

THE ACQUISITION OF EXTERNAL FINANCING BY THE HOUSING FUND OF FINLAND IN 1998-2003

The Housing Fund of Finland was established at the beginning of 1990 and was originally called the Housing Development Fund. It is an off-budget fund belonging to the state that is used to finance measures aimed at improving housing conditions. The name was changed to its present form in 1993 in connection with the reform of housing administration. The Housing Fund of Finland or ARA operates under the Ministry of the Environment and has a governing board ("Management") that decides on its policies.

No other new organization or posts besides the governing board were added when ARA was established. The Government appoints ARA's Management for four years at a time. Its most important task is ensure liquidity and make decisions on borrowing and securitization necessary for ARA's activities within the framework imposed by its budget. Proposals concerning the acquisition of external financing and the methods used for this purpose are made by a working group whose members represent the Ministry of Finance, the Ministry of the Environment, ARA and the State Treasury.

ARA is Finland's largest off-budget fund in terms of assets, which totalled slightly over nine billion euros at the end of the period covered by the audit.

ARA's operating environment has changed considerably since it was established. In 1993 Finland was in a deep slump, with financial markets looking dire while public debt soared. Nowadays conditions are stable and economic development is mainly favourable. Financial markets have changed substantially. In ten years the average interest on mortgages fell by more than half. In summer 2004 the rate was 3.25%.

Changing financial markets and increased competition between banks have allowed loan periods to be significantly extended in recent years. Whereas mortgages used to

be repayable in less than 10 years, they can now be obtained for more than 30 years in the best of cases. This together with low interest rates has greatly increased borrowing and households' willingness to improve their level of housing. Meanwhile the advantage of owning a home rather than renting has significantly grown, taking tax deductions for interest payments into account. The result has been falling demand for state-subsidized housing production. With financial markets stable and banks eager to supply cash, the state's activities as a lender are not as necessary as in other financial market situations.

The present audit concerns the acquisition of external financing by the Housing Fund of Finland in 1998-2003, which was mostly by means of securitization through the Fennica programme. ARA has also acquired financing by issuing notes on the capital market and a bond through the state budget.

The audit sought to evaluate how ARA has planned the acquisition of financing. It investigated the question of whether it is economical and effective for the state to acquire financing for ARA through securitization and direct borrowing on the capital market as opposed to financing through the state budget.

Up to the end of 2001, ARA's strategy for acquiring external financing was determined in practice by the level of public debt. The acquisition of external financing had to be arranged so as not to put a burden on the state's actual borrowing. Since ARA's direct borrowing was counted as part of public debt, the decision was made to acquire external financing by securitizing ARA's receivables. This was accomplished in 1995-2001 through the six-part Fennica programme.

The Ministry of Finance and ARA have calculated that securitization was more expensive than direct borrowing on the capital market would have been. Although the objective was always to acquire financing as economically as possible, considering the market situation, particularly during the first emissions in the Fennica programme the cost of financing was not the deciding factor, but rather making sure funds were available and preventing growth in direct borrowing through the state budget.

The audit observed that the most significant openings in developing the acquisition of financing in 1998-2003 were made by the Ministry of Finance. ARA's board discussed plans to acquire financing and ultimately approved them but in the first part of the period in question it was not very active in changing the way financing was acquired. Its activities cannot be considered forward-looking in this respect. A clear change in attitude was visible in late spring 2001, however.

In 1998-2003 the early repayment of loans granted by ARA constantly increased at a faster rate than predicted. The main reason for this was the development of interest rates in an unfavourable direction from the viewpoint of ARA's financial products.

The State Audit Office notes that since the end of the period in question, administration has taken measures together with ARA to address the issue of acquiring financing and ensuring liquidity.

In the opinion of the State Audit Office, the Act on the Housing Fund of Finland prescribes the procedure for deciding on liquidity and acquiring financing in a way that is also appropriate in the present operating environment. ARA's board monitors liquidity. It also decides on the acquisition of financing, whether this involves borrowing or securitization. In practice the board's decision-making has been quite technical, however. The board only began to take steps to diversify the acquisition of financing when the effects of the operating environment were visible in ARA's liquidity. In addition to the board, the acquisition of financing has been evaluated and prepared by expert administration, which in the opinion of the State Audit Office is as it should be.

On the basis of the audit, clarifying responsibility for directing the acquisition of financing would improve the decision-making process. The division of labour between different actors, working groups and the board is basically clear. In practice, however, there may be room for improvement in the board's approach to acquiring financing. Here again it is worth noting that administrative measures since the end of the period in question have largely corrected or are correcting this situation.

From the viewpoint of overall economy for the state, there was obviously good reason for ARA to act as it did in the early stage of the securitization programme. The total direct costs of securitization have risen higher than what they would have been - at least theoretically - if borrowing had taken place through the state budget. The possibility of restricted access to additional financing on the international capital market because of the high level of public debt at that time and later on the need to meet the criteria for EMU made securitization an economical way to acquire financing when all things are considered.

The audit observed that after conditions changed it took time for ARA to rethink its model for acquiring financing. If the board had looked farther ahead in planning methods and tools to acquire financing, it could have diversified more flexibly and rapidly. This would have made it possible to shift the focus to monitoring the cost of acquiring financing as a key parameter in decision-making. Securitization in fact has proved to be an effective way to acquire financing on the capital market in large tranches.