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Housing Finance in Central America:

What is Holding It Back?

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Abstract[1]

This paper surveys housing finance in Costa Rica, El Salvador and Panama. The development of a secondary mortgage-backed securities market in Costa Rica is very limited despite a broad legal framework, while in El Salvador it is nonexistent and in Panama has not grown due to high liquidity. In Costa Rica's subsidy policy, core institutions responsible for housing policy act as facilitators of private agents. This contrasts with the dispersion of policy and institutional efforts identified in Panama and El Salvador. Government subsidies are especially directed to households where more of 90 percent of the housing deficit is concentrated. A solution based on public budgets is not sustainable, requiring an active role of the private housing finance sector. Increasing the purchase capacity of families and reducing the cost of financing are necessary conditions to reduce housing deficits.

JEL classifications: G10, G18, G28, H81

Keywords: Costa Rica, El Salvador, Panama, Housing, Housing finance, Financial sector, Public policy

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Executive Summary

This study explores the main barriers to housing finance as a key element of housing market development in three Central American countries: Costa Rica, El Salvador and Panama. In 2009, Costa Rica had a total housing deficit of 14.5 percent and a qualitative deficit of 11.7 percent. El Salvador, a country with 1,406,485 households, had a 38 percent total deficit and 35 percent qualitative deficit. The deficit in Panama represents 14 percent of 862,586 households. In Costa Rica and El Salvador more than 90 percent of the deficit is found among households whose average monthly income is less than four minimum wages. In Panama, around 50 percent of the deficit affects households with monthly income lower than US $250.

Developing a housing finance policy has three key components: the creation of housing finance institutions, the regulatory regime, and the allocation of housing subsidies through or in conjunction with housing finance organizations (Angel, 2000). This addresses the limitation of mortgage credit by limited payment capacity of low-income families, the risk of recovery of the guarantee, the risk of fluctuations in interest rates and the risk of maturity mismatch (IDB, 2005).

In Costa Rica, El Salvador and Panama the main policy supporting the development of housing finance institutions is related to stronger competition in the financial system. The banking sector in Panama is salient due to its development, where mortgage finance has reached 29 percent of GDP. Costa Rica has followed an opening process through increased competition from private banks—in 2009 the share of housing lending in GDP reached 15 percent. El Salvador has undertaken a process of privatization, making its banking system one of the more modern in the region; housing finance reached 12 percent of GDP in 2009.

While the development of a secondary mortgage-backed securities market is an essential requirement for housing finance, such markets are not operating in El Salvador and Costa Rica. In Panama, moreover, most banks maintain their mortgage portfolios due to their high liquidity indicators. From a regulatory perspective, the three countries have implemented regulations based on Basel principles. Regarding property rights, Costa Rica and El Salvador have important areas to correct, while Panama has a solid registration system.

Finance and subsidy policy in Costa Rica has a design based on sustainability and efficiency principles. This design sets the Ministry of Housing (MIVAH) and the Government Financial Core Institution (BANHVI) as facilitators of private actions. An additional characteristic is the centralization of overall housing policy. This contrasts with the dispersion of

policy and institutional efforts in Panama and El Salvador. Despite the high development of the financial system in Panama, the government follows policies of direct provision of housing, with a preferential interest-rate program, which is regressive, administratively costly and weak in targeting the poor. Still, it has expanded housing lending access.

These experiences lead to the following policy recommendations:

- Expanding openness and fostering a competitive environment for the entire financial system;
- Following a scheme of government participation as facilitator of private housing finance within a centralized policy;
- A targeted scheme of preferential interest rates backed by tax deductions for households without housing credit under market conditions;
- Reducing the cost of housing financing by extending loan maturity and reducing transaction costs;
- Providing subsidies with savings schemes;
- Following a strategy to remove barriers to the secondary mortgage market;
- Enabling schemes to reduce the time and cost of foreclosure process and to clarify property rights; and
- A prudent fiscal policy to promote the stability of interest rates.

1. Introduction

Housing finance has grown significantly around the world in the last two decades as a result of economic growth, financial liberalization and increased competition, and macroeconomic stability, consisting of lower inflation and interest rates (Chiquier and Lea, 2009). In spite of financial innovations from last years, housing finance in Central America faces many common and country-specific obstacles. Among other obstacles, Consejo Centroamericano de Vivienda y Asentamientos Urbanos (CCVAH, 2009) points out limited long-term financial resources to serve the housing sector, high interest rates, outdated regulatory frameworks, weak property rights enforcement, weak development of the secondary mortgage market and ineffective government policies as key constraints to housing finance in the region.

This study aims to understand the main barriers to housing finance as a key element of housing markets development in three Central American countries: Costa Rica, El Salvador and Panama. A comparative analysis is undertaken in order to identify the main obstacles and policy recommendations for housing finance development in the region.

The paper is organized as follows. Section 2 offers a review of the literature on housing finance in Central America. For the purpose of this study, Section 3 analyzes the housing finance system in every country, exploring key factors that foster or deter the development of housing finance and its impact on housing deficits, including the enabling of the market and the government role as commander or facilitator, the overall development and operation of the financial market, the legal-institutional framework, macroeconomic and income distribution structures, the development of the secondary mortgage-back security market and the operation of the government housing subsidy and finance programs. Section 4 explores three policy components: the development of housing finance institutions, the regulation of the housing finance regime, and housing subsidies schemes. The final section presents main conclusions and policy recommendations. The main characteristics of the housing finance system in the three countries are described in the Annex.

2. Literature Review

According to Angel (2000), the development of a housing finance policy has three key parallel components: i) the creation and development of housing finance institutions: ii) the regulation of the housing finance regime; and iii) the allocation of housing subsidies through or in conjunction with housing finance. Warnock and Warnock (2007) showed that countries with stronger legal rights, deeper credit information systems, and a more stable macroeconomic environment have deeper housing finance systems.

Keivani (2005) analyzes the enabling policy or more direct government intervention and control. The recent emphasis is on market efficiency and enabling housing markets, by focusing on the basic fundamental factors of the mortgage market as legal rights, credit information systems, a more stable macroeconomic environment and the promotion of securities markets. The World Bank (2005) finds the enabling policy approach dominates the housing policy debate, due to the need of overcoming the inherent inefficiencies of the public intervention and lack of financial sustainability.

Secondary mortgage markets have developed almost exclusively in economies with a strong, well-regulated formal housing sector. A key reason is because the secondary market is information-intensive and law-dependent (IDB, 2003). Mortgage market sophistication and innovations in developed (OECD) countries have contributed to restoring housing affordability in recent years. Among other factors, necessary conditions for the development of secondary mortgage markets include the existence of an effective primary mortgage market (with significant volumes of loans) and sound institutional framework—legal and regulatory entities (IDB, 2003).

Chiquier and Lea (2009) argue that many studies demonstrate the correlation between implementing a group of policy tasks and a subsequent growth in housing finance markets, including: enforceable property rights and effective registration systems; enforceable foreclosure for mortgage lenders; access for all lenders to diversified funding (including mortgage securities); comprehensive credit information systems; strong prudential regulations that encourage responsible lending and adequate consumer information; a level playing field among lenders to encourage competition; credit products adjusted to economic and financial realities; different consumer needs, and sound risk-management practices; accessible and reliable information on house transactions and prices; professional real estate intermediaries, including developers, appraisers, insurers, and realtors; urban development regulations adapted to economic realities to encourage the production of formal affordable housing; comprehensive national housing policy, including socially and economically efficient subsidies, slum upgrading, and title regularization programs; and access to titled land for developers. These topics are not addressed in a comprehensive way in the available Central American literature on housing finance. Still, in recent years housing finance has emerged as an important area of study and policy concern in the region.

The regional perspective on housing finance has been addressed by the Central America Housing and Human Settlements Strategy (CCVAH, 2009). According to this view, policies of regional coordination and development of long term planning capacity are necessary for the development of the housing finance system. Regional organizations should provide technical and financial support, and, in the absence of housing finance, multilateral agencies should encourage the development of financial instruments and credit for the generation of business in housing and also creates regional capital markets.

From a country perspective, in recent years, the national housing finance system of Costa Rica has made important advances regarding individual housing solutions provisions. Solano and Madrigal (2009) study the government housing policy in Costa Rica, showing weak continuity over the years. They found underfunding of the program by diversion of the original funds. They additionally found success in reducing existing squatter settlements but inability to avoid the emergence of new ones. Among other reasons, the authors point out weak territorial planning and the lack of a clear long-term approach to sector problems. On the other hand, the housing supply has not been effectively integrated into a sustainable land use and urban planning system (Programa Estado de la Nación, 2009). Public policies have targeted credit growth, without coordinating and integrating housing policy with urban planning and municipal territorial administration.

Held (2000) reviews the experiences of Chile, Costa Rica and Colombia regarding housing policies, which include some of the most important in the region, with potential for implementation in other countries. These policies have shown that they can expand social housing supply and reduce dwelling deficits. However, they also have paid insufficient attention to the qualitative housing deficit, the availability of serviced land for housing low-income households, and the development of a secondary market.

Sancho (2009) studies the secondary mortgage-backed securities market in Costa Rica, finding that although the legal framework is comprehensive, the market has not developed. This requires legal and institutional strengthening on standardization of mortgages, statistical information, and procedures for the transfer of mortgages, promotion of securitization companies, tax incentives, the use of pension funds and the creation of a guarantee fund for credit enhancement during the securitization process.

Grynspan and Meléndez (1999) conclude that the government housing finance program does not combine the granting of housing subsidies with financial efforts and commitment from the household. Therefore, they recommend moving the organized groups to a savings-granting program. To be transparent and predictable, the granting of subsidies must follow waiting lists. The authors suggest that the Mortgage Bank (BANHVI) should centralize long-term fundraising and be the primary source of funding of the system, and that its guarantee scheme can no longer be free or subsidized. BANHVI should also implement a stabilization fund for the secondary market and strengthen efforts to carry out the securitization of mortgages and access to international markets. Gonzáles (2005) argues that BANHVI plays a key role for the housing finance system in Costa Rica, but requires innovative mechanisms in order to ensure longer-term sustainability and independency from the government budget, particularly during critical fiscal deficit stages.

According to Szalachman (2008), the Costa Rican government has made great progress in reforming its housing finance system, decreasing its overall housing shortage and reducing the overcrowding of the financial sector. The author identifies some threats for housing finance sustainability, including the large fiscal deficit, a high public debt, dollarization of the economy, low wages, increasing cost of housing, lack of access to long-term credit, unequal access to minorities, unequal distribution of income, and a growing immigrant population.

In the case of Panama, Angel (2001) concludes that housing sector conditions are relatively good (housing is generally plentiful, affordable and in good condition in comparative terms). However, the author indicates that government housing policy, on the whole, is still non–enabling (paternalistic, inefficient, ineffective, and largely irrelevant to broad segments of the urban population). The author recommends the liquidation of the National Mortgage Bank, phasing out the direct construction and finance of housing units, and refocusing its subsidy program on title regularization, progressive housing solutions, infrastructure upgrading, and subsidy vouchers associated with housing loans. He argues that preferential interest-rate subsidies could be smaller and better targeted, while non-salaried people should take advantage of housing finance subsidies.

For Moreno-Villalaz (2006), the success of the housing financial system in Panama is based on dollarization and financial integration. Banking provides sufficient resources to fund mortgages on favorable terms and with access for large segments of the population. The efficiency of the banking sector in the country is demonstrated by the securitization of mortgages by banks.

Alemán (2003) argues that the development of an international banking center in Panama has been fundamental to promote housing finance. The financing system is sustained on the basis of high liquidity, financial integration and sustained levels of savings. Special programs, such as the Ley de Intereses Preferenciales (preferential interest law), have made access to credit easier for targeted sections of the population and, as a result, have increased the mortgage market.

Jacobs and Savedoff (1999) indicate key factors explaining the decision to rent or own a house are associated with the family's lifecycle, while the choice between buying a house or progressively build it is determined primarily by income and assets. These results suggest that in countries like Panama, with relatively unfettered land markets, low-income households are readily able to become owners because of the alternative strategy of progressive dwelling building, and this has a positive impact for accommodating growth. Initiatives that foster land tenure security facilitate access to credit and provide greater incentives for long-term investment in both rural and urban areas.

In an analysis of the Salvadoran housing market during 1995-2005, Romero and Vides (2006) conclude that a main obstacle to the development of the housing market and particularly for low income households' demand was the absence of a coordinated and coherent national policy. The authors argue that this limitation prevented the formal market's growth and created incentives for unplanned urban development. IDB (2009) indicates that, as in many developing countries, in El Salvador housing finance is available mainly for the middle and upper scales of the salaried income distribution structure, which has led to the proliferation of slums and informal settlements. According to Ruiz (2010), as a result of housing market imperfections and institutional weaknesses, one third of Salvadorans reside in land subdivisions (*lotificaciones*, low-cost minimally serviced land for dwelling constructions).

Herrera (2007) argues that El Salvador's macroeconomic stability since 2001 has resulted in stable and low interest rates and credit growth, particularly for housing finance and private consumption. The banking sector of El Salvador is regarded as one of the most dynamic and competitive in the region (CEO Advisors, 2010; Fitch Ratings, 2010). On the other hand, Sánchez (2009) and BMI (2009) indicate that capital markets are still underdeveloped, while securitization is seen as a potential instrument of housing finance but has yet to be realized. According to IMF (2010), the government of El Salvador needs further reforms and supervisory strengthening of the financial sector in order to create more instruments to diversify risks and strengthen the securities market.

Various reports indicate that the housing deficit in El Salvador has remained high and stable over the last two decades (IDB, 2009; Soto, 2004; ECA, 2001). According to Pandero (2003) housing market performance has been affected by exogenous factors such as recurrent national disasters. USAID (2007) indicates that insufficient access to housing finance by a large sector of the population has led to the growth of housing microfinance at a small scale, while Sáenz (2007) shows how remittances have played an important role on financing dwelling improvement or purchasing of low income families.

3. State of the Housing Finance System

3.1 Housing Finance in Costa Rica

A special feature in the Costa Rican banking structure is the strong presence of three government-owned banks with 53 percent of the total assets of the financial sector in 2008,[2] while 12 private banks share only 34 percent. Three organizations specializing the in housing sector only share 4 percent of the banking assets and 28 Cooperative Associations have 8 percent. In last decade, housing credit has been granted mainly by private and government-owned banks, representing almost 80 percent of the credit. Banks are followed by the Mutual Association of Savings and Loans with 15 percent and cooperative associations with 3 percent of housing lending. In 2009, housing lending amounted to US $4,345 million, 40 percent granted by government-owned banks, 42 percent by private banks, 8 percent by Mutual Associations and 10 percent by Cooperatives. The market concentration of the largest four participants represented 70 percent of construction and housing credit in 2008, and 90 percent for the six largest banks in the market.

A key component of the housing finance system in Costa Rica is the government scheme through the National Financial System for Housing (Sistema Financiero Nacional para la Vivienda, SFNV), and the Housing Mortgage Bank (BANHVI), both created in 1986. This system is overseen by the Minister of Housing and Human Settlements (Ministerio de Vivienda y Asentamientos Humanos, MIVAH), created in the late seventies. With SFNV a group of authorized entities channel subsidies alongside their housing loans, supported by the BANHVI as second-tier bank. The SFNV launched two programs of demand-side subsidy: one to finance housing specifically by a subsidy (*bono financiero para la vivienda*), and another to provide less-costly funds to authorized financial institutions to complement the subsidy. The SFNV pursues a comprehensive housing finance policy in line with sustainability and efficiency principles, with MIVAH and BANHVI as facilitators of private action. With the exception of subsidies to lower-income groups, the SFNV does not assume a central role in the finance housing system. Another important contribution was the centralization of overall housing policy, particularly government housing finance policy. This has reduced the dispersion and overlap of efforts from different government entities.

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[2] Annual Memoir of the General Superintendent of Financial Entities, 2008.

The role of government in the housing financial system has shifted from direct intervention to mostly a facilitator of private action. The main attempt to participate in finance and provision of housing came with the creation of the National Institute of Housing and Urbanism (INVU) in 1954, whose activities included planning, public house provision and financing, among others. INVU proved unable to solve the housing problem, however, paving the way for alternative schemes such as Mutual Associations of Savings and Loan in 1969, aimed at low and lower-middle incomes. Other public entities such as insurance companies, the social security system and labor unions and solidarity associations have contributed with their own lending schemes. Cooperative associations are currently for all-purpose credit; those specialized in housing finance faced financial problems along with weak supervision, leading them to fail.

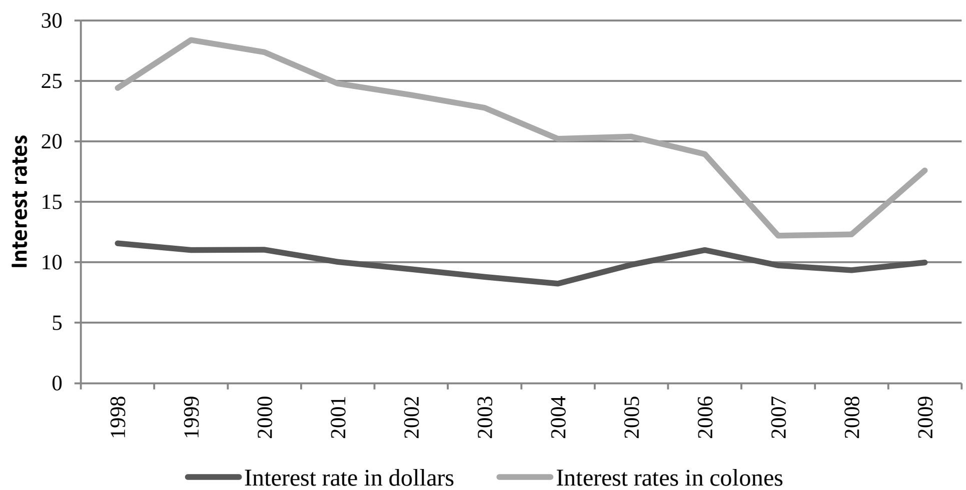
An important piece of the housing finance policy is the enabling of the overall financial market through an opening process. Beginning in the 1980s, but especially during the mid-1990s, the financial system underwent profound reforms which increased the participation of private banks and exposed state-owned banks to a greater competition scheme, removing distortions as fixed rates and capped credit portfolios. This led to the adoption of international standards with the introduction of international-level private banking. The reforms have additionally increased the generation and mobilization of long-term savings, promoted by the pension system and development of institutional investors.[3]

As a result of the financial reforms, the aggregate value of the financial sector rose from 3.7 percent of GDP in 1991 to 6.2 percent in 2009. Since 1998, total credit has increased almost eight times; between 2006 and 2009 credit nearly doubled. Only in 2009 did credit contract due to the global financial crisis. For its part, housing credit has followed a growing pattern within total credit, increasing from 20 percent in 1998 to 30 percent in 2009. Moreover, total credit as a share of GDP increased from 22 percent in 1998 to 49 percent in 2009, and housing lending increased from 4 percent to 15 percent of GDP.

The US dollar is an increasingly used currency in housing credit, its share increasing from 6 percent in 1998 to 51 percent in 2009. This has reduced the risk of internal inflation and maintained variable interest rates with reference to international markets. Funding of private banks from headquarters is also in dollars, widening credit options to middle and high-income classes.

Figure 1 shows how interest rates for housing (in colones) have been declining since 2000, with a significant decline in 2006, which facilitated a significant expansion of housing loans in colones. This is mostly explained by competition in the financial system, which narrowed the spread between active and passive interest rates. Interest rates for loans in dollars fell moderately after 1998, but they stabilized and even increased after 2004. Housing loans may also be in units of development (UD), but such loans are not common.

Figure 1. Housing Credit in Interest Rate by Type of Currency, 1998-2009



Source: Authors' compilation based on Central Bank data.

The origin of the secondary mortgage-backed securities market in Costa Rica dates back to the mid-1970s, when housing developers sought a permanent source of funding for housing trusts. Despite this experience and a specific legal framework, it has barely operated; this market needs more standardized mortgages and the creation of a guaranty fund. Another key factor is the development of the capital market (which remains on the agenda), since the stock market focuses on short-term instruments, with a strong governmental presence and a secondary market not fostering equity capital transactions and dominated only by the liquidity market. An opportunity lies in the long-term savings produced abundantly by retirement funds, investment funds, insurance companies and the banking system.

The legal framework of the housing finance system has two important sources of regulation: prudential regulation and property rights. The former provides a healthy financial system, and the latter provides the protection of the role of mortgages in credit transactions. In addition, several legal bodies compose a robust lending institutional design. As a result of these practices, commercial banking (as well as other entities in housing finance) manages prudential practices and is monitored through early alert indicators, producing a healthy financial system. This is reflected by indicators such as low default rates and overall assessments as CAMELS. Prudential regulation establishes classification criteria of loan portfolios and borrowers which define capital reserves, and it additionally oversees the valuation of properties through appropriately qualified professionals. As a general rule, the loan-to-value ratio is 80 percent and the income-to-loan ratio 30 percent. In regards to property rights, there is a solid legal context and a centralized system for registering and executing mortgages. However, there remain some inconsistencies between registration of the deed and cadastre of a property with exposure to errors and fraud that can produce legal uncertainty or even nullity of a mortgage considered to be correctly registered.

Credit information from the Credit Information Center (CIC) provides standardized and accurate information on the borrower’s creditworthiness and his credit history with financial institutions regulated by SUGEF in order to determine the risk of default or delinquency. The problem arises when considering any debt operation with companies outside SUGEF regulation. Private companies sometimes fill that gap, but potential borrowers have no registry of key information on lenders.

Costa Rica has displayed economic stability in inflation, interest rates and fiscal balance in recent years, which facilitated long-term housing lending. However, the global crisis increased the country’s fiscal unbalance, reviving the threat of crowding out of the financial system and exerting pressure on interest rates. The reduction in poverty from 30 percent of population in the 1980s to 18.5 percent in 2009 increased access to credit, but the country’s housing deficit continued to be concentrated in the first four minimum wages. Poverty thus continued to be a relevant factor in housing.

Since 2002 the country saw a sustained expansion in housing construction, which peaked in 2007, growing 46 percent in respect to the five previous years and 6 percent of GDP. This growth stems from the economic expansion led by external capital flows, low interest rates and banking competitiveness. However, the global crisis caused a 39 percent contraction of the construction sector in 2009. Since 2001, Costa Rica had displaying a pronounced increase in the price of housing, which further accelerated in 2005. This increased the profitability of investments in this sector. The number of real estate investment trusts consequently grew from seven to 20 funds in 2009, managing 482 billion of dollars with portfolio growth of 973 percent from 2001 to 2008. In the same years the number of investors rose from 1,330 to 6,500.

Table 1. Relative Housing Deficit

Concept / Year	**1984**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Figures in percentages of total households											
Quantitative deficit	2.6%	1.4%	0.8%	1.2%	1.0%	1.2%	1.6%	1.0%	1.3%	1.5%	1.8%
Qualitative deficit	21.3%	15.9%	16.1%	16.5%	18.4%	18.1%	16.1%	13.7%	13.2%	12.7%	12.9%
Total deficit	23.9%	17.3%	16.9%	17.7%	19.4%	19.2%	17.7%	14.7%	14.6%	14.2%	14.5%

Source: MINVAH.

With a total of 1.257 million households in 2009 (60 percent located in urban areas), the country has experienced 25 years of relative improvement in the total housing deficit, which fell from 23.9 percent of households in 1985 to 14.5 percent of households in 2009 (Table 1). The qualitative deficit reflects the difference between the total number of households and the total stock of existing houses. This fell from 2.6 percent in 1984 to 1.8 percent in 2009. The qualitative deficit is made up of houses in poor condition and those in moderate or good condition, but showing a state of overcrowding (more than two people per room). This decreased from 21.3 percent in 1984 to 12.9 percent in 2009. More importantly, the qualitative deficit has continued to be the main proportion of the total housing shortage in the country. Government policies have had a strong emphasis on building new homes (yet for years have had no subsidies available for the improvement or expansion of existing housing), which neglects the needs expressed in the qualitative deficit. To understand the origin of the qualitative deficit, it is important to note that it is a result of the component related to the physical condition of the house, because the other component (overcrowding), is almost solved.

Regarding the distribution of the total housing deficit by minimum wages level, the first four minimum wages (segments covered by the SNFV and the BANHVI subsidy programs) account for 96 percent of this deficit. Almost half of the deficit affects families in the range of one minimum salary and a quarter of the deficit families in the two minimum wages range, which links the housing deficit to the poverty condition.

In the past 25 years the ownership increased its presence from 64.9 percent in 1984 to 72.7 percent in 2009. Rental homes have been reduced proportionately, from 20.3 percent in 1984 to 18.2 percent in 2009. Renting legislation is thought to protect the tenant; however, this purpose, despite being socially oriented, has created some disincentives for renting as it can cause a headache for the homeowner. Slums have declined from 2 percent in 1984 to 1 percent in 2009. The main problem that exists is preventing the emergence of new squatters, while still being able to relocate some of them over the time. An important issue is the largest concentration of squatters is in urban areas, representing 67.2 percent of total squatters, while 63 percent of housing subsidies have gone to rural areas.

3.2 Housing Finance in El Salvador

The financial sector in El Salvador is dominated by financial conglomerates, with activities ranging from commercial banking to insurance. The banking sector is among the largest in Central America, with approximately 95 percent of bank assets under foreign ownership (Equilibrium, 2010). Table 2 shows the structure of the housing financial system.

Since 1990 El Salvador has experienced a process of privatization, which has resulted in one of the more modern and competitive financial systems in the region, with the highest level of capitalization, positive liquidity indicators and a high operational efficiency. The country nationalized the banks in 1980 amid a civil war and political-military criteria, which led to a financial system crisis (Gochez, 1997). In December 1990, the “Law on Privatization of Commercial Banks and Savings and Loan Associations” outlined the reorganization and privatization of the financial system, with the consolidation of financial groups. Other key regulations were the Securities Market Act of 1990 and the Organic Law of the Superintendency of Securities of 1996. In 2001, the US dollar was adopted as legal tender, bringing macroeconomic stability, low inflation and stable interest rates, with spreads converging to international levels.

Table 2. El Salvador: Market Share by Banks, 2009

Bank	Total Credit	Housing Credit
TOTAL (US$ Thousands)	8,638,072	2,431,480
Distribution		
Scotiabank El Salvador, S.A.	17%	34%
Banco Agrícola, S.A.	30%	20%
Banco Citibank de El Salvador, S.A.	17%	18%
Banco de América Central, S.A.	9%	12%
Banco HSBC Salvadoreño, S.A.	14%	10%
Other	12%	6%

Source: Superintendencia del Sistema Financiero.

Commercial banks loans have increased steadily since the privatization of state banks. Total credit respect to GDP grew from 30 percent in 1990 to 42 percent in 2009. According to CEO Advisors (2010), the market is highly concentrated among four large banks (79 percent). Housing lending has represented on average 28 percent of total credit provided by the banking system over the 2003-2009 period[4] and 12 percent of GDP. This places El Salvador at the same level of other emerging economies and above the average for Latin America (Warnock and Warnock, 2007). Housing lending balances grew at an average 8.2 percent in 2003-2008, falling during the 2009 crisis. Galindo et al. (2010) indicate that Central American countries are more vulnerable to external credit shocks when the local financial system is more integrated with international markets and financial integration amplifies the impact on aggregate real credit. According to Fitch Ratings (2010), in El Salvador the impact of the global credit crunch was more severe than in the rest of Central America.

The opening process has meant a decrease in housing interest rate from 21 percent in 1990 to 10 percent in 2009. The typical mortgage is provided for monthly payments over a term of 25 years. The borrower may pay off a mortgage before 25 years, subject to a pre-payment penalty limited by law. Credit administrative fees increase the cost of mortgages. Woodward and Hall (2010) argue that potential borrower confusion and limited knowledge on the cost of origination services of mortgages increase their cost.

Public organizations related to the housing sector in El Salvador include the Vice Minister of Housing and Urban Development (Vice Ministerio de Vivienda y Desarrollo Urbano,

[4] Refers to lending by OSDs (Otras Sociedades de Depósito: commercial banks and cooperatives).

VMVDU), the Social Housing Fund (Fondo Social para la Vivienda, FSV), the National Fund for Social Housing (Fondo Nacional de Vivienda Popular, FONAVIPO), the Multisector Investment Bank (Banco Multisectorial de Inversiones, BMI) and the Liberty and Progress Institute (ILP).[5] Government actions are based on the National Housing Policy of 2005, whose purpose is to secure home ownership for every possible household (Government of El Salvador, 2005).

Government actions to promote housing finance date to 1934 with the creation of the Mortgage Bank, a government entity aimed at providing mortgage loans for housing building and restoration. In 1950, the government created the National Institute for Urban Housing to develop and execute social housing projects, and finance home acquisitions and renting. The Rural Colonization Institute was created to manage housing programs in rural areas. In 1963, the National Housing Finance Agency and the Savings and Loan Associations were created to attend the housing needs of low and medium-income families. In 1973, the Housing Social Fund (FSV) was born, and in 1975 the National Institute of Pensions for Public Sector Employees. Both were funded with contributions from workers and employers with the objective of providing housing loans. The FSV is the highest lender for house purchase or restoration in the country, with a share of 25 percent. In 1992, the National Fund for Popular Housing (FONAVIPO) was created as a public second-floor credit institution, aimed to finance less-than-four-times the minimum wage[6] households, with more favorable credit conditions. The Multi-Sector Investment Bank (BMI) was created in 1994. The BMI allocates housing funding mainly to private banks and is responsible for a secondary mortgage development plan started in 2003.

Since 2009, two central government efforts are leading public action for housing finance. The first one is House for All. The main goal is to finance the construction of 27,563 new dwellings for 2010-2014. For this goal the BMI has created a US $10 million guarantee trust fund (FORDEH). Another plan is the implementation of a Savings and Housing Finance System (SAFH), to integrate relevant public and private actors to improve housing finance performance. The key instrument of the SAFH is a registry database of housing finance suppliers, called E-Vivienda, with all information about suppliers and potential beneficiaries of housing finance funds.

[5] *The Insituto Libertad y Progeso* (ILP) supports the poorest households of the country with land purchase or property legalization rather than house acquisition.
[6] Minimum wage = US $208

The legal framework for the development a secondary mortgage market started in 2007 with the “Ley de Titularización de Activos” (December, Decreto N° 470, active since June 2008). However, no advances have been achieved to date. Secondary markets have developed almost exclusively in economies with a strong, well-regulated formal housing sector, and also with an effective primary mortgage market, loan management and supporting institutions, market liquidity and access to capital markets (IDB, 2003). These criteria have yet to be adequately developed.

In regards the supervisory system, the Banking Act of 1999 regulates the banking sector. It has improved the protection of depositors through stricter capital and risk management requirements. The Banking Act has also enhanced compliance with Basel standards, and has given broader authority for supervision. The financial system is regulated and supervised by the Central Reserve Bank of El Salvador, the Financial System Superintendency (SSF); the Securities Superintendency, and the Pension Superintendency. The Financial Standards Report for El Salvador indicates that the country achieves low overall compliance with international standards and codes, and corporate governance and auditing standards are known to be lagging behind international best practice. Currently, Salvadorian authorities are working on the internal restructuring of the SFF, with the aim of moving towards risk-based supervision. According to IMF (2010), the government of El Salvador is seeking congressional approval of the Financial Sector Supervision and Regulation Law.[7]

In respect to credit information systems, all organizations under the SSF must report credit operations to the Central System Risk with information about all borrowers’ operations and credit risk classification. There are three private complementing agencies: DICOM, InfoNet and Procredit. The biggest drawback of the credit reporting system is that there is no universal source for credit information (Lenaghan, 2001).

Economic growth in El Salvador has been modest in the last decade. The 2009 crisis produced a pronounced contraction of the economy. Among the possible explanations for this low growth is the impact of natural disasters, which are particularly relevant for the housing market. In 2001 earthquakes destroyed 108,226 houses and damaged 169,632—20 percent of

[7] The country has requested IMF’s technical assistance on financial system regulation and supervision, the bank resolution framework, mechanisms of parent-subsidiary support within international financial conglomerates, and steps for bolstering the BCR’s lender-of last-resort capabilities and a second update of the Financial Sector Assessment Program of 2004 (IMF, 2010).

country's total stock (Panadero, 2003; FUSADES, 2001). Post-disaster recovery investments have played a considerable role in housing finance dynamics (after Hurricane Mitch in 1998, earthquakes in 2001 and Hurricane Stan in 2005). For instance, housing finance for reconstruction of affected dwellings after Hurricane Ida (2009) is part of the current government's priorities. Due to modest economic growth, poverty rates remain high, despite some improvement in the early 2000s. San Salvador reports 27.6 percent of households living in poverty (DIGESTYC, 2009). The income share held by the highest 20 percent of the population is 52 percent, while the lowest 20 percent hold 4.27 percent of national income (World Bank, 2010).

Inflation averaged 3.7 percent between 2001 and 2009, while it peaked in 2008 (7.3 percent). Even though real lending rates remained above international levels during the whole decade and increased significantly in 2009. Concurrent fiscal imbalances and crowding-out effects might help explain the increase in inflation. Domestic public debt compared to GDP averaged 11.39 percent in 2000-2008 and amounted to 14 percent in 2009.

The construction sector in El Salvador accounts for 4 percent of GDP. Construction grew on average 4.3 percent during the last decade, with peaks in 2001 and 2005-2006. Cabrera (2009) argues that construction and GDP growth have a pro-cyclical relationship. According to DIGESTYC (2009) El Salvador has a total population of 6.12 millions, with 65 percent living in urban areas. Despite significant emigration in recent decades, population growth has surpassed housing supply growth. The financial system has not been able to satisfy increasing demand for housing finance in the last decade.

El Salvador has an important quantitative and qualitative housing deficit. There are 1,406,485 households in El Salvador (Ministerio de Economía, 2008).[8] The total deficit was 545,000 units in 2004, representing 38 percent of households (Government of El Salvador, 2005; Ministerio de Economía, 2008). The supply of new dwellings averaged 32,000 units between 2000 and 2008. Therefore, construction of new homes is just compensating new demand flows, with little contribution to accumulated deficits. Although the deficit has slightly decreased in recent years, a central issue is the qualitative deficit, which accounts for 93 percent of total dwelling shortage (Table 3).

[8] It is worth mentioning the difference of this figure if compared with the availability of dwelling units reported in the results of the National Housing Census of 2007 (1,668,227). Possible explanations for this divergence include dwellings under construction, for vacation, abandoned units and those unsuitable for habitation (IDB, 2009).

Table 3. Housing Deficit, 2008

	N° of Dwellings	%
Total Households	1,406,485	
Total Deficit	540,499	38.4%
Quantitative	37,552	2.6%
Qualitative	502,947	35.7%

Source: Authors' estimations with data from DIGESTYC (2009).

Data from E-Vivienda (SAFH) indicates that 90 percent of housing demand comes from households with income under two minimum wages.[9] IDB (2009) estimates that 75 percent of the target for social housing is a segment with income of three or fewer times the minimumwage. Table 4 shows the composition of housing by tenure.

Table 4. Dwelling Occupation by Property Condition

Condition	N° Households	Share
Own Property	921,201	65.5%
Rented	188,872	13.4%
Guest	150,530	10.7%
Other	17,603	1.3%
Total	1,406,485	100.0%

Source: Author's compilation with data from V Censo de Vivienda 2007.

3.3 Housing Finance in Panama

The banking sector in Panama is prominent due to its development. The country has been a regional banking center since 1970, with various banking licenses: a general license to carry out business at a local and international level; an international license for only international business; and a representation license which allows only the provision of support services. The National Banking System (SBN) is different from the International Banking Center (CBI), consisting of banks holding a general license to conduct local banking business. The presence of international banking has been a key factor allowing this country to develop a first-class, sound and competitive private banking system. This system generates more than 16 thousand jobs,

[9] Data from http://www.evivienda.gob.sv/vivienda, accessed on April 30, 2010.

accounting for about 10 percent of the GDP. Moreover, the share of total local credit in GDP is notable, remaining above 90 percent in the last five years.

Local private banks make up most of the housing loan portfolio, representing about 42 percent of the total housing credit in 2009. Government-owned banking represents about a fifth, and foreign private banking accounts for at least 37 percent. As shown in Table 5, only four banks account for nearly 70 percent of both housing and total credit lines. Other entities targeting housing are not considered financial intermediaries because they channel their own resources. Other institutions are savings and loan associations, savings and loan cooperatives and microfinance. The latter represent only 7.6 percent of the housing credit portfolio in 2007, mostly directed toward maintenance and repair.[10]

Table 5. Panama: Market Share by Banks, 2009

Bank	Total Credit	Housing Credit
US$ Thousands	21,825,452	6,199,050
Relative Distribution		
Banco General, S.A.	21%	29%
HSBC Bank (Panamá), S.A.	17%	21%
Caja de Ahorros	5%	10%
Banco Nacional de Panamá	9%	9%
The Bank Of Nova Scotia	5%	6%
Banco Panameño de la Vivienda, S.A.	2%	5%
Other	41%	20%

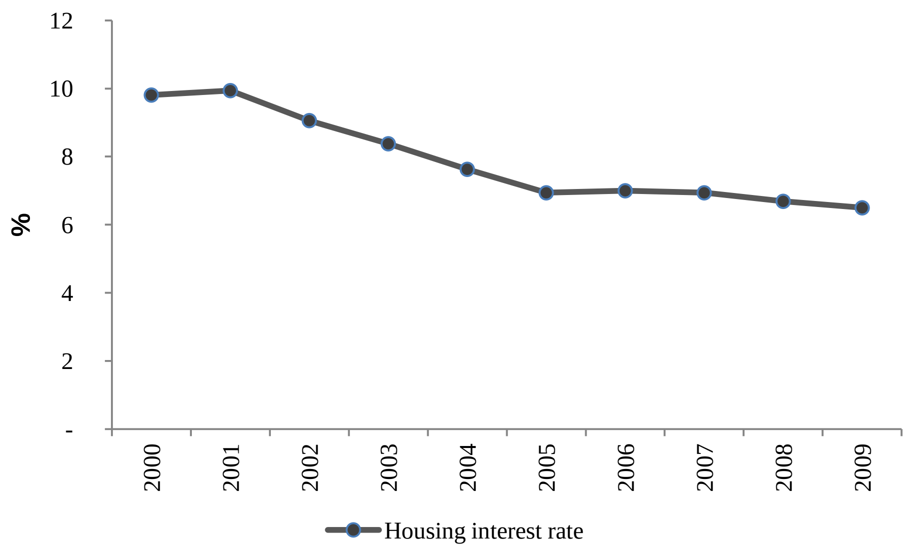
Source: Superintendencia de Bancos de Panamá.

Housing finance has exhibited continuous growth in recent years, explained by several factors such as price stability, sound macro-economic environment and a highly developed financial sector. But a key factor is investment in housing, which has been seen as a major destination for financial investment and has generated substantial coverage by the low interest rates offered by other investment alternatives. For their part, banks have found this an excellent way to drain the liquidity they maintain into a lower-risk activity. This allows them to “close the loop,” since they finance builders who undertake building projects and then applicants for residential credit.[11] This process of growth is unlikely to stop in light of how attractive this activity is, the result of the relative liquidity of the financial system and tax incentives.[12]

The banking system had a balance of mortgage loans of 29 percent of GDP in 2009, offering a 30-year-term mortgage with interest rates between 6 and 10 percent, requiring a down payment of as little as 2 percent. Additionally, the government subsidizes (by about four percentage points for 10 years) the mortgages of middle- and low-income groups, and new construction is exempt from property tax for up to 20 years (Moreno-Villalaz, 2006).

The stability of the banking sector and its level of liquidity have produced a continuous decline of housing interest rates over the years (as shown in Figure 2). The default on the construction lending presents a low rate less than 2 percent of the total credit.

Figure 2. Interest Rate for Housing, 1996-2008



Source: Superintendencia de Bancos de Panamá.

[11] Inside the building process there are also other vertical-integrations that exploit economies of scope, such as when construction companies have their own placement agency, real estate company, or supply of inputs and raw materials.

[12] There is a land tax exemption of up to 20 years depending on the type of real estate—a tax incentive of considerable importance. The justification for such an exemption has been in the eventual dynamic multiplier effect of construction activity within the economy, particularly in terms of employment generation and creation of aggregate demand through consumption.

Housing finance is essentially covered by banking sources. Banks hold their credit portfolio to maturity, preventing an active secondary mortgage market. Although some mortgage securitizing operations have been undertaken, especially by private banks, there has been no widespread need to opt for this alternative; most banks prefer to maintain their mortgage portfolios, given that these are high performing. However, the efficiency of banking is proven by the securitization of mortgages (locally and abroad) without any special law or entity promoting this (Moreno-Villalaz, 2006).

Panama's banking sector is subject to a fairly high level of regulation. The Banking Law of 1997 incorporated the complete supervision of operations and adhered to the international standards of the Basel Committee. Unlike other offshore jurisdictions, the banking business requires physical presence, as well as a formal structure subject to regulation and supervision with international standards. The International Monetary Fund (2007) indicates that the banking industry meets over 90 percent of Basel standards for effective banking supervision, and more than 90 percent of international standards on prevention money laundering and terrorist financing (Paredes and Morales, 2007).

Many financial entities are not supervised by the SBP; rather, they are under the control of other agencies with weak or absent prudential supervision that renders those entities' operations vulnerable. Financial intermediaries account for 161 companies registered at the Ministry of Trade and Industry (MICI), but only 66 of these companies provide complete information on their operations, which implies serious underestimation of managed credit.[13] Savings and loan associations, which are under the supervision of the National Mortgage Bank, present high default rates and have difficulty in recovering loans. Savings and loan cooperatives are under the Panamanian Institute of Cooperatives; this represents an instance of incentives rather than supervision.

The Public Registry, which is in charge of the registration of all property transactions, provides a solid and unified system that permits the transfer of legal rights on properties. The credit information system is considered solid and dependable, and its centralization allows a high level of consistency, provided by the Panamanian Association of Credit (APC). Founded in 1957, the APC has over 600 members of commercial, industrial, banking and finance, as well as

[13] It is noteworthy that the new administration of MITI has emphasized this aspect, since some of these financial institutions assess the possibility of establishing banks, which coincides with the trend of supervision that seeks to promote the SBP to include such entities within its sphere of activity.

financial cooperatives and government agencies. APC maintains high standards of quality, as shown by its ISO 9001 certification.

The macroeconomic conditions are characterized by stability and low interest rates. Beginning in 2001, the country began to grow at an average annual rate of 6 percent. In 2007 the growth rate reached 12 percent, closely followed by 11 percent in 2008. Even during the global crisis, in 2009 GDP grew at a rate of 2.4 percent and the construction sector grew by 4.5 percent. The country's income distribution, however, reflects a divide between sectors engaged in international services and other activities. This produces high pressure on public programs, which experience high demand but have limited resources. Although the poverty rate decreased from 37 percent in 2002 to 28 percent in 2008, it still remains high; about 75 percent of poverty is concentrated in rural areas. Even during the global crisis, unemployment was over 10 percent until 2006, when it decreased to around 8 percent. However, lack of employment opportunities have led to rapid growth in the informal sector.[14] Fiscal stability contributes to stability in the housing finance system, with a surplus of around 4.5 percent of GDP. An important feature is the currency tied to the US dollar, with no central bank, bringing stability in prices and value of assets. Inflation has averaged 2 percent since the 1980s, even lower than US inflation (Moreno-Villalaz, 2006).

Programs managed by the Ministry of Housing (MIVI) range from provision of housing finance with the public budget to direct fixed-amount subsidies or subsidies in interest rates. Housing policy is highly interventionist, but there is not a unified policy covering all institutional efforts, creating duplicity and overlapping of actions. MIVI is charged with the formulation of housing finance policy, but it does not play an active role in overseeing its implementation. The MIVI issues housing loans through the National Mortgage Bank, under its jurisdiction and exhibiting high levels of default.

In respect to the housing finance regime, Panama has four established policies: i) preferential interest rates for low and middle-income families; ii) subsidized loans extended by the National Mortgage Bank (BHN); iii) up-front one-time subsidies of up to $4,000 to supplement a down payment and a 30-year mortgage loan at market interest rates; and iv) down payment guarantees that enable families to reduce their down payments from 20 percent to 2 percent, to reimburse up to 30 percent of any losses incurred (PROFINCO). An interesting policy

[14] BID. Estrategia de Panamá, años 2004-2009.

is the Law of Direct Discount, allowing borrowers to ask their employers to deduct their mortgage payments directly from their salary, with priority over all other personal debt. This measure is a critical factor in improving credit access.

The share of construction in GDP averaged 5.2 percent from 2005 to 2009, and the sector's employment accounted for 18.3 percent of the labor force. The housing boom has allowed the country to overcome the effects of the global financial crisis.

In 2009 the population of Panama reached 3.7 million, with 69 percent living in urban areas. The housing deficit (Table 6) amounts to 125,014 units in 2009, representing 14 percent of households in the country. Around 6 percent of houses present total deterioration, and 17 percent overcrowding. Figures of MIVI show 47 percent of the deficit is in population with monthly income less than $250, 27 percent between $250 and $600 and 26 percent over $600.

Table 6. Housing Deficit and Components, 2009

	Existing Houses	% of Existing Houses
A. Total existing houses	862,586	100.0
B. Total deficit	125,014	14.5
C. Total deterioration	50,684	5.9
D. Overcrowding	152,163	17.6

Source: Unit of Statistical Information and Indicators from the Bureau of Planning and Budget.

The home ownership rates in Panama in 2008 reached 68 percent of households. The rental housing stock has been gradually depleted, and there is virtually no construction of rental housing. Moreover, the abundance of financing leads people, before renting a house, to buy it through one of the financial mechanisms. According to the Social Development Division of the Ministry of Housing, there were 260 squatter communities in the country with approximately 170,000 people in 2008.[15]

4. Analytical Model and Results

4.1 Analytical Model for Housing Finance

Housing finance policy is analyzed on the basis of three key components: i) the development of housing finance institutions; ii) the housing finance regulatory regime; and iii) the allocation of

[15] www.mivi.gob.pa, accessed on September 20, 2010.

housing subsidies through or in conjunction with housing finance (Angel, 2000). These policy components address four key challenges limiting mortgage credit: i) low-income families' inability to pay, ii) the risk of recovery of the guarantee, iii) the risk of fluctuations in interest rates and iv) the risk of maturity mismatch (IDB, 2005).

The development of housing finance institutions is linked to governments enabling the market to improve its performance in housing. The objective is to transform government intervention from the direct provision of housing to creating conditions favorable to housing construction and finance through intermediaries in the private sectors, or by empowering families and communities to acquire a house. Relevant actions to implement this policy component include: stimulus of the full value chain of the housing finance system; removal of barriers to participation by private lenders and a wider array of financial institutions; increasing access to microfinance for home expansion and improvement; supporting institutions and schemes to reduce mortgage credit risk through subsidies, mortgage insurance, government guarantees, variable interest rates, indexation to inflation or use of foreign currency; and fostering a long-term mortgage market, where funding is aligned with maturity of mortgage lending. Housing finance institutions are fostered by strengthening the competitiveness of the financial system as a whole, adopting international banking standards for banking, reducing operational costs and the removing the market barriers that public financial institutions present to private banks.

The second component of the housing finance policy is the regulatory regime. Actions for this component start with prudential regulation to ensure the health of financial institutions. Other actions include removal of restrictions to control mortgage lending by rationing credit (specific types of housing or segments, cap to interest rate fix, lending below market rates, etc). Finally, the regime includes actions related to property rights and enforcement of contracts and foreclosure laws to guarantee secure transactions.

The third policy component is allocation of housing subsidies with schemes of direct and transparent credit-related subsidy (measurable, transparent, finite, predictable and charged to government budget). Actions include the following: i) making subsidies transparent and predictable, ii) ensuring that subsidies are not regressive, iii) targeting subsidies at below-median-income households, iv) focusing on demand-side subsidies, v) abandoning public housing, vi) avoiding supply-side incentives to builders, vii) maintaining a balance between new housing and existing housing subsidies, viii) using subsidies to leverage household savings, ix) reducing taxes and transfer fees, and x) introducing effective property taxation.

4.2 Lessons Derived from Housing Finance in Central America

The revision of the housing finance situation in three Central American countries derives important and remarkable lessons about how developing countries can develop a sound finance housing policy. The observed experiences in these countries stress some important areas of the housing finance system that should be improved in order to reduce the housing deficit.

4.2.1 Competitive Financial System

The main policy supporting the development of housing finance is related to actions introducing more competition in the financial system, where the three countries have taken important steps forward. As a result of the modernization of the overall financial sector, the countries have achieved higher standards, financial depth and expansion of housing credit. This modernization varies, with Panama leading and Costa Rica trailing.

The banking sector in Panama is prominent due to its development, with high stability in prices and value of assets, based on the local currency attached to the US dollar, which "eliminates risk of fluctuations in exchange rate, mismatch between assets in local currency and dollar, capital flight, risk of 'transfer' of foreign commitments, and speculative attacks. The absence of monetary policy reduces the risk to outside investors; requiring less information for their decisions" (Moreno-Villalaz, 2006).

The presence of international banking in Panama allowed a first-class, sound and competitive private banking system, with little government intervention; there are even legal reserve requirements on deposits. There is sufficient freedom of entry for foreign investors, with virtually no restrictions on capital movements, and interest rates are determined freely by the market. It is therefore not surprising that Panama's total credit is almost 100 percent of GDP. Mortgage finance has reached 29 percent of GDP; lenders offer 30-year mortgages with interest rates varying from 6 percent to 10 percent and requiring down payments of as little as 2 percent. In addition, the government subsidizes the mortgages of low and middle-income groups by about four percentage points for 10 years.

Costa Rica has followed an opening process from government-owned banks' having a monopoly on deposits and credit accounts to a scheme with more competition from private banks. This has permitted wider funding alternatives for banks and removing distortions like fixed interest rates and capped credit portfolios. Allowing competition has additionally brought modernization, depth and international standards to housing finance. Total credit rose to 49 percent of GDP in 2009, and housing finance rose to 15 percent of GDP.

El Salvador has experienced a process of privatization in its financial market, making it one of the more modern systems in the region, with the highest level of capitalization, positive liquidity indicators, and operational efficiency after Panama. Total credit reached 42 percent of GDP in 2009, respect to GDP grew to 42 percent in 2009 and housing lending is 12 percent of GDP.

Panama's success in comparison to the other two countries can be assessed by additional measures as well. According to Central American Monetary Council data, in 2009 Panamanian financial institutions' overhead cost was equivalent to 1.4 of assets, compared to 3.1 percent in El Salvador and 4.2 percent in Costa Rica. Likewise, in 2009 the intermediation margin was 4.1 percent in Panama, 7.3 percent in El Salvador and 7.6 percent in Costa Rica.

An interesting policy instrument in Panama is the Law of Direct Discount. Borrowers ask their employers to deduct their mortgage payments directly from their salary, with priority over all other personal debt. This mechanism reduces the risk of default, the transaction costs and collection costs. Additionally, it allows low-income households to access a loan; it does not, however, enable non-salaried people to take advantage of housing finance and subsidies. This system is not found in El Salvador or Costa Rica.

4.2.2 Mitigation of Interest Rates Risk

Fluctuation in the interest rates, and the high sensibility to macroeconomic conditions, bring an important source of risk, curving the mortgage credit expansion. In Panama and El Salvador, the adoption of the dollar has brought considerable macroeconomic stability. This reduction of risk allowed for the widening of mortgage lending, especially by setting the inflation rates at international levels. In Costa Rica, the interest rates risk is mitigated by variable rates in colones and use of dollars. The latter has reached approximately 50 percent of housing lending. Following this expansion, and in light of the risks households face related to currency mismatches, authorities have required recipients of dollar-denominated loans to provide proof of dollar-denominated income. Inflation indexing is rarely used in Costa Rica.

All these arrangements have permitted expansion in housing finance, but they still rely heavily on macroeconomic stability. Although Panama and El Salvador have benefited from the use of the dollar as legal tender, the fiscal situation of all three countries studied remains important due to its influence on interest rate fluctuations and it use as a policy instrument to address macroeconomic cycles.

4.2.3 Matching Long-Term Funds

Intermediary entities in housing finance face risk is the mismatch between most short-term funds raised from the public and the long-term nature of mortgage lending. An essential requirement for ensuring the acquisition of long-term resources for housing finance is the development of a secondary mortgage-backed securities market (SMBSM). Another scheme is the issuing of bonds backed by mortgage portfolios acquired by special funds design for that purpose.

Although Costa Rica has a broad legal framework for the SMBSM's, it is not really operating. There is a need for legal and institutional strengthening in the standardization of mortgages, availability and accuracy of statistical information on defaults and prepayment of loans, flexibility in mortgages right assignments, promotion of special purpose vehicles, management of tax incentives, improvement in registration of deeds and cadastres of properties, attraction of institutional investors through the capital market and the materialization of a guarantee fund as credit enhance (Sancho, 2009). So far, the second-tier mortgage bank (BANHVI) has followed the second approach mentioned, issuing mortgage bonds backed by the portfolios of authorized entities. This approach has contributed to raising lower-cost funds.

In El Salvador the secondary mortgage market is nonexistent. The legal framework for secondary mortgage markets development has not generated securitization. Preliminary explanations include the international financial crisis and local credit constraints, slow learning-by-doing and market obstacles because of the current institutional framework, the absence of a formal housing market information system, unclear rules for main actors, and the lack of complementary financial instruments.

In Panama, long-term funding includes some mortgage security operations, especially by private banks. Such operations, however, have not been widely used. Most banks prefer maintaining their mortgage portfolios because of their good performance. The secondary market is not a basic requirement for funding the housing finance system, due to the overall sound development of the financial system. However, securities operations in Panama have demonstrated the efficiency of the banking system in the absence of any special law or entity promoting it (Moreno-Villalaz, 2006). The lesson from Panama's experience is the higher the development of the overall financial system, the more longer-term mortgage lending is available.

4.2.4 Supervisory Regime

From the regulatory perspective, the three countries' respective legal frameworks have implemented over three decades prudential systems based on Basel principles, which have supported a sound and healthy financial system. This development has exerted a significant influence on how these countries have faced the global financial crisis.

Costa Rica's experience is a lesson to consider, because only in recent years has its prudential system proved to be robust. In the 1990s and at the beginning of the following decade, the Superintendency of Financial Entities was in transition from the previous institutional arrangement, and some supervision activities were the responsibility of BANHVI, as auxiliary supervisor. BANHVI, however, faced a conflict of interest when financial problems in the cooperative housing system were detected. After those problems were identified, instead of applying immediate corrective measures, the institution played the role of financial supporter, aggravating the root problems, which produced a cascade effect of bankruptcy in the housing cooperative system as a whole (Matarrita, 1995). The lesson is not to rely on dual supervisory arrangements delegating supervisory functions to institutions responsible for providing funds to the supervised entities.

According to Paredes and Morales (2007), Panama's bank regulation is based on clear, accountable and transparent principles to manage the risk of depositors. From mid-2004, the Superintendency of Banks has worked on the foundations for the eventual implementation of the standards set by Basel II. However, tests on its applicability have established that Panama has modern legislation that largely meets the standards and principles for effective banking supervision. The International Monetary Fund indicates that the country's banking industry meets over 90 percent of Basel standards for effective banking supervision, and more than 90 percent of international standards on prevention of money laundering and terrorist financing.

4.2.5 Property Rights

All three countries have a sound legal framework in regard to property rights (and the registration of deeds, cadastres and mortgages). However, Costa Rica has inconsistencies between registration of the deed and cadastre of properties, with exposure to errors and fraud, which can produce legal uncertainty or nullity of mortgage even if correctly registered. Additionally, some of this regulation represents operational barriers for the development of a secondary mortgage-backed securities market. Only in a recent program by the national registry have inconsistencies in the deed and cadastre system begun to be addressed and corrected.

In El Salvador, despite the fact that registration of deeds and cadastre is solid and forms a unified system, the problem comes from the high level of property uncertainty in some parts of the country. After prolonged periods of civil war and land invasion, real estate transactions have been made with a degree of uncertainty as to real property rights.

In contrast, Panama's registration system is found to be solid, supporting the certainty of mortgage contracts and foreclosure procedures. Legal conditions permit the confiscation of delinquent properties and expeditious performance of foreclosures, and even common law firms purchase properties (or other debt) in foreclosure and implement legal procedures, or are recorded as assets owned by a trust to the lender (Moreno-Villalaz, 2006). These arrangements in Panama are also lessons for the other countries, where foreclosure typically takes 20 months or more, representing an important cost in respect to the amount of the mortgage.

4.2.6 Subsidy System

Access to housing credit depends heavily on the relationship between the cost of housing and family income. Lower-income sectors thus face lower access to housing because of their inability to pay for mortgages. Subsidies to housing prices or interest rates improve the value-to-income ratio of low income families.

In general terms, Costa Rica's finance and subsidy policy is based on sustainability and efficiency principles. The Ministry of Housing (MIVAH) and the government financial core institution (BANHVI) are designated as facilitators of private actions, aiming to solve the housing problem without assuming a direct (interventionist) role in the finance housing system. A key instrument is a direct demand-side subsidy for low-income sectors, channeled through the authorized entities. This approach follows the principles of direct subsidy to demand. It should particularly be noted that the granting of subsidies is predictable, with a waiting list of applicants. This feature can be found in El Salvador and Panama, but in both countries there are also supply-side subsidies of houses. An interesting feature of the Costa Rican policy design is BANVHI's status as a second-tier bank; the financial system provides loans. This allows BANVHI to concentrate on administration of the subsidy system and the allocation of adequate resources for authorized entities.

In Panama, despite the high development of the financial system, the government follows policies of direct provision of housing, and the National Mortgage Bank is a first-tier bank competing with private institutions and subsidizing the interest rates of its finance scheme. The Ministry of Housing (MIVI) is focused on its role as institutional head of housing policy, enabling markets' functioning rather than directly building and financing housing. The MIVI is also involved in a variety of other programs, most operating on a small and relatively insignificant scale.

The most important policy in Panama is the preferential interest-rate program. For Angel (2000), this policy is characterized by it's a regressive nature, high administrative cost and weak targeting of the poor. Moreover, the subsidy provided is not transparent; its cost is neither counted as part of the housing budget nor made public. While it will be politically difficult to phase out the preferential interest-rate subsidies, they could be lower and better targeted. However, Gonzales (2005) notes lessons from the preferential rate mechanism expanding access to more families. In this case, this is not a grant received by the mortgagor at the expense of the capitalization of the financial institution. In fact, this institution delivers mortgage loans at market rates, as the state covers the difference in tax rates with marketable securities.

An additional important characteristic of the Costa Rican experience is the centralization of overall housing policy, particularly government housing finance policy, in the Ministry of Housing. This contrasts with the dispersion of policy and institutional efforts detected in Panama and El Salvador, where government agencies' initiatives are embedded in various layers of policies and programs, with some level of duplicity and overlapping. In El Salvador, after the recent creation of the SAFH, the allocation of housing funds is managed in a centralized way (with an integrated database of households), and channeled exclusively through authorized financial entities. This would contribute to reduce the dispersion and overlapping of efforts from different government entities.

An important limitation in the subsidy system of Costa Rica is that grants for home repair and improvement have low priority, despite the fact that the largest deficit in the country is qualitative (though the quantitative is relevant as well). In Panama the low cost of financing creates an incentive to replace a deteriorating house by purchasing a new one. In El Salvador credit for house repairing has increased in recent years.

Table 7. Summary of Comparative Features of Housing Finance Policy

Housing Finance Policy	El Salvador	Costa Rica	Panama
General role of government	Facilitator in some areas, but direct provision in some few areas	Facilitator of private action	Facilitator in some areas, but direct provision in some areas
Entities channeling housing lending	Financial entities and government agencies	Financial entities	Financial entities and government agencies
Focus of government mortgage entity	First tier bank, competing with financial system	Second tier bank	First tier bank, competing with financial system
Centralization of housing finance policy	Some level of dispersion among government agencies	Centralized avoiding duplicity and overlapping	High level of dispersion among government agencies with duplicity and overlapping
Type of housing subsidies	Direct demand-side subsidy, indirect demand-side subsidy and direct provision of houses	Direct demand-side subsidy	Direct demand-side subsidy, indirect demand-side subsidy and direct provision of houses
Purpose of subsidy	New constructions and reparation of existing houses	Mostly new constructions	High emphasis in new constructions but schemes of reparation of existing houses
Modernization and competitive environment of financial system	Highly competitive	Medium due to high presence of commercial government-owned banking	High international level development
Secondary mortgage-backed security market (SMBSM)	Secondary mortgage market is nonexistent	Not operating to do be a tool for the mortgage market	Not a basic requirement because funding of the housing finance with high liquidity of banks
Prudential regulatory system	Solid with healthy financial system	Solid with healthy financial system	Solid with healthy financial system
Property rights and registration of deed, cadastre and mortgage	Unified with problems of uncertainty about some real property rights	Unified system, but inconsistencies between registration of the deed and cadastre	Solid and backing the certainty of mortgage contracts and foreclosure procedures

Source: Authors' compilation.

5. Conclusions and Policy Recommendations

The housing finance systems of the three Central America countries under consideration have been analyzed based on the enabling characteristics of the market, the government's role as commander or facilitator, the structure and operation of the financial market, the legal-institutional framework, macroeconomic and income distribution structures, the development of the secondary mortgage-backed securities market, and the operation of government housing subsidy and finance programs.

In all three countries, modernization of the financial system has played an important role, making the market the main channel for the provision of housing finance. The case of Panama offers several lessons in terms of the modernization of the overall financial system and the impact in the housing finance. In this sense, the first policy recommendation is to expand the openness and competitive environment of the overall financial system, because the expected effects on housing finance are modernization, international standards, and low intermediation and operational costs.

In Costa Rica, the government has completed the transition from direct intervention to a more enabling approach. In El Salvador some transition is pending because direct provision of housing still remains. Panama also has direct housing provision and supply-side subsidies that should be reviewed to take greater advantage to its financial system. The second policy recommendation is following Costa Rica's emphasis on the government's role as facilitator of private housing finance within a centralized policy framework involving all government agencies and the financial system.

A third policy recommendation involves Panama's preferential interest rate, backed by tax deductions, which has expanded housing lending even though it is regressive and not directly charged to the government budget. This policy can be targeted to some of the middle class, whose pay capacity does not allow them to access housing credit in market conditions.

The structure of income distribution is a key factor for the performance of the housing system in all three countries. More than 90 percent of the housing deficit is concentrated among households whose income is less than four minimum wages. Government subsidies are directed especially to this segment of the population, but a complete solution based on public budgets is not sustainable. Instead, this situation requires an active role of the private housing financing market in providing credit alternatives to lower income segments. Therefore, the fourth policy recommendation consists of policies to reduce the cost of housing financing. Markets should provide lower-cost financing to make market lending feasible to more low-income sectors. This means that Costa Rica and El Salvador should extend mortgage loans from the currently common 15 or 20 years to 30 or even 40 years. Additionally, financial entities' transaction costs pose a major obstacle to increasing the supply of low-income population lending. Policy options can include, in addition to subsidies to cover those costs, encouraging small-scale and microfinance systems with low transactions costs to enter this loan market.

Clearly, best practices consist of granting subsidies alongside savings schemes, which can enhance access to lending schemes. The granting of subsidies in the three cases studied, however, is not significantly tied to savings schemes. Hence, a fifth policy recommendation is granting subsidies with savings schemes.

In regards to long-term funding, the sixth policy recommendation is a strategy to remove barriers to the development of a secondary mortgage-backed securities market.

As mortgages use agility as a guarantee, Panama's experience provides the seventh policy recommendation: developing a framework enabling more use of leasing schemes and trust funds where the property is not transferred to households until the total amortization, including the necessary specialization of judicial bodies in mortgage and foreclosures to reduce the length and cost of the process.

The prudential supervisory framework in the three countries has reached a solid condition, representing a strong point for the health of the housing financial system. Regarding the legal-institutional framework, property rights law enforcement is currently inadequate in El Salvador and needs improvement in Costa Rica; it has, however, reached a robust state in Panama. An eighth policy recommendation is therefore the clarification of property rights in Costa Rica and in El Salvador.

In terms of the macroeconomic environment, the fiscal situation in El Salvador and Costa Rica poses a significant threat to housing finance because of crowding-out effects, which has an important effect on the performance of housing interest rates. This stresses the importance of the ninth policy recommendation: a prudent fiscal policy behind the stability of interest rates, because of the high sensitivity of housing credit to interest rate fluctuations. In the case of El Salvador remittances represent an additional factor in the behavior of the housing system, which is linked to economic cycles and the demand shocks. Therefore, El Salvador needs to implement policies that isolate the housing system from the economic cycles affected by fluctuations in remittances. One way to do this is through long-term funding matching the maturity of mortgage loans.

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Appendix 1. Features of Government Housing Finance in Costa Rica

The Law of National Financial System for Housing (SFNV) in 1986 led to two demand-side subsidy programs. One, consisting of targeted subsidies, was called Fund for Housing Grant (FOSUVI). The other program is the National Housing Fund (FONAVI), whose goal is to provide funds to authorized financial institutions.

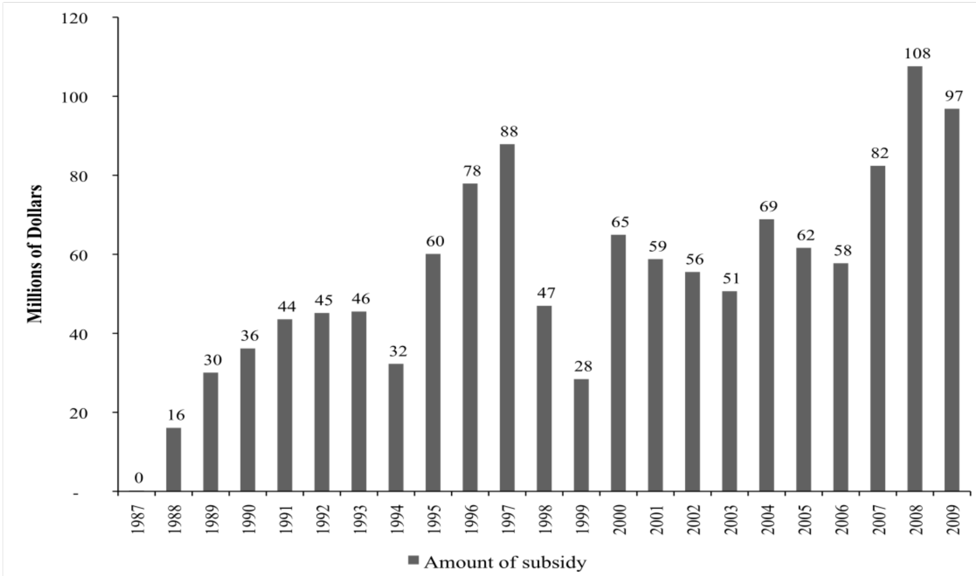
The Family Housing Subsidy (Bono Financiero para la Vivienda: BFV), is a grant equivalent to 30 minimum wages of an unskilled laborer in construction,[16] currently ¢5.3 million (about $9,250). The family income cap for a subsidy is 4 minimum wages (in 2009 equivalent to ¢718,016 or $1,253). The subsidy is progressive, with the first wage tier (minimum wage or less) receiving the maximum grant. Grants are made for purchase of lot and construction, buying only the lot (up to 50 percent of the subsidy), purchasing of existing housing, or for repairs and improvements (up to 50 percent of the subsidy).

New authorities at the Ministry of Housing and Human Settlements have announced policies to foster the solutions for slums as well as address the needs of the middle class. The goal for slums is greater community involvement in the construction of houses and urban services. Assistance to the middle class will take the form of a deferred grant, meaning families could receive a subsidy of about $4,000, delivered directly to the authorized financial entity on a monthly basis, which is used to subsidize the payment of credit.

Since the start of the SFNV, approximately 270 thousand subsidies have been granted (Figure 3). The number of subsidies granted has generally grown over the years, in spite of significant declines in 1998 and 1999 when major cooperative associations were declared bankrupt. Since 1987, 87 percent of the subsidies are regular subsidies (i.e., those with no specific purpose), while 6 percent were for families in extreme poverty, 4 percent for eradication of slums, and only 1 percent for new programs for saving, grants and loans directed to middle-class families. Other program, such as subsidies for the disabled, account for only 2 percent. The number of houses built with the subsidy has remained virtually unchanged since 2001 at around 10,000 dwellings, representing an average of 15 percent of housing built annually in the country.

[16] In 2009 the minimum wage was ¢179,504, about $313.

Figure 3. Amount of Subsidies Granted by Government, 1987-2009

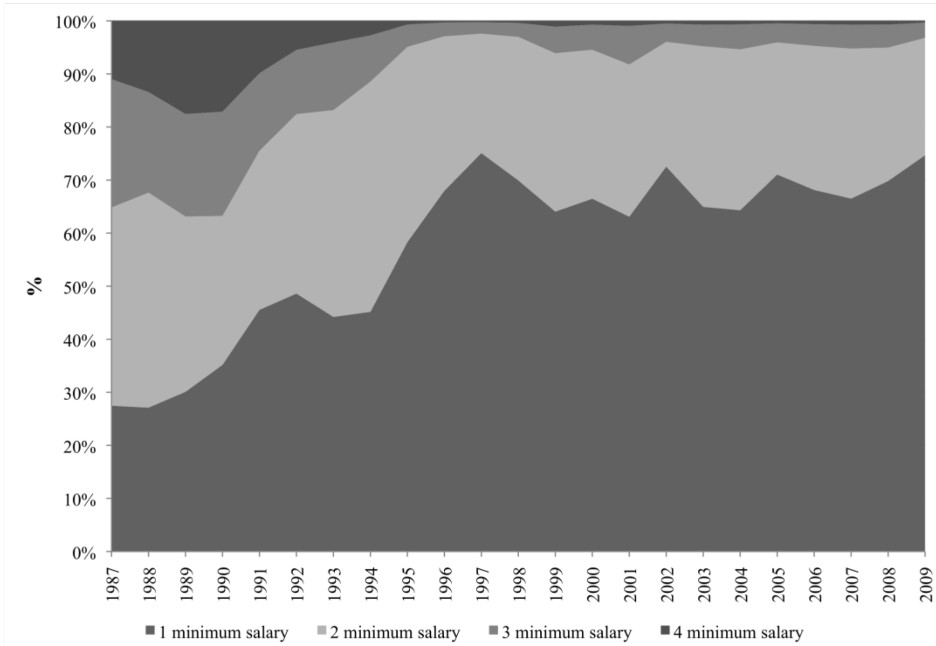


Source: Authors' compilation based on data from MIVAH, Central Bank and INEC.

In the same period, 52 percent of subsidies are given to families with their own lot, because the subsidy amount of $9,250 is not enough to both purchase a piece of property and build a house. Subsidies for the purchase of lot and construction represent 26 percent and the purchase of existing house represent 15 percent. Importantly, grants for home repair and improvement continue to be a low priority, with only 3 percent of subsidies, even though the country's housing deficit is more qualitative than quantitative. In 22 years of the SFNV, 63 percent of subsidies have been allocated in rural areas.

According to the wage income segments covered by the subsidy system, Figure 4 shows that most of the subsidy is assigned to the lower stratum, and that proportion has grown over time.

Figure 4. Distribution of Granted Subsidies by Salary Tier



Source: Authors' compilation with data from MIVAH, BCCR and INEC.

Regarding the sources of subsidies, the social security system has come to be the main supplier of funds, accounting for 75 percent since 1987. A notable development is the declining relative importance of the sales tax, which has contributed almost nothing since 2005 and supplied only 12 percent of funds in the period 1987-2009; this goes against the original spirit of the system. Of the total funds raised from the sales tax to finance the housing system, a large proportion simply has not been transferred by the government, underfunding the system. While FUSOVI's anticipated revenues are 3 percent of the government budget and 6.6 percent of sales tax, between 1997 and 2008 it was allocated only 5.2 percent of anticipated sales tax revenues. This meant that approximately 430,000 grants could not be made. Direct support from the government budget, moreover, has been intermittent, representing only 9 percent of funds in the system's 22 years of existence. To give further impetus to the housing financing system, a tax was recently approved on luxury homes with a minimum of $180,000, of which there 6,492 according to the latest available figures. The expected revenue was $38 million, which could mean an additional 4,000 grants annually. A subsequent legal reform, however, diverted some of these resources to other social programs, a further illustration of the weakness of the government's housing finance schemes.

Appendix 2. Government Housing Finance in El Salvador

Government agencies involved in El Salvador's housing sector include the Viceministry of Housing and Urban Development (*Vice Ministerio de Vivienda y Desarrollo Urbano*, VMVDU), the Social Housing Fund (FSV), the National Fund for Social Housing (FONAVIPO), the Multisector Investment Bank (BMI) and the Liberty and Progress Institute (ILP).[17] Government actions in the housing sector are oriented towards the global objective of the National Housing Policy of 2005, which is to extend home ownership to the greatest possible number of households and thus contribute to the country's human and economic development (Government of El Salvador, 2005).

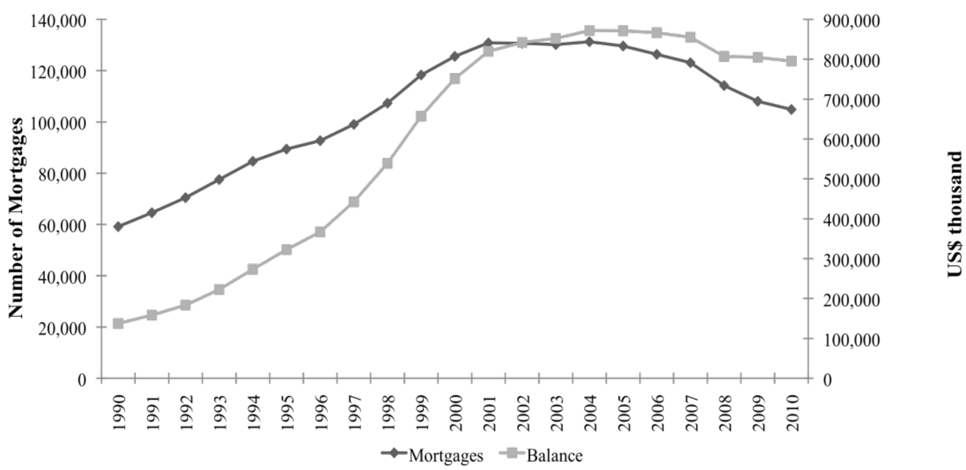
Since 2009, two central government efforts have been leading public action for housing finance. The first is the *Casa para Todos* (CPT, "House for all") program announced in mid-2009 as a government anti-crisis measure. The main goal is to finance purchase or construction of 27,563 new dwellings for 2010-2014. The *Fondo Social de Vivienda* (FSV) is leading the program, focusing on facilitating 25,000 loans for households with less than 4 minimum wages equivalent monthly income. The BMI has created a US$10 million guarantee trust fund (FORDEH) for developers of residential projects with houses priced less than US $28,500.

The second initiative is the implementation and strengthening of a Savings and Housing Finance System (*Sistema de Ahorro y Financiamiento Habitacional*, SAFH), as a central component of the National Housing Policy. The main objective of the SAFH is to integrate relevant public and private actors to improve housing finance performance in the country. The key instrument of the SAFH is a registry database of housing finance suppliers (FSV, FONAVIPO, ILP, NGOs, among others) and households, called E-Vivienda. This is a Web service portal with all information about suppliers and potential beneficiaries of housing finance funds. Currently more than 90 percent of registered households have 1 or 2 minimum wages of income level.

[17] *The Insituto Libertad y Progeso* (ILP) supports the poorest households of the country with land purchase or property legalization, not with house acquisition.

Housing finance from public organizations has likewise been decreasing in recent years. There was a slight recovery in 2009, however, despite the effects of economic crisis. In the case of Fondo Social para la Vivienda (FSV), total housing finance peaked in the middle of the decade and reached US$800 million in 2009. There are presently 115,000 mortgages managed by FSV (Figure 5).

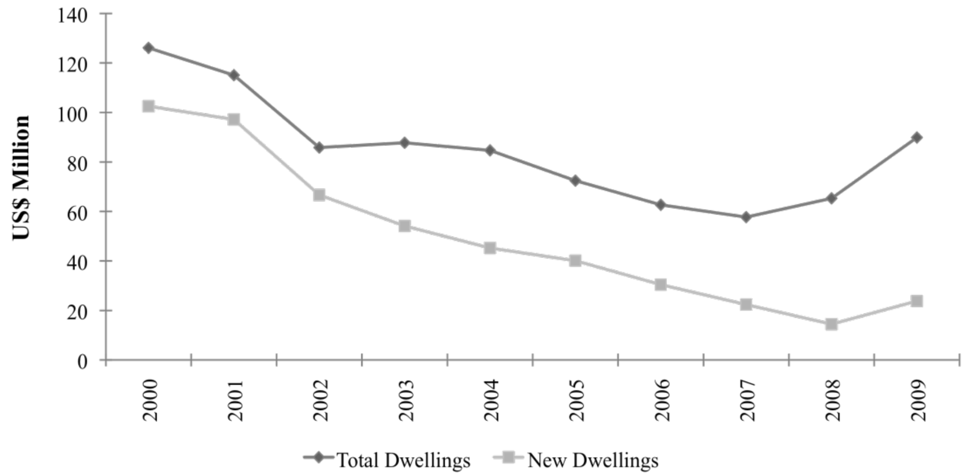
Figure 5. Fondo Social para la Vivienda, Mortgage Balance



Source: Fondo Social para la Vivienda.

Credit for new dwellings purchase decreased significantly in the last decade. At the same time, an important share of credit was allocated for second-hand housing and dwelling reconstruction (Figure 6). The share of number of new dwellings financed fell from 80 percent in 2000 to 15 percent in 2009. Among other changes in credit conditions, FSV has opened housing finance lines for higher-income households and established prime rates for loans. Maximum credit amounts have increased as well. While interest rates have generally remained relatively stable, they have increased in the case of loans to lower-income households. From its creation, FSV has focused housing finance on poor households with lower levels of income. This has changed in recent years, however, mainly because of falling demand from poorer households.

Figure 6. Dwellings Financed by Fondo Social para la Vivienda (FSV)



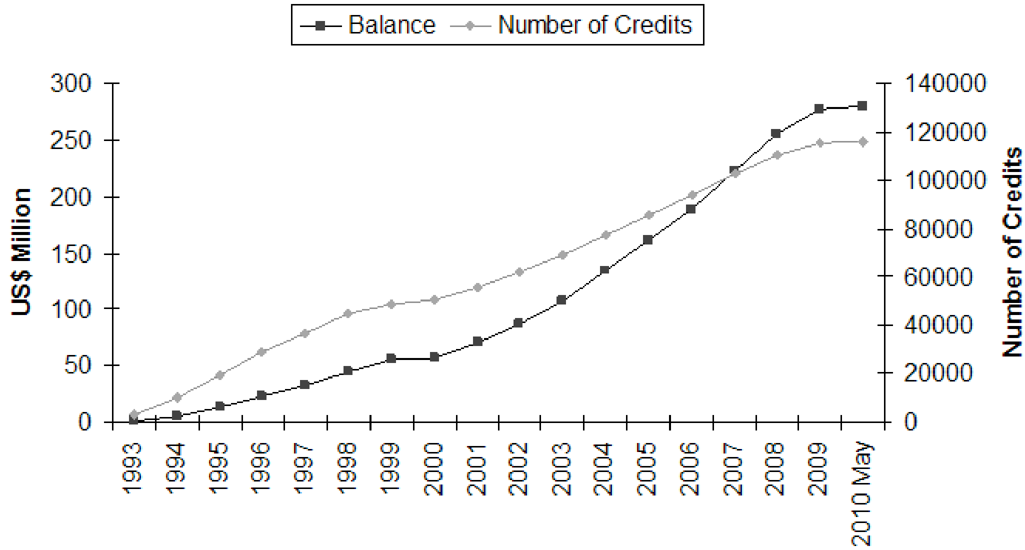
Source: Fondo Social para la Vivienda.

On the other hand, credit for housing purchase and construction from Banco Multisectorial de Inversiones (BMI) increased from US $16,000 in 2005 to US $33,000 in 2009. Reference lending rates from BMI for second-tier banking range between 5.75 percent and 7.25 percent subject to negotiated terms.[18] The majority of credits for house purchase are concentrated in dwelling improvements and the acquisition of houses with a value under US $80,000.

FONAVIPO has allocated almost 120,000 housing credits for a total amount of US$280 million since 1992 (Figure 7). It has also granted US $110 million in subsidies for more than 59,000 households. FONAVIPO has different housing credit lines for dwelling purchase or construction, lot acquisition or dwelling improvements. It also supports basic services in infrastructure construction (water, electricity, sewerage). In addition, there is a small credit line for dwelling improvements in households with a monthly income of less than US $450. An emergency and reconstruction credit line with 30 years term and a subsidy of up to US $2,076 is available for households affected by natural disasters. There are also credit-subsidy options with a savings component, based on household income level.

[18] www.bmi.gov.sv, accessed on May 30, 2010.

Figure 7. Housing Finance by FONAVIPO



Source: FONAVIPO.

Appendix 3. Government Housing Finance in Panama

Panama's housing policy environment has generally been highly interventionist, with government subsidy schemes ranging from provision of housing projects from the public budget to the generation of direct fixed-amount subsidies and affecting interest rates and financing acquisition through National Mortgage Bank (BHN).

The large role of government notwithstanding, there is no unified policy covering all institutional efforts, which results in duplication and overlapping actions. The Ministry of Housing (MIVI), which is officially charged with the formulation and implementation of housing finance policy, is generally concerned with its own building program and does not concern itself with the performance of the housing market as a whole. Developers in the formal sector are now very active in low-cost housing production, relying on mortgage loans with preferential interest rates (a key intervention in the housing market that has little to do with the Ministry of Housing).

In regard to the housing finance regime, Panama has four established policies concerning finance for low and middle-income housing:

- Preferential interest rates for low and middle-income families;
- Subsidized loans extended by the National Mortgage Bank (BHN);
- Up-front one-time subsidies of up to $4,000 to supplement a dandown payment and a 30-year mortgage loan at market interest rates;
- Down payment guarantees that enable families to reduce their down payments from 20 percent to 2 percent for a 0.5 percent increase in the annual interest rate; this is implemented by the guarantee fund (PROFINCO) to reimburse participating banks for up to 30 percent of any losses incurred by the loans granted in this program.

The most important policy affecting the availability of commercial housing finance is the preferential interest-rate program. The borrower receives a subsidy in the interest rate on the mortgage, which functions as a discount on the rate paid by the beneficiary of the credit. This policy was implemented since 1985, but it was not until after the internal political crisis experienced in the late eighties he acquired growth and development. This housing subsidy policy comes from the private bank seeking to lengthen the term of the loans by generating a tax shield. Thus the difference between market rates and the subsidized rate is, from the perspective of an intermediary, an expense deductible on income tax, being transferable and negotiable even were an intermediary to have an excess tax credit from the application of the shield. The preferential rate is calculated by the Superintendency of Banks of Panama on a quarterly basis based on the five major home loan banks, plus the savings bank.

The preferential interest-rate program allows home owners to deduct mortgage interest rates of up to $15,000 per annum from their income tax. An alternative is available as well whereby home owners can, instead of presenting an income tax declaration and deducting the interest paid, can obtain a mortgage loan at a reduced rate of interest. This generates a tax shield that may be transferable if the financial institution exceeds the credit-generating tax payments to do so.

There are some conditions applicable to loans granted under this system. The loan must be destined for the purchase or construction of the borrower's principal residence. Furthermore, this residence must be new. The loan may not exceed US $62,500, and there are two conditions. First, the minimum repayment period is 15 years. Second, the performance of the lending banks' loans is the market's reference rate, which is calculated as being the average of the interest rates of the four largest private banks in the system; currently this rate is around 8 percent per annum, and it is updated every three months by the Superintendency of Banks of Panama. The preferential interest rate may be a maximum of 4 or 5 percentage points above this referential rate.

Only about 10 percent of the housing credit granted in recent years is under the preferential rate modality. This low figure stems from the housing construction industry's movement in recent years towards sale and leasing of properties targeting high-income residents and foreigners, who are not eligible for housing subsidies.

The current system creates the possibility of obtaining subsidies from more than one program. For example, a first-time homebuyer who has access to a preferential rate may also have access to $5,000 for the initial steps of formalizing the operation if the house does not exceed a price of U.S. $30,000.

The Ministry of Housing (MIVI) continues to issue housing loans for the units it constructs through the National Mortgage Bank (BHN), which is under its jurisdiction. Home improvement loans averaged $700, were notoriously difficult to collect, and thus exhibited very high levels of default. Loans are offered at various fixed interest rates, depending on the type of project and the period of execution. Loans for apartments tended to be the most highly subsidized, at average rates of 3.0–3.25 percent.[19] Loans for single-family homes and serviced lots tended to approximate market rates for most years. Under this program up to 98 percent of the value of the house is financed. The state, through the National Bank of Panama, creates a guarantee fund (PROFINCO) to reimburse participating banks for up to 30 percent of any losses incurred by the loans granted in the framework of this program.

The program providing down payment guarantees also permits homebuyers to take advantage of preferential interest rates, but because borrowers can now regularly obtain loans with a 0–5 percent down payment, the program's higher interest rate discourages borrowers from

[19] A striking fact is that financial institutions charge fees every two weeks, to bring the fit with bi-flows of employees, since many of their credit applicants come from this sector. This practice increases the effective yield of the operation, which is reasonable given the low levels of nominal income lending.

taking advantage of it. The program additionally requires the deposit of public funds amounting to 20 percent of the value of loans in participating banks as a security against defaults.

Housing Ministry Programs

The MIVI provides care to low-income families through the development of accessible and safe housing projects that are intended to improve residents' quality of life and contribute to a progressive solution to the country's housing problem.

In 2009 the Housing Ministry managed a budget of $76,623,272, of which $17,541,076 is for operation and $59,082,196 for investment; these resources provided approximately 2,788 housing solutions. Funding sources included central government funds of $38,149,776 (from current revenues) and the remainder from the ministry's trust fund, trust, equity, donations from the government of Taiwan and external sources such as the IDB.

Housing Construction: This program encompasses the measurement and legalization of lots covering families in informal settlements, provision of basic housing solutions of 36 square meters, and floor and roof improvements. In 2009 its budget of $26,122,591 included commitments of $24,106,387 divided into the sub-programs Measurements and Legalization and the Worthy Housing National Plan.

Measurements and Legalization: This program aims to sort, measure and legalize lots covering families in informal settlements after socio-economic and technical cooperation with the active participation of the communities involved, which organizes streets and sidewalks and applies existing planning rules.

The program further seeks to survey land in order to facilitate the legalization of land tenure. The Ministry of Housing serves approximately 500 informal settlements that are in the process of legalization.

Worthy Housing National Plan: This program consists of the delivery of basic shelter solutions of 36 square meters, improvements (building materials) and floor-roof to families located in semi-urban areas close to cities and rural areas and indigenous peasants, with priority for those in poverty and extreme poverty. The annual budget of $25,398,808 in 2009 permitted the construction of 1,573 housing solutions nationwide.

Housing Saving Fund (FONDHABI): This funds aims to promote the financing of social housing and contribute to the development of a National Housing Policy and the establishment of a National Technical Assistance System. It provides financial resources through banks and credit unions in an efforts to meet the housing needs of the country, with emphasis on Social Sector Interest Priority I (annual income less than $8,000).

The social housing program addresses the need for housing by families with monthly incomes below $300, providing resources for the construction of basic units of 36 square meters to benefit low-income families, in poverty and extreme poverty in rural areas and intermediate cities. The management, administration and construction is undertaken by private sector companies after competitive bidding, while the control, monitoring and evaluation processes are maintained by the Ministry of Housing. The basic units are constructed on properties to which the beneficiary family has legal title and that have water service.

Housing Finance: Government-IDB housing finance programs provide PARVIS, comprehensive neighborhood improvement, project management and supervision, housing conditions improvement funded by the IDB and the solidarity fund housing project by the central government. It has allocated an annual budget of $15,902,481, consisting of external credit resources of $4,869,186 and local contributions of $2,791,285.

PARVIS Program: This program has an annual budget of $3,542,642 for the construction of 186 homes nationwide. This program supports the construction of basic units of 36 square meters for the benefit of families with incomes below $300 a month. The design of the Parvis program, which entails everything related to the management, administration and construction of housing units, is undertaken by private and social sector companies, while the control, monitoring and evaluation processes are the responsibility of the Ministry of Housing. The basic units are built on plots of land on which the beneficiary family is entitled and with service of piped water. The program focuses on two areas: in the vicinity of intermediate cities considered as poles of development by the development policies of the Ministry of Housing, and peasant and indigenous rural areas considered a priority by the national social safety net. The housing component is funded through a loan agreement between the IDB and the Republic of Panama.

Housing Solidarity Fund Program: This program, with a budget of $8,346 million in 2009 allocated through special credit, benefited 2,000 families. Its purpose is to provide a contribution of non-transferable basis, for persons and families with low incomes in the formal economy up to $5,000 per family, for the purchase of new homes whose sale price does not exceed $30,000 (this amount does not include legal fees and closing costs). Monthly family income must not exceed $800.

Neighborhood Improvement Program (PROMEBA): This program has an annual budget of $3,578,840 million for 760 housing solutions, infrastructure, community facilities, construction of sewerage and drinking water and construction of streets, sidewalks and curbs.

PROMEBA implements a strategy of intervention in two packages: i) construction of physical infrastructure with financing investments in physical infrastructure works such as new housing, water and sanitation networks, drainage, road paving, lighting, construction of containment of flooding or landslides and facilities for collection of garbage and abandoned furniture as well as community centers, recreational parks, tree planting, sports fields and regularization of land tenure; and ii) social development implementation of social programs and job training in the country such as training, community empowerment and health and environmental education. By implementing this comprehensive approach to addressing the deficit conditions of semi-urban slums, the national government allows people to participate in solutions to the needs expressed by the formation of informal settlements that are built on illegally occupied land.

Administration and Monitoring Program Projects: This program is intended to advise the technical units of its correct implementation program, in addition to direct, supervision, monitoring and implementation of all corrective measures necessary for the successful implementation of housing financing programs. It has an annual budget of $300,000.

Housing Assistance Program (FASHABI): With a budget allocation of $1,409,673, the program's objective is to support families displaced or otherwise affected by disasters, covering administrative costs and contingencies. This program is estimated to provide 1,416 solutions.

Housing Assistance Fund was established in 1973 with the objective of meeting social needs related to national emergencies. This is a direct housing subsidy that provides a house of 36 square meters or housing improvements. The amount of resources allocated by solution is a maximum of $1,500.

Housing Improvement Program: It includes programs as Loan of Materials ($290,000), Urban Revitalization and Alleviation of Poverty ($3,216,659) and Rehabilitation of Housing and Urban Improvement ($11,461,595).

Institutional Strengthening: This program is intended to advise the Ministry of Housing and the technical units on the correct implementation of their programs, as well as on management, supervision and implementation of all corrective measures necessary for the successful implementation of programs. Its annual budget is $562,850.

Generally, the units of the Ministry's building program are sold "at cost," that is, at their investment cost. This includes five kinds of nontransparent subsidies: the value of lands, overhead costs of the Ministry, losses due to sale of lands at prices below market value; interest-rate subsidies and defaults on the payment of mortgage loans. In recent years, the structure of the Ministry's program has remained basically the same. The operating expenses of the Ministry are still very high. In the year 2008, for example, it employed a total of 1,349 persons, at an average annual operating cost of $9,000 per employee.