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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
Washington, D. C. 20523

EL SALVADOR

PROJECT PAPER

MARGINAL COMMUNITY IMPROVEMENT

AID/LAC/P-045/1

Loan Number: 519-HG-006  
Project Number: 519-0251

UNCLASSIFIED

PROJECT DATA SHEET

COUNTRY: El Salvador  
 PROJECT NUMBER: 519-HG-006  
 PROJECT TITLE: Marginal Community Improvement  
 PROJECT ASSISTANCE COMPLETION DATE: MM DD YY (06/15/85)  
 PROJECT START DATE OF OBLIGATION: A. Initial FY (80) B. Quarter (3) C. Final FY (85)

8. COSTS (\$000 OR EQUIVALENT \$1 = )

A. FUNDING SOURCE	FIRST FY 80			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AID Appropriated Total	825	5,000	5,825	950	11,000	11,950
(Grant)	(825)	( )	(825)	(950)	( )	(950)
(Loan)	( )	(5,000)	(5,000)	( )	(11,000)	(11,000)
Other U.S.	1. HG	15,000	15,000		25,000	25,000
	2					
Host Country		6,000	6,000		6,000	6,000
Other Donor(s)						
<b>TOTALS</b>	<b>825</b>	<b>26,000</b>	<b>26,825</b>	<b>950</b>	<b>42,000</b>	<b>42,950</b>

9. SCHEDULE OF AID FUNDING (\$000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH CODE		D. OBLIGATIONS TO DATE		E. AMOUNT APPROVED THIS ACTION		F. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1)	HG				20,000		5,000		25,000
(2)									
(3)									
(4)									
<b>TOTALS</b>									

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)  
 11. SECONDARY PURPOSE CODES  
 12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)  
 A. Code  
 B. Amount  
 13. PROJECT PURPOSE (maximum 480 characters)

To assist the GOES to meet immediate needs for basic Community Services, minimum Shelter and productive opportunities for the poor, and to improve GOES capacity to address basic human needs of the poor in Marginal Communities in a comprehensive, coordinated manner.

14. SCHEDULED EVALUATIONS: Interim (MM YY) Final (MM YY)  
 15. SOURCE/ORIGIN OF GOODS AND SERVICES:  000  94  Local  Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a page PP Amendment)

To add an additional \$5.0 Million to the Housing Guarantee authority, to further the original project purpose of meeting the immediate shelter needs of the target population. These supplemental HG funds are expected to produce an additional 1,500 to 2,000 shelter solutions, both new units and upgrading.

17. APPROVED BY: Signature: Martin V. Dagata  
 Title: Martin V. Dagata, Director, USAID/El Salvador  
 Date Signed: MM DD YY (6/17/85)  
 18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
WASHINGTON, D.C. 20523

ASSISTANT  
ADMINISTRATOR

GUARANTY AUTHORIZATION  
519-HG-006(D)

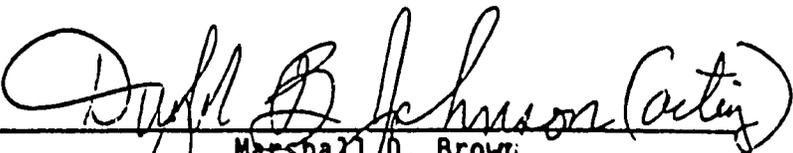
PROVIDED FROM: Housing Guaranty Authority  
FOR: EL SALVADOR: Marginal Community Improvement

Pursuant to the authority vested in the Assistant Administrator, Bureau for Latin America and the Caribbean, by the Foreign Assistance Act of 1961, as amended (FAA), and the delegations of authority issued thereunder, I hereby amend the captioned authorization to increase the amount of guaranties authorized to be issued pursuant to Section 222 of the FAA by Five Million Dollars (\$5,000,000), for a total amended authorization of Twenty Five Million United States Dollars (\$25,000,000). The guaranties shall be issued to eligible U.S. investors (Investor) acceptable to A.I.D. The guaranties shall assure against losses (of not to exceed one hundred percent (100%) of loan investment and interest) with respect to loans, including any refinancings thereof, made to finance housing projects in El Salvador.

These guaranties shall be subject to the following terms and conditions:

1. Term of Guaranty: The loans may extend for a period of up to thirty years (30) from the date of disbursement and may include such terms and conditions as shall be acceptable to A.I.D. The guaranties of the loans shall extend for a period beginning with disbursement of the loans and shall continue until such time as the Investor has been paid in full pursuant to the terms of the loans.
2. Interest Rate: The rate or rates of interest payable to the Investor pursuant to the loans shall not exceed the allowable rate of interest prescribed pursuant to Section 223(f) of the FAA and shall be consistent with rates of interest generally available for similar types of loans made in the long term U.S. capital markets.
3. The Government of El Salvador Guaranty: The Government of El Salvador shall provide for a full faith and credit guaranty to indemnify A.I.D. against all losses arising by virtue of A.I.D.'s guaranties to the Investor or from non-payment of the guaranty fee.

- 4. Fee: The fee of the United States shall be payable in dollars and shall be one-half percent (1/2%) per annum of the outstanding guarantied amount of the loans plus a fixed amount equal to one percent (1%) of the amount of the loans authorized or any part thereof, to be paid as A.I.D. may determine upon disbursement of the loans.
- 5. Other Terms and Conditions: The guaranties shall be subject to such other terms and conditions as A.I.D. may deem necessary.

  
 Marshall D. Brown  
 Acting Assistant Administrator  
 Bureau for Latin America and the Caribbean

Aug 23, 1983  
 (DATE)

Clearances:

PRE/H:JHowley	<u>SPW for</u>	Date	_____
PRE/H:SWalsh	<u>SPW</u>	Date	_____
PRE/H:PVitale	<u>AV</u>	Date	<u>8/12/83</u>
LAC/DR:SMerrill	<u>AV</u>	Date	_____
LAC/DR:DJohanson	<u>SPW for</u>	Date	_____
LAC/CEN:JClary	<u>SPW for</u>	Date	<u>8/22/83</u>
GC/LAC:GWinter	<u>AV</u>	Date	<u>8/22</u>
FM/LMD:HShropshire	<u>SP</u>	Date	<u>8/22</u>

GC/H:MW111ams:gjg 8/12/83 x23054 #1066P

TABLE OF CONTENTS  
519-HG-006D  
Supplement

	<u>Page</u>
I. SUMMARY AND RECOMMENDATION	1
A. Recommendation	1
B. Summary Description of Program	1
B.1 Refinement of Shelter Strategy	1
B.2 Pipeline Status	3
B.3 New Authorization	4
B.4 The Use of local currency in Support of the HG Program	4
B.5 Demand	4
C. Conditions and Covenants	5
II. BACKGROUND AND PROGRAM STATUS	5
A. Program Status	6
A.1 Status of Projects Funded under Contracted Loans (\$15.0 million)	6
A.2 The IVU Package to be Funded under the Sept. '82 Authorization	7
A.3 The Projects under Analysis for the New Authorization	8
B. Marketing and Sales of First \$15 M	9
III. DETAILED PROGRAM DESCRIPTION (SUPPLEMENTAL)	11
A. Goal and Purpose	11
B. Outputs	12
C. Inputs	12
IV. TECHNICAL AND INSTITUTIONAL ANALYSIS	13
A. Economic Considerations	13
B. Solution Types and Cost	14
B.1 Typology for Reception	15
B.2 "Campamento" Model	16
B.3 "Tugurio" Model	16
B.4 "Traditional Unit	17
C. Institutional Analysis	17
C.1 Financial	17
C.2 The A.B.C. Program and IVU's Administrative Structure	18
C.3 Construction Capacity	19

V. PROGRAM IMPLEMENTATION	20
A. Loan Contracting and Disbursement	20
B. Technical Assistance Plan	21
C. Evaluation and Monitoring	23
D. Conditions and Covenants	23
ANNEX I Proposal - The Use of PL 480 in Support of HG Program	
ANNEX II List of Communities Contemplated for ABC	
ANNEX III Site Layouts for ABC Typologies	
ANNEX IV Organizational Chart - IVU	
ANNEX V External Debt Service Analysis	

EL SALVADOR - PROJECT PAPER  
519-HG-0060  
"Marginal Community Improvement"  
Supplement

I. SUMMARY AND RECOMMENDATION

A. Recommendation

USAID/El Salvador recommends the authorization of \$5.0 million in Housing Guaranty funds to finance additional shelter production under 519-HG-0060 as described in the following section. The Borrower of the HG funds will be the Government of El Salvador, acting through the Ministry of Planning.

B. Summary Description of Program

This supplement will fund the production and upgrading of an estimated 1,400 additional shelter units by the Instituto de Vivienda Urbana (IVU), continuing the program initiated with the previous authorizations of HG funds, totalling \$20.0 million: \$15.0 million (April, 1980) and \$5.0 million (September, 1982). Steps have been taken to change the typology of units so that a larger number of lower-cost units will be produced with the available resources.

B.1 Refinement of Shelter Strategy

An evaluation of the HG Program was carried out in March, 1983. The evaluation highlighted the Program's various achievements, including the breakthrough within the private sector which produced 20M<sup>2</sup> core units for the first time, and the construction of projects by both the private sector and IVU under extremely difficult administrative and technical constraints. The evaluation team concluded that the current HG Program in El Salvador provides a sound basis upon which to build, but recommended a sharper focus for A.I.D.'s shelter strategy in El Salvador by strengthening the comparative advantages of IVU and the Savings and Loan System in the housing sector, e.g. upgrading through IVU and new core unit production through the private sector (financed through the S&L System).<sup>1/</sup>

The range of unit types financed under the first \$15.0 million HG authorization have been limited to construction of core units (20M<sup>2</sup>) and modest "traditional" units (30M<sup>2</sup>, two-bedroom). The original program

<sup>1/</sup> The evaluation team also analyzed the potential for the participation of other housing finance institutions, in particular the Fondo Social de Vivienda (FSV), the largest housing finance institution in the country. It was found that the FSV would be an inappropriate vehicle for HG resources at this time since its average unit price is too high (C/.18,000) and more importantly because FSV officials are not interested in changing the institution's interest rates (5-7% for the lowest cost units).

design for the \$15 million HG loan estimated that more than half of the total number of solutions would be home improvement loans. However, because IVU's upgrading program could not be initially financed with HG resources before 1982 due to subsidized interest rates (as opposed to the higher rates charged for its new housing developments), a decision was made in 1981 to reprogram these funds to finance new shelter units.

An agreement was reached with IVU in mid-1983 to restructure the interest rates of its upgrading program (known as A.B.C. or "Acceso al Bienestar Comunitario") so that this type of program could be funded by the \$5.0 million authorized in 1982 and expanded with 1983 HG resources. Building on that experience, at least 60% of the 1983 HG resources channelled to IVU will be used for lower cost A.B.C units.

The "ABC" program has three different models. The reception area or San Bartolo model is a sites and service project. IVU provides the basic infrastructure for the lots and the beneficiaries are responsible for constructing or completing their own shelter. This reception area model is voluntary and used to assist families who have been relocated because of physical risks such as landslides. The second model, "turgurio", is a slum upgrading scheme. Finally, the "campamento" model converts temporary wooden barracks into permanent shelters. These unit types vary in level of construction, depending on the characteristics of the area and the income levels of the beneficiaries. (See Section IV.B.)

Although El Salvador has an existing network of private Savings and Loan institutions, one of which CASA has participated in a previous HG program, there is a temporary hiatus on both the part of the Ministry of Planning and the Financiera Nacional de Vivienda (FNV, the System's central regulatory body) on continuing to finance any new HG projects through S&L associations. There are three primary reasons for this change in policy. First, confusion within the FNV regarding the purposes and procedures of the HG program and how low-cost shelter programs fit into the structure of their System has prevented participation. Second, when previous HG resources were channelled from the GOES to FNV, and distributed to IVU as well as to CASA (the participating savings and loan association), passing the funds to IVU created financial disequilibrium within the FNV because of the differences between the FNV's and IVU's lending rates. Finally, the System's structure has been undergoing change since it was nationalized in 1980, so that lines of authority and decision-making have become confused.

To overcome these constraints, part of the technical assistance package approved by USAID/El Salvador on May 26, 1983, includes hiring a consultant to work with the FNV and its member associations to assess the financial position of each association and to determine the System's needs over the medium term. A policy level seminar will be held to present findings and to clarify how the HG Program fits into the future operations of the System. The consultancy and policy seminar are scheduled for August 1983. Upon completion, a specific recommendation will be made to USAID/El Salvador and RIUDO/LA on the feasibility of channelling 1984 HG resources to the

Savings and Loan System. It is hoped that the relationship with FNV can be continued because this institution represents the best alternative for establishing a home improvement loan program in El Salvador and because the construction of core units through the private sector should be expanded. (The fact that private sector units are being sold at market rates has an important demonstrative effect for the sector, proving that subsidized rates are not required for low-income families.)

Due to the current institutional constraints within the S&L System mentioned above, 1982 and 1983 HG resources will be channeled through IVU to expand the production and upgrading of shelter for families with incomes lower than those benefitting from the first \$15.0 million of HG resources. Upgrading and serviced lots with minimal construction will be given emphasis over the larger (36 M<sup>2</sup>) units which are currently being constructed by IVU.

In Fiscal Year 1984, depending on the results of the work with the Savings and Loan System, another \$5.0 million authorization would be requested for FNV to continue low cost core unit construction projects like those now underway and to initiate a home improvement loan program. Such a program could reach a larger number of the HG target population and would provide significant benefits to the S&L System, since short-term home improvement loans allow greater flexibility in portfolio management and faster recuperation of investments.

#### B.2 Pipeline Status

A summary of the \$20.0 million pipeline of authorized HG resources is provided below. (See Program Status, Section II.A. for a more detailed presentation.)

#### Status of \$20.0 million HG Program

		<u>in dollars</u>		
<u>No.</u> <u>Projects</u>	<u>Type</u>	<u>Status</u>	<u>No.</u> <u>Units</u>	<u>Value</u>
<u>IVU:</u>				
2	Core Units	Completed	734	\$ 3,629,990
3	"traditional"	In construction	599	3,755,730
2	A.B.C.	In construction	682	1,665,700
1	A.B.C.	Approved	376	1,382,336
2	"traditional"	Approved	335	1,947,690
<u>FNV/S&amp;L:</u>				
4	Core Units	In construction	<u>1,650</u>	<u>9,723,775</u>
			<u>TOTAL.</u>	<u>4,376</u> <u>\$22,105,221*</u>

\*Includes \$2,105,221 in counterpart funding.

In 1983, an agreement was reached with IVU to finance upgrading projects worth about \$3.048 million out of a total package of \$5.0 million (September, 1982 authorization). This represents an important shift in the HG supported shelter strategy since the largest number of shelter solutions to be financed will be upgrading types. (This was made Condition Precedent 5.01(D) to the contracting of this HG loan.)

### B.3 1983 HG Authorization

The 1983 \$5.0 million authorization will be used to expand IVU's production of new units and their shelter upgrading program. It is anticipated that approximately 1,400 units will be financed, of which 932 or more will be the lower cost A.B.C. upgraded units, and the rest the lower cost 20 M<sup>2</sup> core "traditional" units.

### B.4 The Use of PL-480 Local Currency in Support of the HG Program

At various times, it has been proposed to mix ESF funds with HG resources in order to lower the interest rates, on the premise that high interest rates were reducing demand and resulting in slow sales and disbursements. The findings of the evaluation team in early 1983, however, indicated that the design/approval process, production delays and the lack of working capital within participating institutions were greater impediments to increased sales than the lending rates.

With regard to the lack of working capital, and to maintain program momentum, the Mission approved the creation of a rotating fund from PL 480 generated local currency for IVU. The equivalent of \$2.0 million is to be disbursed in Calendar Year 1983 and the Mission will consider programming additional resources in 1984, subject to the availability of funds. (See Proposal, Annex I.)

This working capital fund will provide construction financing so that IVU can produce shelter units against which HG resources will later be disbursed for permanent financing. Using this fund, IVU can initiate the upgrading projects and new units approved for the 1982 \$5.0 million authorization and allow the contracting of HG resources as units are being completed, thus eliminating the use of escrow accounts. The working capital fund is structured to capitalize itself over time in order to produce additional resources for low-cost housing.

### B.5. Demand

Demand exceeds production of units. (See Section II.B. Beneficiaries and Demand). Delays in producing mortgages were due principally to technical difficulties in making connections to basic services, not the lack of applications. (See Institutional Analysis, Section IV.C.3).

Of the three core and traditional unit public sector projects sponsored by IVU currently under construction, one has twice as many

applicants as units, and the others are producing applications even before promotional campaigns have begun. The A.B.C. on-site upgrading projects are designed for specific groups of families, so the demand is identified in advance of construction.

In the case of the two private sector projects now under construction, one developer had to curtail promotion because applications far outstripped the advances in construction. More than half the units have qualified applicants. The first mortgages were issued in June 1983. At that time, the developer reinitiated his sales campaign for the remaining 200 units. The second private sector builder is ready to begin sales activities for the first tranche of his project.

### C. Conditions and Covenants

1. IVU programming will finance A.B.C. projects and the production of new units. The majority of the solutions financed by HG resources will be the upgrading type.
2. The GOES will not contract this supplemental \$5.0 million until the previous supplement (\$5.0 million) is contracted and a level of construction satisfactory to AID is underway. (RHUDO/LA anticipates this will occur sometime in December.)
3. The GOES will make best efforts to issue new legislation that will remove the interest rate ceiling imposed on IVU lending and will allow IVU's interest rates to be adjusted according to the cost of its resources

## II. BACKGROUND AND PROGRAM STATUS

Quick disbursement of dollar resources to stimulate the economy and to create employment in the construction sector has been an important objective of the HG program in El Salvador. While rapid implementation remains a goal, a policy decision was reached between USAID/El Salvador and RHUDO/LA to move more systematically towards a housing typology with a wider cost range in order to increase the total number of beneficiaries. RHUDO/LA estimates that the number of beneficiaries can be tripled if upgrading is emphasized rather than the construction of the larger traditional units IVU produced in the past. Contrary to popular belief, it has not been shown that the actual construction period for upgrading projects is any longer than for new units (average 18-24 months). However, earlier project authorization is required to provide sufficient lead time to identify, plan, and design upgrading projects.

**A. Program Status**

A total of \$20.0 million in HG resources has been authorized and projects have been identified and approved for the first \$15.0 million. Given the large HG advances which were provided, the cycle of projects is now self-supporting, i.e. as units are completed and mortgages issued for previous projects, sufficient resources will be freed up to finance the last two projects which are now beginning construction. Projects have also been identified for the \$5 million authorized in 1982 and a illustrative list of proposed projects for the 1983 authorization is included with the PP supplement. To accelerate project development, the Mission has created a working capital fund financed from PL 480 local currency to cover the cost of construction financing for the 1982 and 1983 authorizations.

**A.1. Status of Projects Funded with \$15.0 million HG Loan**

The following tables provide estimates of work completed and the status of applications for projects which are being financed by the first \$15.0 million of authorized HG funds, and the estimated disbursements. To improve the monitoring of the physical progress of projects, a reporting system has been developed which distinguishes three broad categories: (1) basic infrastructure on project site; (2) shelter units; and (3) complementary infrastructure, e.g. off-site wells and networks. The following table presents the status of each project as of June, 1983 and, where applicable, the number of applicants and sales.

**Est. Work Completed, No. Units Reserved, in Process, Approved/Occupied  
Financed with \$15 million HG Resources**

	<u>No. Units</u>	<u>Work Completed</u>			<u>In Qualif. Reserved</u>	<u>Process</u>	<u>Approved</u>	<u>Sold</u>
		<u>Basic Infrastr.</u>	<u>Housing Units</u>	<u>Compl. Infrastr.</u>				
IVU I (2 Projects)	734	100	100	100	-	-	-	734
Prados de Venecia	471	83	80	45	263	36	70	85*
Jose Simeon Canas	200	53	93	70	423**	-	-	-
San Martin	133	32	29	***	40	-	-	-
Llanos del Espino	261	37	32	***	68	68	-	-
La Toma	312	89	51	83	-	-	-	-
Prados II****	853	0	0	0	-	-	-	-
Nuevo San Juan****	112	0	0	0	-	-	-	-

\*Twenty-six (26) families occupied units with rental agreements with option to buy. These mortgages have been processed as well as others. By the end of June, 85 mortgages were signed and at least 50 more are planned for July, 1983.

\*\* All 423 applicants are qualified. A lottery system will be used to assign units when the project is completed in August.

\*\*\*The complementary infrastructure for these projects is minimal, representing an investment of between \$25,000 - \$30,000 for each project. Bids have been requested for this work.

\*\*\*\*These projects were approved in June '83 and construction was initiated. The expected completion date is mid-1984 for one project and the end of the year for the other.

Dollar Value - Issuance of Mortgages/Home Improvement Loans  
Financed with HG Resources(\$15.0 Million)

<u>Projects</u>	<u>No.Units</u>	<u>Amounts</u>	<u>Est.Iss. of</u>	<u>Cumulative</u>
IVU I (2 Projects)	734	\$ 3,629,990	Mortgages Completed	
		( 194,870 pending)		\$3,435,120
Prados de Venecia I	130	690,181	July '83	4,125,301
IVU (Jose Simeon Canas)	200	1,254,000	Aug. '83	5,379,301
Prados de Venecia I	190	1,008,725	Sept. '83	6,388,026
IVU II (Llanos del Espino)	118	739,860	Oct. '83	-
La Toma	150	852,925	Oct. '83	7,890,811
Prados de Venecia I	151	801,671	Nov. '83	8,782,482
IVU II (Llanos del Espino)	148	927,960	Dec. '83	-
IVU II (San Martin)	133	833,910	Dec. '83	-
La Toma	162	921,160	Dec. '83	11,465,512
Nuevo San Juan	112	608,608	July '84	12,074,120
Prados II	853	4,840,505	Dec. '84	16,914,625
	<u>3,081</u>	<u>\$17,109,495*</u>		<u>( 194,870)</u> <u>\$17,109,495*</u>

\*Includes \$2,105,221 in counterpart funds. Currently, \$1.872 million of counterpart have been made available from the interest earned on the first escrow account. The first \$9.5 million has been disbursed to the GOES. The \$5.5 million balance is in escrow and will be disbursed by October-November, 1983, according to the above schedule.

A.2. The IVU Package to be Funded under the Sept. '82 Authorization

The September, 1982 authorization of \$5.0 million will be used exclusively by IVU. In March 1983, IVU presented a proposal to the Ministry of Planning for the use of those funds. The proposal contemplated only the production of "traditional" (36 M<sup>2</sup>) units which ranged in cost from C/.15,250 (\$6,100) to C/.16,500 (\$6,600). If the proposal had been approved without change, between 750 and 820 new units would have been produced with the \$5.0 million.

At A.I.D.'s request, IVU prepared a list of A.B.C upgrading projects which could be financed by HG resources. Five upgrading projects

were reviewed for HG financing, with a total value of about \$3.6 million, benefitting over 2,000 families. Three of these projects were considered eligible and two of these projects are close to completion. If IVU can reach an agreement with community leaders on an increase in the lending rate for home improvements to 12%, disbursement of \$650,000 will be approved for the other two remaining projects. Three other projects are ready to start and are included in the following revised proposal, along with some of the traditional units originally proposed by IVU. Other upgrading projects are being identified with later start dates. The proposed IVU package for disbursement of HG resources is as follows:

Proposed Projects for 1982 HG Authorization

<u>Project</u>	<u>Type</u>	<u>No. Families</u>	<u>Range/Unit Cost</u>	<u>Total Investment</u>
Técnico Industrial.	A.B.C.	103	\$2,044-\$4,524	\$ 347,092
La Fortaleza	A.B.C.	579	\$2,170-\$3,250	1,318,608
San Bartolo	A.B.C.	376	\$2,260-\$5,412	1,382,336
San Bartolo	"traditional"	100	\$5,814	581,400
Santa Ana	"traditional"	<u>235</u>	\$5,814	<u>1,366,290</u>
TOTAL		1,393		\$4,995,726

The first disbursement of the PL 480 working capital fund (See I.B.4) will be made in 1983 at which time these projects will be initiated. It is likely that the drawdown of HG resources will subsequently begin in the second quarter of FY 1984 (the various steps require at least 2-3 months).

A.3 Projects Under Analysis for the 1983 HG Authorization

A limiting factor for future ABC projects is ownership of the land where "tugurios" have appeared. The ABC projects listed below include only one on-site upgrading project (the second stage of Técnico Industrial). The others are similar to the San Bartolo relocation scheme where families would move from their current location to an IVU-owned project site.

Projects Under Consideration for 1983 \$5.0 Million Authorization

<u>Project</u>	<u>Location (depart.)</u>	<u>No. Units</u>	<u>Type</u>
Jose Simeon Canas	San Salvador	100	"traditional"
Campamento Técnico Industrial	San Salvador	297	ABC (on-site)
San Antonio del Monte	Sonsonate	450	ABC (mixed typology)

Atiquizaya	Ahuachapan	276	ABC (mixed typology)
Santa Teresa	San Salvador	3,000	ABC (urbanized lots)

These projects are in the planning phase. Although site specific unit types and costs are not yet available, the distribution of unit costs should be similar to those proposed for the \$5.0 million authorized in 1982 (Section A.2), the total cost of these projects alone would exceed \$10.0 million. Efforts are being made to lower unit costs still further, and to determine the feasibility of constructing these projects in stages. Also, the possibilities of transferring other "Tugurio" sites to IVU are being investigated. (See Annex II for a list of possible campamento and tugurio sites). The final composition for this tranche of projects will be decided by the end 1983.

#### B. Marketing and Sales of First \$15 Million

##### 1) Public Sector Projects

###### a) Core and Traditional Units

The work carried out by the evaluation team in March, 1983 indicated that the target population, defined as families earning less than the median income, was well served by the completed IVU projects. Many of the families living in San Bartolo core units (IVU I) are employed in the informal sector and previously were excluded from housing programs because of low income levels and income variability.

The slow pace of sales in the first IVU projects was partially a problem of definition since the units were not officially "sold" until services were connected, a title was processed and families were making payments. Meanwhile, the houses were "reserved" months before with downpayments, and many people had moved in prior to the formal transactions, built temporary electrical lines by a community action group, and purchased water from trucks. It was evident that even without individual service connections the project offered a definite improvement for families compared to their prior living conditions, many of whom came from "mesones" (sub-standard rooming houses). This has proven to be true with the first private sector project as well. Some families occupied units after signing a rental agreement with the option to buy, even though full infrastructure services had not been provided to the units. The services have subsequently been connected.

While improvements need to be made in promotional techniques and applicant processing, officials of the participating institutions do not foresee sales problems for 3,081 current and projected units. The clients are new for the CASA, less so for IVU. Selection criteria were made more flexible as a result of previous technical assistance and these criteria are undergoing continual changes as the CASA and IVU have more contact with prospective buyers. Additional technical assistance will be provided in the areas of promotion, selection, and processing.

The projects currently being constructed by IVU and financed by AID under the \$15 million loan have units which approximate that institution's larger (36 M<sup>2</sup>) traditional unit. There is a backlog of applications for the San Salvador Area (est. at close to 2,000) and the majority of those applications are for two-bedroom units similar to those being constructed. There are 423 applicants with downpayments for the 200 units in the "Jose Simeon Cajal" project. When completed, a lottery system will be used to assign families. The other two projects (399 units) are in secondary cities, 20 and 100 kilometers from the capital. About 800 families have expressed interest in these projects, although IVU has just begun to accept downpayments, 63 for "Llanos de Espino" and 40 for "San Martin".

b) ABC Units

The A.B.C. on-site projects, by their nature, have pre-identified demand. In upgrading programs for "campamentos" or "tugurios", an IVU team conducts a census of the families, identifying their income levels and other socio-economic characteristics. The families of La Fuerteza represent the lowest income group of the three projects identified in the Section II.A.2. (8-20 percentile). This invasion area, in the coastal city of Acajutla, is composed to a large extent of manual laborers in the city's port facilities. Because of the depressed economy, unemployment is high so total household incomes are reduced.

The "campamento" of Tecnico Industrial was formed about 10 years ago, within the city limits of San Salvador. The residents have income levels which are somewhat higher than those in La Fuerteza (8-40 percentile). The area has barracks which house 366 families with communal cooking facilities and minimal sanitary facilities. The topography of the area is divided; 146 families live on a slight plateau, and 220 families in a steep valley. Two different Ministries claim title to the two areas. The Ministry of Education has ceded the upper level to IVU where it will prepare 103 lots and relocate 43 families to San Bartolo. The second stage of the project will be initiated when the title is clarified with the second ministry.

The A.B.C. program also relocates families from target areas to new sites. The A.B.C. units in San Bartolo represent a fraction of the population which has been identified in the Metropolitan Area as subject to relocation. Various communities are affected by the Right-of-Way of public roads, are in physical risk from landslides, or occupy land which is disputed for other public uses. Over 2,300 families were identified from just four areas. Politically it is not feasible to relocate families on this scale. However, many families will relocate voluntarily if appropriate solutions are offered. Clearly, the limited number of units planned for San Bartolo do not begin to meet this need. IVU will need to acquire more land for larger reception areas if it is to make inroads in the relocation program.

2) Private Sector Projects

The two private sector projects, La Toma and Prados de Venecia, are at different stages of marketing. The "Prados de Venecia" Project (473 units)

in the Metropolitan Area initiated its promotional campaign early in 1983, but suspended it after two months because there was too great a response too early in the cycle. About 1,500 people visited the project site during the promotion campaign and close to 300 filled out applications and made downpayments. A downpayment of C/.690 is required to "reserve" a unit at which point the sales office begins to verify and analyze the applicant's qualifications before sending them to the association's credit office. Disqualification can occur either at the sales office, or in the credit department. As of June 15, 1983, the status of applications for the Prados De Venecia Project was as follows:

	120 approved by CASA
	(includes 85* mortgages processed in June)
	36 in process of approval by CASA
	(13 rejected by CASA)
	100 under investigation by developer
TOTAL	<u>256</u> active, with downpayments

\*26 had occupied units with "rent with option to buy" agreements.

The Prados de Venecia developer has begun to readvertise for the remaining units. After conducting a cost-effectiveness analysis of the first stage of promotions through newspaper, radio and television announcements, he is confident that applications can be generated quickly and at relatively low cost.

In the case of the other private sector project, "La Toma" (312 units) in Aguilares, although 92 units were completed by mid-May, the developer has delayed his sales campaign until main water and sewer lines and the access road are completed. These lines were completed in June and the access road is almost finished. Promotion for the project is now scheduled for July. The preliminary target for that project is 60 mortgages per month, starting in August. If this schedule is met, all 312 units will be sold and occupied by December, 1983. To expedite processing applicants, the financing association, CASA, is establishing a satellite credit office in Aguilares.

### III. DETAILED PROGRAM DESCRIPTION (SUPPLEMENTAL)

#### A. Goal and Purpose

The goal "to direct increased resources to programs which help the poor to meet their basic needs for minimum shelter and productive opportunities" remains unchanged. Greatly increasing resources for shelter from internal sources has been difficult given the economic realities of the country, although the use of PL 480 resources has been one step in this direction and efforts are being made to make limited HG and counterpart funds go further. By expanding the number and the kinds of housing services provided, more families will benefit from each tranche of HG resources. Also the geographical coverage of programs is being widened to provide more housing

production outside the Metropolitan Area of San Salvador.

The Project Purpose is "to assist the GOES to meet immediate needs for community physical services, minimum shelter and productive opportunities for the poor and improve GOES capacity to address basic needs of the poor in marginal communities in a comprehensive, coordinated manner."

The revised strategy in El Salvador stresses the lowest cost core solutions, upgrading, and the development of policies which support a systematic approach to the problems of housing and lower subsidies in housing finance. IVU's small program for slum upgrading and sites and services was the best attempt to date to impose this kind of systematic approach, but it was limited by funding constraints since the World Bank only financed one of three urban development projects (The 1980 proposal to the World Bank estimated total cost close to \$50.0 million, although the feasibility of most of the projects needs to be clarified.) Now HG resources are being used to expand these kinds of projects, as well as to maintain the production of new shelter units similar to those funded under previous authorizations. HG resources will fund as many A.B.C. projects as can be made ready for implementation within a reasonable time. "Traditional" units will continue to be funded with resources which cannot be used by the A.B.C. program.

#### B. Outputs

This supplemental authorization is designed to produce approximately 1,400 new shelter solutions which will include both A.B.C. units (cost range: \$2,200-\$5,000) and new unit production with an average cost of \$6,100. (See Technical Analysis, Section IV.B.). The construction of these shelter units will support at least 9,000 months of employment during the implementation period.

Other outputs will be produced through the technical assistance program which include: (1) development of the capacity of IVU in financial analysis, management, and forecasting; and (2) improvement of sales and collections procedures.

#### C. Inputs

1. HG Resources: \$5.0 million will be borrowed by the GOES and the equivalent in local currency will be lent to IVU. The HG resources will be disbursed against mortgages or sales agreements.
2. Counterpart Resources: \$2.1 million in counterpart funding has been programmed to date for both FNV and IVU projects. An additional \$2.0 million will be secured through PL 480 reflows, for a total of \$4.1 million (compared with the \$3.750 million programmed at the outset of the program).
3. Grant Funds for Technical Assistance: The Mission in El Salvador approved \$30,000 to finance technical assistance

activities for both IVU and the Savings and Loan System (FNV) during FY 1983. Specific activities are:

- a. Policy level seminar for top-level officials of FNV and associations to present the objectives of HG programs, explain guidelines and procedures, and to discuss the financial benefits of participating in low-cost shelter programs.
- b. Review and workshop on FNV procedures for project analysis, approval, and cost revaluations;
- c. Review and workshop on FNV and IVU procedures for promotion, and applicant qualification/selection;
- d. Investigation on future structure for home improvement loans program through the FNV.
- e. Definition with IVU of a medium term program which coordinates HG and other resources for both A.B.C. projects and new shelter.
- f. Analysis of IVU's administrative structure and project budgeting procedures to seek ways to reduce overhead costs and to determine the most efficient operational procedures.
- g. Analysis of IVU's collections system and recommendations for reducing arrears.
- h. Financial analysis of IVU's portfolio and interest rate structure, recommendations for improving its financial position and development of curriculum for selected staff members for training in financial analysis.

#### IV. TECHNICAL AND INSTITUTIONAL ANALYSIS

##### A. Economic Considerations

While the effects of civil violence on investments in El Salvador have greatly affected economic performance, the global recession and deterioration in the terms of trade, in particular for coffee, also have played a large role in the behavior of key indicators. From 1979 to 1982, the economy experienced a sharp decline, with a cumulative drop in real GDP of close to 25%. A stand-by agreement was reached with the IMF in 1982, based on an economic program aimed at containing the decline in aggregate production and replenishing the country's foreign reserves. Some of the tools applied were a reduction in imports, exchange rate adjustments and increased domestic interest rates. An April, 1983 IMF staff report states that "El Salvador's performance to date under the stand-by arrangement has been generally satisfactory despite a continuation of weak underlying economic conditions in

the country". For 1983, the GOES is taking further measures to reduce the fiscal deficit, e.g. increasing sales taxes.

Fiscal accounts may improve, but analysts note that solid economic recovery depends upon the renewal of private sector investment which depends in turn on ending the civil conflict, and on recovery in the export markets for El Salvador's primary exports. Keeping in mind that agriculture supports 60% of the economically active population and produces 65% of the foreign exchange revenues, it is clear why a recovery in coffee and other traditional exports is critical to reverse the downward drift of the economy. Meanwhile, the balance of payments position improved substantially between January and May 1983, and while still negative the shortfall is just half of what was predicted at the end of 1982. Domestic inflation was 11% in 1982 and is expected to remain constant in 1983, compared with an 18% rate in 1979.

U.S. assistance to the Government of El Salvador has stressed balance of payments support and employment generation. The HG Program supports these Mission goals, providing needed foreign exchange as well as stimulating the construction sector. The economy's weakest sectors are manufacturing, commerce, personal services and public administration. Recovery in agriculture and construction is critical in order to compensate for GDP declines in manufacturing and services.

In an external debt analysis prepared by the National Savings and Loan League July, 1983, the report notes that El Salvador's foreign borrowings have been kept at modest levels, with debt service ratios consistently under 5%. Its future credit worthiness will largely depend on increasing export production, continuing to implement domestic fiscal policies and securing external assistance. El Salvador's long term economic prospects are good, provided there is a stabilization of the political situation.

#### B. Solution Types, Cost and Income Levels

The typology of projects is complex. The A.B.C. program has three basic models: 1) reception areas to relocate families from target areas which cannot be improved, 2) on site upgrading of "campamentos", and 3) on site upgrading of "tugurios".

"Tugurios" are generally invaded lands on which people have constructed shacks. "Campamentos" require a different approach because they are sites with barracks style buildings constructed in past years by the government to relocate families, usually because of a natural disaster. Under both the tugurio and campamento models the A.B.C. program converts existing structures into permanent dwellings. The reception area model is limited to the ordering and conveyance of lots, and improvement of services to the area.

The three A.B.C. typologies are described in greater detail below. While each project has unique characteristics, for the purposes of this analysis, the San Bartolo Project has been used as the basis for the "Reception Area Typology", the Técnico Industrial Project for the "campamento"

model, and La Fuerteza Project for the "tugurio" model. Except for the last type (lots), several unit types are included in each model, tailored to the various income levels of the target families. Finally, the "traditional" unit constructed by the Production Department of IVU is described, as it is currently being built with HG financing. (The norms and standards used in "traditional" projects are slightly higher than those in ABC projects. For example, the footpaths in ABC sites are narrower, and pipes are smaller.)

B.1 Typology for Reception Areas (Relocated Families)

The unit types are presented from the lowest construction level to the highest with costs calculated at 12% interest, 20 years. Although IVU does not currently have any downpayment requirements, an affordability analysis will be undertaken in August, 1983 to determine how various downpayment standards will affect the target population. (See Annex III for site layouts.)

<u>Construction Level</u>	<u>Est. Cost</u>	<u>Eligible Income Level</u>
<u>1st</u>	\$2,260 (C/.5,650)	\$100 per month (10th %ile) (C/.250)

Urbanized Lot of approximately 50M<sup>2</sup> (5M X 10M) with compacted streets, cement footpaths, water and sewerage connections, superficial drainage canals for rain run-off, and electricity.

<u>2nd</u>	\$3,292 (C/.8,230)	\$144 per month (15th %ile) (C/.360)
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An urbanized lot with a catch basin and 6" diameter pipe for general drainage of the project area, and a sanitary unit (bath and toilet) of 2.04M<sup>2</sup> with concrete block walls, soil-cement floor and asbestos roof.

or

An urbanized lot on which is constructed a 16M<sup>2</sup> soil-cement floor, asbestos roof and lateral walls of concrete block (3.20M) of the future house which is part of a row of units. The service lines for connections are laid 4m.s into the lot. (As with the "piso-techo" units in other countries, the beneficiary finishes the walls, doors, and windows, and installs the service accessories as well.)

<u>3rd</u>	\$4,716 (C/.11,790)	\$208 per month (40th %ile) (C/.520)
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An urbanized lot on which is constructed a complete multi-purpose unit of 16M<sup>2</sup>, with jalousie windows, two doors

(1 wood, 1 iron), and sanitary facilities. (Interior walls are completed by owner). Like the "piso-techo" unit, it is attached in rows of units.

<u>4th</u>	$\frac{\$5,412}{(C/.13,530)}$	$\frac{\$238 \text{ per month (45th \%ile)}}{(C/.595)}$
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An attached unit on a serviced lot with a total constructed area of 21.50M<sup>2</sup>: 16M<sup>2</sup> area for multiple use and 5.50M<sup>2</sup> for services (bath, sanitary unit and wash tub).

B.2 "Campamento" Model

This type of target area is usually already serviced by electricity. Water and sewerage lines are introduced as well as a drainage system and cement footpaths. "Campamentos" are generally very dense, consisting of multi-room wooden barracks. Average lot size depends upon available space, the average lot being 34M<sup>2</sup> in the model used for this typology. To determine monthly payments, costs were calculated at 12%, 20 years.

<u>Construction Level</u>	<u>Est. Cost</u>	<u>Eligible Income Level</u>
<u>1st</u>	$\frac{\$2,044}{(C/.5,110)}$	$\frac{\$90 \text{ per month (8th \%ile)}}{(C/.225)}$

A lot serviced by basic infrastructure, with a catchbasin for drainage which connects to open canals through 4" pipes. A 12.4M<sup>2</sup> floor and a roof of laminated abestos are constructed, as well as the lateral walls which also serve the adjoining units. Wood from the barracks is used to enclose the front and back walls temporarily.

<u>2nd</u>	$\frac{\$4,032}{(C/.5,110)}$	$\frac{\$177 \text{ per month (30th \%ile)}}{(C/.225)}$
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A 17.16m<sup>2</sup> unit: 12.4M<sup>2</sup> multi-purpose area and 4.76M<sup>2</sup> sanitary core. (Interior walls are completed by the owner).

<u>3rd</u>	$\frac{\$4,524}{(C/.11,310)}$	$\frac{\$200 \text{ per month (40th \%ile)}}{(C/.498)}$
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The most complete solution has a 24.22M<sup>2</sup> unit with a multi-purpose area of 12.4M<sup>2</sup>, a bedroom of 6.72M<sup>2</sup>, and a service area (bath, sanitary unit, and wash tub) of 5.10M<sup>2</sup>.

B.3 "Tugurio" Model

This strategy involves measuring and realigning lots, and legalizing their ownership. Water and sewerage lines are introduced, as well as drainage channels, compacted roads, and cement footpaths. Home range from

100M<sup>2</sup> to 150M<sup>2</sup>, depending on the geographical characteristics of the area. Costs were calculated at 12%, 20 years improvements are the responsibility of each resident. Average lot size can

<u>Unit Type</u>	<u>Estimated Cost</u>	<u>Eligible Income Level</u>
Lot (100m <sup>2</sup> )	$\frac{\$2,168}{(C/.5,420)}$	$\frac{\$99 \text{ per month (8th \%ile)}}{(C/.248)}$
Lot (150m <sup>2</sup> )	$\frac{\$3,250}{(C/.8,125)}$	$\frac{\$149 \text{ per month (20th \%ile)}}{(C/.373)}$

#### B.4 "Traditional Unit" (IVU code VU-2A)

This single family dwelling has been designed to permit vertical expansion which allows a family to increase their living space as well as maintain a green area within their lot. A family receives a completely serviced lot of about 60M<sup>2</sup> (5m x 12m) on which a first stage structure of 20M<sup>2</sup> is constructed which includes a kitchen, multi-purpose area, and sanitary facilities. The structure is reinforced and the roof is level concrete, to serve also as the floor of a second storey.

<u>Unit Type</u>	<u>Est. Cost</u>	<u>Eligible Income Level</u>
"traditional"	$\frac{\$5,614^*}{(C/.14,534)}$	$\frac{\$256 \text{ per month (just below median)}}{(C/.640)}$

\*With 10% down, at 12% interest

### C. Institutional Analysis

#### C.1. Financial

IVU's financial picture has changed dramatically in the past few years. Whereas previously it received low-cost funds from the government's general revenues, this source has been almost eliminated. Because resources have dried up, the HG Program represents a critical funding source for shelter finance institutions. HG funds represent 52% of IVU's 1983 budget of C/.18.1 million (\$7.2 million). Because of historically low interest rates, recuperation on their existing portfolio is low, although the cost of resources in the past was also low because the GOES provided much of the institution's funding in the form of subsidies. In addition, collections are a serious problem, and administrative costs are high.

Taken as a whole, the HG Program is addressing these problems and is beginning to strengthen IVU's position and its contributions to the overall housing sector. While the first objective is to increase production, HG funds will also provide technical assistance and will provide leverage to institute policy changes which will affect IVU's solvency in the future. As a result of AID's efforts, greater attention is being given to financial

projections, portfolio composition, collections, and interest rates.

An analysis of IVU's collections record must take into account the fact that arrears of up to three months are legal under the bylaws of IVU. Since there are no sanctions for this level, a number of clients maintain arrears of 1-3 months as a matter of course. This problem must be addressed through incentives, and possibly through legislative changes. In terms of arrears of more than three months, the options open to IVU must be reviewed. The amount of arrears in financial terms is not available, but the number of clients, classified by the number of months of arrears is provided below. It is of concern that the level of arrears of four months or more is growing (9.8% in 1981 to 11% in 1982).

<u>No of Months in arrears</u>	<u>No. 1981</u>	<u>%</u>	<u>No. 1982</u>	<u>%</u>
1-3 months	6,851	44.4	6,863	41.1
4-6 months	887	5.7	1,159	6.9
7-12 months	495	3.2	547	3.3
12 months +	<u>143</u>	<u>0.9</u>	<u>143</u>	<u>0.8</u>
Total Clients	15,414	100%	16,687	100%

The technical assistance program addresses this important area, as well as promotions and selection. A consultant has been identified to work with IVU, starting in August, which will lay the groundwork for a plan to reduce arrears and to improve the procedures for the qualification of applicants.

The upgrading projects and "traditional" units which will be financed with the FY '82 \$5.0 million package, as well as future projects, will carry interest rates of 12%. For the A.B.C. program this represents a significant increase over earlier rates of 7%-9%. Although for new units, 12% interest is somewhat low compared with the market rate in El Salvador, it is the maximum interest rate, established by law that IVU may currently charge. A draft decree is being introduced to the Constituent Assembly to amend this statute. If it passes, IVU's internal interest rate structure can be made more consistent with the other participating institutions and more compatible with the cost of resources. The recommended legislation would remove the ceiling on interest rates and allow the Board of Directors to establish rates for each project, based on both the cost of resources and an administrative spread for IVU. A.I.D. is actively supporting the timely passage of this legislation.

#### C.2. The A.B.C. Program and IVU's Administrative Structure

IVU's organizational structure includes four major Departments: Administration, Commercial (sales and collections), Production, and A.B.C. The Production Department was the implementing arm of the institution since it was established, and since many of the projects carried out by IVU were for the middle class (its original legislation specifies shelter for lower and middle income families), the units it produces are now

called "traditional" to distinguish them from the A.B.C. program.

An October 1979 Decree established the A.B.C. Program ("Acceso al Bienestar Comunitario") under the IVU umbrella, to improve the social, housing and environmental conditions of families living in sub-standard areas, in particular "tugurios", "campamentos", "colonias marginales", "mesones" and other deteriorated zones. The legislation specified that the A.B.C. program would cover areas which are amenable to improvement en situ, as well as those from which families should be relocated because of physical risk or because the location presents a conflict of interest for public use of the land.

The A.B.C. legislation provides for special treatment in the norms and standards used in projects (subject to the approval of the Ministry of Public Works), and for the donation of lands held by the State, municipalities, or official institutions. A.B.C. projects have benefitted from more flexible lower norms for drainage, footpaths, and water and sewerage lines, but various aspects of urbanization and unit construction could be made even more flexible. In the case of land acquisition, it should be noted that transactions are lengthy, and that some institutions balk at donating lands and request payment. To date, IVU has not purchased either tugurio or campamento sites. The A.B.C. program was initiated on the limited number of IVU-owned sites. Future projects in the Metropolitan Area of San Salvador present greater difficulties since other entities have title to the lands, requiring negotiations to transfer them to IVU. Sites in the interior present fewer delays of this kind.

In addition, the law stipulated that a separate department could be formed within IVU to design, implement, and monitor the A.B.C. projects. As a result, the two departments of Production and A.B.C. both include offices for design, construction, and supervision. Other A.B.C. functions are repeated in the Commercial Department (See Organizational Chart, Annex IV). This duplication of function is noteworthy in that IVU's administrative overhead is much too high. Also, the lack of coordination between the A.B.C. and Production Departments is clearly evident when both are constructing in the same area, e.g. San Bartolo. During the negotiations on the first \$5.0 million package, cost differences were noted in basic infrastructure for the same project area. While these differences were clarified and corrected, communication channels need to be opened between the Departments. Part of the technical assistance program will concentrate on IVU's administrative structure and it is expected that some of the recommendations will be aimed at merging various functions of the two Departments.

### C.3. Construction Capacity

During the construction of the two IVU I projects and the first private sector projects, new arrangements had to be made between developers and the Water Authority (ANDA), and the largest company for the distribution of electricity (CAESS). Previously ANDA supplied all off-site infrastructure for urbanizations and CAESS supplied both off-site and on-site connections. Once a project was approved, the developer was able to lay out the internal

distribution network for water and sewerage connections and be assured that hook-ups for all basic services could be made when the project was completed. Because ANDA was close to bankruptcy by the end of 1981, the normal relationship with developers changed completely. Now developers must build both the on-site and complementary off-site infrastructure, if required. (ANDA provides guidelines and inspectors for new project sites.) A similar situation exists with CAESS.

These problems persist, but to a lesser degree. Participating institutions are now fully aware of the additional requirements and have taken programming measures satisfactory to A.I.D to reduce delays in the installation of infrastructure. However, complementary infrastructure continues to be subject to unforeseen difficulties. Its timetable is the least predictable of the categories of work (urbanization, housing units, and off-site infrastructure). Some developers do not have the internal capacity needed to carry out the work. IVU, for instance, contracts ANDA for the work it previously carried out automatically. If ANDA personnel are reassigned on an emergency basis, e.g. to repair lines destroyed in the civil conflict, the work on the project site is postponed.

IVU maintains a permanent staff of manual laborers, but its internal construction capacity is underutilized. In the past 80% of project construction was carried out through the internal administrative system, while 20% of the work was contracted to private sector builders. Since project construction has declined, even the internal capacity of IVU is not being fully utilized at this time.

## V. PROGRAM IMPLEMENTATION

### A. Loan Contracting and Disbursement

The following schedule outlines the critical steps to be followed in implementing the HG program in El Salvador.

#### Critical Target Dates

1. Authorization - 8/83
2. Letter of Advice - 9/83
3. Signing Amendment Implementation Agreement - 9/83
4. TA Plan Initiation - 8/83
  - (a) Financial Evaluation IVU - 10/83 (Completion: 11/83)
  - (b) Evaluation S&L - 10/83 (Completion: 11/83)
  - (c) Collection Procedures - 8/83 (Completion: 9/83)
  - (d) Promotion Selection - 8/83 (Completion: 10/83)
  - (e) Other TA - 8/83-12/83
5. Signing PL-480 - 9/83
6. Sub-Projects Definition 9/83 (Completion 11/83)
7. AID approves project delivery plan 11/83  
(Value of \$3 million)
8. Initiation of Sub-projects construction - 1/84

9. Initiation of Sub-projects - 2/84  
(Value of \$2 million)
10. Contracting FY 82 HG loan - 3/84
11. Disbursement FY 82 \$ 5 million - 6/84
12. Regular evaluation FY 82 - 8/84
13. Contracting FY 83 HG loan (\$2.5 to \$3) - 10/84
14. Regular FY 83 evaluation - 11/84
15. Contracting balance of FY 83 HG - 2/85

Pursuant to Bureau Policy, it is understood that this tranche of the HG program as well as the 1982 authorization will be contracted within 18 months of authorization.

#### B. Technical Assistance Plan

The technical assistance plan which is now being implemented intends to address institutional constraints in IVU and the savings and loan system as well as addressing areas of concern in the implementation of the program.

The total funding needs estimated for the proposed technical assistance is \$100,000 of which \$30,000 has been committed for FY 83 and \$50,000 will be provided in FY 84 by the Mission and \$20,000 will be provided by PRE/H through an existing regional contract.

##### B.1. IVU

Financial Management (6 person months, estimated cost \$30,000) - The objectives of the assistance will be (a) to determine the present financial position of IVU and identify key problems and alternatives (b) to assist in carrying out organizational changes in IVU to improve financial management (c) to assist IVU in developing a system for the mobilization of additional resources. The technical assistance will examine the long range potential of IVU to mobilize local resources and to finance low-cost housing.

The first task will involve an in-depth analysis of IVU's financial situation. The analysis will examine IVU's current financial position, the institution's future financial health, the policies which impact on its current and future financial position and the changes needed. The consultant will examine work activities including: (1) examine IVU's recent past and current financial condition, the structure of assets and liabilities, income statements, financial ratios, etc. for 1981 and 1982 based on IVU's records and whatever audit information that may be available; (2) project IVU's financial condition taking into consideration the source and application of funds, cash flows, proforma financial statements projected to 1990 assuming PL. 480, HG and other resources (e.g. CABEI loans) that may be invested during the period. Also, in such an assignment care should be taken in examining whatever assets carry fixed or variable interest rates and foreign exchange risks that may exist for IVU liabilities; (3) conduct an inquiry into the rationale for establishing subsidies on IVU projects, the current and projected costs of those subsidies and the extent to which IVU or some other source absorbs those costs; (4) analyze IVU's portfolio structure (assets) in relation to capital markets in El Salvador and the extent to which the rates of return on assets are marketable within the country's financial system; (5)

prepare a set of conclusions on IVU financial condition, recommendations on actions that could be taken to strengthen IVU's financial base and additional follow-up studies and TA that should be conducted on financial condition financial management and policy of the institution.

Collections: (3 persons months \$15,000) The first phase of this assistance which is now being provided is carrying out a detailed analysis of the procedures and guidelines used and the status of arrears. In particular the consultant will investigate the types of sanctions available and their applications, the physical location of collections offices, the use of collections agents, if clients pay independently or whether a salary deduction system is used, and to the extent possible, the differences in levels of arrears by geographical area, type of project, etc. If the last type of information is not available, the consultant will prepare a work plan for IVU to analyze these differences in arrears. The consultant will also review the adjudication process for ABC projects to determine if a different collections system is used, or whether one may be required. Finally, the consultant will develop a set of recommendations concerning collection procedures and monitoring as well as the targets to be achieved in terms of recuperation of arrearages.

The consultant will return to El Salvador to review implementation of procedures proposed and to determine if adjustments are needed and to see how IVU is reaching recuperation targets. At a minimum AID will seek to encourage IVU to reduce the time before IVU considers a mortgage in arrears.

Promotion/Selection (3 person months, estimated cost \$15,000) IWU's organizational structure includes the ABC and Production Departments, as well as a Commercialization Department which has a staff for 'Social Studies', 'Community Organization and Development', and 'Collections'. The Commercialization Department primarily serves the Production Department since the ABC Department has its own staff for 'Estudios Socio-Economicos' to work with ABC target communities. The ABC Program has two different work modes, the first for on-site improvement and the second receiving applications of families who wish to relocate to new project areas. The latter appears to have many similarities to the modus operandi of the Commercialization Department.

The consultant will (a) interview the staffs of the Commercialization and ABC Departments who deal with applicants and selection; (b) prepare a written description of the two structures, highlighting similarities and differences of function; (c) review the application forms and the selection criteria used for the two departments; and (d) prepare recommendations on the areas in which the two departments could work more closely, or coordinate the processing of applications; (e) make recommendations concerning selection criteria of project beneficiaries.

Technical Process (4 person-months estimated \$20,000) - The technical assistance will first update IVU's procedures for project analysis, approval and cost determination (this was last done in July of 1983) - the additional

technical assistance will focus on the evaluation of the specific sub-projects for the program proposed here to determine alternatives to reduce costs and streamline the construction process. This assistance will be coordinated with selection process assistance so the production and delivery of solutions is synchronized.

B.2 Savings and Loan System (4 person-months \$20,000) The first part of the assistance will be to ascertain the financial conditions of the Financiera Nacional de la Vivienda (FNV) and each of the individual associations. This evaluation will conclude with recommendations concerning the improvement of the system including but not limited to the financial management areas, mobilization of resources and lending diversification. The technical assistance will also be directed to work with the associations in setting the procedures for the operations of a credit line for home improvement programs. Finally, the assistance will be directed to find ways in which future HG resources could contribute to the strengthening of the financial position of the system and the role FNV (the Central Savings and Loan Bank) could play in promoting the financing of lower cost shelter units. The technical assistance will also examine the long range potential of the S & L's to finance low-cost housing and to mobilize savings and local resources.

Timing - The financial evaluation of IVU will be conducted in October 1983 along with the evaluation of the savings and loan system. The balance of the assistance will be completed by the end of FY 84.

#### C. Evaluation and Monitoring

Overall project monitoring will be the responsibility of USAID/EI Salvador and RHUDO/LA. Evaluations will be carried out annually, and a comprehensive evaluation will be conducted following the last disbursement of HG funds.

#### D. Conditions and Covenants

1. IVU programming will integrate upgrading projects and the production of new units so that the majority of solutions financed by HG resources is of the upgrading type.
2. The GOES will not contract this supplemental \$5.0 million until the previous supplement (\$5.0 million) is contracted and a level of construction satisfactory to AID is underway.
3. The GOES will make best efforts to issue new legislation that will remove the interest rate ceiling on IVU lending and will allow IVU's interest rates to be adjusted according to the cost of its resources.

ACTION MEMORANDUM TO THE DIRECTOR, USAID EL SALVADOR

FROM: Charles C. Brady, GDO

SUBJECT: Request for PL 480 Local Currency in Support of the  
Housing Guarantee Program (519-HG-006)

I. Purpose:

To date, the implementation of the HG Program in El Salvador has been slow. The lack of momentum in the Program is due in part to the lack of liquidity within participating institutions. IVU lacks working capital to initiate new projects and the Savings and Loan System's cash flow has been seriously damaged by a large, unsold inventory of expensive units.

A working capital fund using PL 480 local currency is proposed which would strengthen A.I.D.'s housing strategy in El Salvador in the following ways:

1. Speed the production of housing units, and secondary benefits in employment generation;
2. Provide leverage for adjusting the housing programs of participating institutions toward lower cost solutions to reach a greater number of families with the available resources;
3. Create new resources for additional low-cost shelter as the rotating fund is capitalized over time; and
4. Strengthen the financial position of participating housing institutions so that they are better able to meet the housing demand of low-income clients in the future, by adjusting interest rates and the margins required for a sound portfolio.

Local currency generated through PL 480 can legally be used to support Housing Guarantee activities. Policy Determination (PD-5) was issued on February 22, 1983 and states the following in reference to the use of PL 480 resources.

It may be desirable to use local currency to reduce the loan repayment burden associated with Housing Guarantee programs financed at U.S. market interest rates as a means of supporting a change in host country policy with regard to subsidized housing for low income beneficiaries. Local currency generations can also be used to support other housing and urban development activities, such as small enterprise loans, training and community facilities which might be difficult to undertake at U.S. market interest rates.

This PL 480 fund is directed at policy changes to help institutions produce replicable, non-subsidized shelter programs for low-income families. The working capital fund provides various benefits to resource poor institutions: increased liquidity to start pending programs, the ability to leverage other resources (HG), and growth in internal resources as the fund is utilized. In turn, it provides a negotiating advantage to A.I.D. in recommending policy and financial changes, e.g. establishing interest rates for upgrading projects on par with other projects, and giving priority to the lowest cost solutions.

## II. The Relation Between PL 480 and HG Resources:

A total of \$20.0 million in HG resources has been authorized, of which \$15.0 million have been contracted. Projects have been identified and approved for the entire \$15.0 million. Given the large HG advances which were provided, the cycle of these projects is now self-supporting.

Despite the fact that an additional \$5.0 million is available and is earmarked for IVU, that institution cannot start new projects with those resources until the new loan is contracted and an advance is provided. Contracting of that loan is tied to progress on current construction. The same relationship will hold true for the new \$5.0 million in HG resources which will be authorized this year.

This modus operandi is a reflection of the lack of working capital in the participating institutions. PL 480 resources will provide bridge financing and greatly assist the GOES in the contracting process by allowing direct disbursement of HG resources against completed units, rather than holding dollars in an escrow account while construction is underway. Because of changes in the U.S. capital market, the use of escrow accounts is not in the best interest of the GOES since interest earned on escrow is less than interest due to the U.S. investor from the GOES.

## III. Placement of PL 480 Resources and Amounts Needed:

With the \$5.0 million in new authorization requested this Fiscal Year, new projects totalling \$10.0 million can be initiated. (Combined authorizations of FYs 1982-1983.) It is expected that most or all of these resources will be channeled through IVU. A package for \$5.0 million is currently being finalized and new projects are being identified.

Also, as a result of negotiations with the FNV it is expected that the next authorization of \$5.0 million in Fiscal Year 1984 will be earmarked for the Savings and Loan System. The development of a program for home improvement loans is an important objective of the continuation of the HG Program through that institution.

RECOMMENDATION: Establish a PL 480 fund equivalent to \$6.0 million for IVU (\$5.0 million) and the FNV (\$1.0 million).

1. Institute a rotating fund equivalent to \$5.0 million for IVU, with a partial disbursement as soon as PL-480 funds become available.

This fund would represent 50% of the resources which are expected to flow to IVU from HG loans over the next two to three years. As a revolving fund, it would provide the bridge financing needed to maintain IVU production at maximum levels. At a minimum, about 1,000 units would be in construction at any given time since the upgrading projects will be included which cost less than the traditional units being financed at this time.

An agreement with MIPLAN would indicate that PL 480 funds will be used to finance the construction of shelter solutions which are eligible for HG financing. The agreement would specify a disbursement schedule based on the physical programming for the projects selected for the first \$5.0 million package. (A preliminary guideline: disbursements over three quarters of \$2.0, \$1.5 and \$1.5 million respectively, starting as soon as funds are available.)

2. Program a disbursement of \$1.0 million in mid-FY 1984 for the FNV to be used for establishing a home improvement loans program.

Beyond the projects which are currently being financed under the first HG authorization, the appropriate level of funding for the Savings and Loan System has not been determined as yet. Tentatively, the FY 1984 authorization is being earmarked for the FNV and associations. Elements of the shelter strategy in El Salvador are to continue financing low-cost shelter through private sector builders and to initiate a home improvement loan program.

With regard to the need for a working capital fund within the Savings and Loan System, it must be noted that some internal resources have been available in support of the HG Program, but the liquidity of the System seems to be diminishing. At the same time, the use of PL 480 resources is for strategic purposes, as well as to increase liquidity. For that reason, it is recommended that \$1.0 million be programmed to provide an incentive to the FNV to undertake a home improvement loan program. If serious liquidity problems are identified in the future, a larger fund may be recommended at a later time.

#### IV. The Capitalization of the IVU Fund:

The positive effects of the fund on IVU's financial condition can be appreciated from the financial spread provided below. Assuming zero cost to the GOES, the following margins will be established.

Construction Finance

Cost to IVU	0%
Adminstr. Spread	6%
Capitalization	<u>10%</u>
Cost to developer	16%

NOTE: Construction finance is set at 16% rather than the usual rates of 18%-20% to lower the cost of shelter units. If loan rather than grant PL-480 resources are used, there could be some cost to IVU (2-3%) and the margin for capitalization would be reduced to 7-8%.

V. Types of Projects and Benefits

An important shift in housing strategy is being made with IVU in the planning of the next \$10.0 million in HG financed projects (combined authorizations of FYs 1982-1983). The PL 480 resources support this strategy and provide much needed momentum to the production of low-cost shelter in El Salvador.

In March 1983, IVU prepared a proposal for the Ministry of Planning for new unit production to be financed through the HG Program. The cost of these units ranged from C/.15,250 (\$6,100) to C/.16,500 (\$6,600). If approved without change, between 750 and 820 new units would have been produced for \$5.0 million. At A.I.D.'s request, IVU prepared a list of ABC upgrading projects which could be financed by HG resources. A package of projects which combines A.B.C. upgrading and new units is being negotiated now with IVU. By including the upgrading projects, the number of beneficiaries will more than triple over the number who would have benefitted from the original IVU proposal.

Currently, seven projects appear to be eligible. Two are close to completion with an investment of close to \$700,000. While these may not require PL 480 working capital, they can be financed by the next HG loan when it is contracted. The other five upgrading programs may be started this year. They will benefit over 2,000 families at an estimated cost of \$3.6 million. Three of these projects can be initiated immediately (requiring an investment of about \$2.3 million) and will probably be included in the agreement with IVU (\$5.0 million) along with some of the units originally proposed in March. If IVU's estimated construction schedule is realistic, the three upgrading projects affecting over 1,000 families would be completed by mid-1984.

A detailed analysis is underway of these ABC projects and IVU's other projects. The analysis will also provide guidance for the level of upgrading activity which will be funded under the FY 1983 HG authorization (\$5.0 million) which is expected this year.

The ABC projects are for the most part urbanized lots with minimal construction, as well as the construction of some new units and the improvement of existing structures, depending on income levels of beneficiaries. Estimated costs of the minimal solutions range from about \$1,200 to \$3,400, depending on the design of the project; these costs are between 20%-50% of the costs of units currently under construction in HG financed IVU II. Thus, ABC projects are affordable to families well below the median income which is the level currently benefitting most from the HG Program.

The projects under review for inclusion in the first \$5.0 million IVU package are listed below. They include three "traditional" projects as well as the ABC projects mentioned above. Since the total value of projects is over \$5.0 million, several projects will have to be programmed for the second \$5.0 million package.

<u>Project</u>	<u>Unit Type</u>	<u>Average Cost</u>	<u>No. Units</u>	<u>Est. Investment</u> ( 000's)
La Fuerzeza	Urbaniz.Lot	\$1,300	495	\$ 636.8
Tecnico Industr.	" "	960	350	336.0
Tecnico Industr.	Core Units	2,000	99	198.0
San Bartolo	Lots-Core Units	3,400	340	1,156.0
San Bartolo	30M <sup>2</sup> Units	6,100	100	610.0
San Antonio del Monte	Lots-Core Units	2,000	450	900.0
Antiquiza	Lots-Core Units	1,500	296	444.0
Santa Ana	30M <sup>2</sup> Units	6,100	400	2,440.0
Jose Simeon Canas	" "	6,100	100	610.0
		Total	2,630	7,330.8

LISTA DE COMUNIDADES ASENTADOS EN TERRENOS ESTATALES  
CONTEMPLADOS EN EL PROGRAMA ABC

<u>TUGURIOS</u>	<u>PROPIETARIO</u>	<u>No. FAMILIAS</u>	<u>EXTENSION APROXIMADA</u>
El Prado	Alcaldia Municipal SS	22	1 manzana
16 de Noviembre	" "	27	1.5 "
Pedrera No.1	" "	120	4 "
La Mascota No.2	" "	20	.57 "
Cristo Redentor No.1	" "	22	.57 "
Cristo Redentor No.2	" "	39	1 "
Jose Cecilo del Valle	" "	70	3 "
El Progreso	" "	40	
El Bambular	Estatat (IV)	160	
Corazon de Maria	Alcaldia Municipal SS	207	2.5 manzanas
Las Palmas	Estatat	896	10 "
El Bambu No.2	Estatat IVU	22	1.25 "
La Pedrera	Alcaldia Municipal SS	36	
La Roca	" "	52	.25 "
Aragon	Ministerio de Defensa	125	1 "
Dario Gonzalez	Alcaldia Municipal SS	400	2 "
5 de Noviembre	" "	12	28 "
San Jose de la Montaja	" "	20	
Itsmania	" "	21	.25 "
Francisco Nuñez	" "	67	.5 "
Arrue	" "	34	4 "
12 de Octubre	" "	52	1.5 "
Sagrado Corazon	" "	43	1.5 "
Valle de Oro	" "		
	Sub-total	<u>2,507</u>	
<u>CAMPAMENTOS</u>	<u>PROPIETARIO</u>	<u>No. FAMILIAS</u>	<u>EXTENSION APROXIMADA</u>
Policia de Hacienda	Ministerio de Defensa	1,500	17 manzanas
3 de Mayo	(Prideco) Santo Tomas	48	.75 "
Cristino Garay	Guardia Nacional	20	14.3 "
Jardin	IVU	150	1.2 "
Tecnico Industrial	Estatat	<u>460</u>	4.25 "
	Sub-total	<u>2,178</u>	

Site Layouts

Reception Area Model 1-4

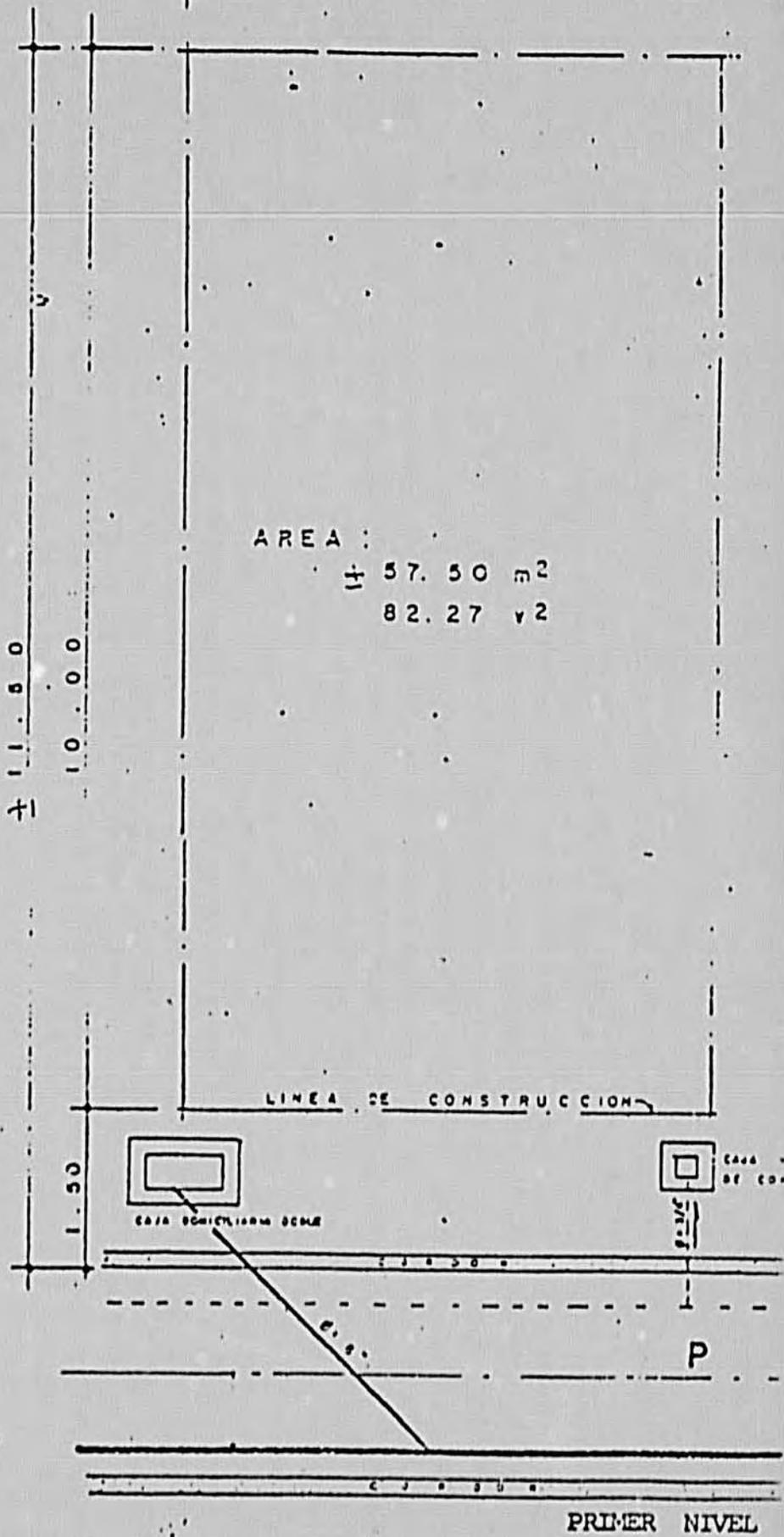
Campamento Model 3

Traditional Model

**Best Available Document**

Reception Area 1

Best Available Document



AREA :  
 ± 57.50 m<sup>2</sup>  
 82.27 v2

+ 11.50  
 10.00

LINEA DE CONSTRUCCION

1.50

CASA DE CONSTRUCCION

CASA DE CO...

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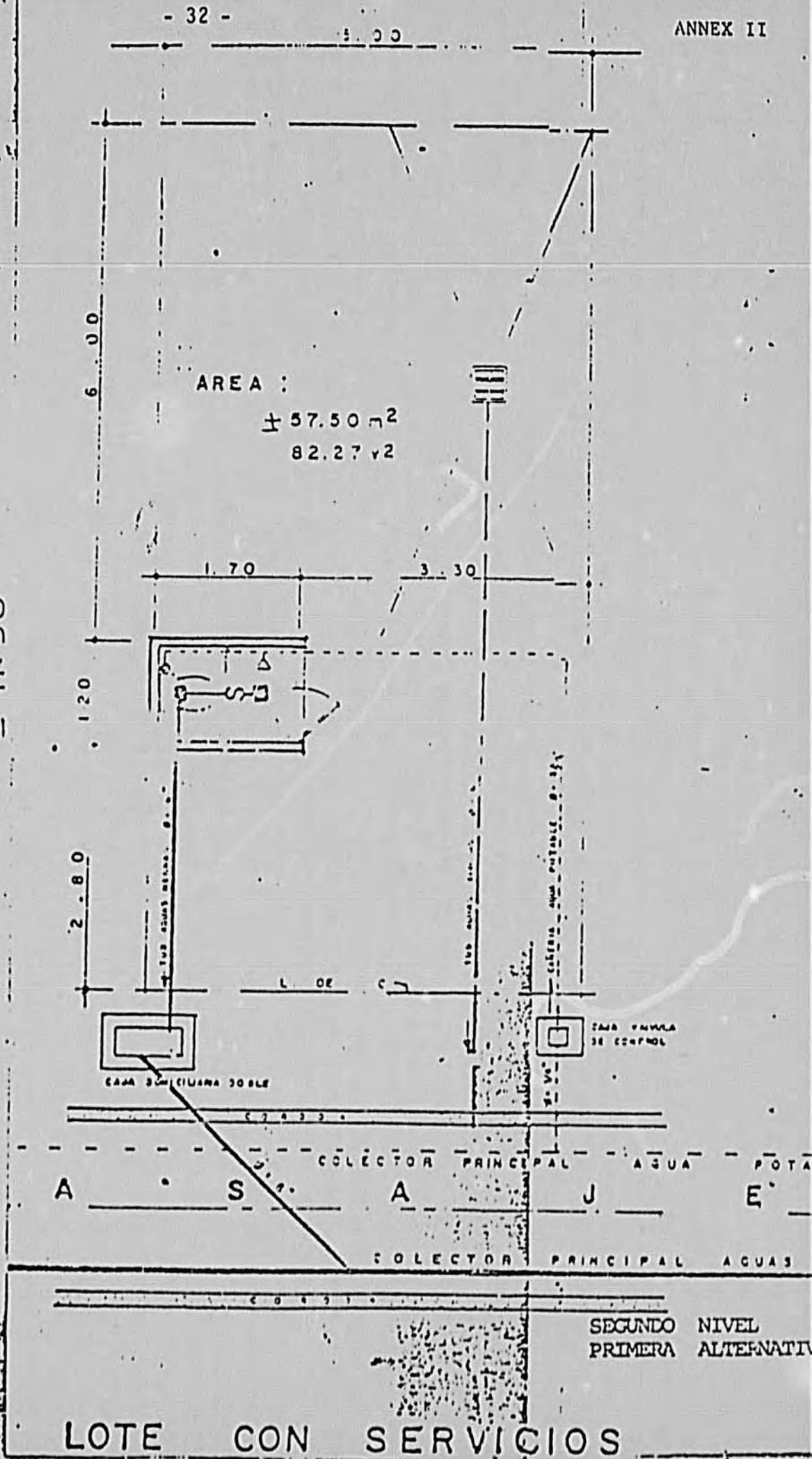
PRIMER NIVEL

LOTE URBANIZADO

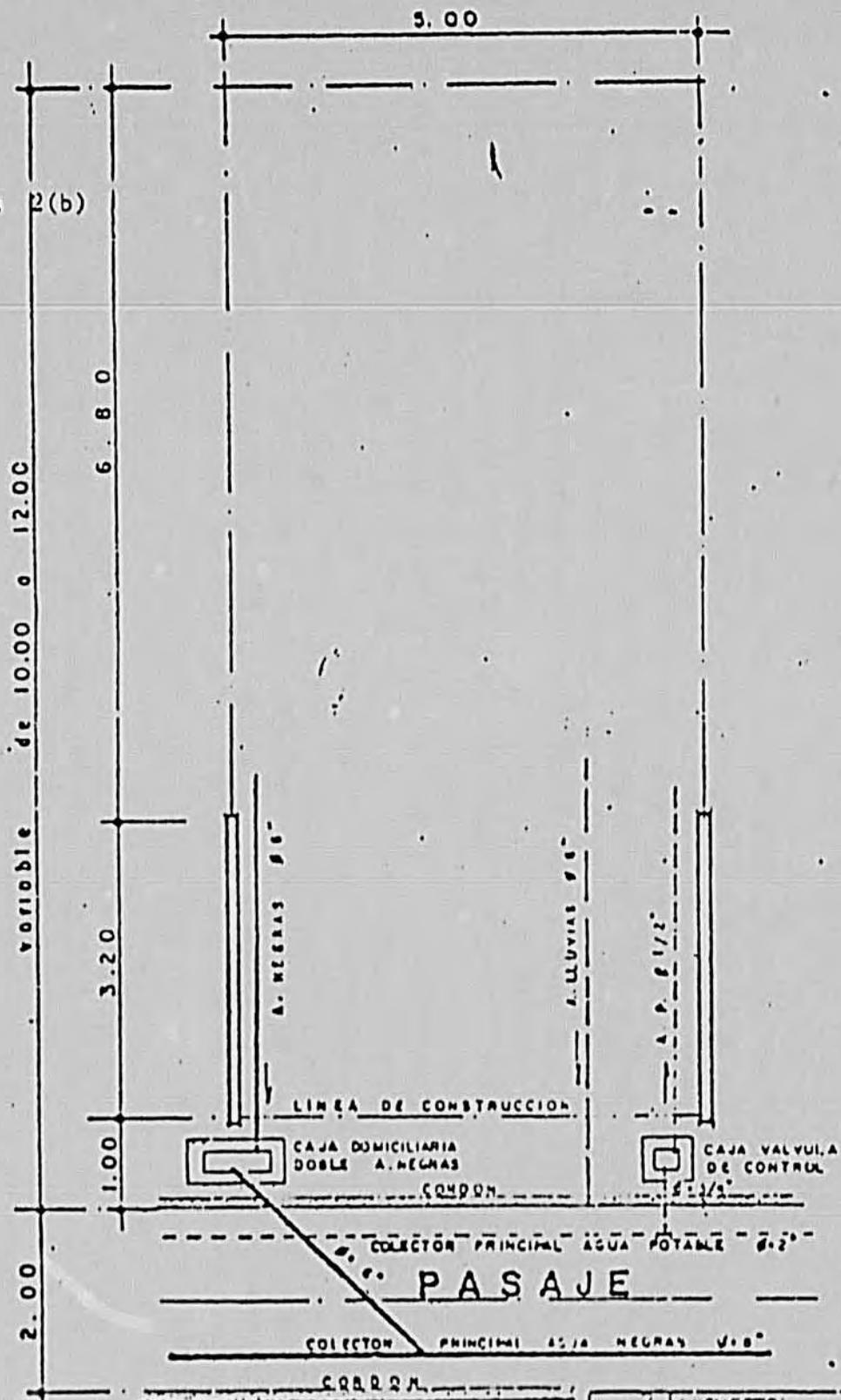
Reception Area 2(a)

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± 11.50



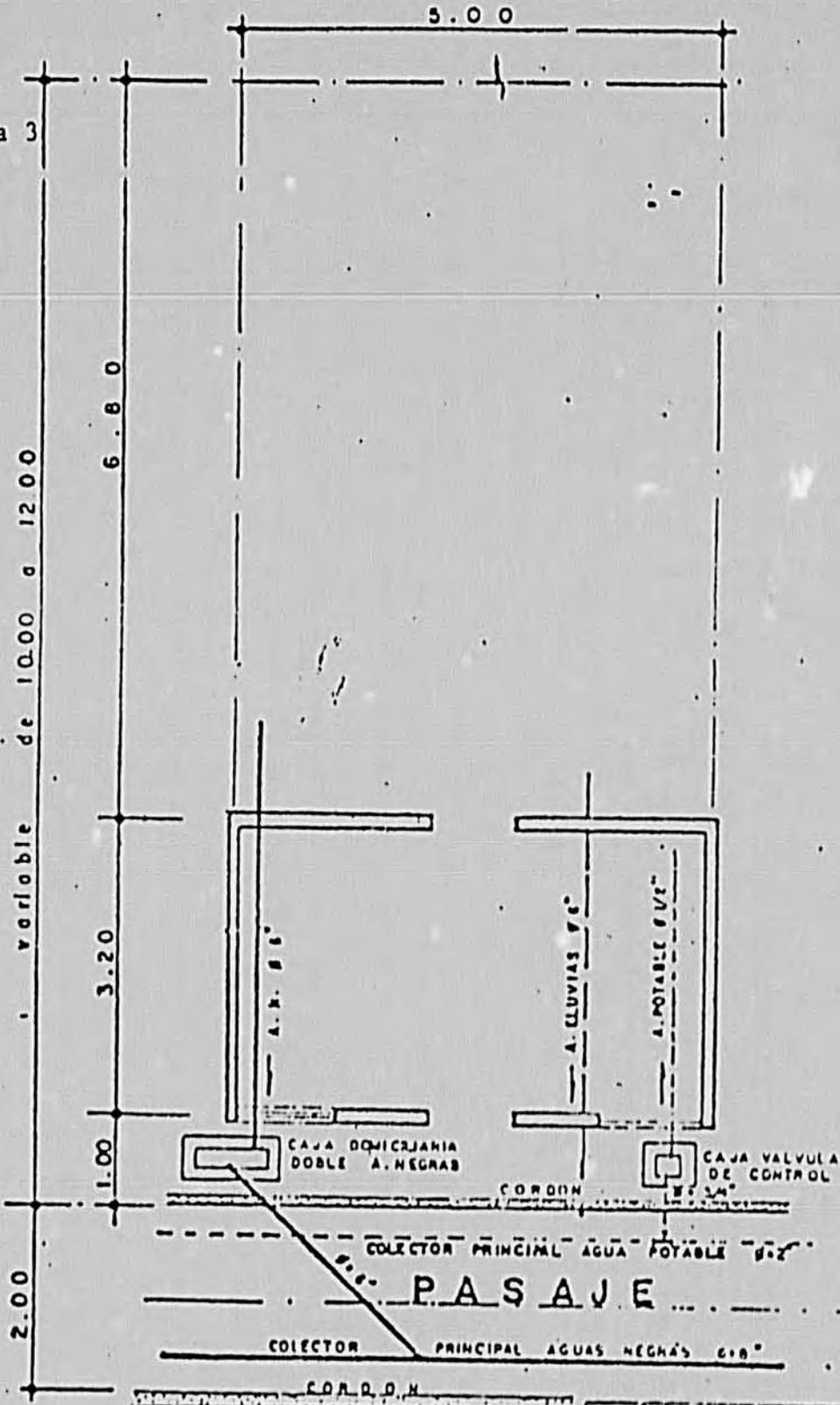
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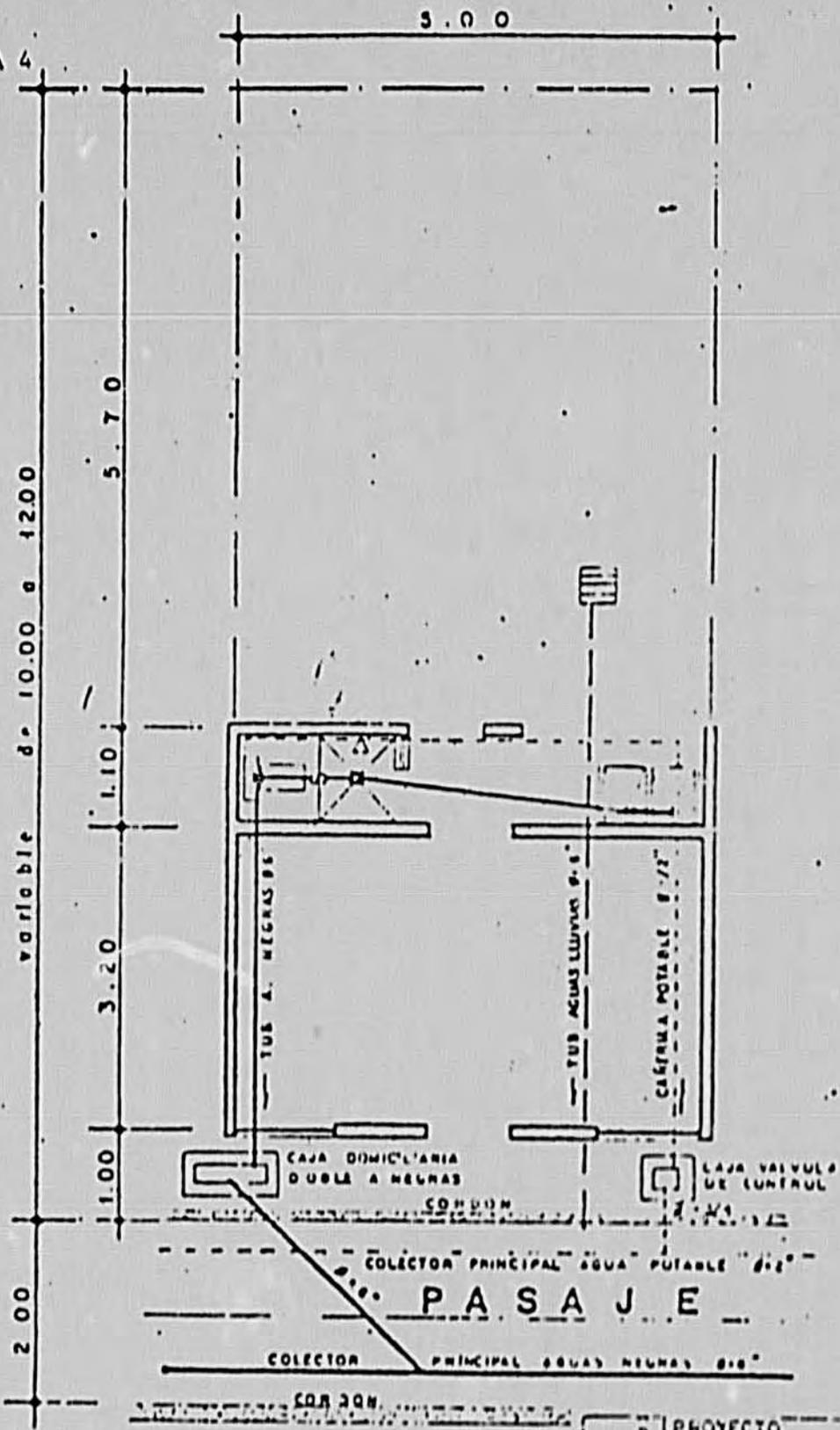
PROGRAMA A. B. C. ACCESO AL BIENESTAR COMUNITARIO	PROYECTO	
	UBICACION	HITO
	2 x 11.000	
	PRESIDENTE	
	GENENTE A. B. C.	
	PLANEAMA A. B. C.	
ESCALA	1:75	UNIDADES
FECHA	MAYO 1983	PROYECTO

Reception Area 3

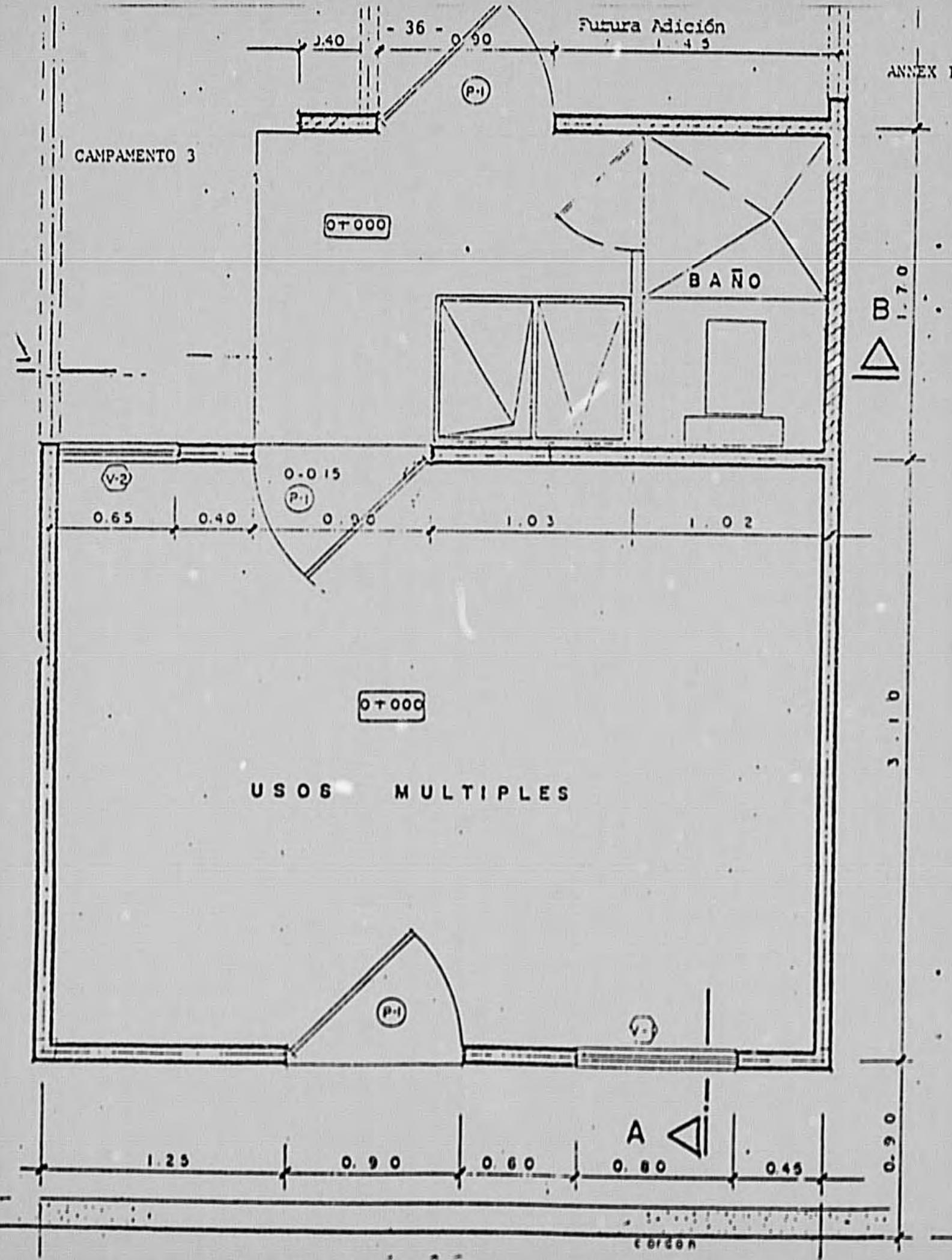


PROGRAMA A. B. C. ACCESO AL BIENESTAR COMUNITARIO	PROYECTO:	
	UBICACION:	HOJA
	PRESIDENTE:	32 III L
	GERENTE A. B. C.:	
	PROGRAMA A. B. C.:	
	ESCALA 1:75	UNIDAD NIZAS
FECHA MAYO 1983	REND. ...	

RECEPTION AREA 4



PROGRAMA A. B. C. ACCESO AL BIENESTAR COMUNITARIO	PROYECTO	HOJA NIVEL
	UBICACION	
	PRESIDENTE	
	GERENTE A. B. C.	
	PROGRAMA A. B. C.	
ESCALA 1:75	ELABORADO POR	
FECHA MARZO 1965	REVISADO POR	



CAMPAMENTO 3

Futura Adición  
1.45

ANNEX II

0+000

BAÑO

B  
1.70

V-2

0-015  
P-1

0.65

0.40

0.90

1.03

1.02

0+000

USOS MÚLTIPLES

3.10

P-1

V-2

A

1.25

0.90

0.60

0.80

0.45

0.90

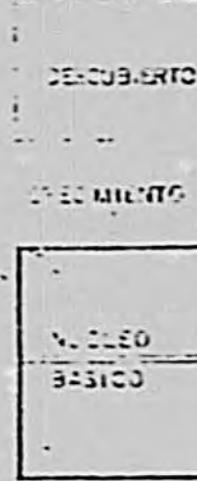
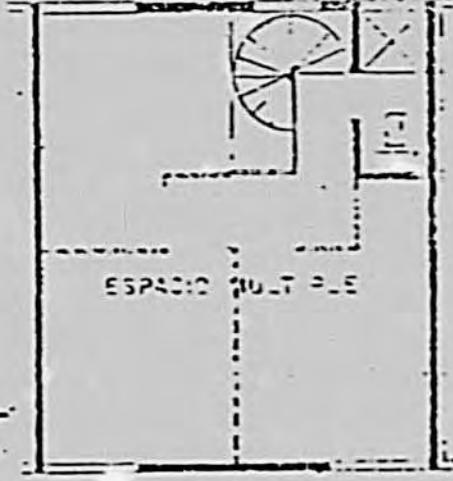
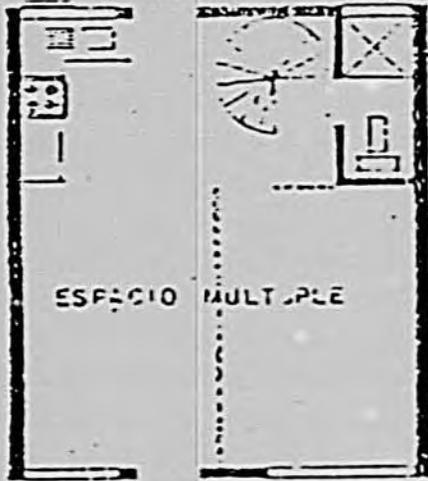
CORDON

PROYECTO DE UNIDAD HABITACIONAL VU-2A Y ALTERNATIVA A.P.-2

ETAPA I  
(Construcción IVU)

ETAPA II  
(Construcción por beneficiarios)

ALTERNATIVA A UTILIZAR



PLANTA BAJA

PLANTA ALTA

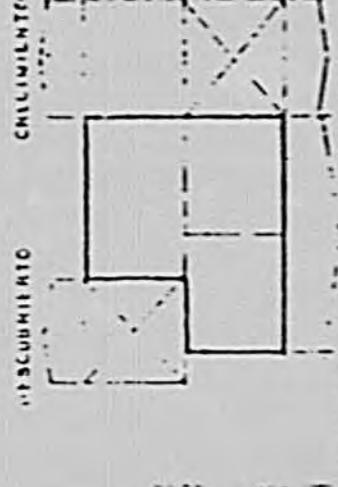
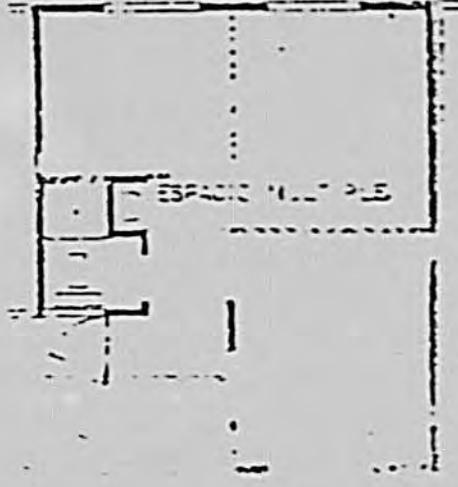
LOTE 5 x 12

T-PO VU-2A Esc. IIIC  
VIVIENDA UNIFAMILIAR - DOS NIV. MODIFICADA

VU-2A  
EL PROYECTO DE UNIDAD HABITACIONAL PROPUESTO PARA LOS PROYECTOS ES LA VU-2A QUE CONSTA DE DOS NIVELES  
LA CONCEPCION DE ESTE PROYECTO ESTA BASADA PRINCIPALMENTE EN LA SUBDIVISION ESACIAL VERTICAL Y HORIZONTAL (FLEXIBILIDAD)  
EN EL PROYECTO SE HA CONSIDERADO UN NIVEL DE CONSTRUCCION QUE CONSISTE EN CONSTRUIR LA PLANTA BAJA Y LOSA DE ENTREPISO  
EL USUARIO PUEDE DESARROLLAR SU VIVIENDA O SU INDIVIDUALIDAD SEGUN SUS NECESIDADES AREA 25 00 M<sup>2</sup>

- 37 -

TRADITIONAL



PLANTA BAJA

VUP-2  
VIVIENDA UNIFAMILIAR

VUP-2  
EL PROYECTO VUP-2 O VIVIENDA UNIFAMILIAR PROGRESIVA SE PLANTEA COMO UNA ALTERNATIVA EN LA CUAL EL LOTE SE HA ESTRUCTURADO PARA QUE LA VIVIENDA SE CRESCA HORIZONTAL Y VERTICALMENTE HASTA 2 NIVELES  
SE CONSIDERA PROPORCIONAR UN NUCLEO BASICO EN UN NIVEL HASTA UNA MAXIMA SATURACION PREFIJANDO LOS ESPACIOS QUE NUNCA SE CUBRIRAN AREA 25 00 M<sup>2</sup>



El Salvador

EXTERNAL DEBT ANALYSIS

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Timothy J. Smith

International Housing Finance Consultant

National Savings and Loan League

August, 1983

## BACKGROUND

The U.S. Agency for International Development/Office of Housing is considering a request to provide El Salvador with assistance in the amount of \$5 million under its Housing Guaranty Program (HG Program).

This \$5 million request would supplement previously authorized HG funds totaling \$20 million. Loan funds would be disbursed based on El Salvador's performance in carrying out its housing program. Typically, 80-90% of housing construction and/or upgrading is undertaken with local currency, meaning that the HG Program's assistance represents a net inflow of foreign exchange to the country. Repayment of the guaranteed loan must still be made in U.S. dollars, but on generally concessionary terms. Currently, HG loans are placed with an interest rate of about 12.5%, amortized over thirty years with a ten to fifteen year grace period on principal. This paper reviews El Salvador's current external debt situation with emphasis on the prospects for repayment of the proposed supplemental assistance under the HG Program.

## SUMMARY

Developments in El Salvador's economy over the last few years, with particular reference to its external debt position, can be summarized as follows:1/

1. Between 1960 and 1978, El Salvador carried out an economic development program characterized by prudent management. Capital outlays were adjusted to the availability of current savings, overall deficits and foreign borrowings were kept low, and current expenditures were tightly controlled. Real growth in the GDP averaged 5.4% annually, led by a diversified export base and investments. National savings increased with a concurrent decline in consumption.
2. Since 1979, El Salvador's economy has seriously deteriorated. Largely as a result of internal and regional political tensions which began to escalate in 1977, lines of credit from foreign banks and creditors have been interrupted, agricultural production has declined and capital has fled the country. Additionally, El Salvador has found it increasingly difficult to receive payment for exports from Central American Common Market (CACM) countries, specifically Nicaragua and Costa Rica. Exacerbating these problems has been an erosion in export prices, principally coffee.
3. By 1980/81, the financial position of the government had seriously deteriorated. A decline in domestic economic activity resulted in a substantial reduction in revenues at the same time that expenditures increased for the military and agrarian reform programs. Government savings became negative and private savings became negligible, creating additional budget pressures. A steadily increasing proportion of public investment has been financed by domestic credit.
4. The balance of payments has likewise deteriorated between 1978 and 1981. Current account deficits have grown, but they are still considered

moderate.<sup>2/</sup> Foreign borrowing has also been kept at modest levels, with a debt service ratio consistently under 5%.

5. In July 1982, El Salvador entered into a one-year standby agreement with the International Monetary Fund (IMF) in an amount equivalent to approximately \$46.7 million. Targets for economic performance were established, including an improvement in the balance of payments, reduction in arrears on foreign debts and restraints on budget expenditures. Almost all targets under this agreement were achieved, and El Salvador and the IMF are currently negotiating a second longer term agreement which will include additional monetary assistance on concessionary terms and continuation of the economic policies established in 1982.

6. Based on past performance, El Salvador's long-term economic prospects are good, provided there is a stabilization of the political situation. The country's future creditworthiness will largely depend on increasing export production, continuing to implement prudent domestic fiscal policies and securing external assistance on concessionary terms.

#### IMPACT AND REPAYMENT OF HG FUNDS

The contemplated \$5 million supplemental assistance under the HG Program would only marginally increase El Salvador's total foreign debt and debt servicing requirements. At an interest rate of 12.5% with a long grace period on principal, a \$5 million loan would increase the country's debt servicing requirements by \$625,000 annually, or approximately 1.4% of El Salvador's servicing requirements in 1981. The \$5 million loan would only increase El Salvador's total debt burden by less than .5%, again based on 1981 year-end figures. It is anticipated that most aid inflows to El Salvador in the next few years will be on highly concessionary terms, and thus the country should easily be able to afford the HG Program's proposed assistance.

#### EXTERNAL DEBT

Through the 1960s and most of the 1970s, El Salvador enjoyed a healthy, growing economy with a diversified export base. The rate of national savings was high, meaning that most investments could largely be financed through savings rather than foreign borrowings. As a result, total external debt was kept at moderate levels and the debt service ratio was low, averaging just over 4% between 1972 and 1977.

In 1977/78, an escalation of political unrest and military activity in El Salvador and the Central American region, coinciding with a sharp deterioration in the terms of trade, resulted in sudden and severe pressures on the domestic economy and balance of payments. Between 1979 and 1981, large declines were experienced in the real output of all sectors of the economy. Overall, the GDP declined by approximately one-fifth, bringing it back to its 1974 level. Within this context, the balance of payments sharply deteriorated with accompanying increases in the current account deficits and losses in international reserves. Several factors explain the balance of payments situation: capital fled the country, lines of commercial and supplier credit

were interrupted, production of sugar and coffee declined, worldwide coffee prices fell and difficulties arose in collecting payments for exported goods from other Central American Common Market countries. The current account showed a deficit of -\$286 million in 1978, but rebounded to a positive \$34.6 million in 1979, showing some resilience to worsening economic conditions. In 1980, the account was essentially in equilibrium, but by 1981, the deficit again increased to -\$260 million. Nevertheless, this deficit which represented 7.3% of the GDP was still considered moderate under the circumstances.<sup>3/</sup>

A significant decline in agricultural export production which is the principal source of foreign earnings has largely contributed to El Salvador's balance of payments problems. Agricultural production through the 1960s and early 1970s grew at an annual rate of 9%, exceeding real growth in the GDP, with agricultural exports peaking in 1979. Coffee production led this export growth, with 1979/80 production increases averaging 60% over 1977/78 levels. By 1981, however, worldwide coffee prices fell approximately 18%, and production volumes of coffee and cotton also declined 16% and 45%, respectively. Volume declines were partly anticipated as a result of the government's agrarian reform programs which changed land tenure patterns and nationalized coffee and sugar production. Sabotage and guerilla warfare in parts of the country have also disrupted production.

Table 1 shows the balance of payment's trends for the period of 1976-1981:

Table 1

SELECTED BALANCE OF PAYMENTS INDICATORS

1976 - 1981

(\$US Millions)

<u>Date</u>	<u>Total Exports</u>	<u>Total Imports</u>	<u>Trade Balance</u>	<u>Net Current Account</u>
1976	871.1	862.8	8.3	20.6
1977	1,106.9	1,082.2	24.7	30.8
1978	945.1	1,221.9	-276.8	-286.0
1979	1,313.1	1,267.2	45.9	34.6
1980	1,218.4	1,185.8	32.6	- 2.5
1981	933.3	1,135.0	-231.2	-260.0

Source: Central Bank IMF Balance of Payments Yearbook;  
IBRD Debt Reporting System; World Bank Staff Estimates.

Other factors have also played a role in El Salvador's deteriorating external position. Manufactured goods, as a percentage of total merchandise exports, had grown from 8.8% in 1960 to 32.4% in 1978, but fell to 22.7% by 1981. The manufacturing sector's decline has been caused by capital flight from the country, lower levels of investment, and destruction of infrastructure by military conflict. El Salvador has also experienced payment difficulties with other Central American countries, especially Nicaragua and Costa Rica.

Deterioration in the terms of trade and rising domestic expenditures have forced El Salvador to rely more heavily on foreign debt. Between 1972 and 1981, the country's external debt increased from \$157 million to \$1.3 billion, or more than a six-fold increase. However, given that foreign borrowing had previously been kept at a minimum, this increased indebtedness is not overburdensome, as reflected in the debt service ratio which was only 4.8% in 1981. Table 2 shows the growth in El Salvador's external debt from 1972:

Table 2

EXTERNAL DEBT AND DEBT SERVICING

1972 - 1981

(\$US Millions)

<u>Date</u>	<u>Total Debt</u> <sup>a)</sup>	<u>Debt Servicing</u> <sup>b)</sup> <u>Requirements</u>	<u>Debt Service</u> <u>Ratio</u>
1972	157.0	10.4	3.1
1974	295.6	24.1	4.6
1976	450.6	36.3	4.0
1977	450.6	69.5	6.0
1978	646.7	29.9	2.8
1979	717.2	33.4	2.2
1980	925.6	41.3	3.5
1981	1,034.6	45.1	4.8

a) Includes disbursed and undisbursed.

b) Includes principal and interest payments.

Source: International Monetary Fund; Central Bank

Although El Salvador's external debt is not considered to be great, capital flight and loss of international reserves resulted in \$65 million in accumulated arrears on debt payments by year-end 1981. In an effort to halt the country's economic deterioration, El Salvador and the IMF entered into a one-year standby agreement in July 1982 which provided approximately \$46.7 million in assistance and established a program of economic reform with specified performance targets. The overall objectives of this program were to contain the decline in aggregate production and replenish the international reserve position of the Central Reserve Bank. Key elements of this program include restraints on governmental expenditures, tightening of domestic credit and formalization of a parallel exchange market. The parallel or dual exchange market effectively depreciates El Salvador's colone for purposes of encouraging exports, discouraging imports and controlling outflow of foreign currency.

Performance under the IMF agreement has been satisfactory, "despite a continuation of weak underlying conditions in the country."<sup>4/</sup> Most performance targets were achieved, which is particularly noteworthy since economic activity was weaker than initially projected. The only target not reached was a reduction in arrears, which had been programmed to be brought down by \$21 million, but were only reduced by \$5 million because of the non-renewal of short-term notes. Currently, El Salvador has debts totalling \$336 million with maturities of less than one year, but it is expected that approximately \$90 million will be converted to medium-term paybacks.<sup>5/</sup>

In 1982, debt service payments remained low, representing the equivalent of 1.4% of the GDP and 5.5% of exports. In the near future, additional aid inflows are expected to be on highly concessionary terms, and thus will not increase the debt service burden in a meaningful way.<sup>6/</sup>

#### ECONOMIC CONDITIONS AND TRENDS

From 1960 through 1978, El Salvador's economy was expanding. Real growth of the GDP averaged 5.4% annually; domestic savings increased from 12% to 20% of the GDP; and consumption decreased from 78% to 68% of the GDP. Capital investments were largely financed through domestic savings, and the level of investment grew faster than the GDP, representing 14% of the GDP in 1960-1962 and 23% of the GDP in 1976-1978. For the same periods, exports as a percentage of the GDP rose from 22% to 36%, respectively. Throughout this period, the El Salvadoran government prudently managed the economy, adjusting capital outlays to the availability of current savings, keeping overall deficits and borrowings low, and tightly controlling current expenditures.

Largely the result of internal political tension and the ensuing armed conflict, combined with a deterioration in the terms of trade, El Salvador's economy suffered a severe setback in 1979-1981. The GDP declined by 18%, back to its 1974 level and down from its 1978 peak; the level of investment declined 60%; exports fell by 17%. By 1981, investments and exports

represented 12.2% and 26.3% of the GDP, respectively. All sectors of the economy experienced significant declines.

The performance of the central government also deteriorated. Traditionally, budget deficits had been kept low, but rose to 7.4% of the GDP by 1981. Revenues had declined as a result of falling export prices and reduced economic activity, the latter accounting for a 15% decrease in tax revenues. At the same time, government expenditures were increasing, particularly for the military. Public savings became a negative-1.1%, and private savings were negligible.

In 1982, under an agreement with the IMF, El Salvador's government introduced reform measures to stabilize the economy and reverse the 1979-1981 deteriorating trends. Performance under this agreement has been generally satisfactory, and accordingly, El Salvador and the IMF are currently negotiating a longer, three-year agreement. In 1982, the serious deterioration of the balance of payments situation was arrested, and arrears on external debt were reduced by \$5 million. All sectors of the economy continued to decline, however, bringing the GDP to 25% below its 1978 peak. In turn, the central government's performance also did not improve, with total expenditures representing about 19.5% of the GDP, about the same level as 1981. The basic framework for improvement, however, has been put in place.

In 1983, El Salvador was expected to continue its 1982 policies. The agricultural and construction sectors are expected to grow, but these increases will be offset by further declines in manufacturing and services, resulting in virtually no growth in the GDP. A modest recovery in exports is projected, with increased sugar production and increased export volume to other Central American countries.

In the next few years, economic conditions are expected to be generally depressed. Until the political situation is stabilized, there will be little private sector confidence for investment, and thus the economy will not turn around. As the World Bank views it, "(P)olitical-military considerations may well dominate economic events in the near future. 7/

Leaving aside the political and military implications, El Salvador's future creditworthiness will depend primarily on increased export production, restrained domestic financial policies and availability of external assistance on concessionary terms. Past performance indicates a strong, diversified export base and potential; the government has introduced necessary financial management reforms; and El Salvador has been able to secure external assistance on concessionary terms. Thus, all the key elements are in place for economic recovery, especially in the medium- and long-term provided the political/military situation can be resolved.

FOOTNOTES

- 1/ This paper relies on data and information from; International Monetary Fund, "El Salvador: Consultation Under Stand-By Agreement," April 22, 1983; and World Bank Report No. 4054-ES, "El Salvador Updating Economic Memorandum," July 21, 1983.
- 2/ World Bank Report, p.9.
- 3/ Ibid.
- 4/ IMF paper, p.3.
- 5/ Ibid., p.20.
- 6/ Ibid.
- 7/ World Bank Report, p. iii.