

*In the Name of God*

## **Mortgage Market and Inadequacy of Housing Finance Mechanisms in Iran**

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### **Abstract**

Housing finance is economically and socially elemental to the housing market. Socially-speaking, housing finance of the low-income households and their problem regarding housing affordability and purchase are some key challenges governments are faced with. Economically, mortgage market rates and facilities extended to the housing sector directly hit the supply-demand mechanism. Housing finance mechanisms and investment in this sector impinge on housing prices which in turn affect some macroeconomic variables especially consumption. Furthermore, macroeconomic and financial condition also influences housing prices and finance.

Research<sup>(1)</sup> conducted in developed countries reveals that housing prices are affected by macroeconomic condition (e.g. disposable income) and financial condition (e.g. credit and interest rates) in a manner that growth rate of housing prices enjoys a positive relationship with real income growth and credit accessibility and a negative one with interest rates.

Housing prices depend on a host of factors; inter alia, the structure of the mortgage market, structural factors of economy, mortgage rates, and innovations<sup>(2)</sup> in the mortgage market. For instance, countries with an adjustable-rate mortgage witness a higher growth in their housing prices than countries with a fixed-rate mortgage. Another example is securitization in the American mortgage market which helps adjust housing prices. The overall consequence of the above not only affects the region in which they occur but also leaves an influence on the financial activities of the global economy via affecting the interest rates.

As mentioned earlier, housing prices influence household consumption. Findings show that household consumption enjoys a direct relationship with housing wealth in a way that every one-dollar increase in the housing wealth leads to a rise in consumption by 5 cents<sup>(3)</sup>. Studies also reveal that changes in housing wealth have a

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(1) Milesi, Ferretti, & Kodres (2004) and Terrones (2004)

(2) Kodres (2004) and Schnure (2005)

(3) Edison (2002) and Bayoumi and Edison (2003)

greater impact on consumption in countries with a Market-based Financial System than the ones with a Bank-based Financial System.

In sum, housing finance and housing prices, on the one hand, remarkably influence economic boom and bust and, on the other hand, are influenced by macroeconomic condition. In fact, the structure of urban areas, centralization of housing activities in Tehran and other large cities, lack of efficient construction and urbanization models, obsolete buildings, unstable and inefficient rules and regulations, low income level of housing applicants, and high construction costs are the major bottlenecks the housing sector is facing. Therefore, reforming the housing finance mechanisms, *per se*, is not expected to solve the housing problem in this country.

In this study, the presupposition of the researcher is that, parallel to the formation of the secondary mortgage market, authorities in the High Council of Urban Planning, Ministry of Housing and Urban Development, and municipalities, have already taken measures to remove these pitfalls. This being the case, at first, some light is shed on the inadequacy of the housing finance mechanisms in the Iranian economy and then mortgage market and secondary mortgage are reviewed as proper liquidity channels.