therefore the development of the relevant infrastructure becomes imperative.

A housing quality control system, a performance guarantee system in housing trading and asset evaluation standards for existing housing stock should be developed at the initial stage. A scheme should also be developed to reflect the above systems and standards in housing distribution.

The initial performance at the time of construction and the maintenance as well as the overall results of functional restoration should be reflected in the housing asset and price assessment. An environment should be created where house-seeking consumers, housing developers and brokers can obtain the necessary information on housing. Based on the collected information they can select and judge a house. If the housing purchasing activities are carried in a transparent and informed way the risks of housing finance are reduces.

In Japan, Housing Quality Assurance Law was enacted in the spring of 2000. The housing performance evaluation, display, and guarantee systems have been established according to the Law. The major structural resistance components of a house (foundation, columns, roof, etc.) and the facilities to prevent the entrance of rainwater should be guaranteed for at least 10 years as stated in the Law. The housing performance display system was elaborated on the base of the Law to specify the requirements for assure durability, fire and

thermal resistance, prevention of formaldehyde, etc. The Law will definitively contribute to improve the housing quality, and promote a sound development of the housing distribution market.

Having described the current condition of China and the various measures taken in Japan, the consumer protection measures will be addressed to provide information on how to buy the desired house in the housing market:

- 1) Public institutions should actively provide housing information for consumers.
- 2) Housing performance evaluation system covering both new and existing houses should be established and promulgated. Important enough, the relation between housing performance and price should be shown in such a way that the consumers could easily understand and compare.
- 3) Execute consumer protection measures by developing a housing performance guarantee system.
- 4) Develop a system to interlock housing finance with secured loan and mortgage using the housing performance evaluation and guarantee system.

(3) Quality Control and Guidance of Housing Stock

Housing quality control should be a priority in the formulation of housing policy to develop a quality housing stock, and support the guarantee and insurance system essential in a sound housing finance system.

In China to secure and insure the house some of the information required concern the individuals' income, owned capital ratio, and housing type. The housing type refers to privately owned housing, political housing (already purchased non-living buildings turned housing, welfare housing, government subsidized housing, and economical housing) and general commercial housing. Regulations for assessing the quality of a house are not provided, therefore it is impossible to develop a quality housing stock in cooperation with the development of housing finance. A housing quality control system should be developed to support the guarantee and insurance system for housing loans.

1) Housing Quality Standard to Facilitate Political Loans

The "housing as a part of welfare policy" is shifting to "housing as a personal asset policy" in the Chinese cities. Hence housing stock is an asset to be developed and built as highly durable houses. The government should indicate technical standards for quality control and not leave it in the hands of the housing market.

China has already established the technical standard in Construction Law of People's Republic of China (November 1997). Housing Design Code (March 1999) is also in place as national standard. The Construction Law refers to all buildings and structures including housing. Housing Design Code defines the minimum standard for housing

for the purpose of “ensuring basic living conditions for urban inhabitants, improving the function of urban housing, and making housing design applicable, safe, hygienic, and economic.”

A technical standard policy to complement the development of a quality housing stock should accompany the minimum standard requirements. This is necessary for an effective operation of the housing loan policy, its guarantee and insurance system, and the housing quality control. The organ of government that organizes the housing finance should conduct consistent housing quality control promoting loans based on the technical standards policy. For an effective combination of housing quality control and housing finance, various housing technical standards may be classified into several groups as shown in Table 2-7.

Table 2-7 Incentives by Quality Level

Quality control level	Loans from general finance organs	Loans from political finance organs	
		General loans (preferential interest)	Political loans (extra-preferential interest)
Minimum standard like Housing Design Code	Applies	Does not apply	Does not apply
Basic standard set by political finance organ	Applies	Applies	Does not apply
Political loan standard set by political finance organ	Applies	Applies	Applies

Source: JICA Study Team

The housing technical standards as required for the loan policy elaborated by the financial organ refer to the highest-grade housing, or the housing that the government wishes to provide in the policy. Political incentives should be included in the loan as well as guarantee and insurance conditions for this group of housing.

All these schemes will offer a preferential loan, and conditions to facilitate the purchase of a politically promoted durable quality housing, housing for the aged, energy-saving housing, disaster-preventive housing, and other specified housing. Besides, the schemes will contribute with the guarantee and insurance systems to the improvement of the general housing quality for the entire society.

Regarding Japan, the housing performance rating system based on the “law concerning the promotion, etc. of securing housing quality (quality securing law)” rates items specified for performance rating by grades and numbers. Among the items for rating, there are those that overlap with regulations of the Building Standards Act that establishes the minimum

standard for construction, and those laid down independently. Houses that meet the requirements of the Building Standards Act but that do not greatly go beyond that in performance are rated “grade 1”, the lowest grade.

Specifically, taking the sub item “prevention of building collapse” from earthquake resistance items as an example, the rating system is much like the following table.

Table 2-8 Sample of performance grade setting according to the Japanese housing performance rating system

Performance items (example)	Grade	Description (in relation to minimum standard)
Earthquake resistance (prevention of building collapse)	3	Building will not collapse from an earthquake that is 1.5 times stronger than an earthquake that has the power to occur at a frequency of once in a hundred years (Building Standards Act)
	2	Building will not collapse from an earthquake that is 1.25 times stronger than an earthquake that has the power to occur at a frequency of once in a hundred years (Building Standards Act)
	1	Building will not collapse from an earthquake that has the power to occur at a frequency of once in a hundred years (Building Standards Act)

Note: Smaller numbers correspond to lower performance ratings

Source: Prepared by JICA from *Guide to Housing Performance Rating System*, compiled under the supervision of Housing Production Division, Housing Bureau, Ministry of Land, Infrastructure and Transport.

2) Guidance on Rent House Quality Standard

The above mentioned concept is not limited to commercial houses but it also applies to rent houses. In this case, preferential interest for loans is not the sole option. For example, a variable rent system may be introduced where for a certain time period the rent is incremented to reduce initial burden for the tenant, and the interest on the balance between initial and normal rent times years of renting is subsidized. It is also possible to deduct a part of rents paid from the income in tax computation.

(4) Quality Control and Guidance for Maintenance of Housing Stock

Recent trends show a gradual movement toward quantitative sufficiency of housing. Future issues of housing policies, therefore, are in raising the quality of used houses, and reviving the used housing market all the while keeping it aboveboard.

In the draft of the “People’s Republic of China Housing Law” currently under enactment, a special focus is placed on the remodeling and management of used houses as a way of revitalizing the maintenance and updating of existing stock. The outline of the bill includes the three items of “utilization and maintenance of housing”, “property management”,

and “remodeling of used houses”. In the future, it will be of utmost importance to revive the used housing market, and plan legislations, and prepare laws and regulations in total for maintaining and managing used stocks.

Quality management and improvement of used housing will particularly be an important part of housing stock formation. Creating measures for obtaining quality used houses that makes good use of housing financing, and measures that deal with remodeling of existing stock is thought to be the starting point of the above policies.

1) Measures to Support Purchase of High-grade Housing

When an existing house is purchased in good conditions, and a certain level of quality should be maintained, certain incentives should be given in the form of increased loan amount, extended repayment period, and preferential interest. Through these measures, the trading of high-grade existing housing should be promoted to allow a smooth circulation of this housing in the market. Note that these measures assume an already settled housing asset evaluation system. Table 2-9 shows the outline of a possible existing housing quality evaluation system.

Table 2-9 Incentives for Maintaining and Improving Quality of Existing Housing

Quality standard for existing housing (assessment standard)	Interest incentive (low-interest loan)	Other incentives	
		Increased loan amount	Extended loan period
General existing housing (fall short of the high-grade existing house common standard)	Does not apply	Does not apply	Does not apply
Class C high-grade existing house (high-grade existing house common standard)	Does not apply	Does not apply	Applies
Class B high-grade existing house (high-grade existing house common standard + maintenance and control evaluation standard)	Does not apply	Applies	Applies
Class A high-grade existing house (high-grade existing house common standard + maintenance and control evaluation standard + structural and functional durability standard)	Applies	Applies	Applies

Source: Prepared by JICA Study Team based on materials from The Government Housing Loan Corporation, Japan

2) Measures to Support the Reforming of Existing Housing Stock

To improve and maintain the quality of housing stock, loans and other supportive means should be provided for house restoration. For intensive and large-scale repair of apartments, in particular, not only loans but also subsidies should be given to ensure that the repair is done within the scheduled time. Individuals (house owners) and housing service providers (specialized reform businesses) should qualify for these loans and subsidies.

Government guidance when housing finance loan incentives are given is particularly important when political reforms take place, such as quakeproof, barrier-free, historical preservation, and two-generation living reform.

(5) Housing Asset Evaluation

The housing asset evaluation system should be in place as the basic infrastructure before developing the above housing guarantee system, and attempting to increase liquidity of housing stock (circulation of existing housing).

In general housing is classified into new and existing houses. Assessment itself is not the purpose for both categories. The result of assessment is used to build up personal assets, ensure the right of ownership, and activate fair trade, sale and transfer.

1) Asset Evaluation of New Housing

The base of asset evaluation of new housing may be the housing performance display system combined with the housing quality control system as discussed above. The housing performance display system may not necessarily be mandatory. The parties actually participating to the housing transaction (purchaser and seller, builder and marketer, etc. of housing) may have the option to choose. If the government wishes to enhance the value of housing assets, it may make the housing performance display system mandatory for properties to which the incentive loan policy has been applied, to promote their classification as quality durable housing.

At any rate, the government should indicate common rules (such as housing performance display standard and housing evaluation method and standard) as the base for an evaluation of the asset. Specialized organs to conduct asset evaluation should also be established. The government should designate or accredit an organ that conducts objective evaluation and develops evaluation specialists. An independent asset certification system is also necessary to ensure fairness and effectiveness of evaluation results.

2) Asset Evaluation of Existing Housing

Many existing houses were constructed before the enactment of Construction Law and Housing Design Code. Many of them do not satisfy the minimum technical standard

for housing, and they should be grouped for separate treatment into those that may be circulated in the market without problem, and those that should be replaced intentionally. The above housing performance assessment system may be used in evaluating existing housing assets in place of the housing performance display system for new housing. The obligatory housing performance assessment system can be an important asset evaluation standard in the trade of existing housing. In similar way as for the new housing, the government should develop the housing performance assessment standard, the existing housing evaluation method and standard, and establish a specialized asset evaluation organ to issue the relevant asset evaluation certificates to the existing housing trading parties.

2.3.4. Developing Housing Plans, Building and Utilizing Statistical Infrastructure

(1) Developing Accurate Housing Plans (Housing Fund Plans)

The current middle and long-term housing plans, the housing 5-year plans in individual cities (five planning years) and the housing development plan in the overall city plan (five and 20 planning years) in particular, should have their basic concept changed and the contents enriched. Without this, it is impossible to foster a housing policy led by the market using housing finance for a middle or a long-term period.

In addition, in order to adapt to market-oriented economy, and economic reforms which will be enhanced by China's membership in WTO, and various social changes, such as increasing number of elders and urbanization, will be necessary to accurately forecast people's needs toward housing, demand for housing, and demand for housing fund. Processes that adapt these demands to the national housing plans promptly and flexibly should also be established.

Following matters should be considered immediately.

1) Developing and Utilizing Methods to Forecast Demand for Housing

To consider ways to develop and promote a new forecast method to replace the regression analysis method, which has been used mainly in China to forecast demand for housing, due to its economic structure in the past. Potential changes in the environment and people's needs should also be studied.

2) Promoting Demand for Housing Fund

To examine ways to develop and refine a forecast method of housing demand, in order to utilize the result of housing demand forecast in housing finance plans and fund supply plans. Specific actions will include identifying necessary data (statistics) to accurately forecast demand for housing fund, meaning of data, and processing and expanding data. It will also be necessary to combine these functions as a package tool for forecasting housing fund demand.

3) Information Network to Help Develop Housing Plans

To investigate a model for information system to support policy development process, equipped with high capacity and human interface. The system will support smooth and prompt data transfer, discussion and decision-making.

4) Retaining and Educating Housing Professionals

To cultivate professionals with extensive knowledge and expertise in various fields, such as statistics, demand forecast, by developing training programs and institutions. Retaining and educating professional in these fields will be critical for developing housing plans based on demand forecast.

(2) Establishing and Utilizing Housing-Related Statistical System

Statistical system to support accurate forecast of the future housing market should be established immediately. This will be necessary as an infrastructure to help structure and refine housing plans and housing fund plans discussed above. Also, it will be important to design a statistical system in order to understand people's needs toward housing, and consequences of establishing housing. In addition, various ways to utilize statistics to promptly reflect these matters in housing plans and housing fund plans should be formulated.

Following matters need to be examined immediately.

1) Key Housing Statistics to Be Developed

To identify types of key statistics that are currently missing, such as information related to housing stock, data used to analyze construction divisions/inter-industry relations table. To examine technical issues (including processing existing statistics), standards for formulating housing statistics, and organization structure for collecting statistics.

2) Strategies to Build Statistical Infrastructure from Viewpoints of Utilizing Housing Statistics

To investigate how to refine statistics in the future, by considering various ways to measure demand for housing and housing fund. This will be necessary since housing statistics infrastructure will be more sophisticated if it is used more effectively.

3) On-line Statistical Collection System between Central and Rural Areas

To study: a) information system to support statistical generation jobs, such as creating, collecting and examining (auditing) statistics, that will be exchanged between central and rural areas, and between related government departments; b) how to format statistics in magnetic medium for provision of statistics, c) how to implement computer equipments to administer statistical research; and d) how to develop software for more efficient administration work.

4) Training Policy for Statistical Professionals

To consider training systems to retain individuals with certain degree of statistical knowledge, and to maximize existing employees' abilities, in order to carry out effective and efficient statistical studies.

Data 1. Housing Construction Planning Law and Housing 5-year Plans in Japan

Data 1.1. Housing Construction Planning Law and Housing Construction 5-year Plans

Housing policy in Japan after WWII was meant to solve the problem of housing shortage. The Government Housing Loan Corporation Law, Public Housing Law, and Japan Housing Corporation Law were enacted in 1950 through 1955 to establish a public housing supply system. In 1966, the central government, in addition to the supply of public housing, started to guide housing development throughout Japan, and enacted the Housing Construction Planning Law to facilitate integrated housing construction planning involving housing construction in the private sector.

The central government has tackled the housing shortage problem quite successfully and improved the living standard. To avoid potential change of housing policy due to government changes and the adverse effects of multiple vertical divisions in the responsibility for housing policy, the government established a comprehensive middle and long-term housing construction plan and defined the role of public and private sector at the national level. The government also decided to effectively invest the limited public sector financial resources and treasury loans and investments (funds at Trust Fund Bureau to collectively manage and operate people's postal savings and pension funds). The government further decided to implement the housing construction plan (quantity of houses to be supplied and improvement of living standard for housing) to adequately supply public funds built housing according to the people's income.

The Housing Construction Planning Law provided an essential framework for the government, the local public bodies, and the people to cooperate on a long-term basis in the promotion of the housing building according to the legal housing construction 5-year plans

Data 1.2. Framework of Housing Construction Plans

In the housing construction 5-years plan, the government determines the construction target for all types of housing, including housing built by the private sector; it guides the housing market and declares the quantity of housing awarded of public funds based on the Housing Construction Planning Law.

Since the first term plan, the following administrative targets were presented. The government and local public bodies should (1) build housing for the low earners and middle-income class urban workers or provide financial aid if they want to go through the market. (2) supply land for housing, provide financial aids, apply preferential tax system, and provide technical assistance to those who construct housing by one's own efforts in the private

sector, and promote these measures to the possible extent, and (3) in the third term period should improve the living system and rent systems so that housing is accurately supplied to those in need of aid, and optimize the relevant control and distribution.

The following points are important to understand the framework of the housing construction 5-year plans:

(1) Target of Plan and Public Funds Housing Quantity

The quantity of housing construction granted by public funds is determined when the housing construction target is set in a housing construction 5-year plan, (mostly the number of houses to be constructed; the amount of funds required is mentioned for reference only). The housing construction standards (living and environment conditions) are established to achieve the target. Housing is built and guidance is given on the base of the established standards. Besides the government has to implement measures directed to the achievement of the 5-year plan and the building of the housing based on public funds.

(2) Local and Prefecture Housing Construction 5-year Plan

Once the national housing construction 5-year plan (Ministry of Land, Infrastructure and Transport, formerly Ministry of Construction) is defined, the local 5-year plans are developed, and the concerned prefectures notified. The prefectures enter in consultation with the municipalities and elaborate a prefecture housing construction 5-year plan based on the national 5-year plan. At this stage, the Government Housing Loan Corporation, representing the political finance organ, exchanges opinion with local public bodies concerning the local housing plans.

(3) Consultation and Cooperation with Related Administrative Organs

To establish the housing construction 5-year plan, the government has to have a prior consultation with the concerned administrative organs to revise the laws for the realization of the plan, secure financial funds, procure loan funds, renew technical standard, and execute the construction plan smoothly. At this stage, the Government Housing Loan Corporation will exchange opinion with the section responsible for housing at the supervising government agencies to adjust the feasibility of the business and finance plans. The administrative organs and other organizations should cooperate in developing public facilities and utilities to ease the implementation process of the plan.

Data 1.3. Role Played by Housing Construction 5-year Plans

The Housing Construction 5-year Plans have already been performed for eight consecutive terms since the first term plan (1996 through 1970). The eighth term plan (2001 through 2005) is now in place. In a broad sense, the first and the second term emphasized the quantity of houses to be supplied while the third and following terms have been directed to the improvement of housing quality. From a long-term perspective, the government has performed very successfully for its large contribution in the Japanese housing development.

Data 1.4. Finance and Monetary Scheme for Implementing Housing Plans

To implement effectively the contents of the government plan in line with the housing guidance, the development of financial and monetary infrastructure of support should be fostered in terms of size and scheme.

(1) Financial and Monetary Scheme for Implementing Policies

In Japan people use to save mainly through the postal savings system and other public monetary schemes. Hence the funds are directly deposited to the Trust Fund Bureau, former Ministry of Finance. Trust Fund Bureau uses the funds to finance political special corporations such as the Government Housing Loan Corporation. This scheme is called the treasury loans and investments scheme.

The government is in charge of controlling the financial activities to fully implement the directives. Therefore, the government establishes the revenue and expenditure plan for each fiscal year envisaging various plans and policies (e.g. housing construction 5-year plans), and presents it to the Diet for deliberation and decision. The budget includes (1) general account budget for basic expenses to implement essential state measures such as social security, education, housing, and public works, (2) special accounting budget for diverse special individual businesses such as Printing Bureau, national schools, and Trust Fund Bureau, and (3) government body budget for operation of quasi-state bodies such as the Government Housing Loan Corporation and other loan corporations and political and other banks. Note that interest subsidies are state's financial burden that is counted in the general accounting budget.

Government bodies are special corporations with investments from the government. The budget is presented to the Diet for decision. Special corporations are founded on special laws. The Government Housing Loan Corporation, for example, is a special corporation founded on the base of the Government Housing Loan Corporation Law.

(2) Political Organs for Implementing Policies

The supply of housing purchasing funds should be stable, free from the effect of economic trends, etc., in accordance with the needs of the household. The loan repayment should be within the ability of the user's family budget. Preferably, the repayment plan should be easily written and the economic burden stable. To meet these needs, the Government Housing Loan Corporation writes loans on a long-term and with low-interest using the treasury loans and investments funds. Hence even the lower annual income households can afford to purchase a house and the number of buyers is greatly increased.

The Government Housing Loan Corporation has lent money to approximately 15 million houses since its foundation. This accounts for approximately 25% of all houses constructed in postwar Japan. The Government Housing Loan Corporation plays a very important role also in the political guidance of housing.

Data 1.5. Helpful features for China

Helpful features from the Japanese Housing Construction 5-year Plan are described below to be used as a reference in the elaboration of future housing plans in China.

(1) Sustainable Planning Backed by Legislation

The housing plans are based on a special permanent law that specifies the mandatory elaboration of plans for the execution of housing projects. Therefore plans become sustainable projects. Sustainable projects are essential for stabilizing the people's living standard at an appropriate level and continuously improved in line with the development of the social economy.

(2) An Integrated Housing Plan

The Housing Construction 5-year Plan encompasses the building of houses by the public and the private sector. As far as the public houses are concerned, it specifies the quantity of various types to be under the control of central housing responsible organ (formerly Ministry of Construction, now Ministry of Land, Infrastructure and Transport). It sets the quantity of houses to be built by the state, state organs, local public bodies, and the quantity of houses financed by the public funds of the state or the local public bodies. Through these political measures, the government is actively and effectively involved in the housing market. The Housing Construction 5-year Plan is a comprehensive housing plan that implements political guidance and involvement.

(3) Clarification of Minimum Living Standard

The minimum living standard for urban housing specifies the structure and size of a living room, etc. (appropriate size and structure of a living room, necessity of adequate accessory spaces), its expected performance and facilities (safety, durability, features required in the aged society).

The minimum living standard is used as a guideline in selecting the houses to which grant funds and in determining the subsidies for the various types. It is also used for determining the level of political housing.

(4) Setting of a Living Standard Guide

The living standard guide is directed to the improvement of the quality of the housing stock on a long-term viewpoint. The evaluation is based on the minimum living standard plus the addition of environmental and energy consideration.

The living standard guide is used to select the houses that qualify for incentives as stated in the various housing policies and it sets good housing standards.

The living standard guidance provides general and urban standards. The general living standard guide applies to detached houses constructed in the suburbs of a big city and in the rural areas while the urban living standard guide refers to condominiums at the center of a big city and its surroundings. The condominiums in Japan apparently share many common features with apartments and other typical houses in China.

Table 2-10 Living Standard in 7th Housing Construction 5-year Plan of Japan

Persons in a household	Minimum living standard		General guidance living standard		Urban guidance living standard	
	Living room area (m ²)	Housing-exclusive area (m ²)	Living room area (m ²)	Housing-exclusive area (m ²)	Living room area (m ²)	Housing-exclusive area (m ²)
One	7.5	18	27.5	50	20.0	37
One (including aged singles)	15.0	25	30.5	55	23.0	43
Two	17.5	29	43.0	72	33.0	55
Three	25.0	39	58.5	98	46.0	75
Four	32.5	50	77.0	123	59.0	91
Five	37.5	56	89.5	141	69.0	104
Five (including aged singles)	-	-	99.5	158	79.0	122
Six	45.0	66	92.5	147	74.5	112
Six (including aged singles)	-	-	102.5	164	84.5	129

Source: Prepared by JICA Study Team based on the 7th Housing Construction 5-year Plan

(5) Estimation of Total Number of Houses Constructed and Enrichment of Housing Statistics

Based on the study of the present and past housing circumstances, the prediction of the future housing demand should also refer to the transitional phase the Chinese housing market is going through.

All available housing statistics should be used to estimate the number of houses constructed. However, the currently available housing statistics present limits due some lack of accuracy in the number of subjects surveyed and survey items. It cannot be neglected that a survey of demand for housing generates important statistics in the study of demand for housing.

In conclusion, the number of total houses built and the housing statistics are closely related one each other.

(6) Number of Houses Built with Public Funds

The houses built with public funds include three major political housing types. The first are the houses for rent for low earners, the second are houses funded by loan corporation

for middle and low earners, while the third houses for rent built from the Japan Housing Corporation for workers in the big cities.

The government offers housing to the people who are in need of public assistance. It directly supplies houses built with public funds or indirectly through housing loans according to possibility of burden bearing.

It is mandatory by law that the government and local public bodies envision on a long-term basis the number of houses that need assistance as estimated from the housing demand and the burden bearing ability of the mover to a new house. As a consequence it can promote effective housing measures for each fiscal year budget.

The need of political assistance is determined during the process of estimation. Generally, a computer program is used to calculate the number of houses qualifying for the application of measures and the rate of aid to deliver to the households.

DATA 2. Public Role in Housing Finance Systems in Major Western Countries

Data 2.1. Features of Housing Finance System

The housing finance is basically provided as industrial funds. It is a financial system by which financial organs gather money to be used in various ways and lent at interest.

Housing finance organs gather money from housing-related savings and debentures including general savings and deposits that move in quest of interests, or circulate loan funds by turning real estate credits into bonds. The loans are naturally limited to individuals who construct, purchase, or improve housing and housing supplying businesses. Basically housing finance has the features and limits of a finance system that offers long-term loans to non-productive properties.

Data 2.2. Complementary Relationship between Private Sector Housing Finance and Public Housing Finance Supporting Housing Policy

Japan and major Western countries are contriving their respective devices to tie the finance market with housing finance. In all these countries, the role is shared between public and private sectors. The funds are insured and then distributed using different systems, such as the savings, deposits systems and organizations, and housing finance systems. The government complements the workings of the public and private sector systems through financial and tax subsidy measures

The housing finance systems in the major Western countries are compared in the table below.

Table 2-11 Housing Finance Systems in Major Western Countries

		U.S.A.	U.K.	Germany	France	Japan	
Housing finance system	Direct or indirect	Direct and indirect	Direct	Direct	Direct and indirect	Direct	
	Separation between large and small loans	Separated	Separated	Separated			
	Public and private	Private	Private	Public and private	Public and private	Public and private	
Housing finance	Private-sector housing finance	Relation between deposits and loans					
		Short-term deposit + floating rate	Savings and loan associations	Construction associations	Savings banks		Banks
		Short-term deposit + fixed rate	Savings and loan associations			Banks	Banks
		Long-term funds + fixed rate			Mortgage banks		
	Contractual savings + fixed rate			Construction savings banks	Deposits loan system		
	Specialized housing finance organ	Savings and loan associations	Construction associations	Construction savings banks			
	Loan credits circulation market	Mortgage market and pool			Mortgage bill market		
	Interest control		Recommended interest		P.C	Administrative guidance	
	Public housing loan	Direct loans		Local public bodies	Social housing	PLA	Housing loan corporation
		Private-sector support	Credit complement	FHA. VA	Local public bodies		
Credits circulation			GNMA FLMA FHLMC			Real Estate Bank of France	
Tax system	Loan interest deduction	Available	Available	Available	Available	Available	
	Aids of housing finance organs	Available	Available				
Savings	Preferential housing savings		Home loans	Housing construction savings premium	Deposits loan system	Workers' property accumulation savings for housing	
	Preferential general savings				Available	Available	
Assistance for persons (those who dwell in their privately owned house)				Housing allowances	APL		

Sources: Prepared by JICA Study Team base on various materials

Data 2.3. Role of Public Sector in Major Western Countries' Housing Finance System

The main reasons why the public housing finance system is established and complements the private sector loan system are introduced below.

- 1) The purchase of a house greatly affects the living of individuals as a stabilizing factor and sign of improved welfare. The provision of the private sector housing loans, sensitive to the fluctuations of the economic environment and that can produce a reverse selection, should be accompanied with housing finance products available to most of the people at a low interest rate with few fluctuations over a long period of time. It is naturally necessary to secure low interest bearing, long-term and stable loan resources and supply funds on a stable base without being affected by the demand and supply of funds in the market.
- 2) Interest risk due to the gap of periods between funds raising and loan period is unavoidable because housing loans extend over a long time period. Risk of advance repayment by the borrower also exists depending on fluctuation of market interest rate.
- 3) Housing finance is applicable to both individuals and businesses. Loans to individuals are generally long-term contracts and the amount of individual loans is relatively small. Administrative cost of credit examination of borrowers, mortgage evaluation, and credits management are relatively high.
- 4) The long-term and sustainable housing policy focused on the improvement of living environment, the development of good housing stock, and the fostering of a sound housing market should be implemented through an effective administrative involvement and guidance of the housing market. The introduction and use of incentives play an important role in realizing an effective housing policy and the public housing finance system is the base of such incentives.
- 5) Methods vary with countries. Japan and all major Western countries use public involvement and guidance in the public housing finance system. The table below summarizes the public guidance in various countries.

Table 2-12 Public Involvement and Guidance in Housing Finance Systems in Major Western Countries

	Business type	Organization type	Resources	Public involvement in funds raising and credit guarantee	Mitigation of repayment burden
U. S. A.	Thrift institutions (savings and loan organs)	Private (joint organization)	Deposits and bond issuance	FHA insurance and VA guarantee Support of housing finance liquidity by Federal Home Loan Bank (FHLB)	Income deduction of loan interest
	Savings and loan associations				
Savings banks					
	Credit unions				
	Commercial banks	Private			
	Mortgage companies	Private	Mortgage collateral securities	FHA insurance and VA guarantee Investor guarantee for credits converted into securities by Ginnie Mae, Fannie Mae and Freddie Mac	
U. K.	Housing finance unions	Private (joint organization)	Contribution, deposits, bond issuance		Subsidies equivalent to 10% of housing loan interests (MIRAS)
	Commercial banks	Private	Deposits and bond issuance		
Germany	Savings banks	Mostly private	Deposits and bond issuance		Housing purchase subsidies equivalent to 5% of the price of house purchased for eight years.
	Construction savings banks	Public and private	Construction savings and deposits	Construction savings incentive money	
	Credit cooperative societies	Private (joint organization)	Deposits		
	Mortgage banks	Private	Bond issuance and deposits	Daily risk control by Finance Supervision Bureau	
	State central transfer banks	Owned by municipalities			
	Banks	Private	Deposits and bond issuance		
France	Savings banks	Public and private	Deposits and savings	Tax-free savings system	Non-interest bearing loans up to 20% of house price
	Banks	Private and state-operated	Deposits, savings and bond issuance	Housing savings incentive money	
	Real Estate Bank of France	State-owned	Bond issuance		
	Money deposit loan corporation	State-operated	Deposit of tax-free savings		

Sources: Prepared by JICA Study Team based on various material

II-3.

Public Housing Finance System Reform: Directions and Strategies

3. Public Housing Finance System Reform: Directions and Strategies.

3.1. Housing Provident Fund System and Its Challenges

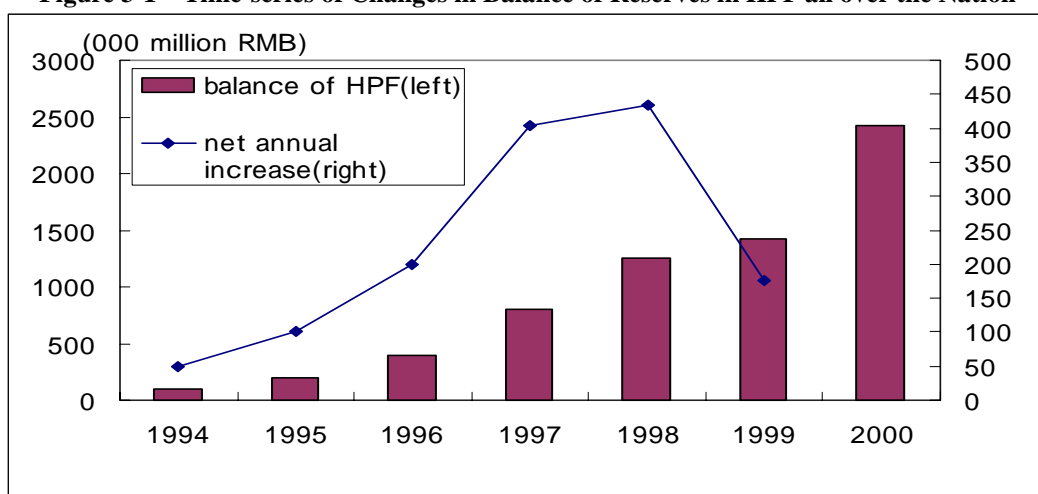
3.1.1. Weakening Growth of Housing Provident Fund Balance, Decreasing Ratio of HPF in Housing Loans

(1) Weakening Growth of Housing Provident Fund

As of the end of 1999, the participants in the Housing Provident Fund (hereafter HPF) reached 70 million people. The sum total of HPF reserve amounted to 241.9 billion RMB. Thus, the overall business size of HPF system has been showing a favorable growth.

Up to 1998, the HPF balance had been continuing to expand on a net value basis. Both 1997 and 1998 hit record high of net increase by 40.4 and 43.4 billion RMB, respectively. In 1999, however, the annual net growth showed a rapid decline to 17.8 billion RMB. With the “HPF Administration Regulations” enacted in April 1999, the HPF system was in the midst of expansion. Under such circumstances, the HPF net growth showed a significant decline presumably. As the notice on the critical state of “Urban Housing System Reform” was released in July 1998, the demand for housing fund increased because of the greater disposal of public housing, due to monetization and allocation of housing promoted in each city. This resulted in the increased liquidation of HPF and the greater demand for Provident Fund housing loans. If such a significant withdrawal of the Provident Fund should continue at the current pace, it is predicted that the sum total of HPF reserve will increase, while its net growth might slow down in some cities.

Figure 3-1 Time-series of Changes in Balance of Reserves in HPF all over the Nation



Source: *Zhongguo Fangdong Chanbao*, arranged in order, based on findings in hearing

(2) HPF housing loan: issues

Housing loans by HPF system consist a large portion of consignment loans by commercial banks. Due to the instructions by the People's Bank of China's and management policies of private financial institutions including four major commercial banks, the ratio of HPF loan has been declining, while private housing loans by commercial banks have rapidly increased.

10 years have passed since HPF system was first tested to Shanghai in 1991, following the examples in Singapore. Up to 1998, HPF housing loans obtained greater popularity compared to private housing loans in Shanghai, where HPF system had most widely diffused. However, by 1998, private housing loans became more common than HPF housing loan. The ratio of HPF loan to private housing loans became 1:3 in 2001.

One of the reasons why HPF housing loan has declined in Shanghai is the shortage of loan fund to execute HPF housing loans, which was caused by the greater demand for housing fund due to rapid economic growth. HPF housing loans have become less popular at the national level, not because of the lack of the fund, but because HPF loans for individual homebuyers have not functioned as expected, due to limitations in the program design.

Table 3-1 Balance of Private Housing Loans in the Four Major State-owned Commercial Banks as of the end of 1999

	BALANCE	RATIO
Bank Loan:	125.9 billion RMB	80%
<u>Entrusted Loan</u>	<u>32.4 billion RMB</u>	<u>20%</u>
Total	158.3 billion RMB	100%

Source: *Zhongguo Fangdi Chanbao*

3.1.2. Housing Loan: Issues in Lending

HPF's most significant role is to encourage workers in urban areas (who participate in HPF) to purchase housing and to upgrade their living standard. HPF Management Center is known for collecting reserves aggressively. However, the organization and its consigned commercial banks have been criticized for being passive about providing housing loans to individuals. As of the end of 2000, the reserve of individual housing loans amount only 57.7 billion RMB in the nationwide HPF balance of 241.9 billion, or about 24% of Provident Fund operation.

Such a shortage for loans offered has been brought about by the following factors:

(1) Insufficient demand for housing acquisition

More than half of the housing loans in commercial banks in China is from the cities located along the coast, which have experimented rapid economic growth, such as Shanghai City, Guangdong Province, Beijing City, Zhejiang Province, Jiangsu Province and Fujian Province. In the inland regions, effective demand for housing acquisition has remained low due to numerous factors, such as delayed economic growth, sluggish growth of individual workers' incomes and delayed urban housing system reform.

(2) Lack of incentives to boost effective demand for housing

Under the existing regulated interest rate by the People's Bank of China, interest rates under HPF loans (variable rate is 4.59% for a 30 year loan as of June 2001) have been set approximately 1% lower than rates of commercial bank loans. Loan limit, on the other hand, is subject to some restrictions, such as the maximum loanable amount determined by HPFMC, household income, reserve balance, number of years elapsed while saving reserves, number of services years prior to the retirement age, and upper limit of a loanable value and so on. In Shanghai, the maximum loanable amount of HPF loans is 100 thousand RMB. This is quite low compared to the actual housing prices. Each household is estimated to borrow 50 to 100 thousand RMB from HPF loans. One-percent difference in interest rate only means 40 to 80 RMB less in monthly interest payment. This will not help boost potential effective demand for housing by average urban workers. In addition, HPF loans currently offer variable rates only. This might also stop urban workers from using HPF loans, since fixed rate loans cannot address their needs to set the amount of monthly payment when interest rates are low (in order to minimize the risk of increased interest payment in times of high interest rate).

(3) Lack of lending function

Reportedly there are approximately more than 3000 HPFMCs all over the nation. Most of them, however, have a small-sized management mechanism only where a few people without expertise in finances are engaged in management. Since there is no ability to examine a loan, many HPFMCs do not render the loan services. In addition, they lack in ability to address a default risk or the like. The HPFMC in which a few hundred persons only can participate would have very participant significantly affected even if one loanee should default to repay. Consequently, a number of HPFMCs are not practically loaning.

(4) Limit of funds

A number of HPFMCs all over the nation are retaining Provident Fund deposited by individual participants in consigned commercial banks as reserve resources. Nevertheless, the

so-called “territorial principle” hinders HPFMCs from lending funds among one another. For example, a HPFMC will not finance another HPFMC in the higher ranked administration district or in an adjacent ward even if the latter should run short of the loan fund due to seasonal fund demands.

(5) Shortage of loan capital

The HPF loan capital is not so-called “total reserve balance” (the amount of gross total of money obtained by subtracting a breakdown amount from the reserves collected). The loan capital is the fund obtained by subtracting the balance of loans and other operations (except for operations with national bonds and ordinary bank deposits).

In other words, approximately 20% of the HPF reserve gross balance has been financed as housing loans. All of the rest 80% of the fund, however, is not the capital always available for loaning.

In case of operating the funds in surplus in bank deposits or while purchasing national bonds, in principle, are always available for the use as loan capital, however, if operated in the following categories, the funds could not turn loan capital immediately:

[Legal Operations]:

Investments and finances in constructing the policy-oriented housing, such as so-called economical and government-subsidized housing, however, involve a risk on business, such as development, sales, etc. Besides, no express means nor security would be available to hedge the risk. In other words, the funds could not have a recovery certainty guaranteed.

[Illegal Operations Scarcely So Recognized]

Some HPFMCs have established an affiliated legal person (economic entity), invested in an affiliated enterprise, and participated in the capital of an affiliated undertaking. Prior to the prohibition notice announced by the Ministry of Construction in January 2001, however, their illegality had been scarcely recognized. In said notice by the Ministry of Construction (according to *Zhongguo Fangdi Chanbao*) it was pointed out as follows:

“At present, some HPFMCs have had such issues that they have established an economic entity, in which they have invested or participated with capital. This has brought about a significant risk to the management of housing fund, thereby impairing the benefit of employees (HPF participants).

[(Illegal) Operations]

Some funds operate their capital following the instructions by local governments, which oversee HPFMCs. Other funds illegally operate on their own. The fund has been improperly applied in a wide diversity of non-legal forms, including an application as local financial resources, allowances of funds for state-owned enterprises, investments or speculations in land/real estate, investments in shares, etc.

Not so small an amount of the funds operated as referred to above, are considered to have a poor level of recovery certainties, or to have tuned bad debt. Therefore, this has brought out the phenomenon that there is a shortage for the capital available for loaning, although there is a large amount of balance of HPF on the book.

3.1.3. HPF's Financial Management: Issues

HPFMCs have been performing an important function of supplying participants with a stable fund for purchasing houses over a long period of time, so that the participant can form an asset. In this sense, the wholesomeness of financial affairs in the HPFMCs is more important than anything else, and to make financial aspects wholesome is indispensably necessary to prepare financial statements with accuracy and in accordance with established rules, and to disclose information timely. Also, HPFMCs must also have an inspection (supervising and auditing) function for such financial management, which inflicts government penalties as needed.

In April 1999, the Ministry of Finance established the "HPFMC Accounting Audit Act," under which HPFMCs are obliged to prepare and disclose their financial statements. The first year for which the new Act is to apply will be Year 2001. Next year, therefore, HPFMCs will have to disclose their financial statements for the first time. At present, however, there are different ideas from region to region about the disclosure of financial statements.

Regarding financial management of HPFMC, the following problems are involved:

(1) Independent Financial Management Unimplemented

Quite a few mid-to-small-sized HPFMCs do not manage their financial standings independently as defined by the law. In fact, some of these HPFMCs manage finances jointly with administration units, such as Ministry of Construction, Housing Committee of local governmental offices etc.

Consequently, actual conditions of the HPFMCs' business management alone are difficult to understand. Although various finance statements by HPFMCs for the year 2000 are yet to be released, if each HPFMC is financially managed independently, not a small number of

HPFMCs mainly medium/small-sized are doubtful in their business continuation with figures remaining on the red.

Factors Impeding Independent financial Management from being Implemented are as follows:

1) Ambiguous Relations between HPFMCs and Administration Units

HPFMCs should be an independent business regulated by the government. However, many HPFMCs are ran together with administrative organizations, because of how HPFMCs were initially established. Reportedly the personnel working in both sides are completely identical. The phenomenon “Personnel Identical under Two Signboards” has been seen frequently. Most of the HPFMCs have their operation cost shared with the administration.

2) Ambiguous Recognition about Nature of Housing Provident Funds (HPF).

HPFMCs should recognize that HPF are as one of the liabilities for them to owe to participants. To the contrary, however, HPFMCs are strongly conscious that the HPF is a type of the special funds “levied” under the law. In other words, they are unfamiliar with the idea of assets and liabilities on a balance sheet.

3) Relations between HPFMCs and HPF Participants also Ambiguous:

HPF Management Centers are sometimes called “Management Center,” has the basic function of managing the Housing Provident fund. This management, however, has not been necessarily defined expressly. What contractual relations (whether the HPFMC should manage money entrusted by mere proxy of participants or there are a certain type of obligation-claim relations between HPFMC and participant) should Housing Provident funds be managed, or based on? What responsibilities and duties should be undertaken by and between both parties? And these questions have not been always clearly answered yet.

4) HPFMCs are small-sized in general:

There is shortage of personnel with technical knowledge who can manage financial affairs due to the small management size. Key officers in HPFMCs, moreover, do not often have expertise about accounting.

(2) Financial Affairs Not Thoroughly Managed

Records on the funds’ incomings and outgoings have resorted to the data furnished by entrusted banks because there is no synthetic HPF data calculation management system in nationwide. Nevertheless, neither a strict balance sheet nor a profit and loss statement have been prepared by a HPFMC itself.

HPFMCs' major responsibility for participants is to offer a revolving housing loan. A HPFMC, however, is allowed to determine and change loan limit and other loan conditions if permission from the supervisory section is obtained. As a result, each HPFMC has been changing loan conditions flexibly. For example, loan limit is lowered when there is greater demand for loans, while it is increased when the demand is small. Under these circumstances, each participant is given different loan conditions, which has resulted in the lack of total balance as reductive loans. This is against HPFMC principles of providing equality and fairness to participants, as a public housing finance system.

On the assets side of HPFMCs' balance sheets, private housing loans and national bonds have been found to be in proper operation, as discussed previously. Among corporate development loans, however, some HPFMCs have not disposed properly on an account basis of those bad debts that are found to be unlikely to recover.

In many cases of a development loan implemented especially in relation to a government-associated project, such as "economical housing," "government-subsidized housing" or the like, such project may not have been revealed as bad debt frequently though it really aborted in the stages of land development, construction, sales or the like.

In an out-of-standard fund operation (so-called the "circulation outside the body of finance") the prime cost only has been summed up on the financial statements despite the fact bad debt took place in reality.

The correspondence cooperated with administrative organs is necessary. For example, to clearly distinguish bad loans by risks on financial statement, and to gradually redeem the irrecoverable credits other than strengthening early collection i.e., disposing uncompleted construction site or discounting houses remained unsold.

(3) Information Not Thoroughly Disclosed

Information cannot be thoroughly disclosed before the information to be disclosed has been thoroughly arranged in order. In addition, there is certainly an inducement for the desire to conceal the problems and postpone dealing with them rather than disclosing the fact.

Each HPFMC has been disclosing the amounts of reserves and housing loans every year, emphasizing their "achievements." On the other hand, in financial aspects, they have not disclosed those "financial statements," which faithfully represent the wholesomeness and efficiency of management on the market value principle.

HPFMCs must have to receive their management condition checked by those interested, or participants. Nevertheless, the "double barriers," i.e. non-disclosure of financial information in addition to the unbuild-up of financial statements, have been used to shut off the

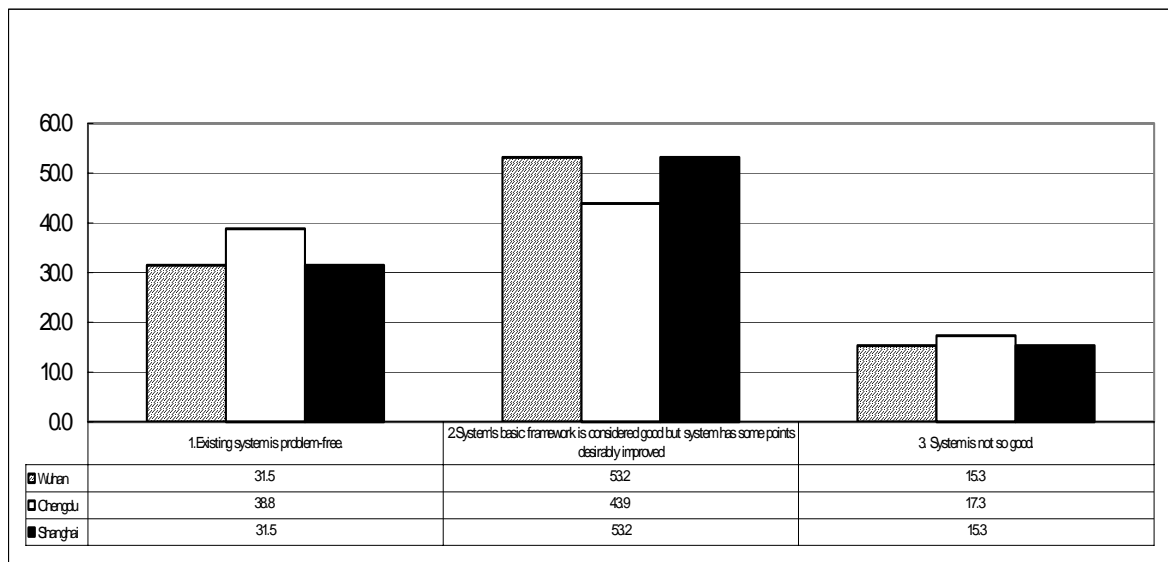
participants for a checkout. Even if the Housing Committee does exist, a soft “semi-in-house” checkout only may function.

The accounting rules for HPFMCs have been established by the Ministry of Finance. And these rules provide for a preparation and disclosure of financial statements. Nevertheless, partial HPFMCs seem not like to disclose the financial information, insisting that it is “commercial secrecy.”

3.1.4. Issues on HPF system based on the Result of Interviews

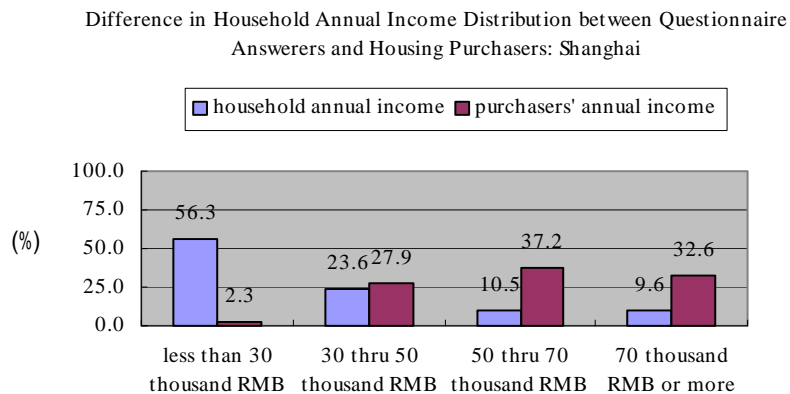
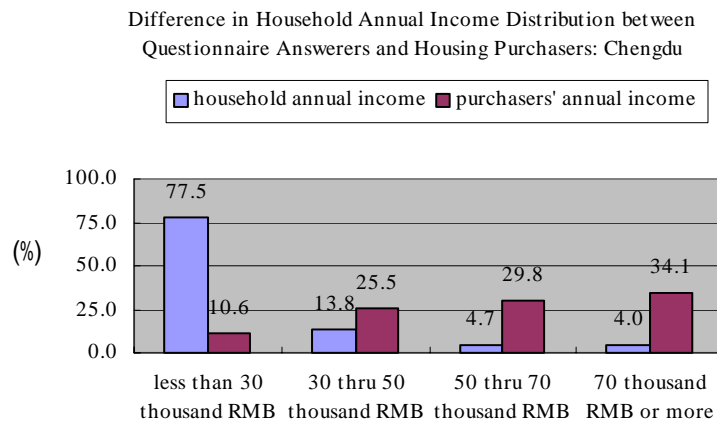
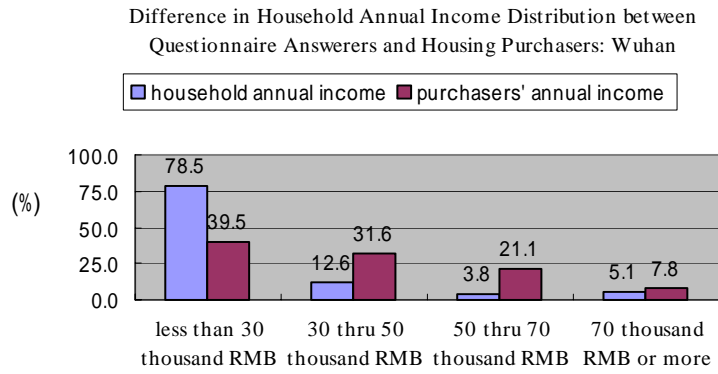
Three model cities, Shanghai, Wuhan and Chengdu, were surveyed by JICA through hearings from the agencies concerned. According to the findings in that survey, the HPF system, in the sense that it is intended to promote systematic savings and planned housing acquisition through a mandatory contribution made by urban workers and enterprises to which they belong, has mostly had high frame in each city. 80% of households state it as fair, basically fair. However, the households who have acquired housing as heard from developers and those consumer households who have answered the questionnaire. This has revealed the problem that the HPF system has not been functioning as originally designed.

Figure 3-2 Evaluation on HPF System



Source: JICA Study Team

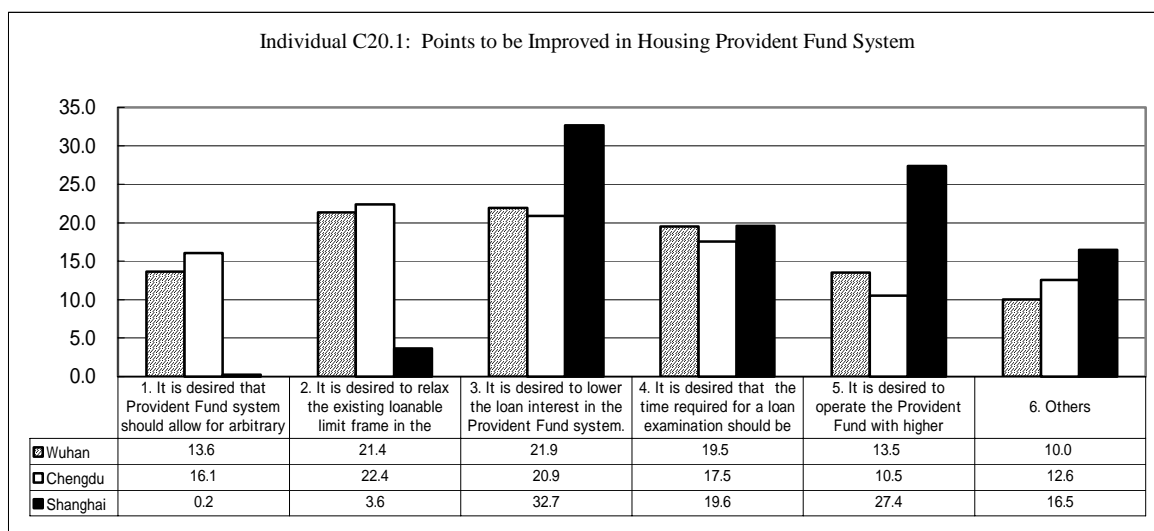
Figure 3-3 Difference in Annual Income Distribution between Households and Housing Purchasers' Annual Income Distribution



Source: JICA Study Team

As the results of hearings shows, the HPF housing system's principle is basically accepted, however, is also pointed their many unsolved issues by participants.

Figure 3-4 Points to be Improved in HPF System



Source: Questionnaire Survey, JICA Study Team

As the tenth five-year plan has been started since 2001, an effective impact is essential to the reform of housing finance systems, with the lead taken by the HPF system to actualize the eventual potential demand for housing in these areas. The demand should reflect the increase of household income and the progress of modernization, coupled with the economic growth as 7% annually.

3.2. The Necessity of Enhancement of Functions for Fund as Public Finance

3.2.1. Basic Roles That Housing Finance Policies Need To Play

As shown in the developed countries, the Government maps out a basic housing policy on a nationwide basis and intervenes housing policies by administrative and financial means because of the following:

(1) Form quality social capital and make effective use of existing housing stock.

In China, the high rate of economic growth has been accelerating urbanization and concentrating the population in cities. Besides, households here have been being divided while

improving the dwelling level. In the near future, China is expected to have a qualitative housing demand with energy-saving technologies coping with the advanced age society and environment conservation measures. From now on, it is also necessary to form a quality social capital.

Moreover, for developing the living level by filtering, it is necessary to promote preserving and maintaining those existing stock such as disposed public housings and to attempt for effective use of them.

(2) Raising Housing Acquisition Ability to Actualize Potential Demand for Housing:

Construction cost has been hiking. A right to use the land has become expensive. A local government may transfer an infrastructure buildup. And housing acquisition cost has been increasing according to a dwelling level. And there is a tendency to expand a significant difference in mean urban workers' wages and housing prices. In addition, a deficiency in the credit supplementing system on the private housing market might lead to an inclination to intensify the selection of a loan against some of the medium/small-income strata. To actualize an enormous demand for housing in urban areas, moreover, it is necessary to upgrade the housing acquisition ability through a policy-oriented intervention in the medium/low-income strata as a complement to a housing loan in the private sector.

(3) Raise stable funds at low cost and secure their supplies.

In every stage of the rapidly growing economy, the demand for industrial funds is increasing more and more while the supply of funds in the private sector is shifting toward the industrial funds. As repetitively experienced in developed countries, i.e., the U.S.A., the saving-oriented deposits in private banking institutions are tilting from housing finances to equipment investments. Housing loan is necessary to secure the policy-based stable funds at a low raising cost and to supply the stable funds not unsusceptible to a fluctuation of the economy.

(4) Invest in policy-based projects and guide investments to the objective of a policy.

An urban redevelopment project with a buildup of infrastructure is often a policy project closely related with a specific region. Such a project requires both construction work and technological development to take a long period of time. In addition, a huge amount of investment funds is required for the project. And it is often difficult for an undertaking in the private sector to carry out the project on a profit-making basis. A highly costly project involves difficulties to turn commercially feasible with the funds in the private sector only. Besides, it is necessary to guide such a project in line with the objective of the policy to improve

and diffuse the housing performance, i.e., barrier-free energy-saving houses, and cost-cut by innovate technologies with governmental finances.

(5) A housing policy should be an effective housing investment, including the measures for an upturn of the economy.

A housing investment has a large far-reaching effect on the entirety of economy since the housing-related industries have a very wide range of outskirts. With the economy in a phase of deceleration, a political expansion of the housing investment should serve as the prime water for housing investments in the private sector. Consequently, it will contribute effectively to encourage personal consumption and to economic growth.

(6) Offer fair housing-related information and consulting services.

The housing that is more expensive than another durable consumer goods cannot be acquired by an urban worker without the information required to map out an appropriate purchasing, fund-raising, and repayment plan by public sectors. This information should be furnished from a neutral point of view.

While furnishing the far and useful information relating to suppliers, building materials, housing quality and performance, construction unit prices and so on, the Government should receive consultation from consumers while striving to protect them.

(7) Build up a housing credit supplementing system.

A stock of quality housing should be formed while proceeding with the policy to promote private homeownership, with the housing acquisition ability in the urban medium-income stratum raised. Thus, the monetization and distribution of housing should be deepened all the more. In this sense, not only private housing finances but also governmental housing finances need be made to grow further. It is necessary to deploy a comprehensive housing credit-supplementing system at a nationwide level while interlocking with the HPF system as well.

3.2.2. The Necessity of Enhancement of Functions for HPF System as Public Housing Finance:

The HPF system is aimed at deepening the urban housing reform. The medium/low-income strata who occupy a majority of the immense potential demand for housing should have their housing acquisition ability upgraded so as to actualize the demand. In addition, efforts should be made to increase the dwelling area up to the dwelling level specified as one of the priority targets in the 10th five-year plan. To achieve this objective of a policy,

the governmental housing finances should be made available. To this end, it is expected to raise quality financial resources at a low interest rate over a long period of time, and to establish a stable fund supply system.

The HPF system should have its positioning feature expressly enhanced as a government housing finance system. To this end, the system itself is essentially requires for a reform in the structural aspects, such as closed fund circulation and the like.

The HPF system should be effectively used to promote the housing finance reform further. In this sense, with what and in which direction the central government should tackle to complete the reform may be summarized as follows:

(1) Clarify the function as governmental housing finance on the housing policy

The HPF system should positively promote the housing finance reform. To this end, it is necessary to establish a housing policy well balanced at the nationwide level so as to enhance the functions as governmental housing finance.

More specifically, the HPF system could not function as a policy-oriented finance system on the behalf of medium/low-income strata without performing the function as follows:

- 1) Precise, appropriate support for improving abilities to acquire housing
- 2) Form a stock of quality housing on a policy-guided basis.
- 3) Supply quality and adequate priced rental housing.
- 4) Renew housing in large cities to build up environments.
- 5) Maintain and control the existing housing stock. And build up the existing housing distribution market.
- 6) Arrange the infrastructure of market for housing distribution

(2) It is necessary to have housing policies more intensively controlled at the central government level.

A medium/short-term basic housing policy at the national level, a yearly housing supply program, a financial burden plan and/or a HPF basic management policy have neither been mapped out nor thoroughly implemented. It is necessary to financially analyze and verify the priority policies and cost (cost vs. effect) involved in yearly HPF projects at a nationwide level.

In this sense, it is necessary for the HPF to enhance the governmental control over housing policies.

(3) It is necessary to thoroughly supervise, inspect, and guide at the central government level.

The HPF system is closely related with those local administrative organs and other, mother group in establishing the OF system while playing an important role in taking various housing finance measures. The Central Government (Ministries of Construction and of Finance and People's Bank of China) have not been "vertically" supervising or guiding the managerial aspects, such as organization, staffing, project planning, fund management, financial control, audit and inspection. Besides, responsibilities have not been expressly shared by and between the Central Government and local governmental administration units.

The reserves saved in the HPF system, for example, have not been checked for their finances, operations, recoveries, and other financial aspects. An effective checkout feature in the Central Government has not functioned but generated a great deal of bad debt. At the local administration level, however, the units in charge have a poor sense of responsibility for recovery. Besides, an insufficient expertise ability of the person in charge has hindered the bad debt from being liquidated within a certain target date (when to establish a recovery organization, to strengthen collecting functions, to depreciate bad debt, to bear financial burdens and so on).

Instruction should be given to the financial information disclosure in various methods while the Central Government should thoroughly supervise, inspect and provide guidance.[A16]

(4) An organization need be founded to take action in preparation for the financial liberalization, coupled with the upcoming participation in the World Trade Organization (WTO)

The funds in the HPF system are to be paid back to subscribers at the locality and on the line of local business. There is no accommodation fund nor scheme of "lateral" collaboration with any other regional HPFMCs in terms of housing policies, organization, staffing, training, investigation, computer system and so on. Consequently, every HPFMC has been being operated at higher cost. Such today's discrete organization would be unable to cope with the movements on the financial market, with the financial sector liberalized.[A17]

In Japan and European and American countries, banking institutions have made progress in covering a wider range of area through consolidation or the like. The HPF system in China is a discrete organization. Under the current unchanged framework, the system would have its risk management limited in relation to funds raised, financial operations, financial affairs administration, system developments, etc.

(5) Foster the manpower specializing in financial affairs.

The manpower specializing in finances is insufficient to manage HPF Management Centers wholesomely and efficiently. It would take a long time, moreover, to foster the experts

able to operate funds, examine loanees, and dispose of claims for bad debt. HPF Management Centers need be consolidated to one another, covering a wide area. Besides, practical use of manpower generated by restructuring and their training are required, accordingly.

(6) Check the HPF system for services and reorganize it.

The HPF system has its operations basically composed of the services entrusted to banking institutions on a clerical work consignment basis. The services may be characteristically divided into credit receiving (reserves deposited), credit giving (loan services), claim recovery services, and banking institution-oriented services or reserved fund operations.

The HPF Management Center, moreover, is to render services, such as promotion of subscription, collection of reserves (mandatory), management of participants (participation and change), guidance and management of services entrusted, and such administrative aspects as to materialize a housing plan closely related with the region.

As far as fund operations and personal housing loans for savers (acceptance of loans, eligibility examination, loan decision, loan implementation and recovery responsibility) are concerned, it is necessary to reduce the management cost, to reduce the clerical cost on repeated procedures between HPFMC and entrusted commercial bank, and to lean the financial skill. And these are considered to differ in nature from those handled by the administration unit. In this sense, the existing HPF system is necessary to be reorganized, simplified, and changed over to an efficient entity on the assumption that a) the system should be autonomously and elastically managed on an independent profit-making basis, that b) operational projects and accounts are to be settled in accordance with the entrepreneurial accounting principles, and that c) service performance is to be evaluated according to management targets and/or management programs.

Currently, the services under the control of HPFMCs are to be separated into a financial department (with control transferred to newly established housing loan organization) and an administrative organization (HPF management sector). Then, new services (credit supplements, housing information offerings, etc.) should be added so as to reorganize the HPF Management Centers services.

3.2.3. Direction of Improving Terms and Conditions for Loans :

(1) Reduce HPF loan interest rate.

For HPF loans, a variable interest rate system (modified type) has been employed. The People's Bank of China has provided a politically preferred interest rate (lower by approximately 1 point than that for a housing loan available in the private sector). The HPF system originally has savings directly linked with loans so that funds can be raised at a lower

cost (saving interest rate for reserves). The existing loan interest rates are felt a little higher. To attempt effective circulation of HPF fund, rather than raising “depository interest” while compressing the HPF operating cost, HPF Management Centers should be operated more efficiently so that the loan interest rate can decrease.

(Reference) Principles of Interest Accrual System in HPF Loans

An interest accrual system should be built up. More specifically, how to determine an interest rate of HPF housing loans should be standardized. It is important to study whether or not policy-oriented difference (political interest rate, basic interest rate, etc) should be provided in loan interest rates by applicant income, housing size, housing standard and policy-guided objective. A variable interest system (modified type) has been adopted for private loans. Nevertheless, there may be some types of selections on loan interest rates and loan repayment methods, including a fixed interest rate system. Below are some basic ideas about interest rate structure.

1) Interest Rate Structure

Loans for individual borrowers: Variable rates will be used. Rates can be reviewed every 3 years, 5 years, 7 years or 10 years.

Loans for corporate borrowers: Variable rates will be used. Rates can be reviewed every year, every 3 years, or 5 years.

2) Interest Rate Standard

Reference rate : For private houses = 1.0% (Current annual interest rate is 4.59%)

Example : National-lending rate 1

Reference rate = Approximately 0.5%

(Current annual interest rate is 4.09%)

Example : National-lending rate 2

Reference rate = Approximately 1.0%

(Current annual interest rate is 3.59%)

Various methods, such as interest rate subsidy programs by companies and the government that can be introduced to the current HPF system, should be analyzed quantitatively.

3) Eligibility : Reference rate

Individuals borrowers: Housing loans for low-to-mid income individuals.

Corporate borrowers: Loans for refurbishing community spaces in apartments, etc.

: National-lending rate

Individuals borrowers: Loans for purchasing public housing or Economical Housing

Corporate borrowers : Politically-guided loans (examples : for building workers' condominiums for installment sale/rent)

4) Other Conditions

Maximum and minimum loanable amount will be fixed.

Paying more down on the principle loan will not be allowed in the first period of a loan cycle. If this is allowed, the amount of repayment will be the total of remaining mortgage loan balance and a penalty will be collected.

(Reference) Interest Rate Rules by the Government Housing Loan Corporation in Japan

- Interest rates feature adjustment “caps” or limitations on how high or how low the interest rate can adjust. Reference rate fluctuates approximately 60% based on the changes in treasury investments and loans.
- Reference rate = 5.5% + (treasury investments and loans - 6.5%) × 0.6 (legal limit is 5.5%)
- Interest rate from the 11th year of repayment and above = in principle, treasury investments and loans +0.2%. However, the lower limit is 4.0% (legal upper limit is 7.5%)

(2) Study the measures for a reduction of housing interest rates.

Japan and European and American countries have housing loan interest reduction measures financially taken by governments (0% financing for 0% private housing loan in France, and grant for paying a fixed rate of interest for loan by the Government Housing Loan Corporation and housing loan tax reduction in Japan). In China, the HPF system has another challenge, which is called the housing subsidy system implemented in the Peking municipality strongly inclined to redistribute income. At present, the housing subsidy system is being implemented in the Shanghai municipality. It is necessary to study the interest involved in the HPF system, including its interlock with the housing subsidy system.

(Reference) Housing Loan Tax Reduction Scheme for Individuals in Japan

According to the housing loan tax reduction scheme for individuals effective in July 2001, the individuals who build, purchase, extend, or rebuild a house satisfying certain

conditions with a loan from a financial institutions (¥50 million max.) are eligible to reduction of income tax equivalent to an amount of 1% of the loan each year for a period of ten years. A maximum of ¥500,000 is reduced each year, and the maximum cumulative income tax reduction for 10 years is ¥5 million.

(3) Raise and attain an appropriate level of loanable limits in the HPF system.

It is necessary to raise the loanable limit to a loan under the HPF system. Wuhan and Chengdu are currently limiting a HPF loan to 150 thousand RMB and Shanghai 130 thousand RMB (as of June 2001). Some say that the loanable limits are unequal since they vary from region to region. The loanable limits are too low to match the selling prices really seen on the housing market. In addition, an amount, in which a loan can be applied for, must meet a lot of restrictive requirements, such as income, repayment ability, balance of reserves, number of service years and so on. The loan, which an applicant can obtain in reality, will be granted in a smaller amount than that desired. Thus, there is a significant difference in value between loans financed and desired. To raise an amount of loan, it is recommendable to study an addition by a loan premium, taken up as an exemplar model.

(NOTE) Problems in Raising an Amount of Loan:

A hike in loanable limits is closely related with the income criteria by region that is the base for hiking, a guideline of construction unit prices, a stable obtainment of financial resources and a system of distribution.

The central government should establish basic loan policy for each fiscal year and check the effect.

The extra loans for political purpose construction in Japan are shown below.

- Extra work for long-life society compatible housing: Construction of barrier-free housing, and provision of facilities for the aged and other people
- Extra work for environmental symbiosis housing: Energy-saving insulation structures, and energy-saving facilities
- Extra work for long-term durable housing: Construction of high standard level housing, and housing for snowy areas.

Figure 3-5 Architecture of Loans offered by Government Housing Loan Corporation in Japan

The loans by the Government Housing Loan Corporation are mainly intended for individuals to acquire housing. In addition, these Japanese governmental loans are addressing a variety of needs related with “Dwellings,” including street renewal, housing lot reclamation and so on.

Types of Loan	Loan Requirements	Repayment Term	Amount of Loan		
			Basic Amount of Loan	Special Addition	
Personal Housing	My home construction	Housing 80 ~ 280 m ² Land 100 m ² or more	within 25 years	Housing 1.28 million yen Land 6.8 million yen	Housing 6 million yen Land 4 million yen
	GHLC lot-out housing	Housing 55 ~ 280 m ²	within 35 years (joint construction)	80%	10 million yen
	Choice lot-out housing	Housing 55 ~ 280 m ²	within 35 years (joint construction)	1.82 million yen (joint construction)	
	Apartment house	Housing 50 ~ 280 m ²	within 35 years	1.42 million yen	
	Ready-built house	Housing 70 ~ 280 m ² Land 100 m ² or more	within 25 years		
	Existing house	Housing 50 ~ 280 m ²	within 20 years (joint construction)	1.28 million yen (joint construction)	
Reform	Extension, reconstruction and repairing	within 20 years	0.53 million yen	0.2 million yen	
Rental housing	Total floor 500 m ² or more Land 500 m ² or more	within 35 years	99.45%	3.2 million yen/house (65 m ² or more)	
Redeveloped housing, etc.	Urban area redevelopment, etc.	Housing ratio 1/4 or more	within 25 years	80%	
	Medium/high-stored buildings	3 or more in number of floors above the ground	within 20 years		
Disaster recovery housing	Housing 13 ~ 175 m ²	within 25 years	Housing 1.1 million yen Land 7.7 million yen		
Industrial workers' housing	Housing 50 ~ 125 m ²	within 35 years	80%		
Related public facilities, etc.	Buildup of related public facilities, etc.	within 15 years (Term of installation: 3 years)	90%		
Housing lot reclamation	Planned area: 1.65 hectares or more (public housing lot reclamation)	within 10 years (Public housing lot reclamation)	90% (Public housing lot reclamation)		
Asset-formation housing	Balance of asset-formation savings 500 thousand yen or more	within 25 years	Within 10 times balance of asset-formation savings		

Source: Data available in Government Housing Loan Corporation

(4) Extend HPF loan repayment terms and diversify repayment methods.

A HPF loan is to be repaid over a long period of time, which may reach a maximum of 30 years. In reality, however, it is said that a housing loan is repaid over a period of approximately 10 thru 15 years mainly for the convenience of the HPFMC to raise its funds. In China, moreover, there is a practice of disliking a debt. In some cases, the applicant itself desires an arbitrary period of repayment. In addition, a loan when applied for is examined under severe terms and conditions. As already referred to, furthermore, a comprehensive series of housing credit-supplementing systems remain immature in many cases. Efforts should be made to build up collaterals, guarantees and insurance systems while striving to extend loan repayment terms. And exertions such as two-generation loan method should be used to upgrade the repayment abilities of medium/low-income strata.

To improve a repayment method for the time being, it is necessary to operate repayment methods i.e., “capital-defer payment” (step repayment method) elastically.

Table 3-2 Financial Goods available at Private Banking Institutions in Japan

(As of March 01, 1999)

BANKING INSTITUTION	LOANABLE LIMIT	TERM OF REPAYMENT	INTEREST DELIMITING							
			VARIABLE INTEREST TYPE	FIXED INTEREST SELECTION TYPE						
				SELECTIVE TERM						
				2 YEARS	3 YEARS	5 YEARS	7 YEARS	10 YEARS	15 YEARS	20 YEARS
Asahi	50 million yen	Within 35 years	2.50%		2.35%	2.90%		3.70%		
Sakura	100 million yen			2.25%	2.40%	2.90%		3.70%		
Sanwa	50 million yen				2.30%	2.90%		3.65%		
Sumitomo					2.40%	2.95%		3.70%		
Daiichi Kangyo	50 million yen			2.25%	2.35%	2.90%	3.50%	3.70%		
Daiwa	60 million yen			2.15%	2.30%	3.00%	3.60%	3.70%		
Tokai	50 million yen				2.35%	2.90%	3.55%	3.70%		
Tokyo Mitsubishi					2.35%	2.90%		3.70%		
Fuji				2.30%	2.45%	2.95%	3.60%	3.70%	4.60%	4.95%

* 1. Exemplar Variants of Housing Loans

Re-borrowing Loan and Repurchasing Loan:

A loan applicable to those trying to re-borrow or repurchase; even if the property in security should be less than its real selling price, this loan is available, with status of repayments in the past, income, etc. taken into account.

Loan with repayment-support insurance:

A loan, in which a housing loan repayment support insurance (an income-compensation insurance with a long-term fault special clause) is set

* 2. GHLC Interest Level (basic interest)

2.20% for the initial ten years, and 4.00% from the 11th year and on

Source: Prepared by JICA Study Team, based on various data

(5) Political Consideration Indispensably Necessary for All Subscribers in the HPF:

The HPF system is originally designed as the national housing reserve saving system to help urban workers to systematically acquire housing through systematic housing savings. An HPF subscriber reserves the down payment and acquires housing. Then, the subscriber systematically repays the housing loan. As gathered from exemplar cases in various foreign countries, this system may be considered reasonable enough since it may lead to a scarce occurrence of bad debt.

What may be taken up as the current problem in the HPF system would be the limit of the amount of fund based on the closed fund circulation, its mandatory subscription requirement, which might lead to the unfairness arising from a mismatch between loanees (housing loan users) and savers (those who have not used any housing loan).

The stratum with a low household income will have an amount of reverses increased at slower pace even if they have continued reserving over a long period of time. As a result, the total amount so reserved is too small for the low household-income stratum to acquire housing in reality even if they try to do so. A rich stratum, on the other hand, is sufficiently able to repay. In addition, a large amount equal to their own payment can be obtained from an enterprise, to which they belong. As a result, they break down the Housing Provident fund in earlier stages and acquire housing. Under the growing economy, the system is an effective inflationary hedge.

This system functions as a mandatory housing saving program by the government for individuals and business enterprises. Since the system pools and operates funds deposited by all participants, it serves as an insurance or pension for individual participants, and housing taxes for business enterprises. Therefore, a reform should not focus only on the system's reductive housing loan functions for the participants in the areas HPFMCs are located. Instead, a macro review of the system as a comprehensive housing policy will be necessary.

For example, on behalf of those who do not make use of a loan, it is keenly recommendable to set a series of the interest rates according to their reserve terms and to establish a saving incentive system (examples in Germany and France) on a financial subsidy basis.

(Reference) Comparison of Interest between Housing Saving Deposits and Loans

- Chinese Case: HPF system as of March 2000
HPF loan: interest rate 4.59% over 5 years to 30 years
Savings for 1 year or more: 3 years fixed-term saving interest rate: 1.92%
HPF loan interest - deposited saving interest - 2.67 points in difference
- French Case: Housing Saving Deposits as of August 1999

(CEL) type: loan interest 2.25% - deposit interest 1.50% = 0.75 points

(PEL) type: loan interest 3.60% - deposit interest 2.57% = 1.17 points

In either case, a saving premium is granted once a certain number of requirements are satisfied.

(NOTE) Housing Saving Deposit System in France:

The French Housing Saving Deposit system is available in two types; cont (CEL) type and plan (PEL) type. Savings are tax-exempt within a range of deposit limits. A saving premium is granted by the government according to the standards established. The Housing Saving Deposit system allows an individual (not limited to those registered in a municipality) to subscribe arbitrarily and apply for two or more accounts. And a banking institution, which has contracted with the Government beforehand (including a post office), is allowed to handle deposits under the system.

(6) Improving Finances where the HPF System Loan is Paired with Private Loan:

It is necessary to examine the qualification of HPF savers to grant a loan, to survey the housing to purchase, to examine the loanability, and to standardize the application form, including the simplification and manual of procedures and for applying for a loan.

A loan user has to receive examinations twice; application paperwork before the HPFMC (applicant qualification examination), and loanability examination paperwork before an entrusted banking institution (economic examination, such as applicant's income checkout, credit rating, loaned house survey, etc.) In addition, there is a time waste when related documents (a non-copying type application-related document, as an example) are complicated.

As a means of simplifying the procedure in granting a HPF loan, a proxy lending system may be implemented. That is, an application, which has satisfied a certain level of requirements, may have a right of decision entrusted on a blanket basis to the entrusted banking institution. Moreover to fill-in for the shortage of available HPF loan, an increasing number of users are opting for a loan set with a private housing loan in the entrusted banking institution. For an entrust banking institution to grant a HPF loan set with a private housing loan, it is advisable to study the feasibility of relaxing the terms and conditions on the bank's own loan, or of simplifying the application and/or loan paperwork, and of sharing the Housing Credit Supplementing System.

(7) Policy-Guiding Quality through Housing Finances and Fostering Housing-related Industries:

The economical housing to be covered by financing with HPF housing loans has a construction price guided by the Ministry of Construction on a region to region basis. As far

as a size of housing is concerned, its targets have been established in the medium/long-term plan. Some of the housing really supplied have had an area of more than 100 square meters per house. Generally, therefore, housing has reached a certain level of size. According to the 10th five-year plan, a per-capita target dwelling area for 2005 has been set at 22 square meters.

Quality and performance, however, have not been interlocked with a policy-oriented interest finance, (such as HPF housing loan) although the Ministry of Construction issued a notice relating to the performance of commercial housing in July 1999.

The Governmental Housing Loan Corporation in Japan, for example, has applied a policy-oriented interest rate while adding a policy-oriented premium to a loan amount. Tying-up with a housing lot-out firm, the Corporation has been supplying a durable house with an ample dwelling area, subject to the environment-friendly, and energy-saving specifications compatible with the advanced agers. At the same time, the Governmental Housing Loan Corporation has been promoting the development of technologies for housing-related industries. In the near future, similar policy-oriented needs are expected to emerge in China, too. With the lead taken by the Ministry of Construction, therefore, it will be possible to guide the policy by financing as interlocked with a HPF housing loan.

(NOTE) Chengdu Commercial Housing Guided Pricing (Ministry of Construction, July 2000)

CLASS	SHANGHAI	WUHAN/CHENGDU (estimated)
Low	1,500 to 2,000 RMB	1,200 to 2,000 RMB
Medium	4,000RMB and up	3,000RMB to 5,000RMB
High	8,000 to 10,000 RMB	6,000 to 8,000 RMB

(Reference) Subsidized Housing Construction Area Standards in Peking (extract)

Public servant	Director class	120 square meters
	Manager class	80 square meters
	Assistant manager class	60 square meters
Engineers	High-class engineer	80 square meters
	Technical staff (junior and mid level)	60 square meters

(Reference) In 2001, the Shanghai municipality will implemented the housing subsidy system. This system is limited to those enterprises that are economically rich only.

(Reference) Construction Standards, under which the Governmental Housing Loan Corporation's policy-oriented interest rates apply:

- 1) Barrier-free type: specification of housing compatible with advanced agers
- 2) Energy-saving type: environment-friendly hear-insulation specification to save cooling

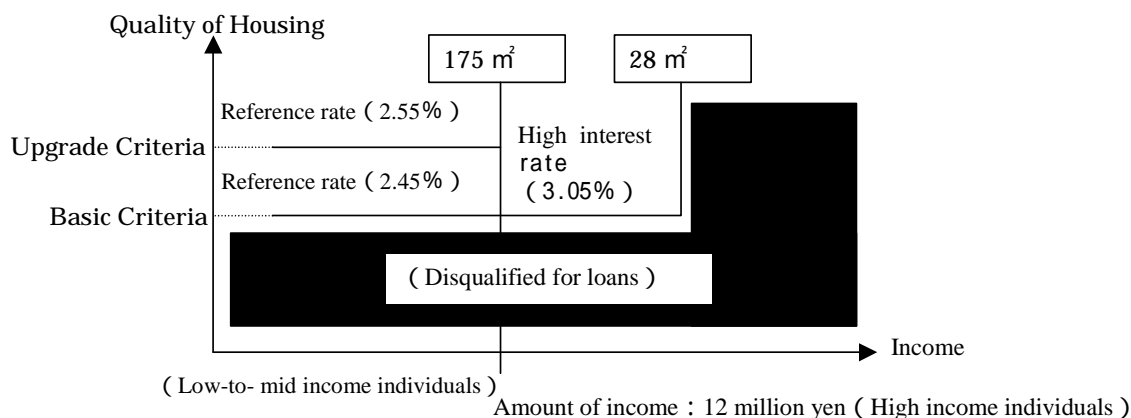
energy

- 3) Durable type: robust and long-lasting construction specification (e.g.) termite-proof measure, etc.

(Reference) Politically Guided Interest Rate Structure by the Government Housing Loan Corporation in Japan

- The Government Housing Loan Corporation (GHLC) in Japan introduced a new interest rate structure for newly built houses in October 1996 and, for existing houses in April 1997. The main objective of this interest rate structure is to improve the quality of housing. Preferential interest rate is used as a reference rate for the houses that meet GHLC criteria, such as barrier-free houses and energy saving houses.
- Reference rate : Quality houses purchased by low-to- mid income individuals that meet GHLC criteria (Note)
- Intermediate interest rate : Other houses purchased by low-to- mid income individuals
- High interest rate : Large houses, houses purchased by high income individuals or expensive houses.

Figure 3-6 Politically Guided Interest Rate Structure by the Government Housing Loan Corporation in Japan



(Note) : Above table shows the interest rate structure for the first 10 years of loan term. Interest rate will be 4.0% from the 11th year and above. Above rates are as of March 1, 1999.

Source: JICA Study Team

3.3. Frameworks for Restructuring the HPF System

3.3.1. Improving HPF Management Control:

In order that the HPF may perform its functions further, it is urgently necessary to expand the loan services. With the above-mentioned loan service-impeding factors taken into account, the HPF management control should be improved.

(1) Creating Attractiveness as Policy-oriented Loan - Efforts to Reduce Loan Interest:

To make a HPF loan more attractive, it is necessary, first of all, to reduce the loan interest so that a loanee may have a burdensome repayment reduced.

1) HPF -related Interest Architecture:

- Interest on reserves saved by HPF participants (Apply to calculations made between HPFMC and participant)

HPF interest on deposits for less than 1 year: An ordinary deposit interest rate applies (existing annual interest rate: 0.99%).

HPF interest on deposits for 1 year or more: A trimester time deposit interest rate applies (existing annual interest rate: 1.98%).

(Date to close yearly interest calculations: June 30)

- HPF Operation Interest Rate (Apply to calculations between an entrusted commercial bank and HPFMC.)

A reserve deposit (three years) interest rate applies (existing interest rate: 2.16%).

In some cases, a one-year time deposit interest rate may apply (existing interest rate: 2.25%).

- Entrusted bank's operation interest rate (An entrusted bank, other than the Bank of Construction, may redeposit in the Bank of Construction at a bank payment reserve deposit interest rate (existing interest rate: 2.07%).

- Personal HPF loan interest rate (Apply to calculations between an individual and the HPFMC.)

Term (1 ~ 5years) 4.14% <Reference: Commercial Bank Personal Housing Loan>
5.31% Term (6 ~ 30years) 4.59% 5.58%

- Interest rate on loan to HPF "Unit" (finance for employees to purchase housing): A little lower than the personal loan interest rate (All of the interest rates referred to above are subject to a variable interest system.)

2) Room for Contraction of Profit Margin between Deposits and Loans

A deposit-loan profit margin for the HPF system is 2.61% (4.59% - 1.98%) as gathered from the interest rates on HPF deposits for one year or more and on HPF loans for six years or more.

There is room for the HPF system to compress the profit margin as nonprofit business and as policy-oriented finance.

A comparison with analogous banking institutions overseas tells us that the HPF system is enjoying a higher profit margin.

Government Housing Loan Corporation, Japan:

(Loan base interest (2.45%) - GHLC debenture (1.60%))= profit margin (0.85%)

Housing Saving Depository in France:

(PEL type) loan interest rate 3.60% - deposit interest rate (2.57%) = profit margin (1.17%)

The HPF system as a policy-oriented finance organ in China has had a deposit-loan profit margin at a level as high as 2 or 3 times that attained by a similar international banking institution in developed countries.

Besides, main commercial banks in Japan are now striving to maximize their deposit-loan profit margin to write-off a huge amount of bad debt in the midst of the ultra-low interest times never experienced before. Nevertheless, they have a housing loan profit margin (variable interest rate for five years - variable deposit interest rate for 3 years) of 2.235%.

In other words, the HPF system with a low level of bad debt and tax-exempt on a nonprofit basis has been enjoying a higher profit margin than commercial banks in Japan who have suffered from a great deal of bad debt.

The HPF should reduce their loan interest rates. And there is room for such reduction. In this sense, every HPFMC should strive to enhance their function of loaning.

3) Simulation

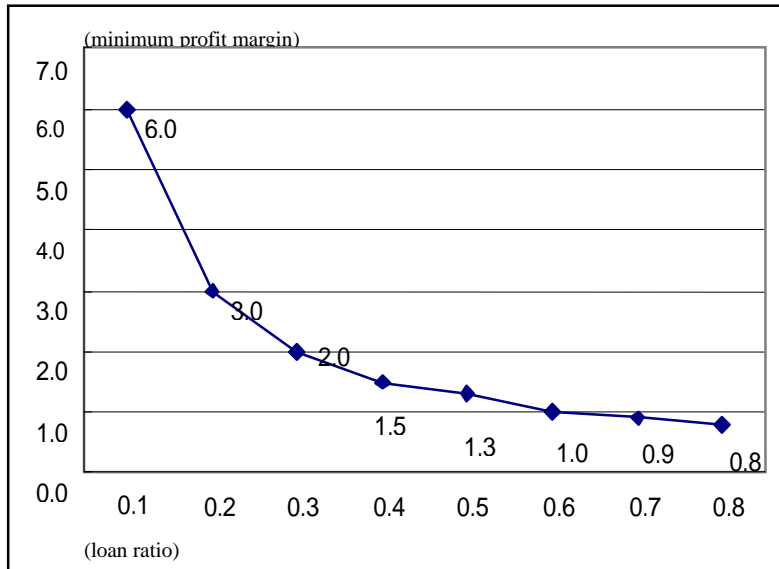
HPF reserve size: 5 billion RMB

Annual administrative expenses: 7.5 billion RMB

Annual bank entrusting cost: 25 million RMB

No fund operated excepts for private housing loans and bank deposits

Figure 3-7 Loan Ratio and Minimum Profit Margin



(NOTE): Loan ratio: balance of loans to balance of reserves
 Minimum profit margin: Deposit-loan profit margin required for HPF operating balance to nearly break even

Source: JICA Study Team

- According to the simulation referred to above, the higher the loan ratio, the lower deposit-loan profit margin required for a HPFMC to maintain its operations can be set.
- The existing profit margin is almost the same as the level required for a %loan ratio of twenties.
- Raising the loan ratio up to 50% will allow the existing profit margin to reduce to 1.3%, or half the current level.
- Raising the loan ratio up to 80% will allow the existing profit margin to reduce to 0.8%. In this case, the current loan interest rate of 4.59% could be reduced to 2.06%.

(2) Enhancing the Function of Loaning:

The simulation referred to above permits us to know that an increase in loan ratio and an enhancement of loan function are essential to a reduction of the HPF loan interest rates. Here is a problem, that is, an insufficient capability for small/medium-sized HPFMCs to offer loans.

- Shortage for manpower with expertise about finances and ability to examine loans,
- Impossible to reduce risks by dispersing them, in offering loans to small scale and small number of loanees being limited to a specific region,

- Impossible to absorb the cost required to enhance such functions as to gather information and manage and recover claims, all required to strengthen the function of loaning, because the economies of scale do not function.

To strengthen the function of loaning, it is urgently necessary to integrate medium and small-sized HPFMCs so that the economies of scale should be used to improve the efficiency of management and reduce risks by dispersing them.

The “HPF Management Regulations” provide that the provincial (municipal) government shall not locate a HPFMC, in principle. However, this provision has been implemented ambiguously. In reality, more than 3,000 HPFMCs are reportedly existing all over the nation.

The requirements for the establishment of a HPFMC should be clearly defined, based on objective numerical values, such as field-proven loans, management standings, fund size, specializing manpower, equipment and so on. And it is necessary to take specific measures so that any HPFMCs not satisfying the requirements for establishment will be integrated into another HPFMC in the higher ranked administration district.

To strengthen the function of loaning, moreover, the personnel in HPFMCs should be trained in relation to all over the loan services. Besides, it is urgently necessary to introduce a computer system required.

(3) Securing and Extending Loan Capital:

A loan capital could be secured and extended by two methods. One is to expand the collection of reserves (to increase the HPF contribution ratio by further increasing the existing 69 million participants). And the other is to prevent reserves from being applied for any other purposes.

In some regions, there is still room for an increase in number of participants. However, to raise the contribution ratio, some limitations will inevitably arise from such a factor as an improvement of entrepreneurial competitiveness.

What could be easily done is to thoroughly prevent reserves from being applied for any other purpose so that a maximum of reserves will be used as the loan capital.

It is difficult to determine why a number of applications for other purposes are reported undue. The problems are related to absence of certain mechanisms of management. The HPF system lacks the needed mechanisms which control illegitimate applications for HPF. Since 1999 when the “HPF Control Regulations” was enforced, illegitimate applications have only been partially rectified. As pointed out in the notice of the Ministry of Construction in

2001, however, such illegitimate applications still raise a significant problem. Control and/or prohibition regulations only would not be sufficient to prevent the illegitimacy. Although, an audit by the administration, can effectively improve the problem, it is not an adequate mechanism to check on illegitimacy on a regular bases.

The problem lies in transparency of operations. In 1999, the Ministry of Finance officially announced the regulations relating to the financial management of HPFMCs. And Year 2000 should be the first year to put such regulations into practice. Nevertheless, any HPFMCs have not yet disclosed the financial statements in accordance with the Financial Management Regulations. Despite the fact that the Regulations by the Ministry of Finance have provided for expressly, no HPFMC has conformed at all. This fact naturally tells us that the problem is all the more critical. It should desirably arouse the attention of competent authorities.

Non-disclosure of their financial standings may be the most cause as far as illegitimate applications of fund are concerned. The existing system would allow a HPFMC to conceal the risk that the cash flow may be stated in the red even if there is a sufficient balance of reserves.

Mechanisms of Government Housing Loan Corporation in Japan will be very helpful for reference in terms of control scheme thoroughly established, rules expressly clarified, financial standings fully disclosed and so on.

3.3.2. Proposition for Solution to Problems --- Referring to Financial Management Model in Government Housing Loan Corporation in Japan:

Enhancing the HPF financial management is a significant challenge in making HPF Management wholesome and establishing a housing finance system. As a solution to this challenge, observing how the Government Housing Loan Corporation in Japan is managing their financial affairs may be a good source of idea.

The financial management of the Governmental Housing Loan Corporation in Japan is being implemented as standardized under a strict system in accordance with the Act relating to the budgets and accounts of the Government Housing Loan Corporation. (Refer to the table 3-9 in the following page: “Financial Accounting (Closing) by the Japanese Government Housing Loan Corporation: Rules and Flow”.)

(1) Especially Important Accounts-related Documents in Financial Management

- Profit and Loss Statement
- Balance Sheet
- Inventories
- Other materials

(2) Functions of Checking Financial Standings in the Interior and in the Exterior, and Information Disclosure

- Implement an audit by GHLC auditors (equivalent to members of the Auditory Board in China).
- Publish on the official gazette after applying for approval to the competent minister (equivalent to the competent manager in China).
- Submit all over again to the competent minister together with auditors' notes, ancillary explanations and service reports.
- Annual report and attached materials (financial statements) sent by the competent minister to the Cabinet (equivalent to the State council in China).
- Submit an inspection report to the Cabinet after receiving an inspection by the Board of Audit (equivalent to the Accounting Examination/Calculation Section in China).
- Submit from the Cabinet to the Diet (equivalent to the National People's Congress in China).
- Get accounts closed after resolved in the Upper and Lower Houses of the Diet.

Such services of closing accounts every year are managed as standardized in terms of timing, routing, and information, all provided for in law. And the information is being positively disclosed. (More recently, financial statements are disclosed at the GHLC web site through Internet in addition to the GHLC annual report.)

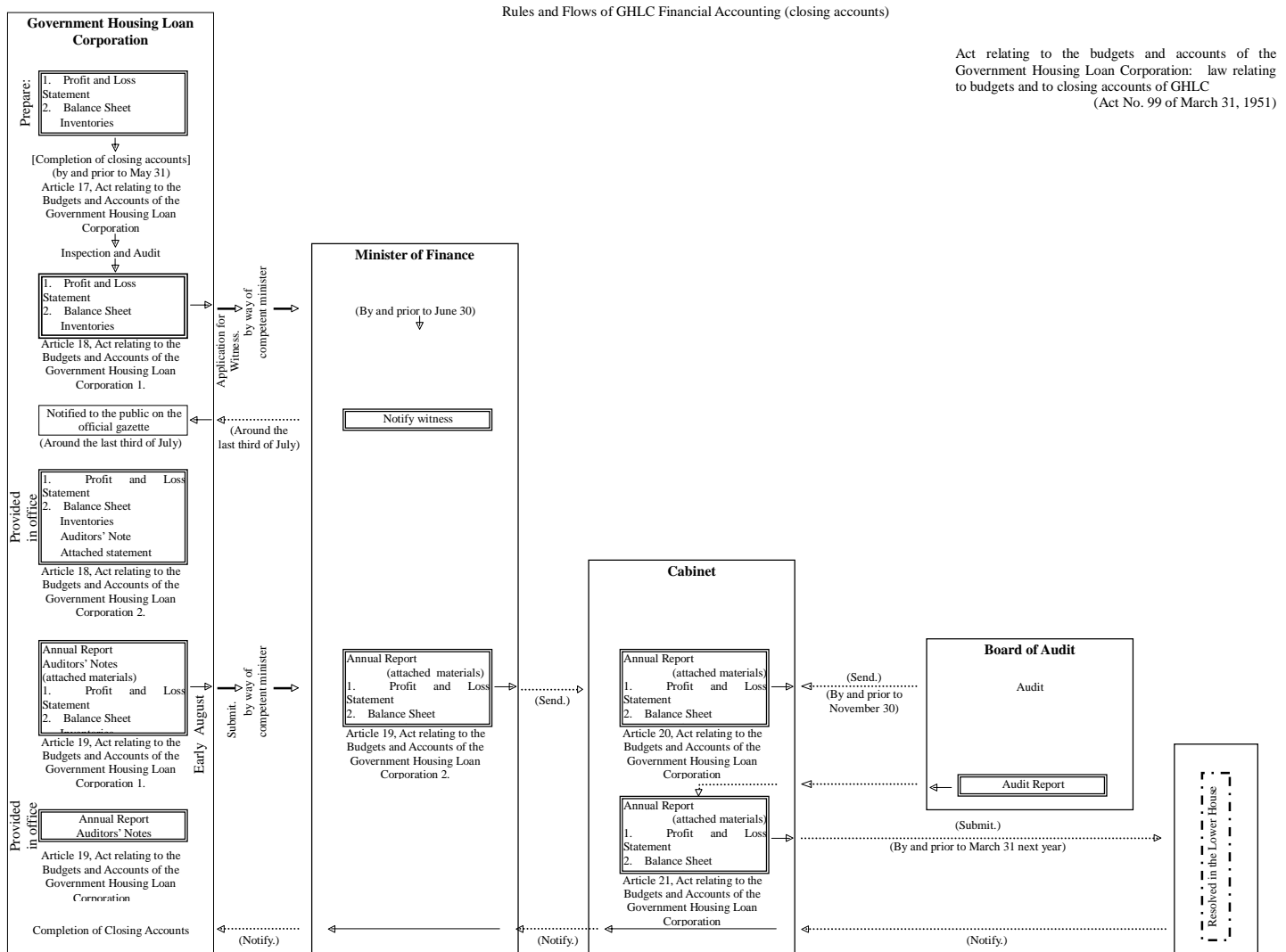
Government Housing Loan Corporation (GHLC) in Japan has its loan fund subsidized by the Government with the national finance (general accounts). The HPF system in China has its financial resources come from the reserves saved by participants. In this sense, the participants' profit should be taken into more direct consideration. For the benefits of participants, it is necessary for the HPF system to raise the wholesomeness and transparency of operations all the more.

(Reference) Operation Inspection System employed by the Government Housing Loan Corporation

The Government Housing Loan Corporation loans the general public a huge amount of money allocated by the Trust Fund Bureau. In addition to the established inspection system for the above settlements, external (Board of Audit, and competent authorities of Ministry of Land, Infrastructure and Transport and Ministry of Finance) and internal inspection organs (auditors and audit chamber) periodically inspect the branch offices, entrusted financial institutions, and loanees to confirm proper business-doing in terms of observance of official discipline, personnel

affairs and training, business entrusting, use of loans, execution of business, loan examination, loan approval, loan recovery, credit control, control of loan properties, etc.

Figure 3-8 Financial Accounting (Closing) by the Japanese Government Housing Loan Corporation: Rules and Flow



Source: Materials, GHLC

3.3.3. Funds Raised by HPFMCs

The HPF system has been actualizing the slow-down of the reserves due to an increase in subscription ratio, the difference in ability to reserve among subscribers and the regionally uneven distribution of fund. A fund shortage, moreover, has taken place to raise those funds, which could cover an increasing number of HPF loans and of reserves broken down. To proceed with the operations with stability from now on, it is necessary to consolidate HPFMCs and to broaden their area coverage. It has turned out as an urgent challenge to diversify the fund raising means.

According to the hearing held by the Ministry of Construction last December, the HPF system had a cumulative total reserve balance of 140 billion RMB and a cumulative total HPF housing loan balance of 36.5 billion RMB (private housing loan usage 26%).

From now on, it is predicted that the HPF system will continue to increase an amount of reserves. Coupled with an increase in demand for housing, however, it is necessary to verify that the fund supply (reserves, operating interest and money recovered) could cover the growth rate of both fund demand (fund breakdown and loan expansion) and bad debt. For the time being, it is necessary to expressly identify the role to be shared by, and between public and private sectors. In order to enhance the policy-oriented finance functions of the HPF system, the Government should secure long-term and low-interest funds, with an input of financial funds taken for granted. Thus, it is necessary to study the mechanisms where the fund requirements will strive to be supplied with stability.

(1) Phase 1: Measures to Improve HPF System for the Time Being:

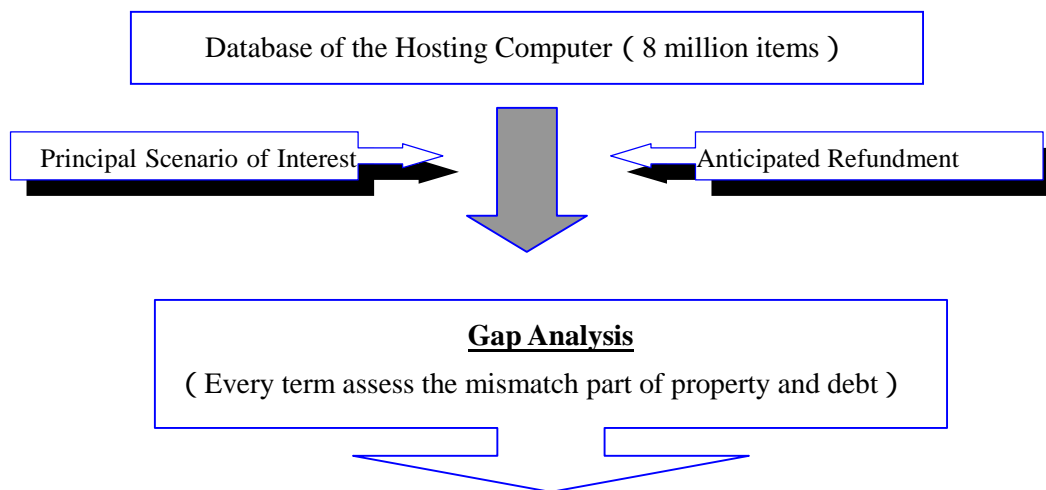
- 1) Every region should increase the subscription rate of applicable people to 100% and thoroughly collect reserves (in cooperation with administrative organs), so as to eliminate any omission in collecting the reserves.
- 2) Increase the rate of contribution from both urban workers and enterprises (currently 7% in Shanghai, 5% in Wuhan and 6% in Chengdu). According to the findings in hearings, the HPFMCs at a personnel-in-charge level have an idea of increasing the contribution rate up to 10%. (The Beijing municipality has planned to raise the contribution rate to 8%.)
- 3) The period, during which reserves are required to allow for a housing loan, should be reviewed on a region by region basis. For example, the existing requirement of 2 years or more should be extended to three years or more (in consecutive 6 or more months) at the minimum.
- 4) A breakdown reduction measure should be provided by establishing a reserve

deferment period (6 months or more at the minimum)

- 5) It should be made as a rule that in the event of a shortage for fund, the HPF system will be allowed to borrow from the local government (including various funds) and from a private banking institution with a guarantee of debt and that a loan will be furnished with a grant for paying a fixed rate of interest.
- 6) The HPF system should map out a project plan (number of loanable houses) and a fund plan (frame of a loanable fund and a mean balance ratio) that could be adhered to judging from an actual standing of the HPF system itself. The ALM technique should be used to systematically receive applications for loans (to adjust the receiving timing according to the availability of funds raised, and the numbers of receiving cycles and of loanable houses) and to control the funds for both loaning and recovery. Thus, the HPF system should strive to make its management wholesome.

In either case with issues as enumerated above, a housing policy mainly for the medium/low-income strata should be materialized through the housing finance at a national level. To this end, the HPF system should be reviewed entirely. And it is unavoidably necessary to make a drastic reform of the HPF system so as to establish a public housing finance system.

Figure 3-9 The general idea figure of ALM in The Government Housing Loan Corporation



Current value analysis (static analysis)	Term profit and loss analysis (dynamic analysis)
<p><u>1 Duration analysis</u> (Determine average residual period for assets and liabilities to estimate the risk attributable to fluctuation of market interest rate)</p> <p><u>2 Basis point value analysis</u> (Estimate the fluctuation of the current value of assets and liabilities by changing the interest rate 10 bp upwardly and downwardly)</p>	<p><u>1 Scenario analysis</u> (Simulate the three financial statements by adding other several possible interest rate scenarios and financial plans to estimate the necessary subsidies, etc.)</p>

Source: JICA Study Team

(2) Phase 2: Building up Housing Finance system and Diversifying Fund-Raising Means

This study, in principle, need be made on the assumption that a new financial institutions at a national level should be organized.

- 1) Being pressed for funds, the housing finance system should set an urgent loan frame (including the “Housing Bond” <tentatively named> operation) in the People’s Bank of China.
- 2) Grant the system a function of issuing the HPF debentures (a debenture eligible for discounting by the People’s Bank of China and guaranteed by the Government).

- 3) Grant the system a function of issuing debentures, with housing credit in security (to fluidize credit).
- 4) A system should be implemented, which has the functions of depositing, loaning, borrowing, and transferring funds among blocks at the central level and at a regional block level, including the HPFMCs.
- 5) It should be made as a rule that the state-owned commercial banks entrusted with the HPF services are to finance coordinately. (A fund financing frame should be established, based on an amount of the HPF entrusted.)
- 6) A housing reserve saving system (with such models as the Housing Reserve Postal Saving System, Housing Reserve Denture System of GHLC and Asset Formation Saving System in Japan, and French Housing Reserve Saving System in Europe) should be established on the basis of private arbitrary subscription covering the Chinese people as a whole. And this system is to be handled by those banking institutions (including credit unions and post offices) which have been approved by the Ministry of Construction as agreed upon by and among the competent authorities, the banking institutions.
- 7) The People's Bank of China should promptly strive to systematize the call market at a local level, covering private banking institutions, farmers' cooperatives saving and so on so that a short-term housing fund can be raised from the financial market.

(Reference 1) Comparison of Funds Raising Methods

Classification	Merits and demerits
Borrowing	<ul style="list-style-type: none"> • Borrowing from the government funds is less costly but the financial resources must be secured. ALM control for borrowing interest rate and period is required to enable stable supply of funds over a long time period. • Borrowing from the private-sector funds in the financial market is costly. Long-term stable funds lack financial resources to get money from due to tight demand for funds expected in the future, and the necessity of disposal of bad loans. Stopgap funds such as conversion of real estate claims into securities are available. Call loan market does not exist. • Setting of emergency loan budget by the People's Bank of China is attractive.

- | | |
|-------------------------------------|--|
| Bond issue | <ul style="list-style-type: none"> • The government-guaranteed bonds incur the second cheapest cost after borrowing from the government funds. They can be procured in the financial market but the amount of procured funds is limited. A new political financial institution, if established, can issue quasi bonds under the same conditions without government guarantee. |
| Reserve deposits, etc. | <ul style="list-style-type: none"> • The new housing deposits and bonds are the least costly supply source for raising long-term stable funds. The arbitrary subscription system lacks procurement ability and immediate effectiveness. |
| Conversion of bonds into securities | <ul style="list-style-type: none"> • Superficial cost is expensive but free procurement according to the repayment period is possible. Existence of money market and other infrastructure is prerequisite, and the amount of procured funds is limited. |
| HPF | <ul style="list-style-type: none"> • The contribution rate may not be increased beyond 10% for both individuals and businesses due to increased social insurance and other burdens. This inevitably sets certain limits to available funds. Compulsory contribution is attractive. Pooling and loaning at the central level of the HPF system are possible. |

(Reference 2) Challenges and direction of action in model cities:

Shanghai

With a vigorous demand for private housing on the backgrounds, the HPF reserves have been encountering with an increase in demand for both breakdown and loaning. As a result, the loan capital has begun to run short. The single means of raising the fund is considered to have a limitation. A certain new fund-raising means, including a changeover of loan claims over to securities, have begun to be studied.

To cope with a shortage for the loan capital, the Shanghai municipal government has really taken such a measure as to borrow temporarily from a public fund, such as Urban Base Construction Fund, etc. Any other fund-raising means has not been legislated in this city.

Shanghai has reached a reserve rate of 7%, which is a high level all over the nation. To cope with an increase in demand for the fund in the future, some have estimated that the reserve rate need be raised up to 15%. A rise of the reserve rate, however, has a fear of bringing about the following effects:

- First of all, it may lead to an upturn of entrepreneurial cost, which might in turn adversely affect the entrepreneurial competitiveness. After China has participated in the World Trade Organization (WTO), the market competition will be more and more severe. While pressing all the enterprises in China, including foreign capitals, to enhance their competitiveness on the market, an increase in reserve rate might turn out as a cost-pressing factor.
- Next, it might adversely affect the private consumption. A hike of the reserve rate would lead to a stimulus for the housing consumption on a medium/long-term basis. Nevertheless, it signifies a decrease in net income and in disposable income for those participants who do not intend to purchase housing (or during the applicable period).

With the above-mentioned effects taken into consideration, there is a limitation to the expansion of funds raised by increasing the reserve rate.

To increase the funds raised, it is necessary to study the feasibility of diversifying the existing single fund-raising means. The changeover of credit over to debentures, whose feasibility is being now studied, has still involved a number of issues to dissolve, including the buildup of a financial market, of related laws and regulations, and of information disclosure.

First, there is a lack of the mechanisms and techniques that would allow a cash flow composed of mortgage pools to be used for paying the principal. In addition, it is usually time-consuming to establish a method of preventing a moral hazard while operating the fund. Besides, a certain long time, moreover, is also required to establish a disclosure system in favor of investors, and an audit by an independent organ, or the like.

Next, there should be a mechanism, which should allow for a dispersion of the risks by dispersing the claims that compose a mortgage pool. In this very stage, however, it is difficult to make up such a mechanism.

No mechanism does exist to pool those loan debentures available in many types, which in turn vary from region to region, too.

A method highly feasible in this stage is such that the required fund is raised by issuing the HPF housing finance debentures guaranteed by the Shanghai municipal government.

As a local government policy-oriented finance, it is necessary to study the feasibility that the housing finance debentures should be accompanied with the following “incentives”:

- First, take a preferred income tax measure limited to a certain extent in favor of debenture purchasers. For example, an income gain within a certain amount should be tax-exempt.

- To promote the housing consumption, the Shanghai municipal government has taken a special measure that a house purchaser may have the total purchasing price withdrawn from the income tax. It is necessary to study a method of introducing a certain percentage tax exemption system for housing finance debentures to be purchased by those who do not intend to purchase housing, or who have been unable to do so yet.
- If such a government-led “incentive” as referred to above is added to housing finance debentures, it will be possible to raise the fund at a low cost on the market.

In addition, all the departments concerned should be worked upon so that housing finance debentures may be issued to HPF Management Centers at other than Shanghai in addition to individuals. A HPFMC with an allowance for the fund would eventually lead to the provision of a more favorable fund operation means while operating the fund to improve the safety, fluidity and profitability of asset portfolios. The existing HPFMCs are allowed to operate their fund in surplus for investment in national bonds. Nevertheless, a study should be made so that such funds in surplus can be operated to buy the housing finance debentures guaranteed by a local government.

To prevent funds from flowing out of a district with small demand (mainly inland) into a district with large demand (mainly along the coast), a study should be also made as the first step to restrict a fund operation across the two regions referred to above. For example, those prospects who may purchase housing finance debentures should be limited to those in the districts under jurisdiction of the Shanghai branch of People’s Bank of China.

Wuhan

The HPFMCs existing in this city are grouped into three, collecting their own funds separately. They have encountered with issues, such as an existence of difference in fund-raising level in addition to a decline of fund-raising efficiency.

The state-owned enterprises which occupy A majority of participants have had the business depressed, being temporarily exempt from their obligation to pay their reserves in the HPF system. Thus, the Housing Provident fund raising has been affected by the business performance of enterprises. Whether or not an enterprise is exempt from the reserve payment obligation, moreover, has been qualified under an ambiguous standard. Some enterprises not authorized to be exempt from the reserve payment obligation, have not paid reserves in reality. As far as the Housing Provident fund collection is concerned, its legal execution is poorly mandatory, forming one of the bottlenecks to fund raising.

The three HPFMCs in the Wuhan municipality should be integrated into one as done in Shanghai. It is likely that interests will collide to one another between provincial government, university, and municipal government. From the basic viewpoint of “For

Participants,” however, a study should be urgently started to integrate fund raising, with the lead taken by the department concerned, such as provincial and municipal governments, etc.

Moreover, as far as some “units,” such as those enterprises which have defaulted to pay reserves are concerned, it is necessary to establish and implement an express thought-out standard of tentative exemption from the reserve payment obligation.

Chengdu

Chengdu currently has only one HPFMC in the city. Nevertheless, some HPFMCs in the neighboring districts exist under the Chengdu municipal HPFMC. These small-sized HPFMCs are operating under the guidance of the municipal HPFMC. In reality, however, they have been raising funds by collecting reserves by themselves. This would decrease the reserve collection efficiency. Besides, the obligation to pay reserves has turned ambiguous in collusion among localities.

It is important to integrate the small-sized HPFMCs into the municipal HPFMC both nominally and actually. If it is promoted with the lead taken by the municipal government, a great deal of difficulties should not arise. The problem lies in the basic recognition, “For whom does the HPF system exist?” From the viewpoint that the HPF system does exist for participants, it could be recognized that the proposed integration will surely improve the reserve collection efficiency. From the viewpoint that the HPF system should be to the benefit of the local government, on the other hands, priority will be given to the interest of the local government rather than either efficiency, or interest of the participants. It is necessary to really understand the recognition that the HPF should be to the interest of participants.

3.3.4. Fundamentals to Design of Financial Goods

(1) Loanee: HPF subscriber, who has satisfied a certain number of requirements

- Housing to be owned by the loanee
- Number of subscribed years required, number of continued years, and number of years deferred
- Amount reserved in HPF as required, and housing allowance
- Age, number of households, and necessity of housing (just married couple, eviction from housing, those socially weak, etc.)

(2) Loanable housing that has satisfied a certain number of requirements

- District where the house is located
- Number of years that have passed after constructing the house.
- How to construct housing
- Area of the house (upper and lower limits)

- Construction unit price of the house (instructional and upper-limit)
- Equipment and performance of the house

(3) Terms and Conditions for Loan

- Loan interest rate: policy-oriented variable interest system (as modified by People's Bank of China)

A selective fixed interest type will be implemented in the future.

(Example)

- 1) Dwelling area 120 or less square meters, policy-oriented interest rate
120 or more square meters, medium interest rate
 - 2) Housing performance/equipment, policy-oriented interest rate[j43]
 - 3) Maintenance period 5 years or less, medium interest rate, 5 years or more, policy-oriented interest rate
- Term of repayment: The existing terms and conditions may remain unchanged for a repayment period of less than 30 years. In reality, it is necessary to extend the number of repayment years[t44].
 - Method of repayment: Select either monthly repayment in an equal amount with interest added or monthly repayment in an equal amount of principal only.
 - Ratio of loan: 70% in principle (even 80% allowable) [t45]
 - Repayment burden ratio: approximately 25% of annual income basically [t46]
 - Loanable limit: the existing limits are unfair and insufficient.

(IMPROVEMENTS)

- 1) Calculate a loanable amount according to the term for which reserves have been saved.
- 2) Estimate a loanable amount by the area
- 3) Add an amount of loan for the policy-oriented purposes.

(4) Mortgage/guarantee/insurance: Credit supplementing system that may not cause medium/low-income strata to select reversely

3.4. Housing Provident Fund System Reform: Basic Directions

3.4.1. Basic Viewpoint of Restructuring of the Organizational System

Compared with the similar systems in foreign countries, the HPF system in China is more like a contract type saving and deposit system for housing finance, where funds are

circulated in dual closed loops of small circulation within units, and large circulation within the system.

Innovation of organization is most important to innovate and establish the HPF system as the core public and political finance system for assisting the urban workers, the middle and low-income layers in particular, in obtaining privately owned housing of a good dwelling level. This is because the management control system, financial control system, funds raising system, and political execution system are all closely related to the organizational system of system operation.

The nine basic viewpoints for innovation of organization are:

- 1) Integration of the current small-sized HPF Management Centers.
- 2) Development and reinforcement of a training system.
- 3) Standardization of businesses of HPF Centers, and establishment of a national and wide area level computerized total control system.
- 4) Promotion of ALM management for HPF Management Centers, and reinforcement of control and supervision function of the central government.
- 5) Wide-area circulation of funds, and liaison of funds with the monetary market.
- 6) Organizational independence of the HPF Management Centers, separation between administrative and finance departments, and reorganization of businesses.
- 7) Reinforcement of the housing policy control of the central government.
- 8) Active support of the central government for the increased housing policy funds and political loans.
- 9) Linking of housing plans and promotion of finance/tax system by the local governments.

Viewpoints 1) through 4) relate to short-term urgent tasks while viewpoints 5) through 9) relate to mid-term political tasks.

3.4.2. Direction of Organizational Innovation: Phased Organizational Innovation

The organization system of the HPF Management Center is investigated from the above nine viewpoints in terms of its: character, authority, business, funds raising and operation, and political finance. This was done for the purpose of establishing a new relation between HPF Management Center and the central and local government, and set up a new system.

The new HPF system will comprise new national and wide-area level organizational systems to solve problems that are difficult to be handled by individual HPF units. It is desirable to innovate the organization in phases as follows:

(1) Phase 1: Control Mechanism Type Innovation

The new national and wide area level organizational system focuses on solving the current urgent problems related to organizational management from viewpoints 1) through 4). This innovation is a control mechanism type innovation.

(2) Phase 2: System Finance Type Innovation

The new organizational system intends to strengthen funds raising and other finance functions, including review of businesses of the HPF Management Center, from viewpoints 5) and 6). This represents a system finance type innovation.

(3) Phase 3: Specialized Finance Organ Type Innovation

The new organizational system intends to develop housing political finance from viewpoints 7) through 9). This is a specialized finance organ type innovation.

Figure 3-10 Phased promotion of Organizational Innovation

Classification		Phase 1	Phase 2	Phase 3
Type		Control mechanism type	System finance type	Specialized housing finance organ type
Basic target		Thorough execution of financial management	Diversification of funds raising	Linking of housing policy and housing finance
Target achievement year		On or before 2003	2003 to 2006	2006 to 2010
Name (central level) – tentative –		Central HPF Center (non-profit making enterprise)	Central Housing Finance Mechanism (non-profit making enterprise)	China Housing Finance Central Bank (joint-stock company)
Image of organization				
Head office (Beijing)	Central level			
Mechanisms, etc. (9 blocks and 2 direct operational departments)	Regional level			
	District level			
Management Committee		×		
Business entrusting		Due-from-agency system	Direct operation department + due-from-agency system	Direct operation department + due-from-agency system
Base funds · Capital	Central level	× (Case 1) Establish departments of Ministry of Construction of People's Republic of China (Case 2) Establishment of construction special department	Contribution →	Stock → (Case 1) Main body store (Case 2) Entrust to BIL with only head office Go public
	Regional level			
	Area level			
Funds raising	Central level	Emergency loan budget of People's Bank of China	People's Bank of China emergency loan budget, new type housing saving deposits and credits, bond issuance, deposits	People's Bank of China emergency loan budget, new type housing saving credits, bond issuance, MBS external borrowing
	Regional level	Transfer among regional HPF s. Loans from the central level.	Emergency loans from the central level. Transfer between regional Centers and deposition.	
	Area level	Loans from regional Centers. Borrowing from private-sector finance with local government guarantee.	Emergency loans from regional Centers	
Contribution of Mandatory HPF				
Financial management	Inspection system			
	Computer system			
Housing policy and plan	Local (plan)			
	Central (policy)			
Credit complement	Institutional guarantee			
	Insurance (life and non-life)			
Training system				

Classification	Phase 1	Phase 2	Phase 3
Others	(1) Integration of HPF Centers by business type, and abolishment (2) Wide area activities, and integration and abolishment (disposal of bad debts) (3) Introduction of computer system (invite foreign investments)	(1) Investigate the national insurance system (Application of private-sector loan set finance) (2) Start investigation of MBS (Shanghai)	(1) The administration department of the HPF Center remains as it is while the finance department is transferred to the new organization. (2) Institutional guarantee will be newly added to the housing-related information service of the HPF Center. (3) Establishment of a housing finance training center.

Source: JICA Study Team

3.4.3. First Reform (Shift to Management Organization)

A national-level “central housing provident fund management center”, and regional-level “provincial housing provident fund management centers” are to be established to form a three-tier organizational system together with the existing district-level provident fund management centers.

Basically, the new system is to inherit fundamental functions from the present housing provident fund system. In other words, it is an organizational system aimed at promoting the solution of managerial and financial problems facing the present provident fund management centers at the national and regional levels.

(1) Provident Fund Management Organizations: A Central Housing Provident Fund Management Center and Provincial Housing Provident Fund Management Centers

1) Functions

- The provident fund management centers, which number nearly 2,300, are to be first integrated into the city provident fund management centers, and then into the central housing provident fund management center. The provincial provident fund management centers will be equal in scale to, for example, the nine regional branches of the People’s Bank of China.
- The central housing provident fund management center’s functions are to include promotion of the integration of the city provident fund management centers, promotion of the development of information systems for the provident fund management centers, and proper location of human resources.

2) Organization(s)

- The process of establishment of the central housing provident fund management center will be similar to the process of establishment of the Central Housing

Reform Commission, which was established jointly by the People's Bank of China, the Ministry of Construction, the Ministry of Finance, the Planned Development Commission, the China Construction Bank, Central Office Work Management Bureau, and the Beijing Metropolitan Government.

3) Important Points to Note

- How to secure financial resources for the establishment of the organizations is the primary consideration.
- Local governments are to be responsible for the disposal of bad loans likely to surface at the time of integration of the housing provident fund management centers.

(2) Integration of the Existing Housing Provident Fund Management Centers into City Housing Provident Fund Management Centers

1) Functions

- The People's Bank of China and the Ministry of Construction are to adjust interests on deposits and loans, and narrow the interest rate differentials by giving public notices.
- If the interest rate differentials are narrowed, the provident fund management centers will inevitably become unable to continue inefficient management, and will have no alternative but to increase sales (strengthen selling operations) and reduce costs. As a result, the provident fund management centers' operations will become more efficient and their integration will be promoted.
- In the process of integration of the existing provident fund management centers, the People's Bank of China and the Ministry of Construction are to prohibit provision of provident fund loans other than provident fund housing loans, by giving public notices.
- These public notices are aimed at avoiding and reducing default risks.

2) Organization(s)

- Public notices are to be given jointly by The People's Bank of China and the Ministry of Construction.

3) Important Points to Note

- Some of the new organizations were already established in fiscal 2001.

(3) Development of a System for Supervision and Management of Operations Carried Out at the Provident Fund Management Centers

1) Functions

- A system with functions to supervise operations carried at the provident fund management centers constantly, not temporarily, is to be developed. For example, the system is to audit all provident fund management centers' financial management, deposit/loan systems, and implementation of housing policy measures every three years.

2) Organization(s)

- As in the process of establishment of the existing provident fund management center investigatory commission, the new system is to be developed jointly by the People's Bank of China, the Ministry of Construction and the Ministry of Finance.

3) Important Points to Note

- There is no need to audit operations of all provident fund management centers every time. For example, small-scale provident fund management centers (less than 100 million RMB) could be excluded.

(4) Development of a System for Training in Housing Finance Practice and a Housing Finance Expert Certification System

1) Functions

- A system to certify qualified experts in fund deposit/loan practice (screening, provision of loans, credit management, debt collection) and escrow business ("Certified Housing Finance Managers" and "Certified Housing Brokerage Managers") is to be developed.
- Only those financial institutions whose staff include, "Certified Housing Finance Managers" can engage in contract provident fund deposit/loan business.
- Training programs aimed at providing the latest information on the public housing finance system, and provident fund deposit/loan business (screening, provision of loans, credit management, debt collection), and practical knowledge of escrow business are to be offered to entrusted financial institutions.
- At the close of each training program, a qualifying examination to certify successful examinees as "Certified Housing Finance Managers" is to be held.

2) Organization(s)

- The Ministry of Construction is to prepare examination questions, and the local housing reform commissions are to certify successful examinees.
- The Ministry of Construction and the Central Housing Reform Commission is to be

responsible for the development of training programs. The training programs are to be carried out approximately twice a year at the provincial level. While these programs are to be offered to financial institutions free of charge, housing construction companies and housing sales companies are to pay for these programs.

3) Important Points to Note

- The certification system must be consistent with the existing certification systems (real estate appraisal, land appraisal and public land appraisal).
- The training programs should be periodical and compulsory, not temporary. Participation in the programs should be the necessary conditions for renewal of “Certified Housing Finance Manger” status.

(5) Streamlining of the Provident Fund Management Operations and Promotion of Development of Information Systems for Customer Management

1) Functions

- Unification of provident fund management operational formats.
- Computerization of information summarizing operations and development of online information systems (in the process of organizational integration--city provident fund management centers “provincial provident fund management centers” central provident fund management center).

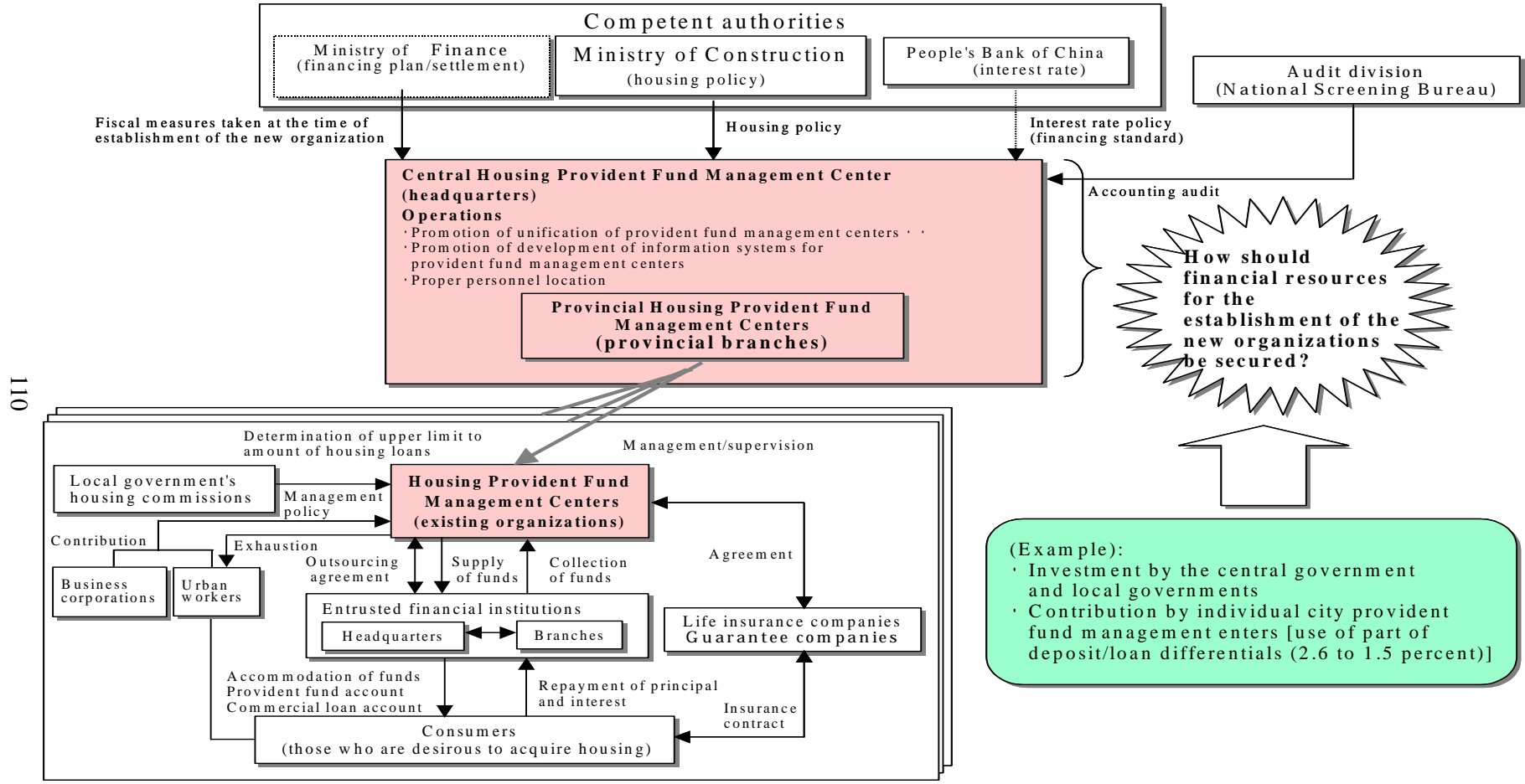
2) Organization(s)

- A system for unifying provident fund management operational formats is to be designed and developed prior to computerization. Next, an information system relating to provident fund management is to be developed by the housing commissions of local governments in parallel with organizational integration of the provident fund management centers.

3) Important Points to Note

- It is essential to discuss network linkage with banks and mortgage/guarantee/personal credit organizations. It is necessary to decide on initial cost, operating cost and organizations to bear such costs.

Figure 3-11 Image of Management Organization



Source: JICA Study Team

3.4.4. Second Reform (Shift from Management Organization to Systematized Finance)

A national-level “central housing provident fund management organization” and regional-level “provincial housing provident fund management organizations” are to be established as nonprofit organizations, and to operate independently of the central government agencies to form a new three-tier organizational system together with district-level provident fund management centers.

These new organizations will be able to fulfill their respective operations as central-level financial institutions that keep and manage customers’ funds and issue bonds on an as required basis, for credit associations and credit cooperatives are going to have the new organizations to function as their central bank. At the regional level, the new organizations will exert their influence on local financial markets through supply of funds. At the local level, they will function as financial organizations to extend mutual aid services to member companies.

Within the framework of the systematized finance system, they will be able to engage in housing finance business which has real relevance for the needs of local communities and maintain the regional characteristics of the provident fund to some extent. They will also be able to form an financial union which is capable of interchanging funds both vertically and horizontally in order to secure financing funds (unlikely to be affected by stable procurement), and management of funds (which is one of guidance policy finance’s weaknesses), and the fund supply-demand situation in the financial market, and thereby overcome such weaknesses.

(6) Shift from Provident Fund Management Organization to Housing Finance Organization

Shift to “central housing finance organization” to “provincial housing finance organization”

1) Functions

- The central housing finance organization is to have a new bond issuing function, and therefore, will be able to procure funds on its own in the financial market.

2) Organization(s)

- Central housing finance organization: The central governments, local governments, entrusted financial institutions and member companies are to invest in the new organization.
- Provincial housing finance organizations: Local governments, district housing provident fund management centers, entrusted financial institutions and member companies are to investment in the new organizations.

3) Important Points to Note

- How to secure financial resources for the establishment of the new organizations is the primary consideration.

Prohibition of local governments' participation in the city provident fund management center and separation of the administration and finance.

1) Functions

- Local government's participation in the interchange of personnel between the city provident fund management centers and local governments affairs, and fund management is to be prohibited, and finance is to be separated from administration.

2) Organization(s)

- The city provident fund management centers are to perform only contact functions concerning deposit of funds.

3) Important Points to note

- Will the new organizations be able to resolutely adjust the vested rights (appointment of former government officials to high positions in private companies)?

(7) Supply of Financing Funds by the Provincial Housing Finance Organizations

1) Functions

- The provincial housing finance organizations can distribute deposited funds provided as unified funds by the provincial provident fund management centers among regions and other localities.

2) Organization(s)

- The provincial housing finance organizations are to distribute funds among regions and other localities with permission of the central housing finance organization.

3) Important Points to Note

- Development of an information system that makes possible deposit management at the regional level is a precondition.

(8) Development of Fund Procurement Measures, Including Bond Issuance, by the Central Housing Finance Organization

1) Functions

- The central housing finance organization as a new organization is to directly procure funds using a bond issuance scheme.

2) Organization(s)

- The central housing finance organization as a new organization is to be responsible for the development of such measures.

3) Important Points to Note

- Enhancement of creditworthiness of the central housing finance organization as the issuer of bonds.
- The central housing finance organization will not be able to limit its loan customers to urban workers since it has a function to procure funds other than compulsory deposits.

(9) Expansion of Guidance Policy Finance and Initiation of Guidance Policy Finance to Providers of Housing (Housed Built for Sale, Houses for Rent)

1) Functions

- The central housing finance organization cannot limit its loan customers to urban workers since it has its own means to procure funds. Here providers of houses for sale and houses for rent are included in its loan customers.

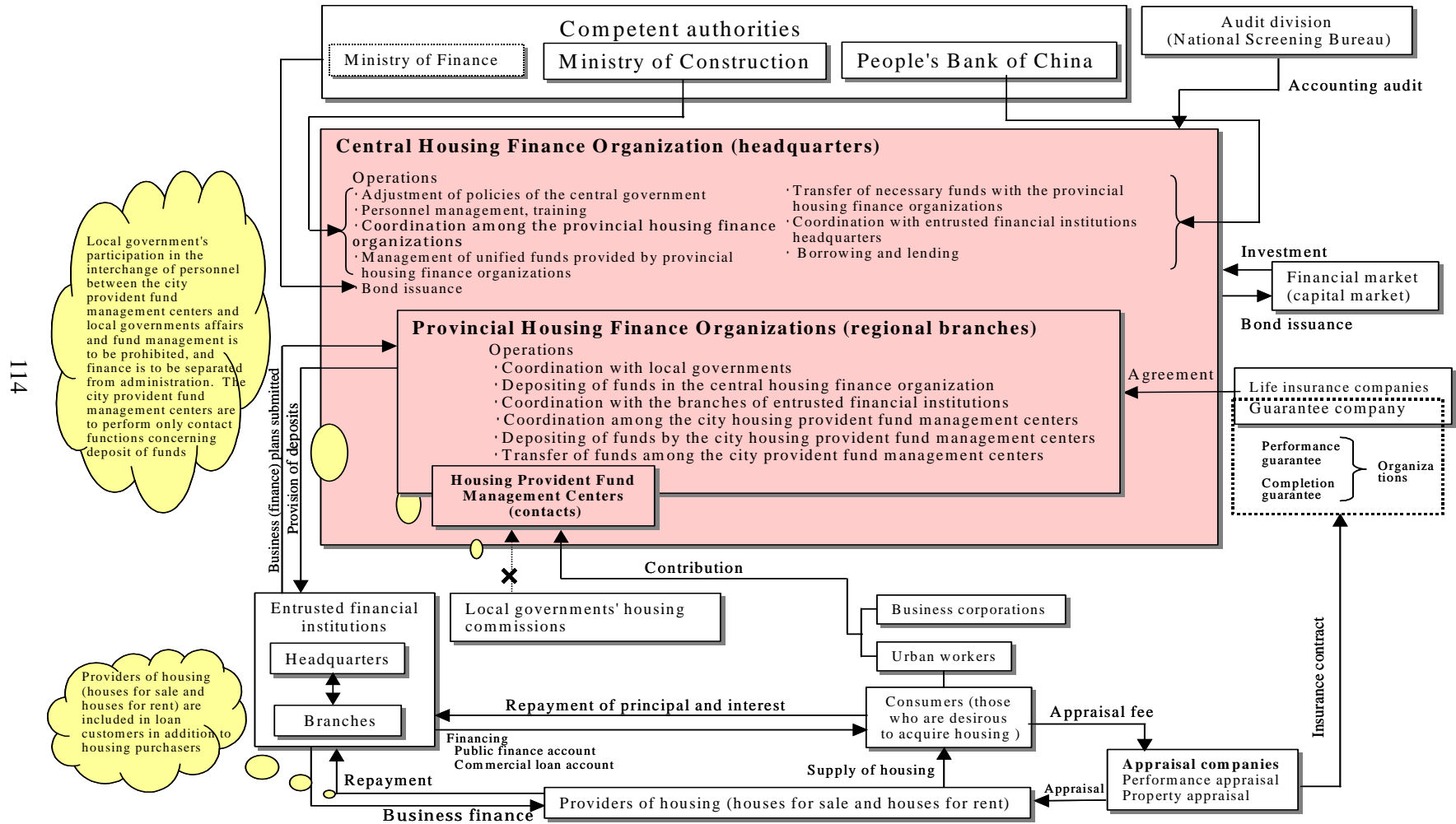
2) Organization(s)

- The central housing finance organization

3) Important Points to Note

- It is necessary to develop a new screening, collateral appraisal, credit guarantee, and debt collection system in keeping with the increase of loan customers.

Figure 3-12 Image of Systematized Finance



114

Source: JICA Study Team

3.4.5 Third Reform (Shift from Systematized Finance to Guidance Policy Finance)

“Central Housing Bank of China” (tentative name) is to be established as an organization to specialize in guidance policy housing finance, with the aim of restructuring the present housing provident fund system.

The Central Housing Bank of China (tentative name) is a new self-financing organization which is to directly procure own funds through housing deposits and bond issuance, and which is to concentrate funds owned by the central government, such as housing provident fund and postal deposits, in the fund management divisions of banks. It is also to carry out housing finance business on the basis of the central government’s housing policy using these funds.

(10) Establishment of “Central Housing Bank of China” (tentative name): Shift to Guidance Policy Housing Finance Institution

1) Functions

- Depositing of funds by the provincial housing finance organizations/fund management/integration of free reserve funds/integration of special-purpose taxes
- Diverse fund procurement through MBS and bonds in the capital market

2) Organization(s)

- Central Housing Bank of China

3) Important Points to note

- It is important to strike a suitable balance between authority and responsibility within this organization because it is an organization to be newly established jointly by a number of government agencies.
- The process of establishment of this organization will be similar to the process of establishment of the Central Housing Reform Commission, which was established jointly by the People’s Bank of China, the Ministry of Construction, the Ministry of Finance, the Plan Development Commission, the China Construction Bank, Central Office Work Management Bureau and the Beijing Metropolitan Government for the purpose of monetization of welfare housing.

(11) Organizational Structure of the Central Housing Commission (to Provide Management Consulting Service to the Central Housing Bank of China)

1) Functions

- Formulation of national-level housing plans/formulation of guidance policy lending guidelines
- Determination of standard prices of housing for the acquisition of which loans are provided/management consulting service to the Central Housing Bank of China

2) Organization(s)

- An organization to be established in the form of a council by the Ministry of Construction

3) Important Points to Note

- Management of local housing commissions' activities

(12) Establishment of Free Reserve Fund System

1) Functions

- The Central Housing Bank should not limit its fund management business to personal finance so that those who cannot afford to acquire housing may not suffer from a sense of unfairness, and that it may bear the costs of construction of rental housing and maintenance, management and repair of spaces for common use of condominiums. To this end, it should accept free reserve funds and at the same time procure funds directly in the market.

2) Organization(s)

- Commercial banks could serve as financial institutions to accept free reserve funds on behalf of the bank.

3) Important Points to Note

- The rate of interest on loans provided through the free reserve fund should be higher than the rate of interest on housing provident fund loans, and lower than the rate of interest on commercial banks' loans.

(13) Introduction of Special-purpose Taxes (Local Tax, Housing Policy Fund)

1) Functions

- The public housing finance system is characterized by "long-range, low, fixed interest rate" and is premised on implementation of fiscal measures. In light of the present shortage of financial resources, however, new special-purpose taxes, including temporary property tax, should be introduced.

2) Organization(s)

- In principle, special-purpose taxes are collected by local governments as local taxes.

3) Important Points to Note

- It is essential to work out a sufficient rationale for the plan to introduce new special-purpose taxes through serious discussions, because such plan will likely meet with opposition.

(14) Improvement of Guidance Policy Housing Finance Functions

1) Functions

- Housing loans are to be provided preferentially for the acquisition of housing which meets certain qualitative (energy saving, barrier-free design, comfortable living environment, etc.) and quantitative (dwelling floor area) requirements.

2) Organization(s)

- The Central Housing Bank of China and the Central Housing Commission

3) Important Points to Note

- It will be necessary to develop a guidance policy finance menu in cooperation with the Ministry of Construction and the Central Housing Commission.

(15) Development of a Housing Policy-Related Information System That Covers the Future Outlook for Housing Supply-Demand Situation

1) Functions

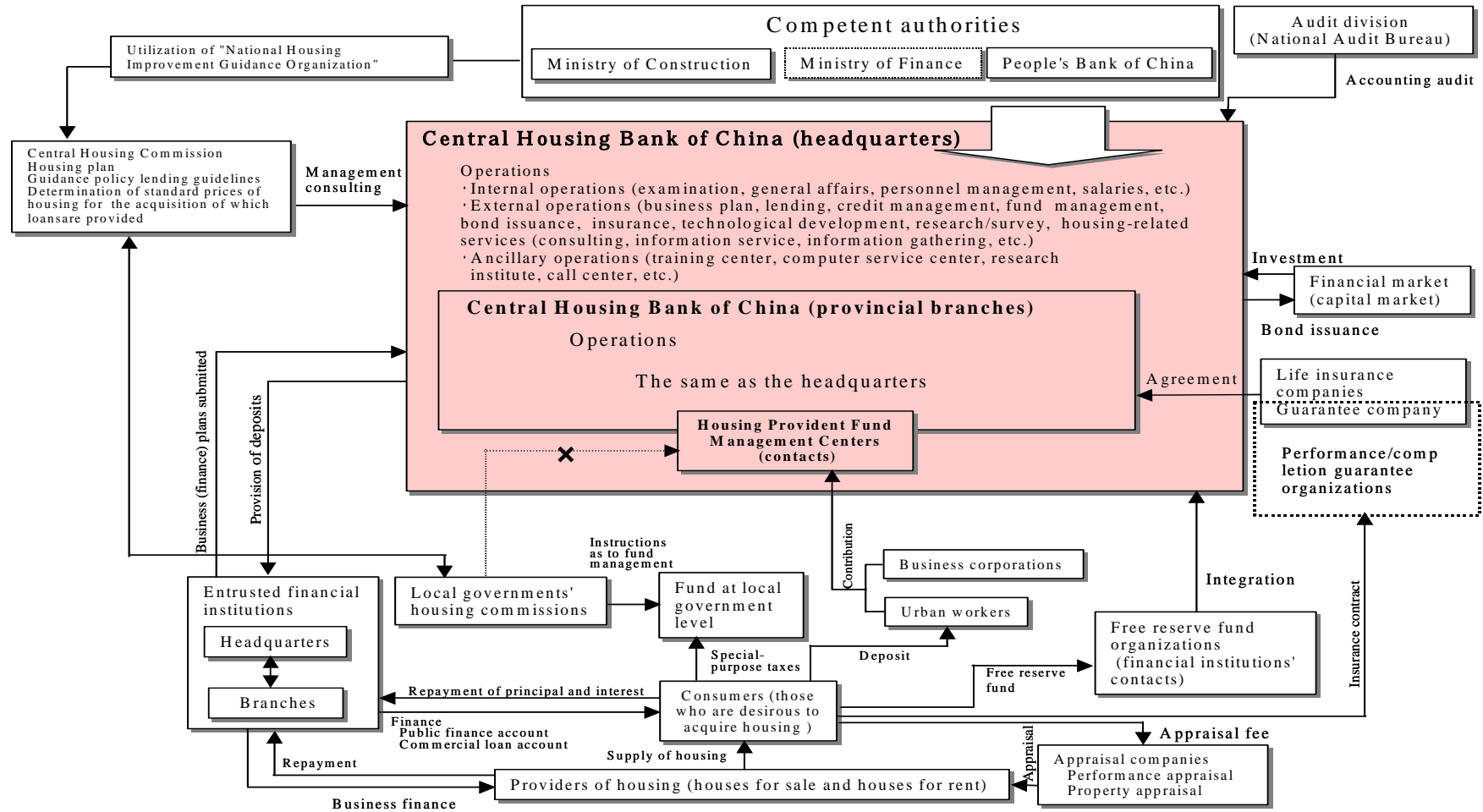
- Housing information, such as the future outlook for housing supply-demand situation will be provided to the central organizations (Central Housing Commission and Central Housing Bank of China) through local governments, and at the same time information on the beneficial effects of public housing finance will flow from the central organizations to the local organizations.

2) Organization(s)

- Local governments' housing commissions and the Central Housing Commission
- Important Points to Note
- Development of an information system to promote the flow of information between the central and local organizations.

Figure 3-13 Image of Guidance Policy Housing Finance Organization

118



Source: JICA Study Team

Appendix 1. Overview of Housing Provident Fund system:

Appendix 1.1. Objective of Housing Provident Fund System:

In 1992, the Public Housing Provident Fund (hereinafter referred to as the HPF) system was started on a trial basis in the city of Shanghai. And it was organized as a nationwide system under the new regulations resolved by the State Council in 1999.

The HPF system has an objective of promoting the supply of housing to urban workers while upgrading their living level as well. To this end, the Government has forced this system to enroll all the workers there, including those working in national organizations, state-owned enterprises, urban-concentrated group undertakings, urban private entities and foreign capitals. With reserved long-term housing savings taken for a fund, the PF system offers a housing loan to its subscribers on a payback basis under the preferred terms as compared with a loan in the private sector for the purpose of purchasing their houses (including the existing ones), constructing and/or modifying dwellings.

The Government has been making effective use of the HPF system as mainstay of the housing monetization distribution policy to promote the disposal of publicly owned houses in which urban workers have been currently living. At the same time, the Government has been guiding them to rehouse from deteriorated housing while striving to improve the dwelling level of urban workers. At the same time, the Government and enterprises have stopped newly supplying publicly owned housing while materializing a significant decrease in the cumulatively increasing financial burden required for maintenance and management of publicly owned housing.

Implementing the HPF system may be deemed aiming at the establishment of a governmental housing finance system while depending upon a success in the urban housing reform in the process of transfer to the socialistic market economy.

To start up the 10th five-year plan, moreover, the Government is prompting the finance system reform in preparation for participation in the World Trade Organization (WTO). To maintain an annual mean economic growth rate of 7% from now on, moreover, the Government is activating private housing investments to expand personal consumption and to foster housing-related industries while conducting on technical innovations. With eyes set on a wide range of their far-reaching effects on the domestic economy, the Government has positioned such measures as one of the mainstays for housing policies.

Appendix 1.2. Housing Provident Fund System

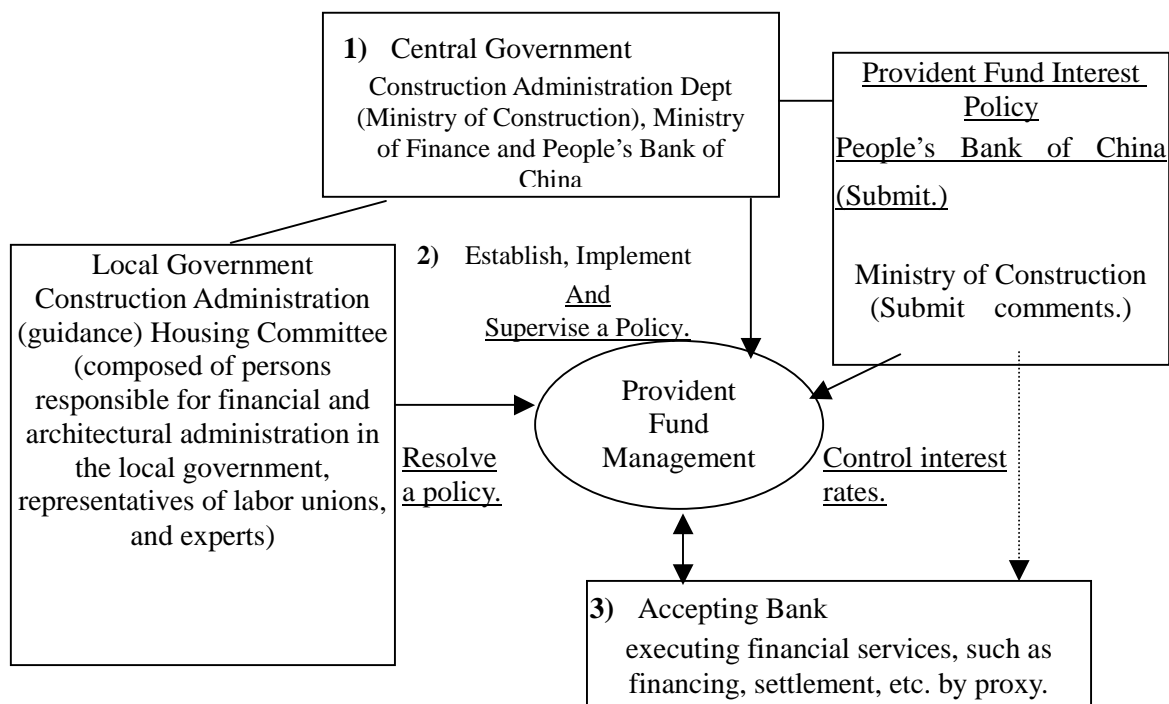
The HPF Management Center is a governmental nonprofit organization allowed to be established in directly controlled cities, provinces, autonomous districts, and cities with people's governments or with wards.

HPF Management Centers so established are designed to let a designated banking institution operate part of the HPF in relation to its entrusted services under the control of local governmental organization and of the Housing Committee in accordance with the standards of the Central Government (Ministry of Construction, finance Dept., Ministry of Finance and People's Bank of China).

The HPF system may well be considered to have the philosophy that a medium-income stratum of the citizens registered (urban workers with income at a certain level or more) be systematically made to obtain housing at a favorable dwelling level (houses at a higher level than that of the economical housing promoted as a project at a Government level). To this end, a certain percentage (5 percent or more as provided for in the regulations) of the monthly wages earned by urban workers are mandatorily saved on a long-term saving basis by both themselves and the enterprises to which they belong. A subscriber, who has reserved over a certain period or more, is entitled to be financed for housing on a pay-back basis. This is a governmental housing finance system, in which the "original fund procurement named housing saving" is linked directly with the "housing finance on subscribers' behalf."

To help urban workers acquire their own housing while saving the reserves for a long time, the Government is able to procure stable financial resources at a low interest rate on a medium/long-term basis. And subscribers are able to have their housing fund financed under the more preferred financing conditions than a housing loan available in the private sector. Besides, they are free from the impacts of busy fund demand and supply on the finance market. Consequently, subscribers could expect to obtain the housing at a favorable dwelling level.

Figure 3-14 Housing Provident Fund Administration Scheme



Functions of Housing Committee	Functions of HPF Management Center
<ul style="list-style-type: none"> • Determine a proportion of reserves in the HPF. • Determine the maximum value of a loan available from the HPF. • Examine and ratify the programs to collect and apply the HPF. • Examine and ratify the reports on a status of implementing the HPF collection/application programs. 	<ul style="list-style-type: none"> • Prepare and execute the HPF collection and application programs. • Record the situations where subscribers (employees) have saved, broken down and used their reserves in the HPF. • Close the accounts of the HPF. • Examine the break-down and use of the HPF. • Assume responsibilities for an increase in assets and for repayment of the HPF. • Prepare a report on implementing the HPF collection/application programs. • Execute those miscellaneous particulars that the Housing Committee has resolved.

Source: JICA Study Team

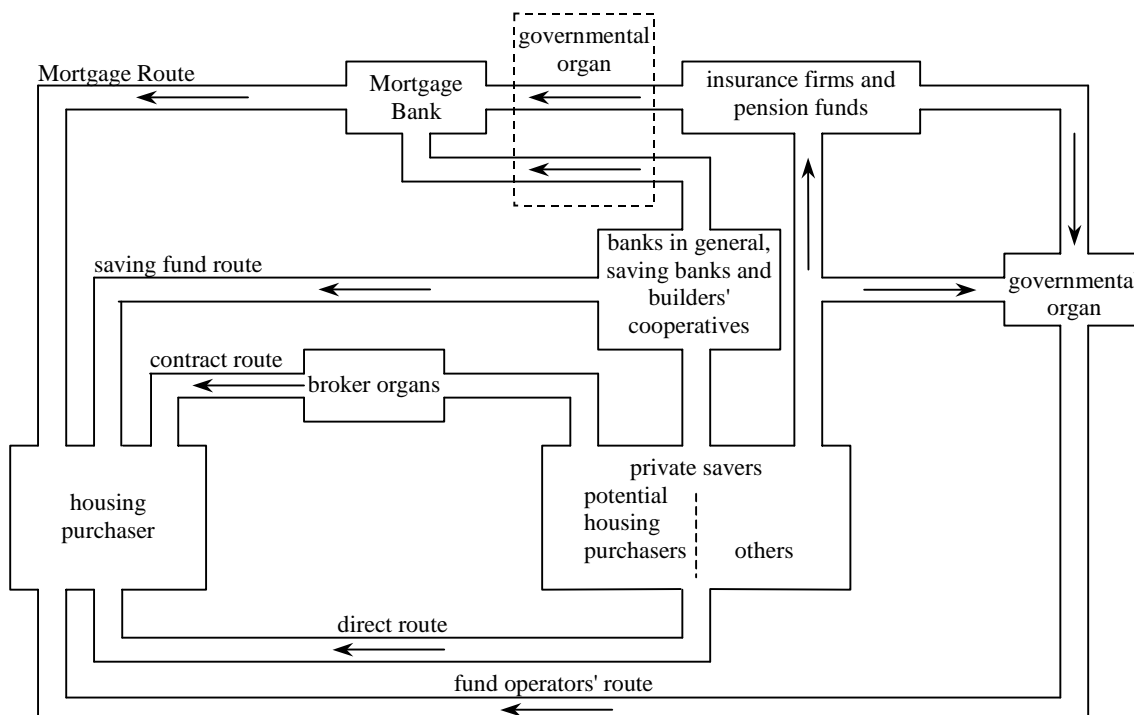
Appendix 2. Housing finance systems in Japan, Europe and America, and Housing Provident Fund system in China:

Appendix 2.1. Housing Saving Deposit System and Types of Housing Finance Organizations

Housing finance is basically identical with a flow of funds in industries. In this finance system, banking institutions raise funds by a wide diversity of methods and render financial services.

Including those general deposits and savings, which are moving for interest, the savings and debentures intended to acquire housing are used to raise the funds for housing finances. With the real estate claims changed over to debentures, furthermore, financing functions strive to be circulated. A breakdown of housing finance systems with such features as referred to above would allow for a classification of such systems by flow of fund as illustrated in Exhibit 3-2 below.

Figure 3-15 Classification of Housing Finance Systems



Source: Prepared by JICA Study Team, based on Boleat (1985) page 8

A rough classification of housing saving/deposit systems and banking institutions by type would permit us to pick up the following five:

- 1) General saving/deposit type (fund-mixed system)
- 2) Contract saving/deposit type (fund self-contained system)
- 3) Mortgage bank type (fund-collaboration system)
- 4) Mortgage company type (market fund-raising system)
- 5) Fund centralization type (fund operation system)

(1) General saving/deposit type (fund-mixed system)

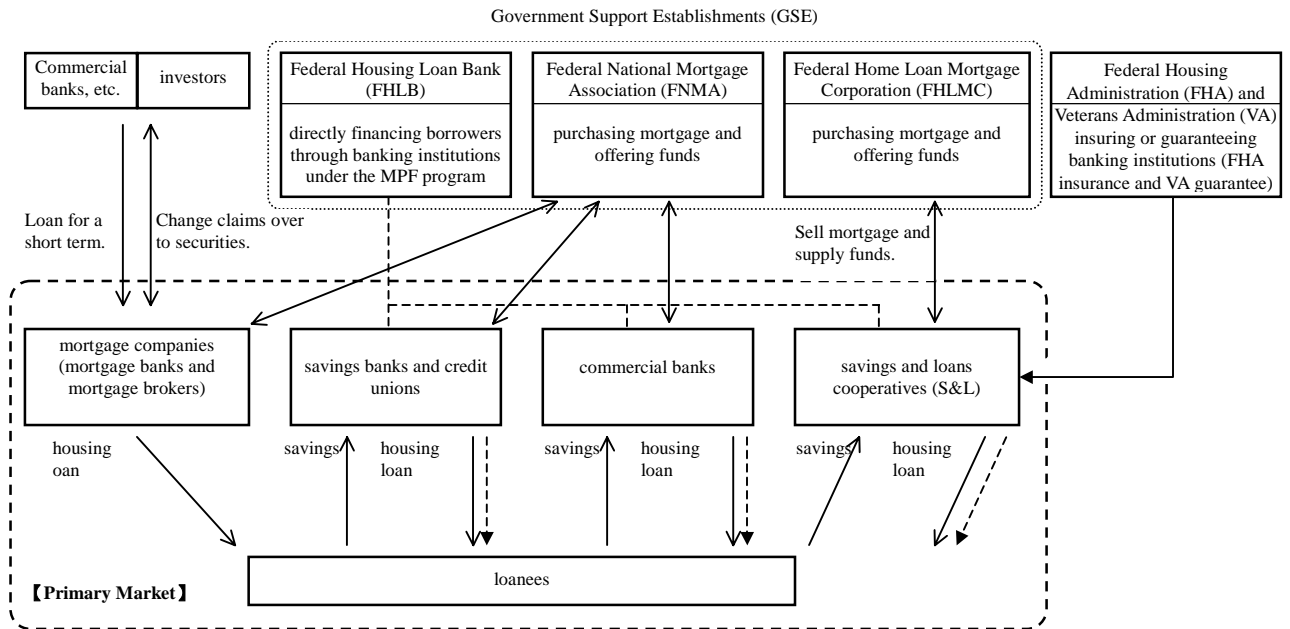
Under a housing finance system of this type, banking institutions widely accept personal savings, which are in turn used as the source capital to finance housing purchasers. This type has savings and finances directly linked to each other. With fund raising given priority, a banking institution should widely gather from those individuals who have the only purpose of saving without planning to purchase housing. In this sense, it differs from the contractual housing saving/deposit type in which housing savings/deposits are linked directly with housing finances.

Typical banking institutions falling in this category include the German Saving Bank, the Saving Loan Cooperative in the USA, and the Housing Finance Cooperative in the UK. They initially started as the banking institutions oriented for mutual aid in housing finance. With their housing finance business expanded later, and in the finance liberalization process, both US and UK cooperatives have been converted into the present form of operations.

This saving deposit type has often adopted an architecture of variable interest rates, financing a relatively large amount for a relatively short term. To raise funds, moreover, some efforts are required to secure savings at an interest rate interlocked with the market interest rates. As a result, the capital cost is expensive.

As seen in housing finance systems in the USA whose financing infrastructure has been built up, however, even a general saving/deposit type banking institution (commercial bank or saving loan cooperative) has been using another fund-raising means. In other words, they are using a technique of converting assets to securities to raise the funds required. To this end, their mortgage bonds privately financed are sold to the Federal National Mortgage Association (FNMA) and to the Federal Home Loan Mortgage Corporation (FHLMC). These government support establishments (GSE) who have bought such mortgage are in turn able to raise funds on the so called second market by issuing mortgage bonds.

Figure 3-16 Primary Market and Main Banking Institutions in the USA



Source: "Housing Policies and Finances in the World" Housing Loan Progress Association

(2) Contract saving/deposit type (fund self-contained system)

The typical housing finance systems of this type include the Construction Savings Depository in Germany, the Housing Saving Deposit system in France in the broader sense, and the Housing Debenture Reserve System, Housing Reserve Postal Saving System and Workers' Housing Asset Formation Saving System in Japan, including the Reserve Lot-out Housing System (a unique system in which reserves are directly linked with the house planned to lot out) managed by local housing public corporations (legal persons under a special act).

In this type, the financial resources for housing loans are secured with the savings reserved by those who have a plan to acquire housing in the future. Under such a mutual aid-oriented mechanism, medium-term housing savings are linked directly with housing loans. (Their especially remarkable linkage is seen in the highly mutual aid-oriented Construction Saving Depository in Germany.) It may be deemed as the self-contained fund circulation system located at a certain distance away from a fund-raising financial market.

This system allows the fund-raising cost to be lower since the contractual savings are used as financial resources so that the system can offer loans at a lower interest rate. Besides, it may allow a fixed-interest rate system to be established more readily. Nevertheless, a plenty of funds could not be raised separately. As a result, a loanable value is limited to a relatively

lower level. And there are another problems involved in allocating the funds for a loan (application timing and loanable value limit).

As seen in the German case, the Construction Saving Depository offers a loan in an amount limited to a level equivalent to the second mortgage. Nevertheless, a shortage for the funds often resorts to a collaborative loan from a saving bank or mortgage bank, which places a heavier weight on housing loans within an affiliated financial group.

In France, the Housing Reserve Saving loan is also limited to a down-payment level. The banking institutions dealing in housing saving deposits under a contract with the Government have a loan shortage supplemented, with a government-collaborating private loan offered in sets.

- In the Japanese Government Housing Loan Corporation case, prospect housing purchasers are systematically reserving the housing debentures issued by the Corporation so that they will save an amount equivalent to the down-payment required to acquire a house. Under this system, a shortage for the fund to acquire housing is filled with a preferred loan in favor of those who have saved reserves on a debenture basis. The Housing Postal Reserve Saving system is also functioning under similar mechanisms. A comparison with various systems in Japan, Europe and America, the Chinese HPF system may be considered to have the mechanisms near the contractual saving deposit type.

(NOTE) As seen in Germany and France, many governments are encouraging a growth of contractual savings, taking such incentives as to pay a saving benefit and offer an interest privilege in terms of taxation. Since financial assistance measures involve an increasing amount of liabilities later, governments have often reduced such benefits.

(3) Mortgage bank type (fund-collaboration system)

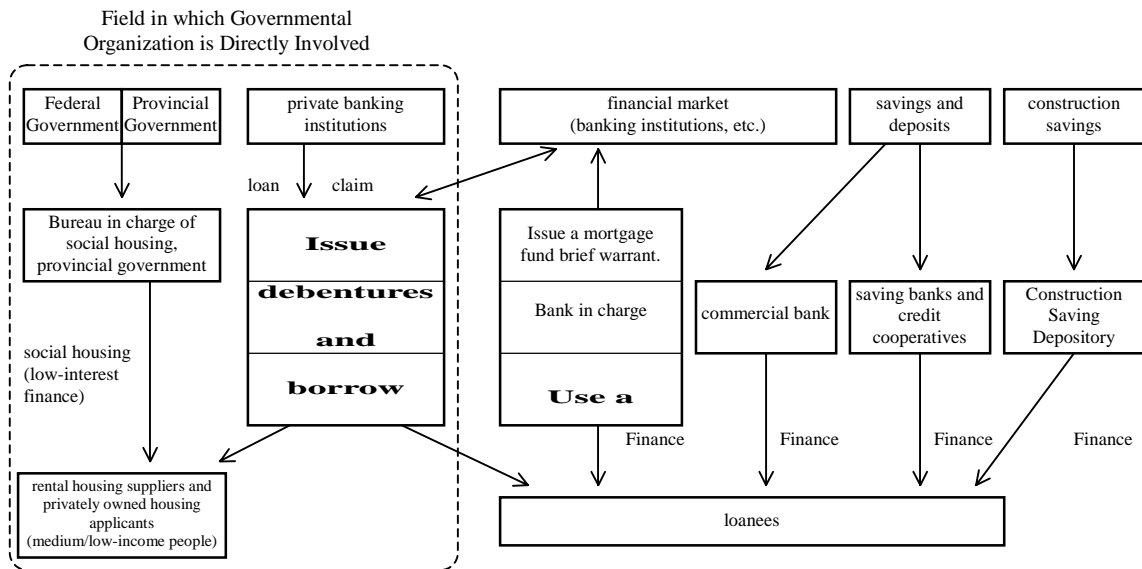
A mortgage bank in Germany issues a mortgage certificate once a private loan has been granted. With this certificate as security, the German mortgage bank issues a fund brief warrant (mortgage bond) to secure the financial resources required for the loan.

When the fund brief warrant is issued in Germany, the strict national standards apply under the severe supervision of the Government. Besides, the real estate is also severely assessed on a revenue return basis in Germany. Since the collateral on the real estate finance could be secured without fail, therefore, the fund brief warrant has been enjoying a high level of reliability on the financial market there. Moody's and S&P have rated the German mortgage bank at as high as Triple A. As a result, the Germany mortgage bank is able to secure funds for a long term at a low interest rate. In Germany, therefore, it is possible to offer a housing

loan of 10-years long fixed interest type (without allowing for an earlier repayment for a certain period).

The mortgage bank, moreover, is financing collaborately with the Construction Saving Depository on a first mortgage basis. And the loan granted by the Construction Saving Depository is taken for the second mortgage. Thus, such a collaborative type loan is often available within an identical group of affiliated banking institutions.

Figure 3-17 Housing Finance Systems in Germany



Source: "Housing Policies and Finances in the World" Housing Loan Progress Association

(4) Mortgage company type (market fund-raising system)

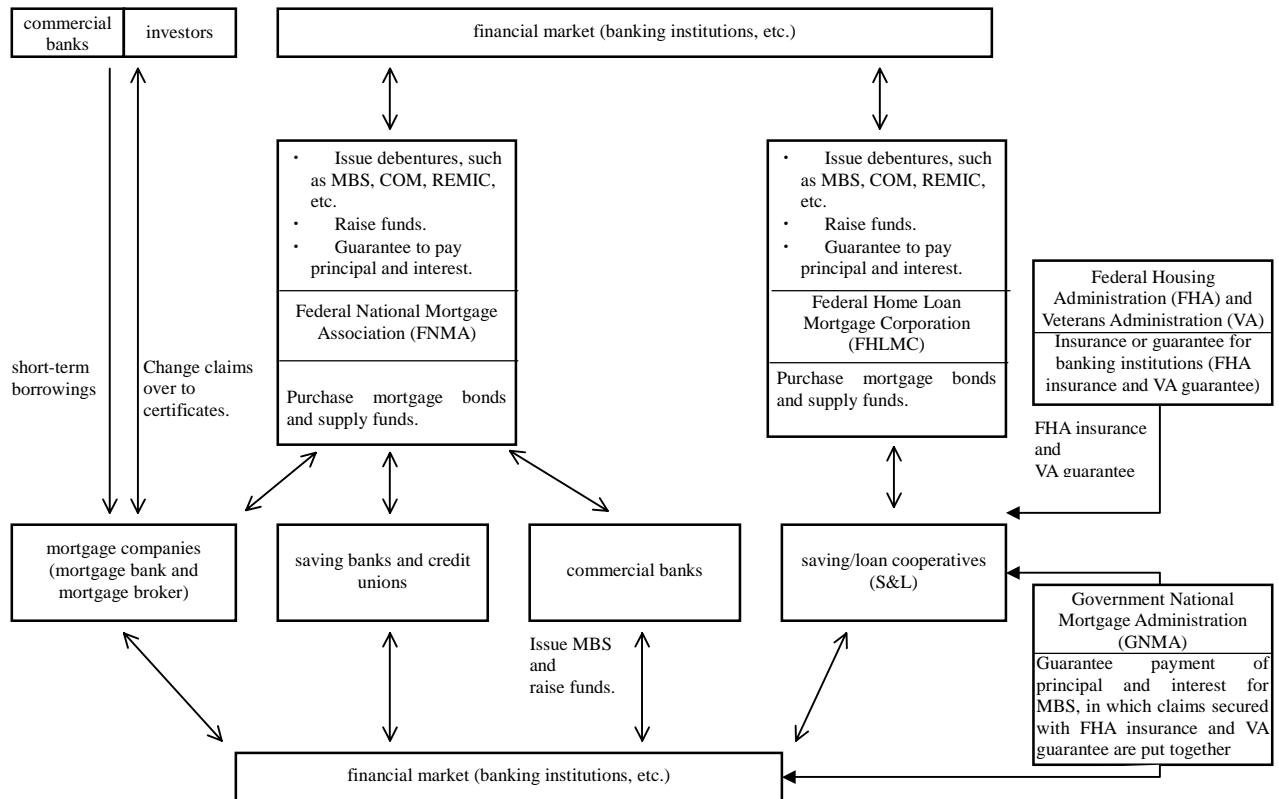
In order that the finance system may function properly, it is a prerequisite that a highly evolved finance infrastructure established (with a mortgage distribution market built-up, that a variety of expert organizations, such as rating organs and servicers, and are capable of efficiently processing clerical work). This type is really seen in the USA.

Unlike banking institutions, such as banks in general, a mortgage company does not render saving services. As a means of raising the funds for long-term housing finances, the mortgage bank changes its housing loan claims over to mortgage certificates, which are in turn sold on the second market to secure the financial resources for financing. This banking institution specializing in housing obtains short-term borrowings from a commercial bank or the like to offer a stopgap loan prior to the execution of financing.

Thus, the mortgage company's main business is to originate loans. Consequently, it does not hold loan claims but has a small amount of loan balances. Besides, many mortgage

companies are subsidiaries of banking institutions. With financing services loosely regulated, business line continue to diversify.

Figure 3-18 Overview of Second Market and of Government Support Organs in the USA

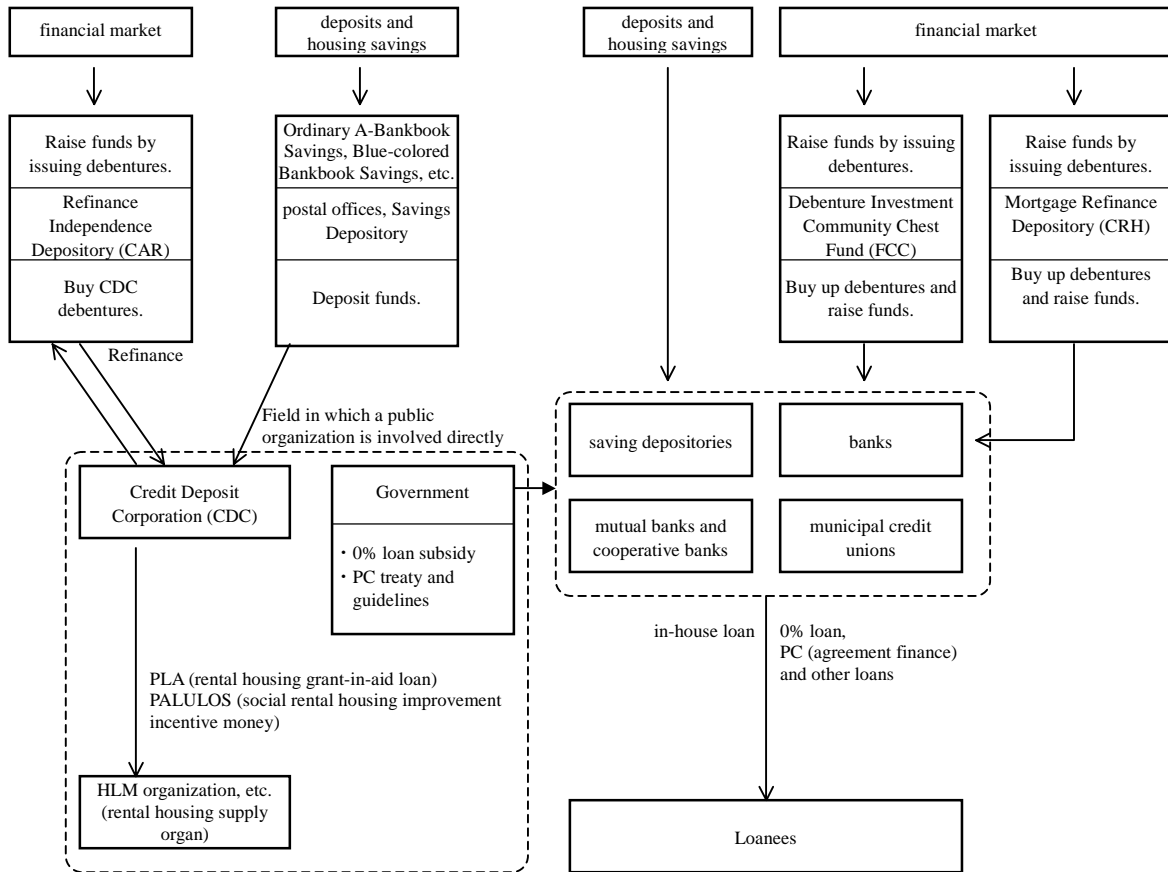


Source: "Housing Policies and Finances in the World" Housing Loan Progress Association

(5) Fund centralization type (fund operation system)

This is a governmental housing finance system that acquires medium/long-term stable public funds, such as tax-preferred deposit savings and the like, deposited in a fund operation department. Thus, financial sources are centralized in the national fund operation department and allocated to housing loans so as to materialize a national housing policy. Included in this category is the Government Housing corporation in Japan (a special banking institution organized under a special act, with the capital wholly owned by the Government). A similar example is the Deposit Finance Depository in France (a special banking institution to be operated on a budgetary basis year by year without having any capital).

Figure 3-19 Outline of Housing Finance Market in France



Source: "Housing Policies and Finances in the World" Housing Loan Progress Association

Appendix 2.2. Mandatory Housing Fund Contribution System in Foreign Countries

As an analogous example in a foreign country, France has the PEEC (Employers' Housing Construction Fund Contribution System) established in 1953. In this system, the Government asks employers for a mandatory contribution.

These funds are applied in executing national housing policies (private housing loan, HLM rental housing loan and source fund for housing allowances). Arrears would be penalized under established rules.

Since it requires a mandatory contribution, the system may be considered oriented for an object tax.

Table 3-3 Savings-linked Finance Systems in Japan

	WORKERS' ASSET FORMATION SAVING SYSTEM	HOUSING LAND DEBENTURE SYSTEM	HOUSING RESERVE POSTAL SAVING SYSTEM
Savers	Those who are saving for the purpose of acquiring housing and of making old age comfortable	Those trying to acquire housing with loan from the GHLC, or Those trying to build housing after acquiring housing lot reclaimed with loan from the GHLC	Those trying to acquire housing with loan from the GHLC
Saving banking institutions	banks, life insurance companies, trust banks, security firms and post offices	Government Housing Loan Corporation	post offices
Saving Items	Finance items offered by banking institutions	Purchasing debentures according to their interest rates	Reserve type postal savings
Term of loan	Employment/Ability Development Organization and Government Housing Loan Corporation	Government Housing Loan Corporation	Government Housing Loan Corporation
Conditions of loan	Max. 10 times the amount reserved, limited to 40 million yen, with GHLC loan jointly available Interest rate is reviewed every five years. Long-term variable interest according to debenture interest	1.5 times reserved amounts of 3 million yen and of 5 million yen available additionally to GHLC loan at fixed interest rates according to GHLC loan interest	A fixed amount (2.75 million yen) added to GHLC loan at fixed interest rate according to GHLC loan interest
Source capital for finances (relations with savings)	Finance organ issues debentures to asset formation saving institution. Up to 1/3 of saved amount is obligated to be financed. Loan interest is interlocked with debenture interest.	Financial investments and finances, etc. (borrowings from the national treasury and debenture issuance), Housing debentures have a smaller procurement size than amount of additionally financed. Loan interest is not interlocked with fund-raising interest.	Financial investments and finances, etc. Savings are not directly related with additional loan.
Business size	Financed value 70.1 billion yen for 1996	Balance of housing debentures: 530.7 billion yen, March 1998	Balance of housing reserve postal savings: 3.8 billion yen, March 1998

Source: "Housing Policies and Finances in the World" Housing Loan Progress Association

Table 3-4 Savings-linked Finance Systems in France

	BANKBOOK TYPE HOUSING SAVING DEPOSIT	RESERVE TYPE HOUSING SAVING DEPOSIT
Deposit limit	100,000 franc	400,000 franc
Characteristics of savings	Saving deposit with flexibility in cancellation and/or amount	Systematic debenture saving
Deposit interest rate	Savings premiums (national subsidy)	2.57%
Savings premiums (national subsidy)	Granted on finance, max. 7,500 franc	Granted upon maturity of reserves, max. 10,000 franc
Loanable limit	150 thousand franc	600 thousand franc
Term of loan	Max. 15 years	Max. 15 years
Loan interest	2.25%	3.60%
Handling banking institutions	Contracted in all of operational forms, such as banks, affiliated banking institutions, saving depositories, etc.	Contracted in all of operational forms, such as banks, affiliated banking institutions, saving depositories, etc.
Number of premiums granted	334 thousand cases (1997)	1,426 thousand cases (1997)
Features	Available jointly another system loans, bank loans, and implemented in many banking institutions	

(NOTE) Interest rates prevailed as of August 1999

Source: "Housing Policies and Finances in the World" Housing Loan Progress Association

Table 3-5 Construction Saving Loan System in Germany

Characteristic of savings	saving deposits under a construction saving contract
Mean amount of savings	22,000 marks
Saving interest rate	2.50%
Construction saving bounty	0.5 thru 1% per annum
(natural subsidy)	granted on acquisition of housing
Amount of loan	33,000 marks
Term of loan	11 years on the average
Handling banking institutions	34 construction saving depositories
Number of saving contracts	33.43 million contracts (as of the end of 1998; same shall apply hereinbelow.)
Balance of savings	18.21 billion marks
Balance of loans	18.87 billion marks
Features	Construction saving depositories are provided banking institutions group by group. At the second mortgage level, up to 80% of the price assessed to be acceptable is loaned, thereby inducing a loan in a grouped banking institutions

Source: "Housing Policies and Finances in the World" Housing Loan Progress Association

Appendix 2.3. Features of Housing Provident Fund system:

A comparison of the HPF system in China with housing saving/deposit systems in Japan, Europe and America reveals that the Chinese system has the following features:

- 1) The HPF Management Center is a nonprofit organization, public in nature, and located from region to region under the ordinance of the State Council to render housing saving/loan services. Some of its services are entrusted to a designated banking institution.
(NOTE) The HPF Management Center characteristically has no capital by itself but derivative savings, such as bad debt reserves, breakdown savings and the like. It is not an independent business entity aimed at making profits.
- 2) A saving reserve contract is not arbitrarily acted upon by and between a subscriber and the PFMC but that the subscription in this saving system is mandatorily required under the governmental ordinance. And loans have their applications limited to housing only.
- 3) Even if a subscriber does not acquire housing, the HPF system is mutual-aid oriented that the subscriber is obligated, in principle, to continue contributing the housing reserves over a long period until his or her retirement age.
- 4) Eligible subscribers are limited to those urban workers who have their domicile registered in their municipality (including a tentative domicile registration), and to the enterprises to which they belong.
- 5) Urban workers have a portion of their wages withheld by their employers (5% or more) determined by the using Committee (a public organization composed of representatives from the local people's government supervising the HPF unit, financial/construction-related organizations, labor union, and of academic experts).
- 6) The HPF system is oriented towards object tax, considering that the enterprise to which an urban worker belongs is obligated to reserve the HPF at an identical proportion.
- 7) Penalty clauses are provided to penalize a non-subscription in the system or arrears in paying reserves.

To support the HPF system, moreover, the government has mapped out housing policies on a nationwide basis (e.g. financial burden programs, such as subsidies by income-stratum, grant for paying a fixed rate of interest, or the like), preferred taxation measures (housing transaction, housing loan, etc.) and comprehensive housing credit

complement systems (agency guarantee in the place of personal guarantee, housing non-life insurance, collective credit life insurance, housing performance guarantee, etc.) Nevertheless, it has pointed out that these measures and systems are not functioning properly.