

How to Turn "Prima Casa" Program from Dream into Reality

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Chisinau, January 2017

This publication has been funded by the British Embassy in Chisinau, through the Good Governance Fund. The content of this publication is the sole responsibility of the author and does not necessarily reflect the views of the British Government.

Defining the Issue

One of the fundamental social goals a modern democratic state must achieve is to provide the population, especially the young families, with large scale reliable tools to solve the housing issue. Despite some previous attempts to initiate "Prima Casa" (*First Home*) projects, they either failed either had a limited amount of time and volume for implementation. In some cases, the authorities mistook the "Prima Casa" program, which is a financing program, for a housing building project (e.g. the program implemented by Chisinau City Hall).

All developed countries pay special attention to housing financing programs for families, as they are considered to be one of citizens' fundamental social needs. Thus, most developed countries offer their citizens an extensive package of facilities such as:

1. Low-interest financing programs, long-term state guarantees for 20-30 years.
2. Exemption from income tax on the part of the salary/income that is intended for mortgage, particularly for one's first home.
3. Retrofitting the old housing by awarding grants in amount of 50-90% of the renovation cost.
4. Credit facilitation programs and grants for energy efficiency projects in the residential sector.

On 7 December 2000, a number of social guarantees were adopted, in the European Union, through the EU Charter of Fundamental Rights¹, whose legal effect was strengthened by the Treaty of Lisbon on 1 December 2009. Among these, Article 34 "Social security and social assistance", paragraph 3 provides: ***"In order to combat social exclusion and poverty, the Union recognises and respects the right to social and housing assistance so as to ensure a decent existence for all those who lack sufficient resources, in accordance with the rules laid down by Community law and national laws and practices."*** The majority of the European states have most of the previously-mentioned programs aimed at ensuring housing and improving living conditions.

At present, in the Republic of Moldova, there is no national program to facilitate – for a large group of citizens – the purchase of affordable housing. However, the Government understands the importance of initiating a national "Prima Casa" program and launched some initiatives on this issue and tries to find solutions appropriate for the situation in Moldova. Thus, on 5 August 2016, the Working Group 3 "Stimulation and Maintenance of Private Investment" of the Economic Council under the Prime Minister² was given a "Prima Casa" draft program. The group members found that the program contains unattractive conditions for both the beneficiaries and financial institutions, therefore – the analysis of and search for new solutions being decided on.

On 15 December 2016, the topic "Housing for young families and diminishing the envelope wages phenomenon"³ was included on the agenda of the Economic Council under the Prime Minister. Continued consultations with NBM and financial and banking institutions were found to be necessary, just like the working group determined.

The creation of a "Prima Casa" program with a wide national coverage is mostly prevented by the lack of cheap and long-term resources in national currency and by the interest rates volatility for national currency resources caused by crises and inflationary processes. This problem becomes even more striking in the context of the low population income, which affects the demand for such products. As long as reliable solutions to address these deficiencies are not found, any initiative of "Prima Casa" project is doomed to failure.

¹http://www.europarl.europa.eu/charter/pdf/text_en.pdf

²http://consecon.gov.md/public/files/PV_05.08.2016.pdf

³<http://consecon.gov.md/libview.php?l=ro&idc=81&id=337&t=/Activitati/Subiecte-pe-agenda/LOCUIRE-PENTRU-FAMILIILE-TINERE-I-DIMINUAREA-FENOMENULUI-SALARII-LOR-IN-PLAC-IN-ATENIA-PREMERULUI>

Conditions for "Prima Casa" Program to Become a National Program

At present, most mortgage offers in national currency are in the range of 10%-12% annual interest rate. In early 2016, real estate credits were granted at an average interest rate exceeding 15%. Promotional offers by the end of 2016 and significant lowering of the interest rate up to 9.5% increased the volume of housing loans issued to individuals compared to the beginning of the year about 3 times. This evolution indicates high susceptibility of the volume of long-term loans newly provided related to the interest rate. Another issue is that during crisis and NBM interventions to half inflationary processes, commercial banks are forced to raise partially interest rates on mortgage. This fact may affect significantly payment capacities of the families or even make them insolvent. During a mortgage lifetime, this may happen several times.

In order to visualize the impact of interest rate on the level of financial burden for a family for servicing the mortgage in the table below it is shown the monthly amount of money to be paid for the same loan, for the same period of time, according to the annuity method with a different annual interest rate. In case of long-term investment loans, slight variations in the amount of the interest rate changes significantly the monthly financial burden on families. Also, for each scenario, the table shows the monthly income required for a family to be considered able to take mortgages: to be sure that a loan can be paid up, it is necessary for the amount paid per month not to exceed 50% of the cumulative net income of the husband and wife.

Table 1: Financial burden on a family when the interest rate is different

Amount of the loan, MDL	800,000			
Term of the loan, years	25			
Annual interest	15%	10%	5%	3%
Monthly rate paid by annuity method	10,247	7,270	4,677	3,794
Minimum cumulative family income (gross salary)	27,101	18,989	11,922	9,516
Estimated percentage of employees who could access this loan*	< 4%	< 7%	~ 14%	~ 28%

Amount of the loan, MDL	400,000			
Term of the loan, years	25			
Annual interest	15%	10%	5%	3%
Monthly rate paid by annuity method	5,123	3,635	2,338	1,897
Minimum cumulative family income (gross salary)	13,138	9,083	5,548	4,399
Estimated percentage of employees who could access this loan*	~ 12%	~ 32%	~ 48%	~ 70%

*Note: Considering that both spouses work and have roughly equivalent incomes.

For comparison, the "Prima Casa" program in Romania offers a ROBOR 3M + 2% interest (about 2.9% annually), without any disbursement fee or administration fee. See Annex 2 for details. To qualify the "Prima Casa" project as national project, the annual interest rate for the final beneficiary should not exceed 5%. If the interest stays commercial, no other parameter of the program, including state guarantees, will make the program attractive and nation wide.

Optimal Key Conditions for “Prima Casa”

Considering the situation in the Republic of Moldova, the maximum limit of the loan granted under the terms of the “Prima Casa” program should not exceed the amount of EUR 40,000 equivalent and should be granted for the purchase on both the secondary housing market, of new housing at various stages of construction or for the construction of private houses. All families who don't own a home or whose home is smaller than 50 m² should be eligible for “Prima Casa” program. *The interest must not exceed 5%.*

How to get a 5% interest without the Government incurring any costs and what would be the reliable mechanism to ensure financial resources at such a cost?

Modern tools for financing extensive national programs and ensuring economic development

The current international monetary and financial system is still very young, it is constantly developing and seeking new tools. National monetary policies and financing instruments continue to grasp the minds of researchers and practitioners who look for the best solutions to ensure stable economic development, financing of financial programs, low interest rates and low inflation.

The latest experiments with instruments combining monetary policy and financing national economy was the use of the “Quantitative Easing” (QE) instrument – an unconventional monetary policy first applied by the authorities of Japan in 2001 to stimulate economic growth, reduce interest rate and finance long-term investment government programs. Although results were obtained slower than was expected, the experiment was considered a success.⁴ Following the financial crisis, the United States followed the example of Japan and started using this tool since 2008, followed by Great Britain. The United States are believed to have recovered faster mostly due to the use of the QE tool and of programs initiated by the government for economic recovery, including housing programs, recognized as an engine driving economic growth. European Union started to use this instrument only in 2015.⁵

Using these tools requires enhanced skills, good macro-economist teams able to assess the impact and provide qualitative forecasts to handle correctly the injections of money supply when purchasing state securities (T-bills, bonds, etc.) purchased on a currency issuance basis.

In the current circumstances, Moldova has similar signs of deep stagnation in conditions of low inflation. Moldova also needs monetary and financial instruments to solve its fundamental issues: the lack of long-term national currency resources, high cost of financial resources, lack of extensive programs of economic recovery and fostering the creation of new jobs whose shortage is acute in Moldova. After the establishment of monetary doctrines and financial instruments in nineties, Moldova failed to develop new instruments. The “Prima Casa” program could be a pilot in the use of innovative financial instruments. In addition, it has to be recognized that the implementation of “Prima Casa” with the current toolkit is rather doomed to failure.

⁴<https://www.federalreserve.gov/pubs/ifdp/2011/1018/ifdp1018.pdf>

⁵<https://www.theguardian.com/business/2015/jan/22/quantitative-easing-around-the-world-lessons-from-japan-uk-and-us>

The optimal mechanism for the implementation of “Prima Casa” at a 5% interest for the final beneficiary under the macroeconomic conditions of Moldova

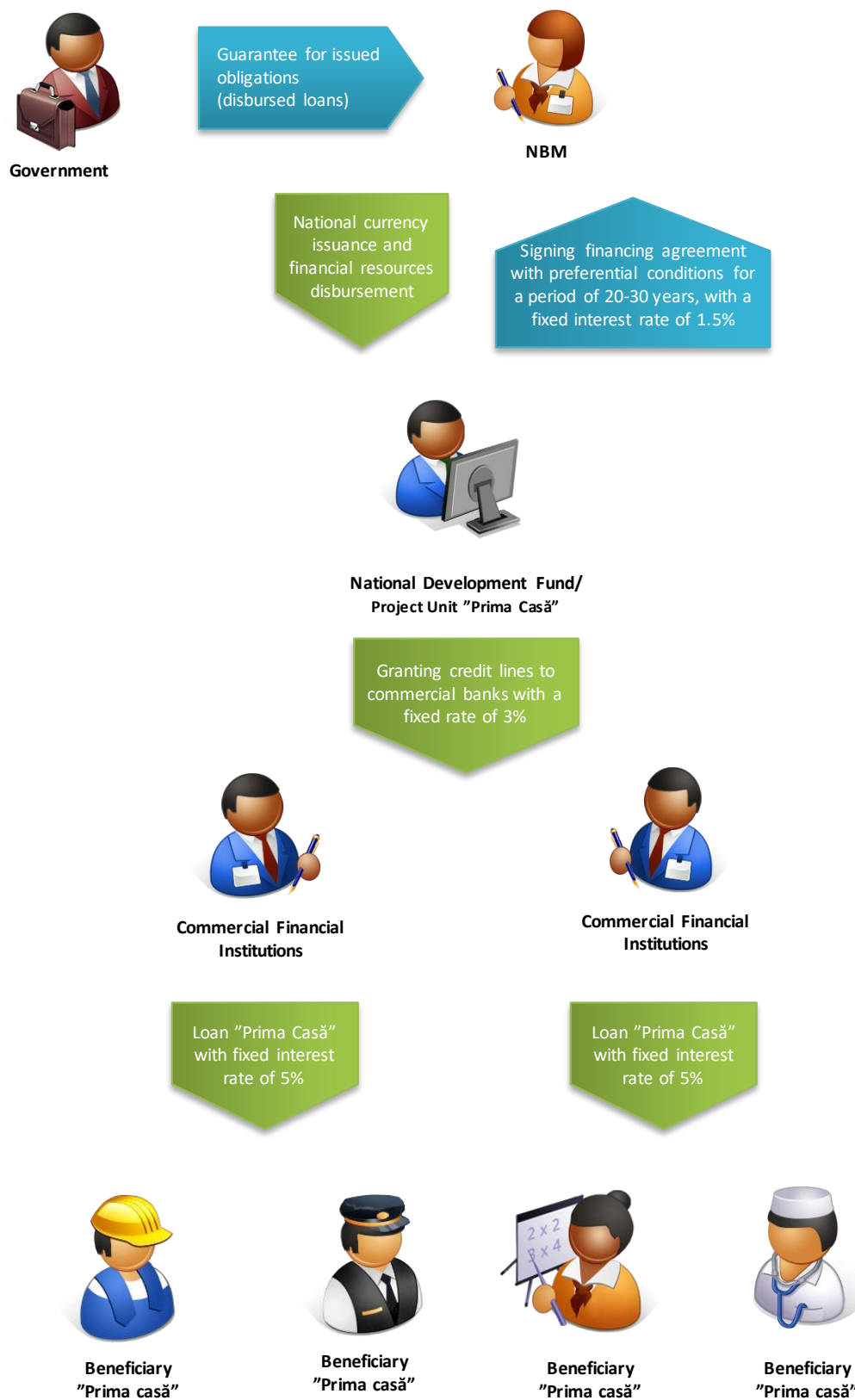
Moldova has a quite fragile macroeconomic configuration and the direct injection into the economy either through traditional or new financial instruments to stimulate economic growth is not possible. The classical use (pure market approach) of these instruments is extremely limited by the small size of the economy and low tolerance to the fluctuations of the injected free money supply, which is immediately channeled towards direct imports, which has an immediate impact on the currency market, stimulating inflation. To dampen speculation, to reduce the impact on the exchange rate and inflation processes, there is a need to use a financing instrument that enables targeted liquidity injections to sectors that have minimal impact on stimulating imports and maximum impact on creating jobs and value added within the national economy. “Prima Casa” and programs meant to stimulate the construction sector is one such sector that stimulates job growth and has a high share of domestic value added, besides the fact that it ensures a better social situation for many families, especially for the young ones.

To this end, it was proposed to use a Quantitative Easing financing instrument adjusted so as to direct money supply conditionally towards certain sectors and not to inject directly into the free market.

Below see the simplified scheme of the mechanism for financing the “Prima Casa” program.

Chart 1.

Financing mechanism for "Prima casă" program



Creating the Mechanism for Financing the “Prima Casa” Program:

1. Creating the National Development Fund (NDF) as an independent public not-for-profit self-managed institution and the legal framework on its activity. The purpose of NDF is to develop financing programs for the strategic sectors defined by the Government, assess the macroeconomic, monetary and currency impact, coordinate these programs with the Government and the NBM and ensure proper management of cash flows, compliance with the financing clauses, monitoring of lines of credit and to secure the settlements with financial institutions participating in the programs.
2. Preparing the package of amendments to the regulatory framework to ensure the possibility of issuing currency by NBM for development programs at preferential cost based on state guarantees.

Key Conditions for a Correct Governance and Elimination of Embezzlement Risks:

1. Financial resources to be distributed to final beneficiaries exclusively through commercial financial institutions selected based on stability criteria.
2. The funds will be allocated to financial institutions exclusively through lines of credit and according to predefined, uniform and transparent eligibility criteria for all participants. In this regard the EBRD, IBRD, EIB and other international banks have a great experience that can be taken over and implemented.
3. The funds will be released by NBM exclusively under contracts granting lines of credit signed between NDF and bank institutions and based on the request of drawing the installment from the financial institution. NDF will play exclusively a transit role, so it will not hold any funds on its account.
4. The NDF team will consist of macroeconomic, monetary and financial instruments professionals and of a broad professional council, mainly non-governmental.
5. The FND operational financing will be made from the 1.5% received from the managed lines of credit, the financial independence of this institution being thus secured.
6. NDF, the Government and the NBM will not have any power of decision on the financing of individual projects by private financial institutions and this will be conducted on the basis of internal review and lending procedures, audited beforehand by NDF or by specialized agencies at the request of NDF.
7. Control over the observance of lines of credit conditions and eligibility of criteria will be carried out by both NDF and the NBM. Financial institutions failing to observe these conditions will risk exclusion from the program and will pay penalties.

Steps of the Financing Mechanism:

1. NDF develops the financing program, eligibility criteria, quantifies the impact on the macroeconomic and monetary market situation, determines the optimal amount for financing the program.
2. The program is coordinated with the Government and NBM and validated by the General Board of NDF.
3. The lines of credit and financing criteria of final beneficiaries, the contract templates for lines of credit and the mandatory clauses in the contract concluded with the final beneficiary are developed based on the program.
4. After the contract between NDF and the financial institution is signed, the financial institution apply drawing requests for financial resources, which FND centralizes and requests needed amount from NBM.
5. NBM accomplishes the transfers required on the basis of currency issuance.

6. NDF is required to carry out the transfer in X days to financial institutions under the terms provided for in the agreement concluded with NBM or reimburse unused funds to NBM.
7. The financial institution disburses loans according to the concluded contracts.
8. The main fee paid by the final beneficiaries and the interest related to the line of credit (in case of "Prima Casa" it is suggested 3%) are reimbursed to NDF.
9. NDF reimburses funds collected from financial institutions and the related interest (in case of "Prima Casa" it is suggested 1.5%).
10. NBM writes off the money supply issued, recording the profit earned.

Mitigation of Inflationary Risks:

1. The financing mechanism described above ensures a high control of the issuance of national currency and ensures its use exclusively under goals set by the program, its immediate return to NBM and write off.
2. Each program will be subject to a separate expert review of the impact on the national economy and, in particular, on currency market. Each program will be separately quantified in terms of allowable amounts of financing and coordinated with BNM.
3. The programs will be directed mainly to the economic sectors that contains a high domestic added value or for the stimulation of exports. Thus, these programs will secure the strengthening of the external payment balance of Moldova and currency market and will improve the elasticity of these markets.
4. In case of crises and if necessary, the disbursements in these programs can be stopped to protect the country's financial stability. The withdrawal of money supply along the payment of program loans will ensure, under these conditions, an additional instrument to naturally reduce money supply.

Advantages

Government

1. Development of a "Prima Casa" program at zero cost for the state budget, which is indeed socially-oriented and comprehensive. It is recommended that credit risks are fully transferred to the financial institutions under the classical terms of granting lines of credit. The risk for government would be limited only to the residual value of losses if a commercial bank – beneficiary of the line of credit – goes fully bankrupt, which is an event mitigated by the eligibility criteria, filtering of risky institutions and by exercising strict control of both the National Development Fund and the NBM. Even in this case the residual risk that the mortgage portfolio of the bankrupt commercial bank is exposed to is minimum, because the loans are secured by procured houses that are used as collateral for disbursed loans, and the contract will include provisions regarding the transfer, in such situation, of the right of pledge to the Government of the Republic of Moldova, represented by the National Development Fund. The program could be initiated with MDL 1 billion, and during the following years – extended by 1 - 2 billion per year in case of increased demand.
2. More additional jobs in the construction sector and the advantage of more taxes to the budget.
3. Testing an instrument of preferential financing of some programs meant to revitalize the economy. The possibility to replicate the mechanism for financing strategic sectors at zero cost, especially those that have a good impact on country's monetary situation, such as the financing of export operations.
4. Replication of that tool in the strategic sectors could revolutionize the national economic growth and ensure a development that is incomparable to the first 25 years of independence.

NBM

1. Increasing the loan portfolio of the banking system; this type of loans at minimum financial costs will entail low risks, which will lead to a better quality portfolio in the entire banking system and to its enhanced stability.
2. Making a further profit of 1.5% annually based on the currency issued.
3. Minimal impact on the monetary policy and the possibility to test a new targeted monetary policy instrument. Issuance of a MDL 1 billion next year, the equivalent of USD 50 million, given that NBM has made acquisitions of about USD 500 million during 2016 in foreign exchange reserves, does not pose any risk, even if they would have been directed straight to consumption and import, which will not happen due to the targeted injection of money supply into a sector which will limit the use of these resources for direct imports.

Construction and Residential Sectors

1. Increased demand for new housing . Revitalization of the sector.

Civil Society and Population

1. This would be one of the few comprehensive programs to support the population.
2. Homelessness and inaccessibility to cheap financial instruments is one of the causes of population exodus. The possibility of purchasing a home at minimum financing costs would be a factor reducing outward migration.
3. This mechanism ensures a segregation of functions and insures a governance of program's processes that minimizes the possibilities of fraud and embezzlement of funds., This governance model has is significantly more fraud resistant than any other current mechanism for distribution of funds. The risk of transformation of guarantee in public debt is near zero, the risk associated with lending being transferred entirely to private banking and financial institutions.

Final Conclusions and Recommendations

Using the targeted issuance of national currency as a tool to finance the program “Prima Casa” by adapting the quantitative easing tool could ensure the development of a financial instrument able to revolutionize the financing of the country’s socio-economic development. The application of the described mechanism, which would significantly widen the access to finance for non-home-owning families would be a strong signal to the society about the commitment of the government to grant the fundamental social rights. The further extension of this tool to finance other major investment programs for the development of strategic sectors of the national economy would help overcome a series of fundamental issues regarding the lack of financing and high costs thereof.

In this respect, there are the following recommendations:

1. The Government – with the support of NBM, national and international experts – to form a robust working group to define the mechanism in detail, the appropriate regulatory adjustments or develop new legislation to ensure the establishment of “Prima Casa” project unit or of a more robust institution – the National Development Fund, and the regulatory framework for the implementation of the financing instrument described.
2. To develop the inter-institutional package of agreements and operating criteria for the program. To have this package coordinated with IMF, development partners and key stakeholders.
3. To enjoy a greater support of the Government for the “Prima Casa” social project, it is recommended for the interest payments related to housing financing (not only “Prima Casa” program) to be exempted from income tax and the social fund. Similar practices are used in Sweden, USA, the Netherlands, Norway, India with the certain limits either in terms of time or of the maximum allowable deduction value (annual, total).
4. To remove the tax provisions according to which the difference between the effective interest rate on credit and interest calculated by applying the base rate announced by NBM as taxable, for 3 reasons:
 - a. this difference is NOT an actual income. It is just as a taxpayer would be taxed for consuming less bread or for spending no money because he/she travels by bicycle. The application of this provision is wrongly taken as an increase in capital.
 - b. it represents double taxation because the taxpayer is forced to make additional payments to the state from the income for which tax was already paid, and the calculation basis does not represent an actual value of either revenues or asset that can turned into value.
 - c. NBM base interest rate is far from being an appropriate benchmark. The base rate does not reflect the real cost of financial resources in the market, but an instrument of monetary policy, which under certain conditions, can be significantly above the actual cost of financial resources or sometimes below the actual cost depending on NBM policy. Thus, this provision treats the taxpayers in an unequal and discriminatory manner.

Annex 1: The evolution of interest and the volume of new real estate loans granted in MDL to individuals

	Over 5 years	
	%	Amount, mil. MDL
Jan. 2016	15.07	11.48
Feb. 2016	15.20	24.72
March 2016	14.47	19.69
April 2016	14.37	20.41
May 2016	14.07	20.18
June 2016	12.11	37.90
July 2016	11.88	48.63
Aug. 2016	11.97	30.42
Sept. 2016	12.11	43.88
Oct. 2016	10.77	36.65
Nov. 2016	10.30	52.30
Dec. 2016	9.90	80.13

Annex 2: Conditions of “Prima Casa” program in Romania

Object:

Loan in MDL to purchase a finished home, an unfinished one – at various stages of construction, to purchase after completion (upon issuance by the bank of a unilateral lending promise) or construction (both by individual beneficiaries and associations made up of at least two beneficiaries).

Eligibility:

People who do not own a home either alone or together with their spouse – no matter how and when it was acquired – or own a home at most either alone or together with their spouse – acquired by any means other than by “Prima Casa” program – with the useful floor area less than 50 square meters.

Minimum down payment of 5%

Without front-end fee

No monthly management fee

The possibility of reimbursement in equal or descending monthly installments

Currency: RON

Interest: ROBOR 3M + 2% (less than 2.9%)

Lending period: Minimum: 120 months; Maximum: 360 months

Wide range of acceptable income from: salaries, dividends, pensions, independent activities, royalties, per diem, annuities, etc. (except for rent)

Maximum Value of Credit

Purchase of finished or unfinished home, which is at different stages of construction, for purchase after completion (upon issuance by the bank of a unilateral lending promise):

MDL equivalent of EUR 57,000

Purchase of new housing property, built based on building permits issued after 22.02.2010:

MDL equivalent of EUR 66,500

Housing construction:

MDL equivalent of EUR 66,500, individual beneficiary

MDL equivalent of EUR 71,250, beneficiary who is part of an association made up of at least two beneficiaries

Guarantees

Housing purchase:

- first-degree legal mortgage on housing financed by credit, in favor of the Romanian state represented by the Ministry of Public Finance

Housing construction:

- first-degree legal mortgage on land and future housing (financed by credit), in favor of the Romanian state represented by the Ministry of Public Finance and of the commercial bank

Insurance

- extended insurance for all risks of the mortgaged property, in favor of the Romanian state, represented by the Ministry of Finance and in favor of the commercial bank