Commentary on House Resolution 611
Author: Hon. Maria Lourdes Acosta-Alba
Topic: Housing and Real Estate Development and the Potential Risk of a Housing Bubble

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1. Real estate activity is strongly influenced by economic growth. It becomes very active in periods of economic expansion and slows down in a recession. Trends in private construction in the country reveals the strong positive influence of export growth, the industrialization and commercialization of localities, and the increase demand for housing. This is usually followed by increase real estate sales and property prices.

2. While increase real estate activity indicates that the economy is growing, it can be a threat when the market responds to speculative demand. The situation can lead to a real estate bubble (or housing bubble for residential markets). A real estate bubble or housing bubble occurs occasionally in local or global real estate markets. It is indicated by the following: (1) rapid increases in valuations of real property and housing; (2) significant number of vacant or under-performing commercial and residential properties and the continued construction of property despite this fact; and (3) high price-to-income ratios. The bursting of the bubble means huge decline in property prices which immediately impact on owners of property assets due to lower value of assets as well as the financial system since investors tend to pull out of the market causing high incidence of past dues and defaults leaving the banks and creditors holding soured assets.

3. Warnings of a housing bubble in the country have been raised recently by the academe and the IMF based on the following observations:

    - In the last two years private construction activity has been growing high speed at the rate of 15 to 20%;
    - For the period 2011 to 2013, Philippine real estate showed year on year increase in prices higher than that in Indonesia and Singapore. Nominal prices of high end residential units increased annually by 8% with rents rising at 15%.
    - There is a suggested oversupply in the higher end market of about 5 to 10%.
    - About 80% of new residential construction (by number of units) is in the low middle price bracket and half are reportedly purchased pre construction by overseas foreign workers. The possible non-renewal of OFWs' short-term employment contracts can be a potential risk in the market.

4. A key indicator of the likelihood of a property or housing bubble is the lending activity to real estate. A combination of low interest rates and loosening of credit underwriting standards can bring borrowers into the market, fueling demand while a rise in interest rates and a tightening of credit standards can lessen demand. In particular, the 2008 US housing bubble was the result of the combined effects of very low interest rates, relaxed standards on mortgage loans and exuberance in the market that was aided by financial syndication.

5. So far, BSP and the banking industry have not spotted red flags in the area of lending (or of an overheated property market). The prudential regime applied by BSP to banks is conservative based on two measures:

   - A 20% maximum proportion of real estate loans to total loan portfolio. In 2012 BSP has further tightened regulations by providing a comprehensive measure of a bank's real estate exposure in both loans and investments in debt and equity securities. Previously only real estate loans were covered.

   - A 70% maximum loan to value ratio also applied to home loans, all real estate loans being risk weighted at 50% for capital adequacy purposes.

6. The property exposure of banks (i.e., universal, commercial and thrift banks) to real estate loans based on the expanded definition is 18.45% as of end-2012 (BSP Statistics). This ratio increased to 20.95% in March 2013 slightly exceeding the 20% cap. However, the increase is attributed mainly to a rise in real estate loans (not securities) primarily to finance the acquisition, construction and improvement of housing units. This seems manageable considering that the level of non-performing property loans, i.e. loans unpaid 30 days after the due date, remained low at 4.0 percent, which is also considerably lower than the 6 percent level in 2010. Moreover, there is no significant easing of credit standards on loans based on BSP survey. The primarily real estate end-user financing currently undertaken by banks is a response to the demand from new households and those with new jobs rather than speculators or investors. These indicators suggest that housing bubble is not forming in the medium term.

7. On the other hand, a potential source of problem could be other sources of property finance. BSP supervision is limited only to banks. The largest but hidden part of home loan finance is made of credit receivables extended by developers to the buyers through contract to sell (CTS) agreements. CTS is common in emerging economies where there is a shortage of accessible mortgage market. Developers use deferred sale contracts, which in practice is a credit facility granted to a purchasing household. The title to the property is transferred only upon full payment and in case of default, the CTS is cancelled and the unit can be resold to another client. This lending activity is neither

regulated nor measured by BSP. Although the idea of CTS is positive in terms of expanding home finance to low and middle income sector, it is possible that these developers or real estate companies may have been applying less stringent lending standards and more generous loan terms than required of banks (e.g. zero interest rates, zero downpayment) which opens up the financial system to trouble.

8. CTS are channeled to the financial system through a refinancing scheme by banks and government housing finance corporation (e.g. HDMF) but the amount of CTS retained by developers could still be large. Based on the assets of the largest developers it is possible that about 15% of assets are made of CTS considering preselling activities. Other developers could have more since banks are more reluctant to finance them.

9. Government housing finance corporation such as HDMF also needs to be watched. Government housing policy tends to relax mortgage policy primarily because of the focus on homeownership, which may lead non-bank financing institutions to relax credit standards and undertake more aggressive financing schemes.

10. The Bangko Sentral ng Pilipinas (BSP) plays a major role in preventing a property bubble through monitoring lending activity but it should have an oversight responsibility to the housing sector as well from a macro-financial perspective.