



CENTRAL BANK OF THE REPUBLIC OF TURKEY

**Housing Sector in Turkey:
Challenges and Opportunities**

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Dear Guests,

I am delighted to be here to address such a distinguished audience in Istanbul. I hope this timely and important Conference on housing markets will contribute much to current and future debates in this sector, through exploring many prominent issues.

Housing market, which became the focal point of governments and regulators recently as a response to the recent financial turbulence, is one of the key parts of an economy. Through construction of new houses it contributes to the economy via several ways like creating value added, supporting employment, and generating tax revenues.

After several years of rapid price increases across the world, the housing markets in several advanced economies have been experiencing a marked turbulence. These problems began in 2006 and have accelerated considerably since summer 2007. Needless to say, problems in the housing sector have adverse implications for other sectors as well. In fact, according to research conducted by the International Monetary Fund, the spillovers from the housing sector to the rest of the economy are likely to be larger in economies like the United States, where it is easier to access mortgage credit and use homes as collateral. This is because movements in house prices, influence household spending plans through the role of housing as collateral. In the past, increases in house prices raised the value of the collateral available to households; loosened borrowing constraints, and supported spending.

Of course, as a central banker, an obvious question that comes to my mind is whether monetary policy can smooth the business cycle that is caused by the developments in the housing markets. Is it possible to pursue a monetary policy that responds to house price movements, particularly when they are unusually rapid or lead prices away from past relationships with fundamentals?

According to Alan Greenspan, the former governor of the Federal Reserve, there is no clear-cut answer and during his term he never said in plain English that there was a bubble in the housing market. It is not easy to identify bubbles in the housing market. And sometimes, if you cannot identify a disease, it may be a better idea to follow Hippocrates, and "Do no harm". Some observers have raised doubts as to whether non-intervention policy of the monetary authority was the right policy

choice, especially in light of recent sub prime mortgage crisis in the United States – but, of course, things always look clear in hindsight. Whether central banks, should respond to movements in asset prices as well or not is a big debate. However, I can formulate a central banking postulate about the issue as follows; central banks should neither let the monetary policy to ease asset price bubbles nor should they accommodate irrational exuberances.

Dear Guests,

Now let me turn our attention to housing market in Turkey.

Turkey has been facing a housing shortage since the 1950s when the industrialization process led to rapid urbanization and migration from rural areas to large cities. This has led to burgeoning of squatter buildings (known as gecekondu-built in a night) and illegal constructions. Nearly a quarter of urban population still lives in such settlements. Uncontrolled building stock aggravates taking measures against disasters; especially against flood, earthquake and fire. Since the existing infrastructure and social services fall short of meeting the demands, the problems of urban population related with economic and social life remain unsolved and they gradually increase. Therefore, the housing problem in Turkey is a qualitative problem as well as a quantitative one.

Starting from 1980, the government took important steps towards the improvement of the housing sector, and as a result investment in housing increased substantially. The establishment of the Housing Development Administration of Turkey, Housing Fund and mass housing projects through social security institutions as well as Türkiye Emlak Bankasi (Emlak Bank) were few examples of initiatives taken in the 80s. Throughout that decade and mid 90s, a remarkable growth in the housing sector was observed. However, the deficiency of housing loan system arising from the macroeconomic instability was a significant problem, preventing low and middle-income families to finds means to finance their housing demand.

Eventually in parallel to macroeconomic problems in late 90s, the housing sector also experienced a severe recession. In the aftermath of the Russian Crisis in 1998, of the earthquake of 17 August 1999 and of the economic and political

instability, investment in this sector decreased significantly. The economic crisis in Turkey in 2001 constituted the lowest point of the housing sector.

Thanks to structural reforms implemented right after the crisis, which aimed to rehabilitate and strengthen the banking sector, banks began to compete with each other to increase their market shares in credits. Furthermore, economic activity increased following the recovery from the crisis, interest rates declined as inflation fell rapidly and the elimination of fiscal dominance thanks to sound fiscal discipline created room for private borrowing through crowding-in. The restoration of economic and political stability and the accession process of Turkey to the EU decreased risk perception of global investors and hence enabled Turkish banks to borrow from the international credit markets at low rates.

As a consequence of all these factors we witnessed a considerable increase in the housing activity. Housing loans ratio to the total household credit, which used to range between 14 to 21 percent from the early 2003 till mid 2005, jumped to nearly 50 percent of household loans in mid-2006. However, May-June 2006 turmoil negatively affected the housing sector. Increasing interest rates curbed households' willingness to buy house and as a result year-over-year increase in housing loans declined from over 300 percent to 25 percent.

Dear Guests,

The development of financial systems to support housing growth in emerging markets requires a reasonable degree of diversity and efficiency, which usually involves creating specialized financial intermediaries.

As you may know the parliament has recently passed the Mortgage Law, which is likely to substantially improve the framework for mortgage loans. The law will allow mortgages to carry floating interest rates and prepayment penalties. It will also facilitate mortgage securitization, thereby allowing risks to be transferred out of the banks to other parties who are willing to take them, and increasing the funding for mortgages. The law also provides for the establishment of mortgage finance companies that can raise non-deposit funds and intermediate the securitization process. Securitization will nonetheless take time to develop. Only mortgages with good titles and standard contracts will be attractive for securitizations at reasonable

interest rates. Registration of real estate is not fully efficient in Turkey and represents a significant roadblock in mortgage system. Thus, the development of mortgage securitization will depend on the speed with which better titles and standard contracts develop.

There is a distinct tendency for Turkish households to favor short and medium term maturities to longer dates, which is mainly a result of frequent crisis episodes. Average maturity is less than 7 years. Nearly half of the households prefer the maturity of 5 to 10 years while the share of loans with maturities longer than 10 years is 19 percent, which is quite low when compared to international figures. As financial and economic stability are being enhanced and price stability is achieved the maturity structure will change in favor of longer-term maturities.

Dear Guests,

Looking at the future, there are huge challenges, as well as a vast potential. According to the data from the Turkish Statistical Institute (TURKSTAT) and the State Planning Organization (SPO), Turkey's housing requirement as of today is about 2,5 million either for renewal or conversion projects or quality house production projects. Due to population growth and continuing urbanization, Turkey will require an additional 5,5 million housing units by 2015. Added to the existing housing deficit, this represents a requirement for more than 500,000 new housing units to be built each year. Furthermore, with a growing economy and rapid urban expansion, there is a need for commercial/office/professional buildings. Likewise shopping malls and retail establishments need to be built as consumer spending is getting increased. Tourism development continues to generate new construction projects.

Although housing market grew significantly over time and despite the fact that home ownership ratio in Turkey is 68 percent, which is exactly the same what it is in the United States, housing credit's ratio to GDP is still at low levels compared to developed economies. For instance housing loans to GDP ratio in the United Kingdom, United States and European Union are 85, 75 and 47 percent respectively, whereas the corresponding figure for Turkey is a mere 4 percent. These numbers imply that there is a significant potential for the housing sector and mortgage loans to grow over time and increase its share in the economy. This fact was shown by a

report prepared by Real Estate Investment Trust Association in 2006. It is projected that construction sector will grow 6 to 10 percent and its contribution to GDP will range between 0.5 and 0.7 points till 2015. Also it was estimated that over an 8-years period an additional value added of nearly 200 billion US dollars would be produced.

It is no surprise to expect these estimates to realize when we take into the consideration the demographic structure of the Turkey and also continuing urbanization process. It is important to note that recent regulation concerning the mortgage market would contribute to the financial deepening of Turkish markets by allowing the issuance of asset backed securities and securitization of receivables from mortgages and that developments in turn will definitely improve the financing options of banks and leasing firms.

An important item of the agenda should be to provide affordable housing to every segment of the society. Under current economical conditions, poor people or low-income groups cannot acquire quality houses with favorable terms and conditions. According to research by the Central Bank of Turkey, only those which take the biggest share from the income distribution (the top 10 percent) are able to use the mortgage credit, based on the assumption that households will spend 30 percent of their annual income on housing credit payments. When the payment capacity of households related to housing credits for various interest rates and maturities is analyzed, it is found that the number of households who can use housing credits is only 1.8 million. If monthly interest rate (which is about 1.5 percent today) diminishes to 0.5 percent and the maturity (which is about 7 years today) extends to 30 years, this figure would increase to 9 million. Currently, the Government Housing Administration (TOKI) addresses this problem, by constructing and selling homes, mainly to families in the lower 40 percent of the income distribution. TOKI contributes significantly to the supply of housing in Turkey, but there is risk that it may dominate the mortgage market and crowd out private lenders.

Another challenge is how to increase the quality of existing dwellings. According to the "Housing Demand Research of Turkey" carried out by the Prime Ministry Housing Undersecretariat, illegal construction of buildings in Turkey has reached 40 percent. In the urban areas, 62 percent of the housing stock on the average are licensed and authorized. When permits to use buildings are taken instead of the licenses, this number falls to 33 percent. In other words, 67 out of 100

buildings are illegal. There is a clear need to renew the existing stock of infrastructures and buildings.

All in all, I believe that as long as the macroeconomic stability is maintained and that the inflation is kept under control, there is a bright future for the Turkish housing sector. The Central Bank of Turkey will contribute to this prospect by achieving and maintaining price stability.

Thank you all for your kind interest. Let me now conclude by wishing you every success with this Conference and I hope you enjoy your stay in Istanbul to the full.