03

EVALUATION OF
IDB GROUP'S WORK
THROUGH
FINANCIAL INTERMEDIARIES

HOUSING FINANCE

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Abbreviations and Acronyms

CMAC	Caja Municipal de Ahorro y Crédito
CONAVI	Comisión Nacional de Vivienda
E&S	Environmental and social
ESMS	Environmental and social management system
FI	Financial intermediary
GDP	Gross domestic product
IDB	Inter-American Development Bank
IDBG	Inter-American Development Bank Group
IIC	Inter-American Investment Corporation
INFONAVIT	Instituto del Fondo Nacional de la Vivienda para los Trabajadores
LAC	Latin America and the Caribbean
NBFI	Non-bank financial institution
OECD	Organization for Economic Co-operation and Development
OMJ	Opportunities for the Majority
OVE	Office of Evaluation and Oversight
SCF	Structured and Corporate Finance Department
UN	United Nations

I. INTRODUCTION AND HOUSING FINANCE CONTEXT IN LAC

A. Scope of this paper

1.1 **This background paper on housing finance supports a broader evaluation of the work of the Inter-American Development Bank Group (IDBG) through financial intermediaries (FIs).** IDBG works extensively through FIs in Latin America and the Caribbean (LAC), and in 2015 the Office of Evaluation and Oversight (OVE) conducted an evaluation of these activities. During the 2005-2014 period covered by the evaluation, IDBG funded 466 operations for LAC FIs. Fifty of these operations, accounting for 18% of the funding, aimed at expanding housing finance, particularly for underserved beneficiaries accessing new housing or funding home improvements through mortgage-based credit provided by regulated FIs.

1.2 **The purpose of this background paper is to provide additional (and more detailed) information on IDBG's operations supporting housing finance.** This document is not meant to provide a full evaluation of LAC's housing finance market and its evolution. Instead, it focuses on the context of and barriers to the housing finance markets in LAC, as well as on the specificities of IDBG's housing operations through FIs. The paper focuses in particular on Mexico and Peru, where IDBG's FI operations were concentrated (80% by volume of approvals). This review is based on project and client data gathered through document reviews, interviews, and focus groups conducted during OVE's country missions.

B. The role of housing finance in LAC

1.3 **Adequate housing is linked to improvements in health, safety, and school performance, as well as to reductions in domestic violence.** Home purchases and improvements not only raise living conditions but also represent an investment, as the value of the home usually appreciates over time. Particularly for the low-income population, homes are the primary form of asset accumulation.[1] Houses also often serve as productive assets to produce goods, store inventory, and generate income, and they can be used as collateral to finance small businesses. In fact, in 1948 the UN Charter declared adequate housing a basic human need and universal human right.

1.4 **However, access to housing in LAC is limited by significant market shortages and deficiencies in quality.** The LAC region, the most urban in the developing world (76%), enjoys high ownership rates (73%) and relatively high family incomes.[2] However, despite significant progress over the past two decades, many of the region's city inhabitants are still poorly housed (see Figure I.1). Of the 130 million urban families in the region, 5 million rely on another family for shelter, 3 million live in houses that are beyond repair, and another 34

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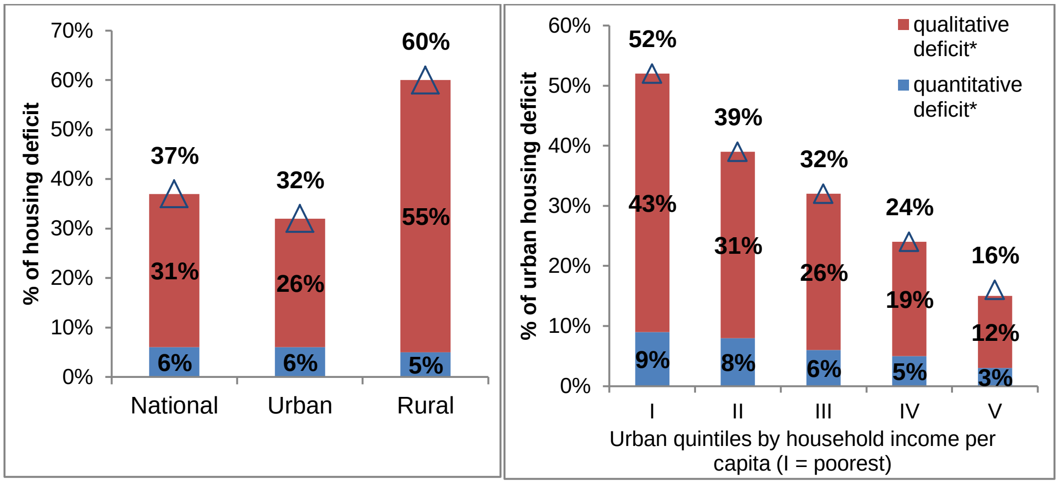
[1] Magalhaes and Di Villarosa, 2012; Scanlon and Page-Adams, 2001.

[2] Bouillon, 2012.

million live in houses that lack title, water, sewerage, adequate flooring, or sufficient space. Finally, most of these dwellings, and many more that are otherwise satisfactory, are located in neighborhoods that lack basic urban amenities, such as public transportation, parks, and hospitals.

Figure I.1. LAC's regional housing deficit relates mainly to the quality of housing and lower-income segments



Source: Bouillon, 2012 (data as of 2009).

*_Quantitative deficit_ measures households that live in inadequate houses that cannot be repaired and are shared with other households. _Qualitative deficit_ measures households that live in houses with insecure tenure that are built with poor materials, have dirt floors, do not have access to water or sanitation services, and are overcrowded.

1.5 **Housing needs vary by country and city, depending on income levels and local and national policies and regulations, but in all cases housing finance plays a key role.** Housing needs range from those families squatting illegally or living in temporary shelters, all the way to those families enjoying homeownership with secure tenure, whether formally or informally documented. Satisfying housing needs for low-income households requires legalizing land ownership, providing affordable land, facilitating incremental housing or home improvements (e.g., core house construction, expansions, enhancements, or repairs), or providing access to affordable new homes.[3] In all cases, availability of funding to purchase or improve housing is typically a constraint for most segments, and housing finance can help to relieve it, using the property as collateral.

1.6 **Housing finance constraints are particularly acute among the region's low-income population.** Housing finance consists of loans for the renovation or expansion of an existing home, construction of a new home, land acquisition, progressive or incremental housing construction, and the installation of basic infrastructure (e.g., hooking up to the city sewage line). Traditional housing finance has largely ignored low-income segments. In countries with underdeveloped housing finance systems or systems that only provide access to finance for high-income households, poorer households are left to either informally self-build their homes over long periods of time or to settle for

3 Stickney, 2014.

inadequate housing. In addition, the price of serviced land in LAC is among the highest in the world relative to income.[4] Nearly half of the housing deficit in urban areas is attributable to the high cost of homes and lack of access to finance. In this context, LAC accounts for 8.6% of the world's population, but only for 1.5% of its mortgages.[5]

1.7 **In the absence of developed mortgage markets, people often use savings and microenterprise loans to make home improvements and to buy plots lacking basic services from illegal developers to build homes progressively.** However, the terms of such loans do not necessarily match the way low-income people build and improve their homes. The demand for housing microfinance in LAC is high. Although several FIs have added home improvement loans to their offerings, such loans still represent a small percentage of their overall portfolio. Anecdotal evidence, for example from Cajas Municipales (CMACs) in Peru, suggests that many clients resort to consumer credit or redirect to housing construction loans that were intended for business. Misclassifying housing loans as consumer credit also implies higher costs for the FIs, and ultimately for the borrowers.

1.8 **In this context, IDBG aimed at increasing access to housing finance – particularly for underserved populations – through both microfinance and mortgage-backed loans.** *Housing microfinance* provides low-income clients with relatively short-term loans, small- to medium-size amounts, and alternative forms of collateral for progressive building and home improvement. *Mortgage-backed loans* typically aim at somewhat higher-income clients with longer-term loans for the construction of new homes or the purchase of existing ones. Over the evaluation period (2005-2014), IDBG supported both private and publicly owned (second-tier housing development) FIs in expanding access to housing finance for underserved populations.

C. Barriers to housing finance availability in LAC

1.9 **LAC housing finance has increased over the past two decades, but it still lags, especially for low-income populations.** Four global trends – urbanization, democratization, decentralization, and globalization – have influenced the housing finance market by leading to (i) greater depth of financial systems, (ii) a wider range of housing financial instruments, and (iii) a transformation in the role of governments, from housing finance providers to enablers. Yet credit availability for low-income housing finance has lagged in LAC relative to developed countries. Mortgage financing averages only 5.5% of GDP (versus 60% in developed economies)[6] (see Figure I.2). Real interest rates for mortgages are, on average, higher in LAC (8.1%) than in OECD countries (3.2%). Some countries register even higher levels, such as Brazil (10.9%), Honduras (13.2%), Nicaragua (10.2%), and Venezuela (14.4%).[7]

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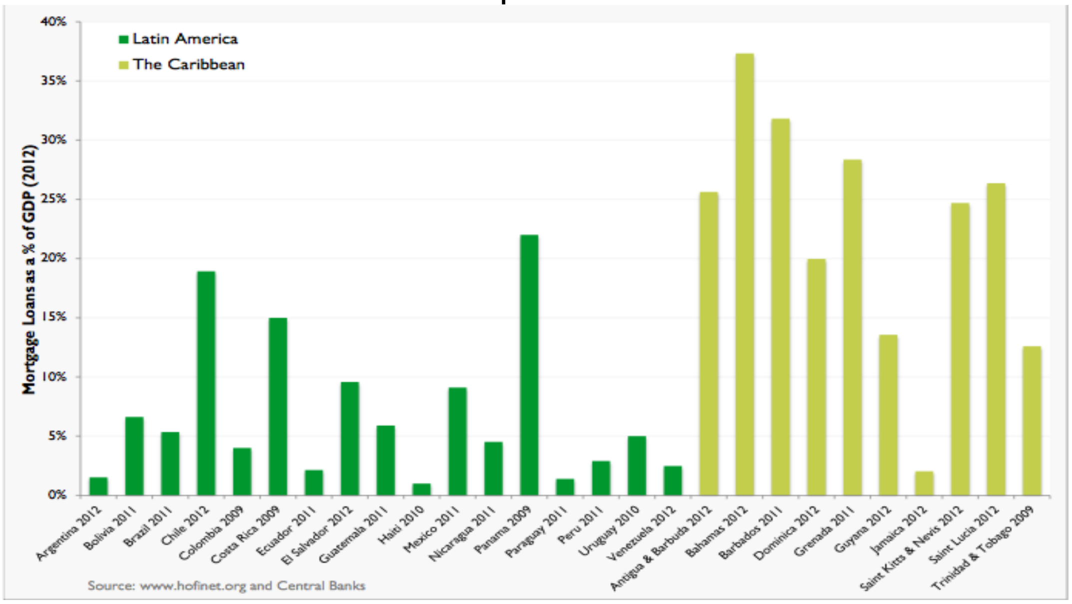
4 Ibid.

5 Warnock and Warnock, 2008, and United Nations World Population Prospects, 2015.

6 Bouillon, 2012.

7 Stickney, 2014.

Figure I.2. Mortgage loans are typically a large part of GDP in the Caribbean, but a small part in Latin America



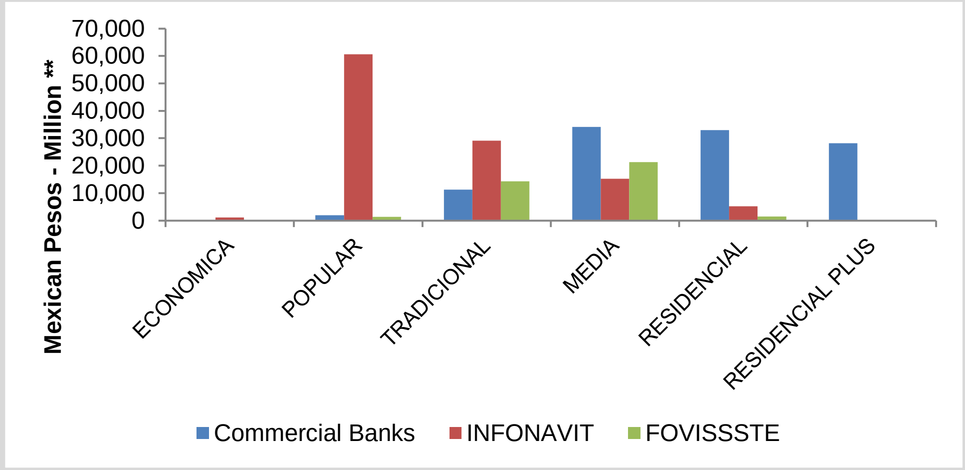
1.10 **On the demand side, the main barriers to credit availability for low-income people are their lack of land housing titles and their informal income sources and volatility of income.** Areas accessible to low-income segments usually face significant challenges with property registries, and the lack of legal titles reduces financing options and property values. Land security is also essential, since lack of legal title may result in insecure tenure and a constant threat of eviction. Moreover, lower-income segments tend to work in the informal sector where income streams are more difficult to verify, fluctuate more widely, and are therefore less compatible with long-term financing obligations. Moreover, families without savings struggle to meet down-payment requirements for purchase. Even to qualify for subsidies, prior savings are usually obligatory.

1.11 **On the supply side, limited access to medium- and long-term capital and perception of high risk are the main credit constraints.** A lack of macroeconomic stability and insufficient development of local capital markets prevents many FIs from accessing funding to match the longer terms needed for housing loans. Available local currency funding, mostly short-term deposits, does not allow FIs to meet the demand for longer-term housing loans. Additionally, credit supply is affected by FIs' risk perception. The housing sector is vulnerable to shocks, and the low-income population is usually hit the hardest by them. The lack of collateral and guarantees, as well as legal regulatory frameworks that lead to lengthy foreclosure processes, augment FIs' perception of high risk.

1.12 **In this context, in many countries the low-income housing finance market is dominated by government institutions, often acting as second-tier entities**. Housing finance involves a variety of players: large public mortgage banks, commercial banks, non-bank financial institutions (NBFIs), microfinance institutions, national and multilateral development banks, nongovernmental organizations, developers, and providers of long-term finance, such as pension funds and insurance companies. However, housing finance systems in LAC are still subject to government subsidies and are dominated by public institutions.

1.13 **For instance, in Mexico, the government supports the low-income segment through a National Housing Commission (CONAVI) that provides funding and subsidies to FIs.** As of 2014, more than 77% of these subsidies and guarantees were channeled through the Institute of the National Housing Fund for Workers (INFONAVIT). INFONAVIT, which accounts for 60% of the housing market share, provides below-market-rate interest rate subsidies and benefits from payroll deductions to help originate mortgages – but it also serves lower-income market segments (Figure I.3).

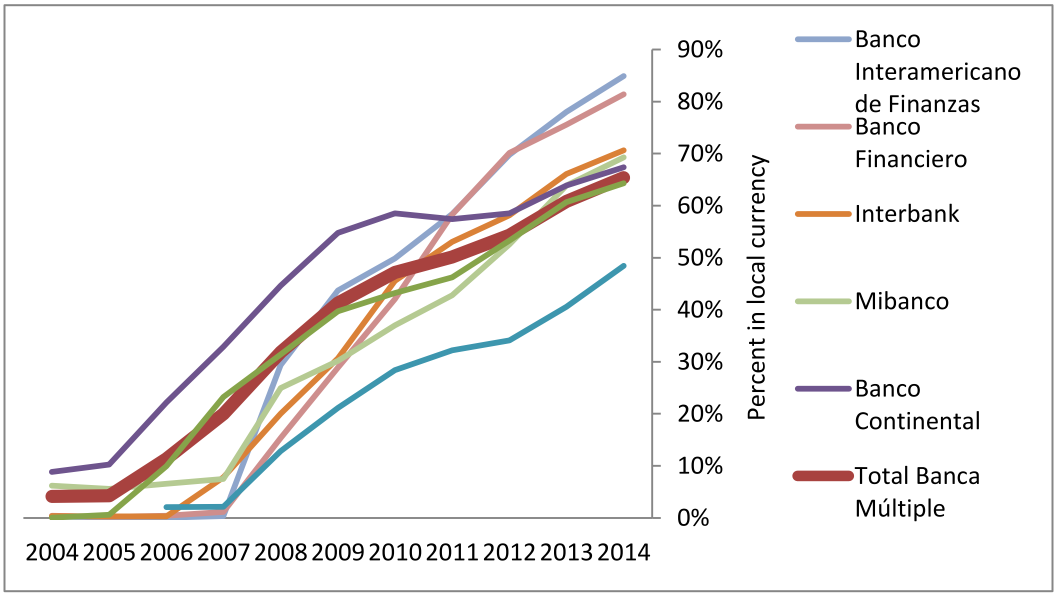
Figure I.3. Mexico – Public institutions hold the lion's share of the mortgage market for lower-income segments



Source: Sistema Nacional de Indicadores e Información de Vivienda (SNIV), SEDATU, CONAVI, 2014.
Notes: Economica: up to 118 times the minimum wage (TMW); *Popular*: 118.1-200 TMW; *Tradicional*: 200.1-350 TMW; *Media*: 350.1-750 TMW; *Residencial*: 750.1-1,500 TMW; *Residencial Plus*: more than 1,500 TMW. Exchange rate at end-2014: 13.29 Mexican Pesos per $1.

1.14 **Similarly, in Peru, the government plays a key role in the middle- and low-income segments—directly through housing finance programs, and indirectly through regulation**. The government-financed low-cost mortgage program MiVivienda provides funding in local currency to FIs for the middle- and lower-income sectors. In addition, mortgages are increasingly in local currency, at least partly because of the regulatory efforts of the Banco Central de Reserva del Peru to reduce the level of dollarization in the system and decrease the foreign exchange risk for borrowers. In the banking system, the share of loans denominated in local currency (Soles) increased from under 5% in 2004 to over 65% in 2014 (Figure I.4). CMACs in Peru successfully reached the low-income sector by providing housing improvement loans in local currency.

Figure I.4. Peru – Soles-denominated mortgage loans increased significantly in the last decade, representing between 50% and 90% of FIs' mortgage portfolio



1.15 **Finally, governments facilitate or hinder credit availability through financial infrastructure and regulation.** On the one hand, regulators can facilitate credit availability, for instance by simplifying the registration of titles and thus standardization. On the other hand, regulators can burden FIs with compliance controls that make lending more expensive. A lack of a holistic housing policy, with disparate initiatives and objectives, can also affect credit availability. Finally, rigidities in credit bureau systems can also preclude competition by creating information asymmetries among potential players.

II. IDBG's Housing Finance Portfolio, Objectives, and Results

A. Composition of IDBG's housing finance portfolio

2.1 **From 2005 to 2014, IDBG approved guarantees and loans for the housing finance sector for $3.1 billion in 12 countries, of which $2.4 billion was disbursed** (Table II.1 summarizes IDBG's housing finance portfolio). Of the senior loans, only 11% were provided in local currency. The loans to FIs were meant for onlending to low-income populations. Operations also helped FIs raise additional funding by securitizing housing portfolios. Guarantees – typically partial credit guarantees – were used rarely

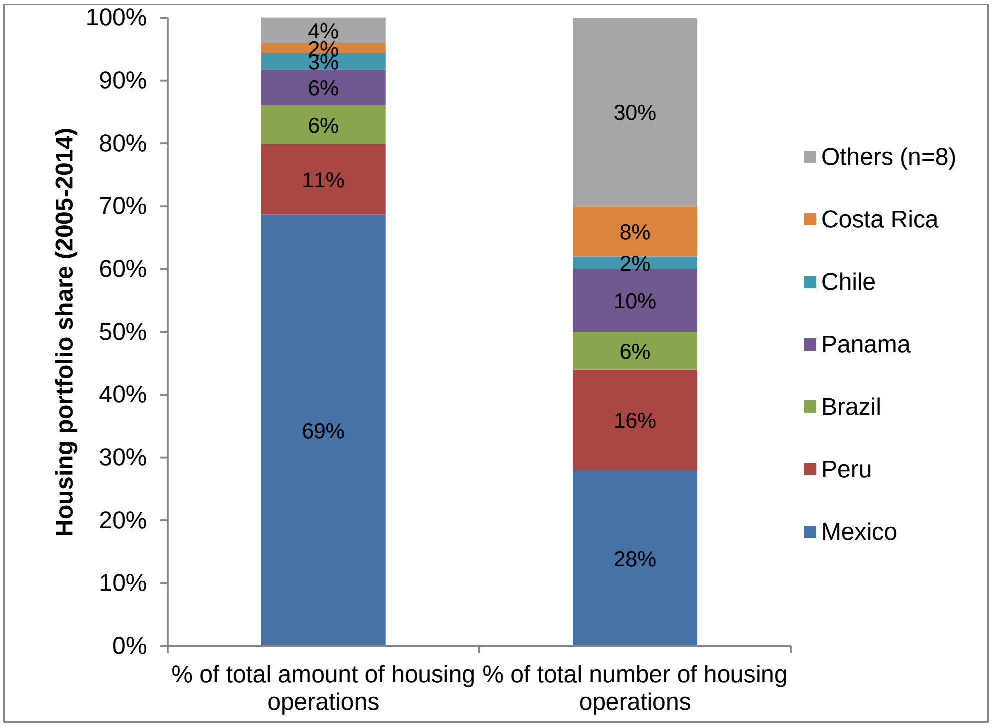
Table II.1. Housing finance

Approved	**Amount:** $3.1 bn. (18% of all IDBG FI operation approvals from 2005-2014.) **Number:** 50 ops.
Disbursed	**Amount:** $2.4 bn. (78% of approvals)
By window	**CMF** (59%), **SCF** (34%), **IIC** (5%), **OMJ** (2%)
Instruments	**Senior loans** (88%), **Guarantee** (12%)
Types of FIs	**2TB** (64%), **NBFIs** (23), **1TB** (13%)
Top countries	**Mexico** (69%), **Peru** (11%)

(only by SCF and OMJ), mainly for NBFIs to help them overcome relatively lower credit ratings and/or to reduce foreign exchange risk for IDBG's clients.

2.2 **IDBG's housing FI operations were highly concentrated (90%) in A and B countries,[8] particularly in Mexico and Peru** (Figure II.1). The Mexican financial market, one of the most developed in LAC, received by far the most IDBG funding for housing finance ($2.1 billion, almost 70%), followed by Peru, Panama, and Brazil. By contrast, from 2005 to 2014, the less developed C and D countries were granted only 10% of total IDBG FI approvals aimed at expanding housing finance ($325 million).

Figure II.1. Operations in Mexico accounted for over two-thirds of the total housing portfolio by value, but under 30% by number



2.3 **In addition, IDBG's housing FI portfolio was highly concentrated in supporting public second-tier FIs, especially in Mexico.** Housing operations with second-tier FIs accounted for 64% of the portfolio. Among these FIs, the major client was a public Mexican housing finance entity; over half of the approved amount for housing ($1.8 billion) went to this institution in the form of sovereign-guaranteed operations (Box II.1). In large part, this situation emerged from IDBG's efforts to help the Mexican housing market after the 2008 sub-prime crisis in the United States led to a freezing of funding sources and a deterioration of housing portfolios, including across the border in Mexico.

8 A Countries: Argentina, Brazil, Mexico, and Venezuela; B Countries: Chile, Colombia, and Peru.

Box II.1. Contributions to the Mexican housing finance sector during times of crisis
The residential mortgage market in Mexico enjoyed a relatively stable environment after the mid-1990s. However, during 2007 and 2008 this environment was affected by the sub-prime crisis in the US and the consequent global liquidity crisis, which directly affected all sources of funding – medium- and long-term – in Mexico. To ease the impact of the global crisis on the Mexican housing finance sector, the Government of Mexico focused its actions on providing liquidity to the private housing markets through a second-tier FI. For this, the Government and the second-tier FI required the support of IDBG and the World Bank to tackle two key challenges: (i) how to reach further down-market with mortgage lending, and (ii) how to reduce the instability in the mortgage market. Therefore, in November 2008, IDBG and the World Bank approved loans of $1.5 billion ($0.5 and $1 billion, respectively). Between 2009 and 2012, IDBG approved and disbursed an additional $1.3 billion. In terms of results, the operations were rated as satisfactory by both the World Bank and IDBG and contributed to the stabilization of the market, in which a number of mortgage lenders went into bankruptcy. The World Bank operation was processed faster than the IDBG operation (disbursed in December 2008 vs. March 2009). Also, both IDBG and the World Bank had set targets for final beneficiaries (e.g., households, and low-income households receiving financing), but only the World Bank reported in the Project Completion Report that these targets had not been met. IDBG did not report this, as the Project Completion Report was done before the target date.

B. Objectives of IDBG's housing finance operations

2.4 **Although there was no overarching IDBG strategy for housing finance, IDB's "Urban Development and Housing Sector Framework" served as a reference to understand IDB's priorities for housing.** According to this framework, IDB seeks to promote the delivery of housing services with a variety of tenure modalities, addressing the households' socioeconomic characteristics and level of vulnerability. The lines of action include promoting and expanding (i) access to public and private financing for housing services for the poorest populations, and (ii) supply of housing services.

2.5 **Specifically, through its FI operations, IDBG aimed at sustainably increasing the supply of financing solutions (for housing improvement and new housing) for low-income segments.** Specific objectives included the following: (i) widen and deepen the housing finance system by increasing the number of loans and improving terms; (ii) provide long-term credit and adequate funding instruments for FIs to expand their portfolios and avoid a mismatch between the source and use of funds; and (iii) diversify funding sources or strengthen local community FIs. Additionally, over half of IDBG housing FI operations had goals related to innovation—including the introduction of products that opened new markets such as "green" mortgages, or that focused on low-income segments.

2.6 **However, each IDBG window differed in its approach to housing finance.** MIF supported commercial banks in developing low-income housing programs.[9] IIC used banks and specialized mortgage lending institutions as distribution channels for financing housing for low- and middle-income families.[10] OMJ

9 "IDB Group and the Private Sector: Integrated Business Plan," GN-2428, CII/GN-227, and MIF/GN-116, 2008.

10 "IIC Business Plan for 2008-2010," CII/GN-232-2, 2007.

conducted ad hoc interventions with specific types of FIs, such as the "Capital Strengthening and Low-Income Housing Program" in Peru,[11] and used different models to support housing solutions (Box II.2). Finally, SCF included in its 2011-2015 strategy affordable housing as part of its financing social inclusion objective, and worked on it with selected FIs.[12]

Box II.2. OMJ's housing projects – two different models to provide "complete" housing solutions
Within the OMJ portfolio, two different business models are used to reach the same housing outcome. The first model, implemented by a NBFI in Colombia, combines a more traditional form of mortgage financing, tailored to low-income earners, with government subsidies. The second model incorporates a rent-to-own scheme, allowing families to build a payment history and sufficient capital to meet their down payment to qualify for a mortgage loan. Another NBFI in Colombia and a NBFI in Nicaragua are pilot-testing this second model, working in partnership with commercial mortgage lenders.

C. Results for clients

2.7 **IDBG reported reaching the expected number of final beneficiaries and accounting for the funds provided**. Of IDBG's housing operations, 85% met or exceeded their targets in terms of number of beneficiaries. Overall, IDBG FI operations reached an estimated[13] 300,000 individuals from 2005 to 2014, representing about 2%[14] of homeowners in the region. Operations with larger commercial FIs had more difficulties achieving the objectives because, according to a survey conducted by OVE, in the absence of clear business opportunities, these FIs lack incentives to provide financing lines to IDBG segments of interest, such as lower-income households.

2.8 **Yet the fungibility of money makes it virtually impossible to attribute the funding of specific beneficiaries to IDBG, thus making beneficiary lists and estimates unreliable.** IDBG's FI operations typically employ "use of proceeds" to structure operations, which can result in cherry-picking final beneficiaries. FIs obtain funding from different sources and use this funding to acquire assets other than loans; hence, attribution for specific loans is virtually impossible. FIs can – and do – report to IDBG loans that would have been granted anyway, or that had already been granted. As long as an FI has a large enough portfolio, it will almost certainly be able to provide IDBG with a list that fulfills certain eligibility requirements.

2.9 **To mitigate the implications of the fungibility of money, OVE used three alternative measures: (i) relevant portfolio increases, (ii) increase of the**

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11 "Peru. Proposal to establish a Program for Funding Microfinance Institutions in Peru," CII/PR-587, 2006.

12 "SCF Strategy 2001-2015." Audiovisual presentation, PP-137, 2010.

13 Sum of the reported number of beneficiaries of the operations in the sample, multiplied by the total number of operations and divided by the number of operations that reported a number of beneficiaries.

14 Bouillon (2012) reported 59 million individuals living in substandard infrastructures. This information, combined with the latest estimates on average size of a LAC household in 2012 – around 3.7 members – yields a number of around 16 million householders. OVE estimates that IDBG has reached 300,000 households in the period. Note that the 2% assumes that all of IDBG's funding reached households in substandard infrastructures – likely an overestimate.

share of the relevant portfolio in the FI, and (iii) increase compared to the market. The total size of these portfolios is unique – and objectively ascertainable – as it does not require the FI to pick any list of beneficiaries following a third party's (IDBG's) eligibility criteria. For the second measure, an increase in the share of the relevant portfolio in the FI would indicate whether it is a strategic priority of the FI and whether IDBG's funding may have helped increase the focus on that portfolio. An assessment of the third measure—whether IDBG's client increased the relevant portfolio by more or less than competitors—was, unfortunately, only possible in a small number of cases when information for non-IDBG clients was available.

2.10 **The majority of operations increased the FIs' housing portfolios, and over half increased the FIs' share of the housing portfolio.** In addition, IDBG's FI clients had stronger growth of the relevant portfolio than non-clients. OVE's calculations of 18 housing operations indicated that 83% increased the FI housing portfolio and 56% grew the share of the housing portfolio in the FIs' total portfolio. The housing portfolios of IDB's largest FI client in Mexico (accounting for 85% of IDBG's housing portfolio in the country) and OMJ's housing client in Peru grew faster than the ones at comparable FIs in the same markets.

2.11 **However, FIs' housing portfolio definition tends to use a higher income cut-off for the beneficiaries than IDBG's.**[15] As an example of misalignment of beneficiary definition, for an operation in Costa Rica, the Board document stated that the FI would provide 125 subloans for an average of $80,000 for lower-income housing. In the end, the FI reported to IDBG a list of 35 subloans averaging $176,000, with house values over $200,000.

2.12 **Current financial products for new housing are not likely to reach low-income beneficiaries; only finance for home improvement does**. Projects from the sample portfolio provided evidence that the operations that successfully reached the lowest-income population focused primarily on home improvements and "sweat equity" [CMACs].[16]

2.13 **Furthermore, publicly subsidized housing finance may not meet the housing preferences of low-income people, partly because the incentives of developers, financiers and beneficiaries are not always aligned.** In Mexico, for example, as of 2013 one-quarter of the housing stock financed by INFONAVIT is vacant, largely because people refuse to live in suburban areas that lack services and are far away from their workplaces[17] (Box II.3). In part, the emergence of this risk is also due to lax regulation that allowed low-cost mortgage funding for "investment" properties in peripheral urban areas that were not yet fully consolidated.

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15 Although IDBG windows rarely collected total FI mortgage portfolio information, OVE was able to gather information on these relevant portfolios for most of IDBG housing FI operations. In fact, information on housing in LAC is much more readily available than, for example, information on SME portfolios within the FIs.

16 Sweat equity is a party's contribution to a project in the form of effort, as opposed to financial equity in the form of capital. It explains the fact that value-added to someone's own house by unpaid work results in measurable market rate value increase in house price.

17 Libertun, N., Brakarz, J., and Navarrate, J., 2013.

Box II.3. Inclusion of city perimeter limits as a criterion for housing finance
In Mexico the two government housing institutions, INFONAVIT and FOVISSSTE, assessed the time of contribution and payment capacity when granting a loan to a developer, but did not consider the location of the houses in their analysis. The law required INFONAVIT and FOVISSSTE to finance homes, regardless of their location. Consequently, developers built projects far away from the main cities for the lower-income population, taking advantage of large government subsidies. Some of those developments did not have access to basic utilities or transportation services, and were located up to five hours away from the main cities. INFONAVIT and FOVISSSTE realized the negative impact that transport costs and location were ultimately having on their portfolio quality and therefore proceeded to discuss the need to include a location criterion in their loan process. The main change was the inclusion of city perimeter limits within which these institutions were allowed to provide finance.

2.14 **Some housing operations also had innovation as a criterion for selecting the FI.** For instance, IDBG provided a Brazilian securities company with several warehouse-financing operations to enhance its ability to originate and accumulate mortgage instruments until there was sufficient volume to place mortgage-backed securities in the domestic capital markets, based on the origination capabilities of the borrower and on market demand. Although it was a private company, over time this client played a key role in helping set origination standards for mortgages in Brazil that could later be securitized as collateral for capital market issuances. IDBG – along with IFC – played a continuous role in supporting this Brazilian company over a decade, but did not actively build the market dissemination and standardization goals into any of the operations. Rather, the company made these changes out of its own business incentive to "educate" other market players so they could better generate securitizable mortgages.

2.15 **The main environmental and social (E&S) risks in the housing sector are sustainable construction, safety issues, and site contamination, as well as risks emerging from specific locations like exposure to natural disasters or land tenure conflicts.** Considering E&S risks in the housing sector is important not only to mitigate negative E&S consequences and reputational risk, but also because they can affect the repayment capacity of final beneficiaries. In fact, one of the major problems regarding housing is litigation due to unclear property rights and property damages when real estate is affected by a natural disaster. Site contamination from installment of inadequate facilities can also lower the value of the property as collateral. E&S impacts are typically higher for real estate development projects than for single households, since they need to consider additional issues (e.g., potential resettlement, urban sprawl, loss of green areas). To the extent that the housing sector is also closely linked to the construction sector, sustainable, eco-efficient construction practices can also reduce environmental risks beyond housing.

2.16 **OVE found that IDBG's E&S safeguards were used mainly to mitigate E&S risks, but they were not part of an integrated system to achieve E&S benefits.** Both IDB and IIC have a development mandate not only to mitigate risks, but also to create E&S benefits for all of their operations. OVE found little evidence, except in some green lending and an identified good practice in the housing sector (Box II.4), that E&S developmental benefits were specific objectives or expected results of FI operations. An environmental and social management system (ESMS) typically tracked the mitigation of negative impacts and did not identify or track positive effects.

Box II.4. Sustainable building eligibility criteria
In addition to E&S requirements, an incentive scheme was included in a SCF-financed securitization operation with a Brazilian securitization company. The structure offered attractive financial terms for mortgages on properties with sustainable building certifications or those that met specific sustainable building criteria, including efficient lighting and water usage, efficient use of construction materials and appliances that promote energy efficiency, recycling, and low-carbon emissions. This is a good example of how to promote the adoption of environmentally responsible practices among developers, lenders, and other participants in the real estate financing market.

III. Conclusions and Suggestions

3.1 **IDBG recognized the need for increasing access to housing finance for the low-income population.** About one in three families, approximately 53 million households, live in dwellings that are unsuitable for habitation, were built with poor materials, or lack basic infrastructure services. Nearly half of the housing deficit in urban areas is attributable to the high cost of homes relative to household income and lack of access to finance. Mortgage financing in LAC averages only 5.5% of GDP (versus 60% in developed economies).[18]

3.2 **However, IDBG's current offering is not likely to reach these relevant beneficiaries.** Most of IDBG's housing finance (89%) was in the form of US dollar-denominated senior loans. Beneficiaries, especially in the low-income sector, rarely earn in US dollars. Additionally, FIs' appetite to attend to the low-income market may remain low if the higher-income market with cheaper rates in US dollars is still large enough and continues to allow for higher profits with lower transaction costs and less risk. FIs sometimes used a higher income cutoff for beneficiaries than IDBG, resulting in financing the purchase of new homes for a higher-income population.

3.3 **Within the current offerings, IDBG could help mobilize long-term local currency lending to better serve the low-income population.** Because of IDBG's operational policies and insufficiently developed and/or expensive swap markets, most of the housing FI operations were disbursed in US dollars. This led to a transfer of the foreign exchange risk either to the FIs or to the final beneficiaries. This risk has increasingly caught the attention of regulators. Regulators across the region are – appropriately – discouraging housing finance lending in US dollars; indeed, Colombia, the most extreme case, requires one-to-one matches (in terms of size and maturity) of foreign exchange, thus making IDBG money unattractive for housing finance. However, IDBG can also structure investments to help attract local currency funding (Box III.1).

18 Bouillon, 2012.

Box III.1. An IDBG guarantee and a fixed interest rate help attract investors
An operation with an NBFI in Mexico involved the establishment of a $175 million collateralized credit facility to finance the origination and accumulation of residential mortgages for securitization in the form of mortgage-backed securities in the Mexican capital market. IDBG was able to access local currency markets by providing guarantees for local banks (at competitive rates), as it did also through OMJ in the case of a Colombian housing finance provider focused on the low-income segment. Alternatively, IDBG can itself issue local currency bonds and use (part) of the proceeds to finance such projects or attract local investors.

3.4 **IDBG's support to housing finance could go beyond credit lines to promote alignment of interests among promoters, financiers, and low-income populations, and to structure rental and rent-to-own operations.** Aligning the incentive structures for developers would help meet the housing needs of low-income people, including in appropriate locations with access to public services, and would help generate a more standardized housing stock, better suitable for financing. This approach would also benefit from the participation of the public sector to facilitate land availability and land development. For instance, the program Macroproyectos in Colombia developed a commercially sustainable public-private model for land and housing development that overcame land and housing market rigidities through a combination of public and private investment and the reform of relevant regulatory instruments.

3.5 **Although the construction of new homes provides opportunities for poorer segments of the population, new, innovative approaches are needed—for example, much lower-cost construction methods and, possibly, a greater focus on rent or rent-to-own.** Low-cost solutions permit sustainable strategies for housing in low- and medium-income groups. For example, the cost to acquire a new apartment for a medium-income family in Mexico City is equivalent to 10 times the cost of extending a house. Regarding rental housing, for many years it was assumed that home ownership is a universal aspiration, and government policies have not favored renting through tax treatment, rent control laws, and so on. There is a need to better understand this market and develop innovative financial instruments like rent-to-own (Box III.2) and lease-to-own solutions.

Box III.2. Description of the rent-to-own model
This model provides access to new, developer-built homes by incorporating an innovative rental scheme that allows families to build a payment history over several years while saving sufficient capital to make the down payment on a mortgage loan. Critical to this model is a supply of low-cost housing built by developers at certified quality standards, including the provision of basic services and infrastructure. Also necessary is a link with mortgage lenders that are committed to issuing mortgages once clients have met the necessary obligations upon completion of their rental period.

3.6 **IDBG should move away from focusing on a self-selected list of beneficiaries fulfilling certain eligibility criteria to increasing the relevant portfolio using the FI's definition.** Given the fungibility of money, obtaining a self-selected list of beneficiaries fulfilling certain eligibility criteria does not ensure that more financing is going to more intended beneficiaries. IDBG should focus instead on increasing the number and volume of the relevant portfolio (e.g., low-income borrowers), using the definition the FI uses – if it is aligned with IDBG's development objectives.

3.7 **Additionally, IDBG could promote the development of secondary markets by supporting FIs in developing conforming loans and then by advancing securitization in the region.** The bond market in LAC is relatively underdeveloped. Furthermore, private mortgage lenders and real estate developers face limited access to financing with adequate tenors, leaving them vulnerable to market volatility and maturity mismatches. This hampers the continued growth of their activities in the mortgage market. IDBG could shift its focus to helping develop conforming loans or supporting third-party structures. Conforming loans[19] benefit from greater liquidity since they can be repackaged in the secondary market. Once there is a critical mass and a certain market development, including an existing swap market (as in Mexico), IDBG could advance securitization. For example, in Mexico and Ecuador, IDBG helped develop a viable secondary mortgage market through local currency debt facilities by providing warehouse credit lines to support mortgage securitization and other capital market securities.

3.8 **Finally, further cooperation between IDBG's public and private sector windows would help develop the housing market.** Appropriate government intervention and support can affect the development of the mortgage industry by reducing the barriers mentioned earlier. Solving the housing problem demands action in several policy areas—from finance, taxation, and regulation to land development and innovation. In addition, private sector participation is key for mortgage financing and saving, the production of owner-occupied and rented housing, finished progressively built housing, and the provision of land areas with services and urban infrastructure.

[19] Conforming loans comply with certain guidelines, including a loan-to-value ratio, size of down payment, debt-to-income ratio, credit score, and history, as well as documentation requirements.

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