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CHILE PRIVATE SECTOR COOPERATIVE  
HOUSING GUARANTEE PROGRAM  
INTERIM EVALUATION

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## LIST OF ACRONYMS

|                   |  |
|-------------------|--|
| <b>AFP</b>        | Sociedad Administradora de Fondos de Pensión   |
| <b>BCC</b>        | Banco Central de Chile   |
| <b>BDD</b>        | Banco del Desarrollo   |
| <b>BDE</b>        | Banco del Estado   |
| <b>BHIF</b>       | Banco Hipotecario Internacional Financiero   |
| <b>CHCCC</b>      | Corporación Habitacional de la Cámara Chilena de la Construcción   |
| <b>CONAVICOOP</b> | Cooperativa Abierta de Vivienda  |
| <b>COVIP</b>      | COVIP S.A., as well as its member associations:<br>CONAVICOOP, HABITACOOP, Corporación Habitacional and INVICA-PROVICOOP |
| <b>COVIP S.A.</b> | Corporación de la Vivienda Popular, S.A.   |
| <b>GOC</b>        | Government of Chile  |
| <b>HABITACOOP</b> | Cooperativa de Financiamiento, Construcción y Servicios Habitacionales de Vivienda                                       |
| <b>HG</b>         | Housing Guarantee  |
| <b>MVU</b>        | Ministerio de Vivienda y Urbanismo   |
| <b>NGO</b>        | Non-governmental organization  |
| <b>ODEPLAN</b>    | Oficina de Planificación Nacional  |
| <b>RHUDO/SA</b>   | USAID Regional Housing and Urban Development Office, South America   |
| <b>UF</b>         | Unidad de Fomento  |
| <b>USAID</b>      | United States Agency for International Development   |

## **DEFINITIONS**

### **UNIDAD DE FOMENTO:**

A monetary reference unit adjusted daily in accordance with the consumer price index.

### **OPEN HOUSING COOPERATIVES:**

Housing development cooperatives open to all comers who qualify.

### **MUTUARIAS:**

Newly authorized form of housing finance intermediaries akin to "mortgage bankers" in the U.S.

## EXECUTIVE SUMMARY

### A. Program Description

The "Chile Private Sector Cooperative Housing Guarantee Program," 513-HG-008, dated January 19, 1988 was designed to:

- demonstrate the capability of Chilean private, non-profit, democratic housing institutions and the private sector financial community in marshalling domestic capital resources to meet the demand for adequate housing affordable to low-income families in Chile;
- enable the participating housing institutions to expand their production of shelter affordable to families with below-median income levels; and
- strengthen the capacity of the participating institutions by developing Corporación de la Vivienda Popular, S.A. (COVIP S.A.) as the legal entity established to implement the Program on behalf of the participating institutions.

A US\$ 5 million 4-year Housing Guarantee (HG) loan was signed with Citibank New York and a complementary US\$250,000 local currency line was established with Citibank Santiago on July 6, 1988. Local institutional members of COVIP were to fund an additional US\$500,000. It was expected that the HG loan would finance some 2,000 housing units throughout Chile for families with incomes below the urban median --initially expressed as being of UF 10 (*Unidad de Fomento*<sup>1</sup>) per month-- over the initial four years of the HG authorization, and that reinvestment of reflows in the remaining term of the HG authorization could generate up to 4,000 additional units.

### B. Purpose of the Interim Evaluation

The primary purpose of the interim evaluation was to determine:

- if the Program is on schedule in achieving the goals originally set for it;
- if the US\$ 5 million HG loan and related resources are being used as planned;

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<sup>1</sup>

1 Unidad de Fomento = US\$18.

- if the borrowing entities are performing as expected;
- if the resulting housing units for low-income families are being produced and delivered in a timely fashion; and
- if the Program is likely to continue once AID funding stops.

The secondary purpose of the interim evaluation was to determine the relevance of any follow-on AID shelter sector development assistance, and to help formulate proper design elements of future programs.

The evaluation was conducted in Chile by Claude J.J. Bovet, Consultant and Eduardo Fuentes (RHUDO/SA) during January 1990. It involved a sample of on-site inspections, review of pertinent documentation and meetings with relevant GOC authorities and representatives of the private sector (See Annex B).

### **C. Findings and Conclusions**

The HG loan was disbursed by Citibank New York in its full amount of US\$ 5 million during July 1988, and COVIP reached full first-round disbursement by September 1989. To date US\$ 1.2 million have been repaid and re-utilized in second-round disbursements.

By the end of December 1989, the Program had financed 1,120 housing units, of which 822 had been completed for an average price of US\$5,904 (UF 328) per unit. The remaining units are in various stages of construction. These prices are affordable to median income families even without the available Government of Chile (GOC) subsidy. When the subsidy is considered, they are affordable to families earning as little as UF 6 (US\$108) per month.

These figures indicate that before its half-way mark, the Program will have produced approximately 67 percent of the total housing foreseen for the full Program period. Extrapolating from current results, it can be expected that 3,200 units may be produced by the end of the Program's four year duration; i.e. 60 percent in excess of the initial target.

Housing units completed by COVIP during 1989 were distributed between the Santiago metropolitan region and the rest of the country at a ratio of 90/10 with HG funds and 66/34 with overall funds. The preponderance of units in Santiago is explained by current legal restrictions on cooperatives to operate outside the region where they are domiciled, as well as by high demand for housing in the metropolitan region.

COVIP states that use of Program funds has allowed it to increase its housing production by approximately 15 percent and that, in general, the availability of Program funds has permitted housing cooperatives to initiate programs they could not otherwise have funded with commercial banking lines. Bank loans are not available for land purchases and their construction finance lines are extremely expensive.

Although very low income groups (i.e. those "extreme poverty" families earning below UF 5) normally fall exclusively within the purview of GOC action, it was found that at least one COVIP cooperative has managed to service very low income groups. In each of the last two years, PROVICOOP has more than doubled the number of "extreme poverty" families which it has serviced out of its total housing solutions: 4 percent in 1987, 9 percent in 1988, and 21 percent in 1989.

The management officials of COVIP's member associations were unanimous in declaring their satisfaction with COVIP's effectiveness as their representative in the Program, as well as its performance as their agent and group spokesman before GOC authorities. The management officials did not believe that COVIP should be transformed into a financial institution itself and, therefore, it has not been capitalized as such.

The currency swap arrangements with Chile's Central Bank are fundamental to the continued success of the Program. Use of the available local currency alternative with Citibank Santiago could, depending on market conditions at the time, result in higher interest costs.

None of the private sector financial institutions is active, nor has any intentions of becoming active, in originating mortgages for housing units of under UF 400 (US\$7,200). In effect, the two banks that do originate mortgages only serve markets of UF 700 (US\$12,600) and upwards, and the *Mutuarías*, the market of UF 2,000 (US\$36,000) and above. The Banco del Estado, acting as GOC's agent, is the only financial institution presently active in providing mortgages for housing with unit costs of up to UF 400 (US\$7,200) and, as such, it is the only channel for financing the mortgages originated by the HG-008 Program and most other programs of the housing cooperative movement.

The Chilean solution to its lower income housing needs relies to a great extent, on a system of direct subsidies which are granted to qualifying families in fixed amounts to cover an important portion (up to 75 percent) of their home purchase price. Contacts with incoming GOC officials confirmed a firm resolve to maintain the housing subsidy system in its current, basic form, with any eventual changes being oriented towards making it even more accessible to lower income families and utilizing it to promote innovative shelter solutions reaching out to the "extreme poverty" levels.

Chile's interest rate structure is based on market terms, with the Central Bank exerting a regulatory function. Interest rates applicable to the mortgage financing of houses produced by COVIP are definitely positive in real terms, in so far as UF values are adjusted daily for inflation.

#### **D. Recommendations**

Although the 513-HG-008 Program is fulfilling its objectives and achieving its quantitative goals ahead of schedule, certain measures can be recommended to reinforce and expand current Program operations, as well as to give substance to on-going policy dialogues with the government of Chile and its private sector institutions. These recommendations are incorporated within the following three suggested courses of action:

- A rollover or replacement at maturity (June 1992) of the existing US\$ 5 million borrowing, for the remaining six years of the HG-008 Program, to help improve upon and exceed the attainment of Program objectives;
- A supplementary US\$ 5 million HG loan to be contracted in 1990, for a ten year term, to consolidate the achievements of HG-008 and to expand its goals towards:
  - An increased targeting of beneficiaries at the lowest income and "extreme poverty" levels;
  - A more effective bias towards housing developments in regions beyond the Santiago metropolitan area;
  - The adoption of appropriate lower income shelter solutions, such as: sites and services, progressive construction, aided self- help, home improvement loans, etc.;
  - A major effort by COVIP to qualify other open housing cooperatives, whether currently existing or newly sponsored, to enable them to be included among COVIP's institutional membership, with the purpose of ensuring that the benefits of the Program reach out to the broadest possible constituency, both geographically and among social groups not being served currently; and
  - An increase in the social service follow-up role of COVIP's member cooperatives, whether directly or in coordination with other service-oriented cooperatives.

- A follow-on HG loan of between US\$10 and US\$15 million for a term of twenty or more years, to support Chilean government efforts to broaden the links between social housing needs and the availability of private sector investment funds through established financial mechanisms and intermediaries.

Although COVIP will be able to—and should—continue to play an important role in these expanded programs, their much larger reach and scope will obviously require the participation of broader based and more specialized institutions. In this regard, in order to spread the influence and benefits of the proposed program over the widest possible range of beneficiaries and institutions in the lower income housing finance field, the choice of a local counterpart in this case should not be restricted to a single participant. Rather, it should attempt to draw from all areas and institutions concerned. To this end, the establishment of a non-profit foundation to promote the conditions for optimal program development, and to serve as a distribution channel for program funds is recommended.

The follow-on loan should provide opportunities to secure appropriate GOC interventions in the following areas:

- Legislating a payroll deduction scheme (similar to that existing for pension fund contributions): to ensure both a prompt collection of lower income loans and achieve a considerable reduction in servicing costs; thus overcoming a mortgage lender's traditional (and understandable) reluctance to write small denomination loans;
- Legislating a credit insurance scheme (in an amplification of the existing mortgage insurance coverage): to guarantee the timely and uninterrupted payment of principal and interest quotas on low-income mortgage instruments; thus effectively enticing institutional and other investors to build up substantial portfolios of these securities;
- Establishing the conditions for promoting institutional support of an active secondary mortgage market: to provide prompt, easy and inexpensive negotiability, as well as in-depth liquidity to low-income mortgage instruments, thus providing the housing production industry with refinancing alternatives in local capital markets;
- Encouraging and supporting initiatives to promote a broad range of home improvement, progressive construction and aided self-help loans in low cost housing programs, to make home financing fully available to the lowest income sectors; and

- Establishing full-costing for its Basic Housing Program (to include land, marketing and financing costs at market rates) to remove constraints currently impeding the private sector from participating in the production of housing solutions for the very low income groups. Therefore, the private sector will be encouraged to increase its participation in this housing sector and the public sector will be allowed to withdraw gradually from an active into a facilitator role.

The HG-008 Program has clearly demonstrated the merits of a Central Bank currency swap as a means --barring the more traditional sovereign country guarantees-- of protecting local borrowers from the exchange and convertability risks attached to foreign currency borrowings used to finance local currency investments. It has also highlighted the limitations of this approach when the swaps are necessarily for shorter periods than the intended use of the foreign currency. A major feature of future HG programs in Chile should be to encourage the Central Bank to enter into longer-term swap arrangements under the special HG circumstances.

## I. BACKGROUND

The "Chile Private Sector Cooperative Housing Guarantee Program" was conceived to support independent, democratic private sector cooperatives and to serve the needs of low income families. It embodied a specific foreign policy objective discussed with and supported by the U.S. Congress based upon the determination that:

- private sector cooperatives play important roles in keeping alive the spirit and practice of democracy in Chile; and
- the United States government wants to support democratic processes in Chile by establishing a foreign assistance presence.

The Program was designed to:

- demonstrate the capability of Chilean private, non-profit, democratic housing institutions and the private sector financial community in marshalling domestic capital resources to meet the demand for adequate housing affordable to low-income families;
- enable the participating housing institutions to expand their production of shelter affordable to families with below-median income levels; and
- strengthen the capacity of the participating institutions by developing COVIP S.A. as the legal entity established to implement the Program on their behalf.

Funding for the Program was to be provided by:

- a US\$5 Million HG loan;
- a local currency bank line of credit equal to US\$250,000; and
- resources provided by the borrowers specifically for the Program in the local currency equivalent of US\$500,000.

It was expected that during the initial four years of the HG authorization, the HG loan would finance some 2,000 units of housing for families with incomes below the urban median, and that reinvestment of reflows in the remaining term of the HG authorization could generate financing for up to 4,000 additional units.

The Program is being carried out under an Implementation Agreement dated January 19, 1988 and a Custody and Financing Agreement entered into with Citibank in Chile on July 6, 1988. The latter includes innovative features designed to protect the borrowers from the foreign exchange risks attached to their dollar borrowings. It permits the borrowers to enter into appropriate currency swap arrangements with Chile's Central Bank and, as an alternative, to replace their dollar borrowings with a local *Unidad de Fomento* (UF) currency line of credit.

The Program operates in the context of extensive housing subsidies provided by the Government of Chile. The World Bank considers the Chilean system to be a model for the management and provision of housing subsidies because:

- They are provided directly to each family.
- The total cost of the subsidy is identified up front and is fully funded each year as a specific line item in the national budget.
- All other costs are recovered in the sales prices. Loan financing is at real, unsubsidized rates.
- Non-governmental organizations (such as the cooperatives), private construction firms, and private banks can and do participate extensively.

There are four "open" cooperatives participating in the Program. They have a fifteen-year track record of successful development of housing projects, including a \$55 million HG-financed program in the mid-seventies.

The Program is being implemented following the established procedures of these cooperatives, which include:

- Any person needing a house can become a member of the cooperative (hence the term "open" cooperative).
- The coop members join a savings plan, which will help them in the purchase of an affordable house.
- The cooperatives invest a large share of the members' savings in the purchase of land as sites for future development of housing projects for their membership.
- The cooperatives also assist their members to qualify for a housing subsidy from the Government of Chile. Approval of the subsidy also includes assurance of a long-term loan to finance the portion of the house price not covered by the accumulated savings and the subsidy.

- Once a group of members have been notified that they are qualified to receive the subsidy, effectively providing 100% assured pre-sales of all units, the cooperatives seek bids for the construction of the houses from private firms and secure construction financing from private commercial banks. In the case of this Program, Citibank Santiago is managing the construction financing, using HG loan funds held in escrow in that bank.
- Once the houses are completed, the cooperatives help the members to complete all of the paperwork to formalize both the government subsidy and a long-term mortgage loan. The cooperatives, which are completely self-financing and unsubsidized, include full payment for their services in the sales price of the houses.
- Ownership of the houses is individual, not cooperative. The cooperatives have no role in the management of the housing project nor do they participate in the administration or in the risk of the mortgage loan portfolio.

## II. PRINCIPAL FINDINGS

### A. Results to date

The Foreign Loan was disbursed by Citibank New York in its full amount of US\$5 million during July, 1988 for credit to the Escrow Account held by Citibank, Santiago. Funds were drawn down from this custody account by COVIP in accordance with work-in-progress requirements, reaching full first-round disbursement by September, 1989. To date, US\$1.2 million has been repaid into the custody account and re-utilized in second-round disbursements.

By December 31, 1989, Foreign Loan proceeds of US\$5 million had been fully disbursed. Additionally, interest earned by the Escrow Account (US\$243,000) and repayments into it (US\$1.2 million), allowed for further disbursements in the amount of US\$885,000. Balance in the Escrow Account at year end was US\$536,000.

The following table is a breakdown of the origin and use of funds. It is based on reports from COVIP and Citibank for periods ending June, September and December 1989:

|                                     | <u>6/30/89</u><br>(US\$ 000) | <u>9/30/89</u><br>(US\$ 000) | <u>12/31/89</u><br>(US\$ 000) |
|-------------------------------------|------------------------------|------------------------------|-------------------------------|
| <b>Use of Funds</b>                 |                              |                              |                               |
| Land acquisitions                   | 381                          | 213                          | 644                           |
| Construction                        | 3,204                        | 3,941                        | 4,179                         |
| Financial costs                     | 451                          | 769                          | 770                           |
| Interim loans (*)                   | <u>0</u>                     | <u>276</u>                   | <u>292</u>                    |
| <br>Total draws from Escrow         | <br>4,036                    | <br>5,199                    | <br>5,885                     |
| <br><b>Origin of Funds</b>          |                              |                              |                               |
| Total draws from Escrow             | 4,036                        | 5,199                        | 5,885                         |
| Refunds to Escrow                   | <u>527</u>                   | <u>573</u>                   | <u>1,178</u>                  |
| <br>Net draws from Escrow           | <br>3,509                    | <br>4,626                    | <br>4,707                     |
| <br><b>Net Draws by Institution</b> |                              |                              |                               |
| CONAVICOOP                          | 537                          | 841                          | 1,005                         |
| HABITACOOP                          | 775                          | 1,043                        | 1,236                         |
| Corporación Habitacional            | 712                          | 877                          | 886                           |
| INVICA-PROVICOOP                    | <u>1,485</u>                 | <u>1,865</u>                 | <u>1,580</u>                  |
|                                     | 3,509                        | 4,626                        | 4,707                         |

(\*) Included in Land Acquisitions and Construction this period.

Program funds have generated the following housing activity by December 31, 1989:

|                          | <u>Units Under Construction</u> | <u>Units Sold</u> | <u>Sales (\$000)</u> |
|--------------------------|---------------------------------|-------------------|----------------------|
| CONAVICOOP               | 178                             | 0                 | 0                    |
| HABITACOOP               | 126                             | 262               | 1,396                |
| Corporación Habitacional | 42                              | 112               | 679                  |
| INVICA-PROVICOOP         | <u>130</u>                      | <u>270</u>        | <u>1,730</u>         |
| Total                    | 476                             | 644               | 3,805                |

A comparison of housing units generated from Program funds with total production from all sources during 1989, follows:

|                        | <u>Units Initiated</u> |              | <u>Units Completed</u> |              |
|------------------------|------------------------|--------------|------------------------|--------------|
|                        | <u>AID</u>             | <u>Total</u> | <u>AID</u>             | <u>Total</u> |
| CONAVICOOP             | 178                    | 948          | 178                    | 178          |
| HABITACOOP             | 126                    | 438          | 262                    | 1,472        |
| Corp. Habitacional (*) | 42                     | 216          | 112                    | 319          |
| INVICA-PROVICOOP       | <u>130</u>             | <u>806</u>   | <u>270</u>             | <u>1,774</u> |
| Total                  | 1,056                  | 2,408        | 822                    | 3,743        |

(\*) Corporación Habitacional also participates in GOC sponsored low cost housing programs. Under these, it initiated 1,218 units (Programa Extraordinario) and 328 (Asesorías) during 1989.

The housing solutions produced include a full gamut of single detached units, townhouses and row houses; with individual units ranging between 36 and 46 square meters of living space. Bricks and concrete are broadly used, as is wood in its traditional areas.

## B. Projections

Initial projections anticipated that Program funds would finance, over a four year period, a minimum production of 2,000 units throughout Chile for families with incomes below the urban median; and that the investment of Program reflows over the remaining term of the HG authorization (another six years) could generate up to 4,000 additional units.

By September 1989, COVIP had completed the first-round investment of the US\$5 million loan proceeds. By the end of December 1989, the Program had financed 1,120 units, of which 822 had been completed for an average price of US\$5,904 (UF 328) and the remainder is in various stages of construction. COVIP's latest quarterly projections expect that it will have financed 1,330 units by the end of March 1990, of which 952 will have been sold.

These figures indicate that before its half way mark, the Program will have produced approximately 67 percent of the total housing foreseen for the full Program period. Extrapolating from current results, it can be expected that 3,200 units may be produced by the end of the Program's four year duration, i.e. 60 percent in excess of the initial target. And even this could be exceeded if it is considered that the first five months of the Program were necessarily expended in land acquisition and development project preparation.

### C. Fulfillment of Program Objectives

#### 1. Affordability

The Program requires that the projected housing production be affordable to families with incomes below the urban median. This median is currently set by the Implementation Agreement at UF 10 (US\$180) per month. Thus, the values of homes affordable to families earning the stated urban median and below, with and without subsidy, are as follows:

|                          |      |              |              |              |
|--------------------------|------|--------------|--------------|--------------|
| MONTHLY INCOME *         | UFs  | 5            | 7.5          | 10           |
| (US\$ Equivalent)        | US\$ | 90           | 134          | 180          |
| 25% payment limit        | US\$ | 23           | 33           | 45           |
| Max loan @ 8% 20yrs      | US\$ | 2,690        | 4,000        | 5,380        |
| Required savings 1/8     | US\$ | <u>336</u>   | <u>500</u>   | <u>673</u>   |
| Affordable w/out subsidy | US\$ | 3,026        | 4,500        | 6,053        |
| Subsidy (estimated)      | US\$ | <u>2,700</u> | <u>2,700</u> | <u>2,340</u> |
| Affordable with subsidy  | US\$ | 5,726        | 7,200        | 8,393        |

(\*) One *Unidad de Fomento* (UF) = US\$ 18

Average sales prices for the units completed in 1989 under the Program were:

|                   | <u>Units</u> | <u>UFs</u> | <u>US\$</u>  |
|-------------------|--------------|------------|--------------|
| CONAVICOOP        | 178          | 326        | 5,867        |
| HABITACOOP        | 262          | 296        | 5,328        |
| CORP.HABITACIONAL | 112          | 337        | 6,058        |
| INVICA-PROVICOOP  | <u>270</u>   | <u>356</u> | <u>6,411</u> |
| Total             | 822          | 328        | 5,904        |

These average prices, as can be seen from the preceding two tables, are affordable to median income families even without the available GOC subsidy. When the subsidy is considered, they are affordable to families earning as little as UF 6 (US\$108) per month. Average prices of units initiated with Program funds (as opposed to those completed) during 1989 have been on the rise -- mainly because labor costs have increased at a faster pace than the adjustment of the UF. The following table compares average prices of units in UFs and US\$:

|                   | <u>UFs</u> | <u>US\$</u> |
|-------------------|------------|-------------|
| CONAVICOOP        | 348        | 6,264       |
| HABITACOOP        | 400        | 7,200       |
| CORP.HABITACIONAL | 350        | 6,300       |
| INVICA-PROVICOOP  | 385        | 6,930       |

Statistical information on the actual income levels of Program beneficiaries was not generally available. However, in the projects visited, average monthly incomes were determined to be:

| <u>LOCATION</u> | <u>PROJECT NAME</u> | <u># UNITS</u> | <u>INCOME</u> |
|-----------------|---------------------|----------------|---------------|
| Santiago        | Pucará              | 131            | UF 7.53       |
| Santiago        | Madrid Osorio       | 127            | UF 5.88       |
| San Antonio     | Mirador Pacífico    | 68             | UF 8.14       |

It is evident that COVIP has made great strides in lowering the price level of the units it produces. The current range includes a low of UF 265 (US\$4,770) and a high of UF 380 (US\$6,840) per unit, although it must be pointed out that the low of UF 265 is not really representative, as it relates to a 196 unit emergency

housing project developed by HABITACOOOP (Madrid-Osorio) for victims of the 1986 earthquake. At that time, each unit was assigned to two families, with the understanding that eventually one of the two families would be relocated. HABITACOOOP funded the conversion back to single-family units and the relocation of the second family under the HG program. The sales prices of these units is not comparable to that of other houses funded under the HG program because about \$1,000 of the cost was paid by U.S. earthquake relief assistance provided in 1986.

In general, both the individual COVIP associations and most builders involved in the Program believe that further price reductions to below UF 280 (US\$5,040) will be very difficult to achieve in the case of the typical, fully finished houses currently being produced.

Undoubtedly, a further reduction in price levels will require the adoption of different shelter solutions. Before non-governmental organizations, such as the cooperatives, and other private sector entities can participate in building and financing houses costing less than UF 280, government housing in this price range must be put on the market at full cost. Although government basic housing units are sold for UF 200, their real cost is closer to UF 280. The government does not charge market prices for land, market rates for construction financing and does not recover all its administrative costs. Suggestions on how to address this issue are included later in this report.

## 2. Geographic Distribution

Housing units completed by COVIP--with AID Program funds and overall funding--during 1989 were distributed as follows between the Santiago metropolitan region and the rest of the country:

|                   | <u>Metropolitan</u> |              | <u>Other Regs.</u> |              | <u>Country</u> |              |
|-------------------|---------------------|--------------|--------------------|--------------|----------------|--------------|
|                   | <u>AID</u>          | <u>Total</u> | <u>AID</u>         | <u>Total</u> | <u>AID</u>     | <u>Total</u> |
| CONAVICOOP        | 178                 | 178          | 0                  | 0            | 178            | 178          |
| HABITACOOOP       | 192                 | 399          | 70                 | 1073         | 262            | 1472         |
| CORP.HABITACIONAL | 98                  | 110          | 14                 | 219          | 112            | 329          |
| INVICA-PROVICOOP  | <u>270</u>          | <u>1774</u>  | <u>0</u>           | <u>0</u>     | <u>270</u>     | <u>1774</u>  |
| Total             | 738                 | 2461         | 84                 | 1292         | 822            | 3753         |
| Percentages       | 90                  |              | 10                 |              | 100            |              |
| "                 |                     | 66           |                    | 34           |                | 100          |

The high incidence of Program and overall funds invested in the Santiago region has a number of explanations. On the one hand is the heavy (39 percent) concentration of the country's population in this growing metropolitan area. On the other hand are the operating constraints imposed by current legislation on COVIP cooperatives.

Housing cooperatives are not allowed to develop projects outside the region where they are domiciled. The two COVIP members with operations beyond their Santiago domicile are able to do so because of special circumstances pertinent to them. HABITACOOP benefits from a grandfather clause allowing it to operate on a nationwide basis. CHCCC is not a cooperative and, therefore, is unaffected by the restriction.

COVIP has been lobbying for a change in the law, which it expects will be forthcoming, to enable all member associations to expand their operations to other metropolitan areas. Both CONAVICOOP and INVICA-PROVICOOP reportedly are eager to do so.

### **3. System Development**

COVIP states that use of Program funds has allowed it to increase its housing production by approximately 15 percent, although detailed statistical evidence of this is not yet available.

In general, the availability of Program funds has permitted housing cooperatives to initiate programs they could not otherwise have undertaken. First, the cooperatives gain an advantage in cost and in ease of programming project development by purchasing large tracts of land in advance. Members' savings are insufficient and commercial bank loans are not readily available for advanced purchase of land. Second, the cooperatives, while successful in securing commercial bank loans for construction, have operated at less than full capacity because of the limits on the total volume of construction loans established by the banks. The HG has helped the cooperatives by financing the advanced purchase of land and by increasing the volume of construction financing available for their housing projects.

Unfortunately, these particular constraints are not expected to disappear any time soon and, therefore, the availability of HG financing continues to be critical for the cooperatives to be able to initiate new developments involving land purchases and to ensure affordability of the finished product by the lower income groups.

Regarding the desired shift in the mix of units towards ever decreasing average costs -- designed to address the needs of lower income groups-- COVIP is not yet able to document its contention that this is being effectively achieved. Nonetheless, reports submitted to AID show that such a lowering has already been attained within the Program itself and that all units produced by it are affordable to the target population.

Another aspect queried was the extent to which the system was reaching the very low income, "extreme poverty" groups; i.e. those families earning below UF 5. Although this sector is normally reputed to fall exclusively within the purview of GOC action, it was found that at least one COVIP cooperative has managed to service very low income groups. PROVICOOP has more than doubled in each of the last two years the number of "extreme poverty" families which it has serviced, as follows:

|      |     |                            |
|------|-----|----------------------------|
| 1987 | 4%  | of total housing solutions |
| 1988 | 9%  | " "                        |
| 1989 | 21% | " "                        |

PROVICOOP is the creature of INVICA, a twenty-five year old private foundation with a strong tradition of focusing on the housing needs of very low income families. INVICA/PROVICOOP compensates for the lower incomes of their members by extending the period during which the members save toward the purchase of a house. Whereas, the savings period in the other coops can be twelve months or less, for members of PROVICOOP it averages 18 to 24 months. The additional down payment allows the poorer members to buy a house within the UF 280 to UF 400 price range.

### III. ISSUES TO BE CONSIDERED

#### A. Corporación de la Vivienda Popular (COVIP)

COVIP S.A. was constituted in 1987, on the basis of a previous association set up in 1983, to act as a service organization for the various associations participating in the Program. COVIP's shareholders and their respective percent of ownership are as follows:

- Cooperativa Abierta de Vivienda (CONAVICOOP), 20 percent;
- Cooperativa de Financiamiento, Construcción y Servicios Habitacionales de Vivienda (HABITACOOOP), 26 percent;
- Corporación Habitacional, 22 percent;
- INVICA, 16 percent; and
- PROVICOOP, 16 percent.

The management officials of COVIP's member associations were unanimous in declaring their satisfaction with COVIP's effectiveness as their representative in the Program, as well as with its performance as their agent and group spokesman before GOC authorities.

In the initial discussions leading to the HG authorization it was anticipated that COVIP, on the basis of eventual Chilean debt-equity swaps, could be capitalized by its shareholders at around US\$500,000. This idea did not prosper because the availability of appropriate equity swaps did not materialize, and thus, the capitalization option was not included in the Program structure.

The subject of a possible capitalization was once again investigated. However, the generalized opinion of COVIP's shareholders was that this capitalization is not immediately warranted, inasmuch as they do not believe that COVIP should itself become a financial institution. It was mentioned that, if the creation of such an institution should eventually become necessary, COVIP's member associations could then study their collective participation in it through COVIP.

Another issue explored with COVIP's Board of Directors was the possibility of encouraging other open housing cooperatives to join COVIP. It was determined that there are 22 such cooperatives in the country, although not all are active or even solvent. The Board agreed to study the matter in the future with the objective to help organize the more promising cooperatives to where they would qualify for incorporation into COVIP.

## B. Currency Swap

COVIP, through the intermediation of Citibank, entered into a currency swap contract on July 8, 1988 with the Central Bank of Chile in the amount of US\$5 million. The local currency obtained is being used for HG Program purposes in local fundings expressed in *Unidades de Fomento* (UF). The swap contract covers only the principal of the HG borrowing and does not extend to the interest and other payments involved.

The swap contract runs for 720 days and gives COVIP the right to repurchase its dollars on June 28, 1990. The sales price was set at P246.61 per US dollar and the repurchase at a rate of exchange equal to P243.97, adjusted to reflect the intervening variation in the value of the UF and diminished by a percentage representative of the external rate of inflation as estimated by the Central Bank.

These US dollar swap arrangements were established by the Central Bank in 1982 and made available to financial institutions on a general basis for terms up to a maximum of 720 days. COVIP could not, therefore, use it to cover its exchange risk over the full four year term of the HG loan, leading COVIP to rely on an eventual renewal of the swap, or on the alternative conversion of the loan into a local UF currency borrowing. Other than for this term limitation, however, the arrangement has worked well for COVIP as foreseen in the original plan design.

The continued availability of currency swaps at the Central Bank in their current --or any-- form should never be taken as absolutely granted, even less so in times such as the present, when both the bank and the GOC are undergoing changes.

Certain banking sources expect that the Central Bank may well decide that the need for these swaps in its own portfolio has been overcome, and that currency hedges should, in the future, be left entirely to the commercial banking sector. This would effectively bar COVIP from any future use of these mechanisms, given their high cost, short-term, and non-assurance of renewability. Furthermore, if the swap can not be renewed at its maturity on June 28, 1990, COVIP would then face the difficult choice of deciding between converting the HG loan into its local currency equivalent --for a substantial increase in servicing costs-- or closing down the Program. Fortunately, however, after meeting with Central Bank staff, it is believed that the required renewal will be available as needed for an additional two year term.

Regarding future HG borrowings, it is possible that the Central Bank could consider the needs and opportunities of the "social" housing sector as a special case and that it could contemplate entering into long-term currency swaps with this sector, regardless of the Central Bank's normal attitude toward ordinary

commercial swaps. In this regard, it is encouraging to note that a positive echo to these concerns has been found among incoming authorities at ministerial and Central Bank levels. A case is made later in this report for the establishment of such a long-term swap.

### C. Private Financial Sector

Chile's financial sector is characterized by having eliminated the existence of financial institutions devoted exclusively to the provision of mortgage financing. The savings and loan system was effectively dismantled and the specialized mortgage banks were encouraged to become multi-purpose banks.

Of existing banks, only two are still actively providing home mortgage loans: Banco del Desarrollo and Banco Hipotecario Internacional Financiero (BHIF). On the other hand, there are a few recently created *Sociedades Administradoras de Mutuo Hipotecario (Mutuarias)*, akin to a United States mortgage bank, beginning to become active in the field.

These institutions all rely on eventually selling off their mortgages to longer-term institutional investors, which presently consist primarily of pension funds and insurance companies. This is done through the creation by the banks of marketable *Letras Hipotecarias*, which are then sold through the Stock Exchange on a full-recourse basis. The *Mutuarias*, by contrast, refinance themselves through the outright non-recourse sale of their mortgages.

However, none of these existing institutions are active, nor have any intention of becoming active, in originating mortgages for housing units of under UF 400 (US\$7,200). In effect, the two banks are more oriented to serving markets of UF 700 (US\$12,600) and above, and the *Mutuarias* of UF 2,000 (US\$36,000) and above.

A proposal for utilizing the *Mutuaria* vehicle and the *Letras Hipotecarias* mechanism on behalf of lower income groups is included later in this report.

### D. Banco del Estado

The Banco del Estado is the only financial institution presently active in providing mortgages for housing with unit costs of up to UF 400 (US\$7,200). As such, it is also the only channel for financing the mortgages originated by the HG-008 Program and most other programs of the housing cooperative movement.

In these cases, the Banco del Estado acts as a mere agent of the Ministry of Housing, its role being limited to the creation of *Letras Hipotecarias* representative of the loans granted. These *Letras* are then sold in the Stock Exchange to individual and institutional investors (AFPs currently hold 75 percent

of outstanding *Letras*). The Bank itself is compensated by the GOC for any discount required to sell the *Letras*. This is referred to as the "implicit" subsidy.

Although there has been some past consideration of privatizing the Banco del Estado, this is no longer believed to be probable. In any event, it is reported that the proposed privatization would only have entailed transferring ownership to employees and accountholders.

## **E. Housing Subsidies**

### **1. Current Situation**

Housing production for lower income groups in Chile relies upon three distinct support systems, all of which provide direct subsidies of acquisition costs:

- **Basic Housing Program (Programa de Vivienda Básica):** This program is carried out by the Ministry of Housing on the basis of tenders to private sector builders. It is designed to finance shelter solutions not exceeding UF 200 (US\$3,600) per unit in cases of slum eradication, metropolitan decongestion and assistance to "allegados" (families doubling up). The direct subsidy in these cases represents 75 percent of the purchase price, with a maximum of UF 150 (US\$2,700).
- **Extraordinary Programs (Programas Extraordinarios):** These programs arise under extraordinary situations, such as natural disasters, settlement of new areas, development of growth poles, etc. They are carried out by the Ministry of Housing in the same way as its basic housing program, except that these could, in justifiable cases, exceed the UF 200 limit.
- **Housing Subsidy System (Sistema de Subsidio Habitacional):** This system includes subsidy programs for rural housing and colonization developments, as well as the General Unified Housing Subsidy System (Sistema General Unificado de Subsidio Habitacional). This latter system is the one applicable to the Program.

In addition, as mentioned earlier in this report, basic housing solutions built by the government also benefit from hidden subsidies in the cost of land and in the marketing and construction financing costs.

The Housing Subsidy System replaced in 1988 the two original subsidy programs (the "Traditional" and the "Savings and Finance" systems) established in 1976 for middle income groups.

Chile developed the Housing Subsidy System on the dual premise that:

- low income families normally cannot acquire their homes without some form of financial assistance; and
- any subsidies granted would have to be quantifiable, transparent, socially fair, and attuned to financial market realities. This led Chile to discard the hidden subsidy systems traditionally deployed in most countries where housing finance is strongly subsidized by below market interest rates and other distorted pricing mechanisms.

The subsidy program for 1989 forecasted the production of 78,600 units, with 77,000 already having been achieved. The cost of the subsidy was estimated at UF 9.5 million (US\$172 million) according to the following breakdown, representing somewhat less than 1% of the UF 1.2 billion Internal Gross Product (PIB) for 1989:

| <u>PROGRAMS</u> | <u>UNITS</u>  | <u>UF00</u>  | <u>US\$000</u> | <u>PIB%</u> |
|-----------------|---------------|--------------|----------------|-------------|
| Basic Housing   | 24,650        | 3,698        | 66,555         | 0.03        |
| Extraordinary   | 20,400        | 1,224        | 22,032         | 0.10        |
| Rural           | 6,550         | 852          | 15,327         | 0.30        |
| Unified         | <u>27,000</u> | <u>3,780</u> | <u>68,040</u>  | <u>0.30</u> |
| Total           | 78,600        | 9,554        | 171,954        | 0.77        |

Under the Chilean system, subsidies are granted to qualifying families in fixed amounts to cover an important part (up to 75 percent) of their home purchase price. The subsidies are referred to unit costs exclusively and there is no income-cap requirement to qualify, except in the case of housing units of up to UF 400 (US\$7,200), where an income-cap of UF 15 (US\$270) per month is imposed.

In the case of the Unified System, subsidies are granted on a merit point basis, where the amount and length of savings applied to the purchase price are important considerations.

The range of housing benefiting from the Unified System is as follows:

| <u>Price of the units</u> | <u>Max. Subsidy</u> |
|---------------------------|---------------------|
| Up to UF 400              | UF 150              |
| From UF 400 to UF 900     | UF 130              |
| From UF 900 to UF 2,000   | UF 110              |

Subsidies are normally offered through three yearly tenders, in which the bulk of available resources is concentrated in the under UF 400 range and only a very minor part is destined to the top of the range. As an example, the last tender for UF1.3 million (US\$23 million) in November 1989, allocated 75 percent (US\$17.2 million) to the lower level, 19 percent (US \$4.3 million) to the middle level, and 6 percent (US \$1.5 million) to the upper level. No distinction is made between beneficiaries in Santiago and other regions. The subsidy made available for each level is distributed in proportion to applications received.

A sample of beneficiaries visited in projects in the Santiago metropolitan region and in the San Antonio port area, seemed to confirm that the subsidy program was in effect reaching the intended below-median income population. Detailed statistical information on beneficiary income levels was not made available at this time, emphasis being placed on the "affordability" of the units being produced. It is expected that such income data will be available in the near future.

## **2. Future Prospects**

Contacts with incoming GOC officials confirmed a firm resolve to maintain the housing subsidy system in its current, basic form. Any changes would probably be oriented towards making it even more accessible to lower income families; and in utilizing it to promote innovative shelter solutions reaching out to the "extreme poverty" levels. One possible new feature mentioned was the development of "sites and services" solutions, the costs of which would constitute the direct subsidy element granted under the Basic Housing Program. Another, was making the subsidy system extensive for home improvement and urban renewal purposes. Another aspect of this approach would be to provide solutions to those families currently doubling up under one roof (*Allegados*).

The GOC officials also expressed their satisfaction with the present system's features which allow an important degree of private sector participation. If anything, they would expect to reinforce this involvement so that the private sector could become more active in the lower income and "extreme poverty" levels.

The World Bank's recent US\$ 200 million loan for social housing is seen as another element reinforcing the continuation of GOC shelter policies and, specifically, its subsidy program.

## **F. Interest Rates**

Chile's interest rate structure is based on market terms, with the Central Bank exerting a regulatory function. Where favorable conditions are desired for certain borrower groups, such as in the housing sector, the GOC provides these through direct and mostly transparent subsidies to users.

COVIP itself does not lend money. In regards to financial costs during the construction period, COVIP merely passes on the rates borne by its own borrowings which are on average somewhat lower than current market rates. Although this implies a cost advantage in the pricing of COVIP's houses, it does not, in any event, result in financial losses to COVIP.

Interest rates applicable to the mortgage financing of houses produced by COVIP are definitely positive in real terms, in so far as inflation is covered by the daily adjustment of UF values. These interest rates currently stand at 8% per annum, which is below market rates of 14% to 16% on comparable loans.

An 8% rate, in addition to the daily adjustment for inflation in the UF is comparable to a 12% mortgage lending rate in the U.S., if inflation remained at 4%. This real, below-market rate is justified by COVIP's social purpose.

#### **IV. RECOMMENDATIONS**

As described under Findings and Conclusions, the 513-HG-008 Program is fulfilling its objectives and achieving its quantitative goals ahead of schedule. Nonetheless, certain measures can be recommended to reinforce and expand current Program operations, as well as to give substance to on-going policy dialogues with the government of Chile and its private sector institutions, designed to bring the benefits of adequate housing production and finance to the very lowest of income levels on a country-wide basis.

These recommendations are incorporated within the following three suggested courses of action:

- A rollover or replacement at maturity (June 1992) of the existing US\$5 million borrowing for the remaining six years of the HG-008 Program.
- A supplementary US\$5 million HG loan to be contracted in 1990 for a ten year term, to consolidate the achievements of HG-008 and to extend their impact over a wider range of lower income beneficiaries nation-wide.
- A follow-on HG loan of between US\$10 and US\$15 million for a term of twenty or more years, to support Chilean government efforts to broaden the links between social housing needs and the availability of private sector investment funds through established financial mechanisms and intermediaries.

##### **A. Current and Rollover HG - US\$5 Million**

An extension of the current (4 year) borrowings up to the full (10 year) term of the HG authorization would help improve upon and exceed the attainment of Program objectives.

Continued access to a Central Bank swap facility is crucial for Program viability. As determined in meetings with Central Bank officials, the renewal of the existing swap for another two years on June 28, 1990 seems assured. However, COVIP should still cover itself against any possible future obstacle to such renewal, preparing appropriate actions to avoid or transfer the eventual higher costs of a local currency borrowing alternative.

The use by COVIP of the US\$ 500,000 that the Implementation Agreement allows to be drawn down on the basis of institutional (non-mortgage) guarantees is, by mutual agreement, presently being limited to only the most essential needs. In particular, it will no longer be used to purchase land where a mortgageable title is not readily available. Also, the practice of certain cooperatives of making unsecured loans to their members out of Program funds is being discontinued.

Negotiations between COVIP and RHUDO/SA concerning proper and prudent usage of the Citibank US\$ 250,000 line of credit are on-going. These should give COVIP the necessary flexibility for drawing against this facility, but without in any way impairing its full availability for the main purpose of ensuring sufficient and timely funds to meet periodic financial payments to lenders in the HG Program.

Another area of concern to COVIP is the opportunity for including financial costs as elements increasing the stated value of the guarantees pledged to AID. These consist basically of the interest and commissions payable to US lenders and are a substantial draw on Program resources. These are believed to be proper construction costs and that, as such, they could be included proportionally with each physical input of construction. Nonetheless, COVIP has proposed to accumulate these for inclusion at the time each house is finished, to which there is no objection.

Citibank has revised and expanded its reports on the Escrow Account and COVIP is supplementing these reports to the extent required to reflect the use of HG funds. However, it was requested that COVIP expand further the reports to show results of the full Program, including the use of COVIP's own US\$500,000, and any utilization of Citibank's local currency or other credit lines.

These reforms, and those mentioned in the following section, should be formally incorporated in the rollover or replacement agreement, extending to ten years available borrowings under HG-008.

#### **B. Supplementary HG - US\$5 Million**

This new HG would reinforce the purpose and objectives of HG-008, but with the following expanded goals:

- An increased targeting of beneficiaries at the lowest income and "extreme poverty" families;
- A more effective bias towards housing developments in regions beyond the Santiago metropolitan area;
- The adoption of appropriate lower income shelter solutions, such as: sites and services, progressive construction, aided self-help, home improvement loans, etc.;

- A major effort by COVIP to qualify other open housing cooperatives --whether currently existing or newly sponsored-- to where they can be included among COVIP's institutional membership, with the purpose of ensuring that the benefits of the Program reach out to the broadest possible constituency, both geographically and among social groups not being served currently; and
- An increase in the social service follow-up role of COVIP's member cooperatives, whether directly or in coordination with other service-oriented cooperatives.

The new agreement would retain the same local counterpart (COVIP) and, presumably, Citibank as a lending and custodian institution.

Once the aforementioned modifications to HG-008 are agreed upon, they should be incorporated formally in the new agreement; in particular, those relating to discontinuance of non-mortgage backed advances, use of local (Citibank's) credit lines, and expanded control and reporting requirements.

The present latitude for drawing advances of up to 100 percent of proffered collateral and securities, in respect to eligible expenses, should be curtailed in the new agreement. A prudent practice would be to limit these advances to not more than 90 percent of pledged collateral. The 10 percent difference would, in any case, normally correspond to the Borrower's required counterpart (US\$500,000 under HG-008) contribution.

The new agreement should also provide an opportunity to tighten certain other clauses of the existing HG-008, such as: definition of permissible liquidity investments, restrictions on allowable loans (e.g. savings advances to cooperative members), appropriate limitations on outside borrowings, etc.

### **C. Follow-on HG - US\$10 to 15 Million**

This new program would support AID's broader policy dialogue with the GOC, specifically addressing and supporting actions in the following major areas:

- To complement and expand existing private sector financial mechanisms and private sector financial institutions to where they become available for the long-term financing of shelter solutions affordable to lower income groups (this is not currently the case). A prudent application of the substantial savings accumulated by private sector institutions (e.g. insurance and social security funds), would afford valid opportunities for depoliticizing demand pressures in these sectors.

- To encourage the private sector to progressively increase its participation in the provision of housing solutions for the lower income and "extreme poverty" groups nation-wide, thus relieving the public sector from its current role as sole provider.
- To strengthen efforts to include the informal sector, local non-governmental organizations (NGOs) and other community groups within the scope and benefits of formal financial mechanisms and institutions.

Although COVIP will be able to --and should-- continue to play an important role in these expanded programs, their much larger reach and scope will obviously require the participation of broader based and more specialized institutions. In this regard, since a principal objective is to spread the influence and benefits of the proposed program over the widest possible range of beneficiaries and institutions in the lower income housing finance field, the choice of a local counterpart in this case should not be restricted to a single participant. Rather, it should attempt to draw from all areas and institutions concerned.

To this end, the establishment of a non-profit foundation to promote the conditions for optimal program development and to serve as a distribution channel for program funds is recommended. The perceived advantages of such an approach are that:

- The foundation could serve as a focal point for all participants, drawing its directors from leading personalities in each sector having something to contribute to, or benefit from, the program, such as: appropriate GOC agencies, participating financial institutions, the housing construction and development sector, major businesses developing employer/labor housing development plans, representative NGOs, etc.
- As such, it would promote the GOC's plans in the area without directly involving the bureaucratic or political process.
- It would provide an opportunity to enlist --as president of its board of directors-- the strongest, most influential, and committed personality who, with the assistance of the other directors and a very small professional supporting staff, could ensure the broadest possible participation by pertinent public and private sector institutions.
- Administrative costs could be minimal, since its activities would be of a promotional and guidance nature only --actual project execution would be undertaken exclusively by private sector institutions on a competitive basis.

- It could develop as a major think-tank and research center in the primary and secondary housing finance field.

Regarding the special features of the proposed program designed to include the lower income sectors in the scope of long-term mortgage instruments, appropriate GOC interventions should be sought in the following areas:

- **Legislating a payroll deduction scheme** (similar to that existing for pension fund contributions): to ensure both a prompt collection of lower income loans and achieve a considerable reduction in servicing costs, thus overcoming a mortgage lender's traditional (and understandable) reluctance to write small denomination loans.
- **Legislating a credit insurance scheme** (in amplification of the existing mortgage insurance coverage): to guarantee the timely and uninterrupted payment of principal and interest quotas on low-income mortgage instruments, thus effectively enticing institutional and other investors to build up substantial portfolios of these securities.
- **Establishing the conditions for promoting institutional support of an active secondary mortgage market:** to provide prompt, easy and inexpensive negotiability, as well as in-depth liquidity, to low-income mortgage instruments, thus providing the housing production industry with refinancing alternatives in local capital markets.
- **Encouraging and supporting initiatives to promote a broad range of home improvement, progressive construction and aided self-help loans in low cost housing programs:** to make home financing fully available to the lowest income sectors.
- **Seeking eventually to replace with fully transparent subsidies all the hidden ones still remaining in the housing area, such as the one underlying the Basic Housing Program (waived or below market land, marketing and financing costs):** to remove constraints currently impeding the private sector from participating in the production of housing solutions for the very low income groups, thus encouraging the private sector to increase its participation in this housing sector and allowing the public sector to gradually withdraw from an active into a "facilitator" role.

#### D. Housing Finance Institutions

With Chile having decided to discourage the existence of mortgage specific banking institutions, it would be inappropriate at this time to suggest the creation of a new specialized housing finance entity to cater to the lower income groups. Instead, an important part of AID's expanded assistance could--and should--be

oriented toward developing those existing institutions which, being already empowered to originate mortgages, can show a meaningful commitment towards the lower income groups, with particular reference to the existing (albeit weak) credit union movement and to the recently created system of *mutuarias*.

The "foundation" proposed as an implementing vehicle for the suggested follow-on HG could provide the necessary impetus to encourage lower income mortgage originations by credit unions and certain *Mutuarias*. Credit unions should obviously be encouraged as a system, in the hopes that all member institutions would get involved. *Mutuarias*, on the other hand, would presumably not respond to such a group approach given the diversity of their origins and affiliations; thus, a more selective approach would be in order.

The most immediately obvious use for one or more *Mutuarias* would be as captive or affiliated vehicles for the housing cooperative movement. Corporación Habitacional is already affiliated with one such *Mutuaria* through its parent, the Chilean Chamber of Construction. COVIP has also expressed interest in promoting and participating in the creation of another *Mutuaria* specializing in lower income mortgage generation. These efforts should be strongly endorsed in any new HG Program.

The success of these *Mutuarias* (as mortgage bankers to the lower income groups) will inevitably hinge on their ability to refinance themselves in Chile's capital markets. To this end, the policy recommendations for GOC actions referred to above are of fundamental importance.

#### E. Currency Swaps

The HG-008 Program has clearly demonstrated the merits of a Central Bank currency swap as a means --barring the more traditional sovereign country guarantees-- of protecting local borrowers from the exchange and convertability risks related to foreign currency borrowings used to finance local currency investments. The Program has also highlighted the limitations of this approach when the swaps are necessarily for shorter periods than the intended use of the foreign currency.

A major feature of future HG programs in Chile should be to improve on this successful first experience. The Central Bank should be encouraged to enter into longer-term swap arrangements under the special HG circumstances. Although this would not normally be seen as a typical Central Bank operation, we still feel confident of a favorable reception in Chile's case, given its successful past experience with these mechanisms. Our recent contacts with GOC and Central Bank representatives tend to bear this out.

The advantages of a long-term currency swap is that it reaches out to all the parties concerned. For the HG borrowers, as we know, it provides adequate coverage against possible exchange risks. For the Central Bank, it provides a long-term source of foreign currency reserves, without increasing its level of foreign indebtedness. For the GOC and the country as a whole, it provides the long-term financing necessary to fund meaningful and replicable shelter solutions for its lower income groups, as well as to secure a corresponding structural and institutional development.

Questions were raised as to: (a) whether such long-term swaps by the Central Bank could result in an exchange risk for itself; and (b) whether the issuance of the local currency counterpart could be considered inflationary.

On the first point, there is absolutely no exchange risk incurred by the Central Bank in so far as it retains the dollar proceeds in this same denomination. This is admittedly hard to understand by some who would argue that, at the time of unwinding the swap, the local currency received could prove insufficient at the then prevailing exchange rate to match the dollars being returned. But the exchange "loss" implicit at this point would only be offsetting the corresponding exchange "gains" implicitly earned during the time the dollars were being held by the Central Bank. In the case of Chile, the Central Bank would even be protected against loss through eventual internal devaluation of the local currency itself inasmuch as the swap's local currency component would be expressed in UFs.

On the second point, first of all, the local currency amounts involved would not be of material magnitude. Secondly, the local currency issues would not be "inorganic" inasmuch as they would be based on the swap acquired foreign reserves. Lastly, the local currency thus placed in circulation would in any case have a powerful stimulative effect on the country's economy in construction materials, building industry, employment, etc., and in stimulating national savings, both as housing down payments and as mortgage loan amortizations.

## **ANNEX A**

### **CHILE PRIVATE SECTOR COOPERATIVE HOUSING GUARANTEE PROGRAM**

#### **HIGHLIGHTS**

- U.S. Agency for International Development/Chile and USAID Regional Housing and Urban Development Office, South America (RHUDO/SA)
  - Lenders: Citibank New York and Citibank Santiago
  - Transfer Agent: Riggs National Bank, Washington, D.C.
  - Local Counterpart: COVIP (COVIP S.A. and its affiliates CONAVICOOP, HABITACOOOP, Corporación Habitacional, INVICA- PROVICOOP: the Borrowers)
  - Local Custodian: Citibank Chile 513-HG-008 Implementation Agreement dated 01/19/88
  - Custody and Financing Agreement dated 07/06/88
  - Foreign Loan Amount: US\$5 million (by Citibank New York)
  - Local Loan Amount: US\$250,000 (by Citibank Santiago)
  - Local Counterpart Funds: US\$500,000 (by COVIP)
- Full Repayment due by July 1992

## ANNEX B

### LIST OF ENTITIES AND PERSONS CONTACTED

#### U.S. Agency for International Development

|                   |                           |
|-------------------|---------------------------|
| Jeremy Hagger     | PRE/H/O Housing Officer   |
| Jeanine Kleimo    | PRE/H/O                   |
| Tamara Wessel     | PRE/H/O                   |
| Timothy Alexander | PRE/H/O                   |
| Eliécer Fernandez | PRE/H/PS -former RHUDO/SA |
| John Schneider    | LAC/SAM Desk Officer      |
| Frances Conway    | Director, RHUDO/SA        |
| Sonny Low         | Deputy Director, RHUDO/SA |
| Paul Fritz        | Representative, AID/Chile |

#### Ministerio de Vivienda y Urbanismo

|                         |                                     |
|-------------------------|-------------------------------------|
| Peter Bromberg Commentz | Asesor Ministerial                  |
| Alberto Echegaray       | Ministro (designate)                |
| Joan Mac Donald         | Sub-Secretaria Vivienda (designate) |

#### Oficina de Planificación Nacional (ODEPLAN)

|                     |                      |
|---------------------|----------------------|
| Sergio Molina Silva | Ministro (designate) |
|---------------------|----------------------|

#### Banco Central de Chile

|                           |                                  |
|---------------------------|----------------------------------|
| Francisco Garcés Garrido  | Director Internacional           |
| José Luis Corvalán Bücher | Director Administrativo          |
| Ricardo French Davis      | Director de Estudios (designate) |

#### Banco del Estado

|                 |                                   |
|-----------------|-----------------------------------|
| Fernando Molina | Gerente Departamento Inmobiliario |
| Ramón Meneses   |                                   |

#### Banco del Desarrollo

|                     |                                 |
|---------------------|---------------------------------|
| Fernando Lavanderos | Gerente Vivienda y Construcción |
|---------------------|---------------------------------|

#### Banco Hipotecario Internacional Financiero (BHIF)

|                            |                                |
|----------------------------|--------------------------------|
| José Gabriel Varela Morgan | Gerente Casa Banca de Personas |
|----------------------------|--------------------------------|

### **Administradora de Fondos de Pensión (AFP) Habitat**

Eugenio Valck Varas  
Fernando Gonzalez Marín

Gerente de Inversiones  
Gerente de Marketing y Sucursales

### **Citibank**

Fernando Yñigo  
José Luis Lathrop C.  
Andrés Mardones V.  
Germán Alessandri

Vice Presidente  
Vice Presidente Residente  
Manager  
Ingeniero Inspector AID

### **COVIP and constituent entities**

Ramón Undurraga Montes

Presidente COVIP; INVICA,  
PROVICOOP

Walter Sommerhoff Ruer  
Vicente Domínguez Vial  
Cristian Wood Armas  
Hugo Bosch Andrade  
Ramón Venegas Carrasco  
Sergio Granados

Gerente COVIP; HABITACOOP  
Vicepresidente COVIP; CHCHC  
Director COVIP; CONAVICOOP  
Director COVIP; HABITACOOP  
Director COVIP; INVICA  
Asesor de Finanzas

### **Builders**

Jaime Muñoz Peragallo  
Carol Weil Cataldo  
Fernando Pérez de Arce  
José Luis Cisternas Z.  
Daniel Lowener Maron  
Carlos Vergara Larraín

Hepner y Muñoz Ltda.  
Diez, Luongo y Weil Ltda.  
Baquedano Ltda.  
Soc. Constructora Zaci Ltda.  
Visal Ltda.  
Visal Ltda.

## **ANNEX C**

### **LIST OF DOCUMENTS CONSULTED**

- **Implementation Agreement of January 19, 1988**
- **Custody and Financing Agreement of July 6,1988**
- **Currency swap contract of July 8,1988**
- **Regulations of the General Unified Housing Subsidy System**
- **Memoria 1988 - Ministerio de Vivienda y Urbanismo**
- **Banco Central - Boletín Mensual Noviembre 1989**
- **World Bank Staff Appraisal Report - Chile, Second Housing Sector Project, March 3,1989**
- **World Bank Staff Appraisal Report and President's Recommendations to the Executive Directors - Chile, Financial Markets Loan, November 16, 1989**
- **Project Reports by Citibank and Covip**

**ANNEX D**

**SCOPE OF WORK**

# memorandum

RHUDO-023-90

DATE: January 11, 1990

REPLY TO  
ATTN OF: Sonny Low, Acting Chief RHUDO/SA *SL*

SUBJECT: 01/09/90 Meeting on Chile, HG-008 Evaluation

TO: Claude Bovet, ISTI Consultant

Following a thorough review of the SOW for the subject evaluation with Eduardo Fuentes and you plus my review of the scope of work delivered by ISTI for the subject evaluation, we reached the following agreements which should provide additional clarification of these same points presented in the two above referenced documents:

1. Agreements were reached in dividing between Claude Bovet and Eduardo Fuentes the specific sub-tasks/questions to be addressed by the evaluation. This distribution of sub-tasks/questions is noted in Appendix 1, attached. This was done with the additional understanding that once Bovet and Fuentes are in Chile that minor variations of agreements on the assignment of sub-tasks/questions reached this date and recorded here between Bovet and Fuentes may be re-negotiated out between these two individuals. Should there be disagreements on this or any other points related to the performance of this evaluation work scope, this officer, or in his absence the AID Rep in Santiago, should be consulted to resolve them.

2. It was reiterated that Claude Bovet would have the ultimate responsibility for preparing the evaluation report in accordance with the instructions/guidance provided by Santiago 10960 attached to ISTI's scope of work. Note should be made that under the ISTI scope of work "Deliverables" section, there is some difference between what is presented from that concerning reporting requirements in Santiago 10960. Agreement was reached with Bovet that the guidance/instructions presented in Santiago 10960 should be followed in being responsive to this assignment, with the following adjustments concerning reports:

a) Agreement was reached that a draft of the Executive Summary of the Report in English would be delivered to the AID Rep in Chile and to RHUDO/SA upon completion of the field work.

b) Agreement was reached that a draft of the final report in English as described under the reporting requirements section of Santiago 10960 would be produced within 30 days after Bovet received comments on the Executive Summary draft from the AID/Chile Rep. and RHUDO/SA.

c) Agreement was reached that Bovet would deliver 6 copies of the final report in English to the AID/Chile Rep and 4 copies to RHUDO/SA 30 days after his receipt of comments on the draft of the final report.

d) Agreement was reached that 30 days after the delivery of the final report in English that Bovet would deliver 10 copies of the Spanish translation of this final report to the AID Rep in Chile -6 copies- and RHUDO/SA -4 copies.

3. Agreement was reached that completion of the abstract and the AID Evaluation Summary Form would be determined once Bovet, this officer, and the AID/Chile Rep were able discuss this matter in Santiago.

Attachment: as stated

cc. Elssy Zapata, ISTI ✓  
Paul Fritz, AID Rep/Chile

10. a. USAID/Chile requests the provision of technical assistance in the evaluation of the Private Sector Housing Guarantee Program. These services will be provided through the LAC/PS contract with the International Science and Technology Institute, Inc. (ISTI).

b. **BACKGROUND**

Chile's Private Sector Cooperative Housing Program was originally conceived to support independent, democratic private sector cooperatives and to serve the needs of low-income families. Under USAID's Worldwide Private Sector Housing Guarantee Program, US \$5 million has been authorized to COVIP. The programmatic rationale for providing a loan to the Chilean housing cooperatives was based primarily upon AID's desire to respond to the coop system's request for assistance in short-term construction financing of housing projects which was not readily available in Chile. Also, the loan was meant to assist the cooperatives in financing larger portions of housing for families with incomes lower than what they normally served.

c. **PURPOSE**

The basic reasons for conducting this evaluation are:

1. To determine whether the program is on schedule to finance its first 1,000 projected housing units for low income families.
2. To ascertain whether the program will use the US \$5 million for eligible project activities as was originally projected by the first eighteen to twenty month bench mark established to monitor progress in project implementation.
3. To enable AID to respond adequately to Chile's request for a follow-on Housing Guarantee loan.
4. To provide findings and recommendations which will be drawn upon to assist the A.I.D. Representative in Chile, RHUDO/SA, and the Chilean housing cooperatives in designing any follow-on shelter sector assistance package for Chile.

d. **SCOPE OF WORK**

To adapt this task to the current LAC/PS contract expiration date of January 31, 1990, the task has been divided in two parts. This task order covers the

first phase; the second phase will take place under the follow-on LAC/PS contract.

The consultant will conduct an interim evaluation to assess whether the HG program is utilizing project funding for construction financing as originally scheduled to produce the new housing. In particular, the consultant will determine:

1. How the implementation of the current HG loan might be made more effective and efficient through adjustments and modifications in its project design.
2. Whether the development constraints the project was initially designed to address (i.e. lack of construction financing available to housing coops) continue to be germane, and whether the project design should be revised to justify follow-on assistance.
3. What positive and/or negative effects have resulted from the current project implementation experience, particularly with respect to the program's beneficiaries.
4. The prospects for the type of financing being provided by the current loan to become more readily available to the housing coops from the Chilean financial system once AID/HG funding is terminated.
5. The effectiveness of the relationship between COVIP, CITIBANK-Santiago, and A.I.D., and, in particular, with respect to the risk management techniques utilized by the HG program (i.e. swap/hedging contracts, risk sharing with CITIBANK, CITIBANK's role as A.I.D. fiduciary agent, management of commercial risk, etc.).
6. The adequacy of and prospects for continuity of the swap mechanisms employed to manage the foreign exchange risk in the repayment of the HG dollar loan used to generate the Chilean pesos for program operations, and their reconversion to dollars to service the HG loan.
7. Whether COVIP has served effectively and efficiently as the legal entity designated to speak with a single voice on behalf of the cooperative movement as was originally intended.
8. The custody, financing, and any other legal agreements entered into by the various parties to implement the US \$5 million HG loan to COVIP.
9. The level of income of the program's beneficiaries, and the differences in subsidies for residents of Santiago and those residing outside the metropolitan area.

10. Whether the coops would choose to undertake a second contracting of funds after 1992 under this same A.I.D. Housing Guarantee Program, or whether the design of a new program would be preferred.
11. The current impact of subsidies, if any, and future prospects for coop members to receive increased or decreased amounts of subsidies for new housing.
12. Whether the program is using an interest rate structure that is positive or market-determined.

**11. Consultant Team Composition:**

Claude Bovet

12. Prior to his field work in Chile, the consultant will spend one day in Washington, D.C., where he will meet with PRE/Housing officials, and two days in Quito, Ecuador with RHUDO/SA officials for review and orientation. The consultant will travel to Santiago with RHUDO/SA's Financial Policy Advisor who will provide technical expertise and guidance to the consultant.

While in Chile, the consultant will meet with the AID Representative in Santiago, the President and key staff of COVIP, key staff of each of the five participating housing coops, CITIBANK-New York and CITIBANK-Santiago representatives, Central Bank staff, Banco Del Estado officials, and pertinent GOC officials. Also, the consultant will allocate time to interview a sample of builders, representatives of private banks, and program beneficiaries from several housing projects in the Santiago metropolitan area financed by the loans.

**PLEASE NOTE: ATTACHED CABLE IS INTEGRAL PART OF THE SCOPE OF WORK.**

**Deliverables:**

The consultant will prepare a detailed report (minimum fifteen-pages) evaluating the Private Sector Housing Guarantee Program. Three copies of the draft will be delivered to the AID Representative in Santiago and three copies sent concurrently to RHUDO/SA no later than 5 working days after completion of field work in Chile. The consultant will be responsible for finalizing the report upon receipt of comments from the AID Representative and RHUDO/SA. Six copies of the final

report will be delivered to the AID Representative and four copies to RHUDO/SA no later than 30 days after receipt of their comments.

The consultant will be responsible for making arrangements for translation into Spanish of the final evaluation report in Quito or Santiago, and ensure that the translation be delivered to ISTI, RHUDO/SA and the AID Representative in Santiago no later than 30 days after delivery of the final report in English.

13. Work Week Authorization: 6 days.

Prepared: December 28, 1989