

**PERU  
SHELTER SECTOR ASSESSMENT  
VOLUME I: POLICY ISSUES**

**June 1985**



**OFFICE OF HOUSING  
AND URBAN PROGRAMS  
AGENCY FOR  
INTERNATIONAL DEVELOPMENT**

Prepared by  
**PADCO**  
**PLANNING AND DEVELOPMENT  
COLLABORATIVE INTERNATIONAL**

**PERU  
SHELTER SECTOR ASSESSMENT  
VOLUME I: POLICY ISSUES**

**Prepared for  
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT**

**Prepared by  
PADCO, Inc.  
1834 Jefferson Place, NW  
Washington, DC 20036  
USA**

**June 1985**

## TABLE OF CONTENTS

	Page
List of Persons Contacted	
Glossary of Acronyms	
INTRODUCTION	
I. CONTEXT FOR SHELTER POLICY	1
II. POLICY ISSUES	3
A. Limiting and Focusing Public Sector Shelter Programs	4
B. Facilitating Increased Private Sector Efforts in Shelter Delivery	7
C. Improving the Efficiency of Financial Intermediation in the Shelter Sector	9
D. Establishing an Ongoing Public-Private Shelter Policy Analysis and Formulation Capability	12
III. SUMMARY OF SHELTER POLICY AGENDA	14

LIST OF PERSONS CONTACTED

USAID/Lima  
George Hill, Deputy Director  
George Wachtenheim  
Kraig Baier, Housing and Urban  
Development Office  
Rodolfo Salinas, Housing and Urban  
Development Office  
Ray Bromley, Consultant  
Allan Austin, Consultant

Asociacion Peruana de Corredores de Inmuebles  
Angel Rolandi Cavallero

Banco de la Vivienda del Peru  
Oscar Bauer C., General Manager  
Raul Hidalgo Morey, Manager  
Federico Melo Vega, Manager  
Pedro Sarmiento P., Manager  
Miguel Zevallos Ugaz, Manager  
Herbert Johanson, Manager, FONAVI

Banco Central de Reserva  
Jorge del Buato Quinones, Deputy Manager  
Henry Barclay

Banco Central Hipotecario  
Carlos Ansejo, President

Banco de Materiales  
Orlando Rivera, General Manager

ELECTROPERU  
Hercules Centero de Souza, Implementation  
Department

Empresa Nacional de Edificaciones  
Victor Wyzkowski Campos, General Manager  
Luis A. Robles Recavarren, Manager of  
Property Administration  
Alfredo Arbulu, Manager of Investments

Equipo Uno S.A.  
Ramon Barua A., Managing Director

Grana y Montero S.A.  
Jose Grana Miro Quesada

Haaker-Velsochaga S.A.  
Miguel del Rio Perez, General

Instituto Libertad y Democracia  
Mariano Cornejo Battifora  
Maria de Los Angeles Murillo

Instituto Nacional de Desarrollo Urbano  
Luia Dorich Torrea, President  
Armando Garcia Campos, Executive Director

Instituto Nacional de Investigacion y  
Normalizacion de la Vivienda  
Urbano Tejada, Executive Director  
Raquel Machicao

Instituto Superior Tecnologico San Ignacio de  
Loyola  
Carlos A. Bolona Behr, Director

Ministerio de Vivienda  
Carlos del Pino, Direccion General de  
Edificaciones  
Freddy Cortez, Oficina de Presupuesto y  
Planificacion

Municipalidad de Lima  
Jorge Ruiz de Somocurcio, Director, Plan de  
Desarrollo Metropolitano  
Victor Tantalean

Mutual Peru  
Edgardo Palza, General Manager  
Manuel Sanchez Palacios, Deputy Manager and  
Counsel  
Juan Selva, Operations Manager

Servicio Nacional de Agua Potable y Alcantarillado  
Roberto Hart, General Manager  
Mr. Mansur

Superintendencia de Banca y Seguros  
Ramon Rosales Diaz, Associate Superintendent

Universidad del Pacifico  
Alejandro Toledo, Centro de Investigaciones

World Bank  
Ulrich Thumm, Resident Representative

## GLOSSARY OF ACRONYMS

BANVIP	Banco de la Vivienda del Peru (Peruvian Housing Bank)
BCH	Banco Central Hipotecario (Central Mortgage Bank)
BCR	Banco Central de Reserva (Central Reserve Bank)
BM	Banco de Materiales (Materials Bank)
CAPECO	Camara Peruana de la Construccion (Peruvian Chamber of Construction)
ENACE	Empresa Nacional de Edificaciones (National Building Company)
FONAVI	Fondo Nacional para la Vivienda (National Housing Fund)
INADUR	Instituto Nacional de Desarrollo Urbano (National Urban Development Institute)
INE	Instituto Nacional de Estadistica (National Statistics Institute)
ININVI	Instituto Nacional de Investigacion y Normalizacion de la Vivienda (National Institute for Housing Research and Standarda)
INP	Instituto Nacional de Planificacion (National Planning Institute)
MEF	Ministerio de Economia y Finanzas (Ministry of Economy and Finance)
SEDAPAL	Servicio de Agua Potable y Alcantarillado de Lima (Lima Water Supply and Sewerage Service)
SENAPA	Servicio Nacional de Agua Potable y Alcantarillado (National Water Supply and Sewerage Service)

## INTRODUCTION

This document is the first of two volumes making up the 1985 Peru Shelter Sector Assessment. This volume, Policy Issues, presents an "agenda" of shelter policies that is to serve as a basis for discussions between AID and the Government of Peru. The second document, the Technical Report, contains documentation and analysis to support the policy agenda.

Two years ago, AID prepared a shelter policy document (PADCO, Inc., Shelter Sector Policy Issues in Peru, Vols. I and II, Agency for International Development, January 1983) that focused on reducing subsidies, shifting public sector shelter investment to low-cost solutions, improving management of public shelter programs, clarifying institutional roles, strengthening participation of the private sector in housing, and improving infrastructure delivery and financing. The present update shows that all of these are still central issues and that, in general, the problems of the Peruvian shelter sector have worsened. In addition, persistent and growing inflation has pushed "maintenance of value" in housing finance to the forefront of the policy agenda.

This report was prepared by Alan Carroll (PADCO), Pedro Lasa (Consultant), and Carlos Linares (PADCO). Alfred P. Van Huyck (PADCO) provided guidance on policy issues. Field work took place in December 1984. The authors are grateful to many people in Peru who supplies information and assistance. Most of these individuals are named in the List of Persons Contacted. Special thanks are due to Kraig Baier and Rodolfo Salinas of USAID/Lima's Housing and Urban Development Office.

## PERU SHELTER POLICY ISSUES

### I. CONTEXT FOR SHELTER POLICY

Any dialogue on shelter policy in Peru will take place in a context of serious difficulties: severe national economic problems, fiscal constraints, institutional weakness, and tremendous shelter deficits coupled with very low incomes. At the same time, the advent of a new government offers opportunities to take important new steps to improve shelter delivery in Peru.

#### Economic Situation

Peru is now suffering from a major economic depression. Real GDP fell 12 percent in 1983 and is estimated to have grown by only about two percent in 1984. Per capita real GDP fell by 14 percent in 1983 and probably will have declined again in 1984. At the moment per capita GDP is down to the level of 1965. Market prices of Peru's main exports, two-thirds of which are minerals, are at the lowest levels in 50 years. Foreign credit has almost stopped in the face of Peru's difficulties in paying its existing external debt. Foreign interest payments now amount to about 30 percent of export receipts. Inflation was 111 percent in 1983 and is expected to be in the same range in 1984. Devaluation is also running at over 100 percent per year. Open unemployment is estimated to be about 10 percent, and underemployment around 55 percent, the highest levels in 15 years. The government's fiscal problems are grave: public savings dropped from 4.5 percent of GDP in 1979 to -2.2 percent in 1983. The fiscal deficit rose to almost 12 percent of GDP in 1983 and remained at that level in 1984. At the same time, private investment dropped in 1983 to below half of total investment for the first time since 1974. The 1983 investment rate was a low 14 percent of GDP. Finally, serious distortions are affecting the financial market. The devaluation of the sol has been a major cause of depressed domestic investment. A majority of Peru's money supply and credit is now in dollars.

#### Housing Needs

While there are few official figures on housing for the last four years, there is no doubt that housing conditions in Peru have deteriorated. High interest rates and declining real incomes have virtually wiped out formal housing finance. Low incomes have also depressed home improvement (upgrading). Extreme budget constraints have prevented significant expansion of public services. In 1981, the last year for which national housing data were available, about half of urban housing units and virtually all rural units were built of "non-permanent" materials (mainly adobe). Regarding services, about 60 percent of urban dwellings had piped water, 45 percent sewer connections, and 63 percent electricity.

Meeting the annual need for new housing in 1990 would require building a total of about 58,000 units in the Lima Metropolitan Area, 79,000 units in other urban centers, and 28,000 units in rural areas, for a 1990 annual total of about 165,000 units. The annual requirement for new housing will grow over the following 15 years. In addition, there will be a need for upgrading of the existing (as of 1985) housing stock, estimated at about 63,000 units per year in urban areas and 59,000 per year in rural areas over the next two decades. Formal sector housing production in recent years has been far below these levels. Total formal sector (public and private)

housing construction has averaged about 22,000 units annually over the last five years. This suggests that between two-thirds and three-quarters of new urban housing units in Peru are being produced through informal construction.

#### Housing Affordability

Effective demand for housing is extremely low in Peru because of the combined effect of low incomes and high interest rates. Given standard current financing terms (63.5 percent interest, 10 years amortization, and 10 percent down payment), an average Lima-Callao household in the middle quintile of the income distribution can afford a unit costing a maximum of S/.10.5 million in 1984 prices (slightly over US\$2,000). Households in other urban areas have substantially lower capacity to pay, with the middle quintile of this group able to afford a unit costing an average of S/.3.8 million (around US\$750). Middle-quintile rural households can afford an average of only S/.1.1 million (a little over US\$200). In physical terms, the figures mean that a minimal basic house of 40 m<sup>2</sup> is affordable only to the richest 20 percent of households in the Lima-Callao Metropolitan area. Lesser-income urban households can at best afford serviced lots or upgrading loans. The poorest one third of urban households in general are shut out of the formal market for shelter solutions. In rural areas, households in the top 40 percent of the income range can afford minimal credits for upgrading or services, but the majority cannot afford a formal shelter solution. The principal conclusion is that Peru must give high priority to measures that will lead to a reduction in inflation and market interest rates. In the meantime, available shelter sector resources must be used to provide minimal solutions to as many families as possible at the lowest possible subsidy.

#### Housing Finance

The savings market as a whole has come under severe pressure as a result of:

- The need to finance high fiscal deficits, which has limited the availability of resources for other uses;
- High inflation and devaluation, which have helped create a massive dollarization of savings and narrowed the scope of action of financial intermediaries;
- The difficulty of providing an adequate return to savings without damaging credit recuperation, making new credits unaffordable, or providing huge subsidies;
- The large drop in the volume of financial intermediation in the last three years. Total assets of formal sector financial institutions declined by 22 percent between 1980 and 1983.

Housing finance institutions--the BCH and the Mutuales--and the development banks, including BANVIP, have had poor performance in recent years, as measured by key financial indicators. Part of the problem is due to the inability of BCH and the Mutuales to compete for resources with other financial institutions, notably the commercial banks. Unlike the latter, BCH and the Mutuales are excluded from the dollar savings market and are obliged by law to lend at negative real interest rates.

## II. POLICY ISSUES

The principal shelter policy issues for Peru have been grouped into four major categories. These categories reflect broad institutional and financial concerns that touch almost all the organizations and groups involved in housing. The four policy categories are:

- **Limiting and Focusing Public Sector Shelter Programs**  
Government shelter programs should be limited to infrastructure upgrading, preparation of serviced and non-serviced residential lots, and provision of small home improvement loans for low-income families. In addition, the government should increase the priority on critical urban infrastructure investments, especially water supply and sanitation. There should be no public financing of housing units.
- **Facilitating Increased Private Sector Efforts in Shelter Delivery**  
Public policy should support the efficient functioning of the the housing market, making it possible for private builders, developers, and financial intermediaries to regain a major role in housing. It should be abundantly clear from past experience and the housing market analysis done for this paper (see Technical Report, Chapter III) that the public sector cannot possibly meet housing needs in Peru even over the long term. Thus, encouragement of private sector initiative, both large and small scale, is essential for housing in Peru. Regulatory and legal structures that impede private initiative should be streamlined, and pricing policies should provide incentives for private investment.
- **Improving the Efficiency of Financial Intermediation in the Shelter Sector**  
Indexing for lending and savings should be phased in to all shelter finance operations. Financial management should be improved in all institutions. An increase in the flow of private savings into the housing finance system, especially through the Mutuales, should be promoted. Public financial resources not explicitly and specifically designated for subsidies should yield a return at or above the market cost of savings. Finally, all prospective subsidies in shelter or infrastructure programs should be evaluated before initiation to determine their overall long-term cost and identify where the funds will come from.
- **Establishing an Ongoing Public-Private Shelter Policy Formulation and Analysis Capability**  
At the moment the shelter sector in Peru operates under a fragmented and sometimes contradictory legal framework. There is little capacity for formulating shelter policies and programs that relate to overall national economic development objectives. A structure should be established to lay the foundation for dialogue and coordination between private and public organizations and for technically sound, practical policy analysis to guide decision-making for the shelter sector.

## A. LIMITING AND FOCUSING PUBLIC SECTOR SHELTER PROGRAMS

### 1. Nature and Targeting of Public Shelter Programs

Housing is not a "public service". Housing construction is fundamentally a private sector activity, and public sector investment should be directed primarily into supporting infrastructure, especially water supply, sanitation, electricity, and roads. Any person, household, or organization whose individual benefits from an investment, public or private, can be measured, should be required to repay the cost of the investment (provided the net benefits are positive). This is the principle, for instance, behind levying "valorization" charges on properties whose value is enhanced by street improvements or other public works.

Accordingly, the use of FONAVI funds for construction of single-family houses, apartments, or core units should be terminated. Public sector support should be focused on the kinds of approaches that AID has been helping to finance so far, namely:

- Sites and services;
- Infrastructure upgrading in low-income areas;
- Building materials loans.

In addition, the government should support a large-scale program of lots without services ("lotes tizados") in principal cities.

A review should be conducted of the beneficiaries of current and prospective shelter programs to determine if in fact they reach the target group, households below the median income.

### 2. Subsidies

For the period 1979-83 the differential between the rate of inflation and the average interest rate for FONAVI-financed projects (effectively zero over the period due to the grace periods allowed: 50 percent grace for the first two years and another 50 percent grace for the first three years) produced an implicit subsidy of approximately S/.398,000 million. This total subsidy was spread over 29,289 housing units, for a per-unit subsidy of about S/.13.6 million. In addition, the monthly mortgage payment per million of loan value made by beneficiaries of FONAVI's ENACE projects (the beneficiaries having obtained their units through lotteries) was S/.9,656 (after the third year) in comparison with S/.83,339, which is the monthly payment per million at an annual interest rate (to roughly match inflation) of 100 percent for ten years.

There are several fundamental problems with these subsidies. Foremost is the inequity in providing large subsidies to a very small number of beneficiaries while leaving aside the vast majority of families who need shelter assistance. Moreover, the sheer cost of the subsidy to the public treasury makes the investment difficult to justify. Non-recoverable public expenditures of this magnitude should not, in principle, be made in housing because, as suggested above, housing is not a "public service". Finally, there is the problem of who has been benefitting from the subsidies. The ENACE projects of recent years have been allocated to FONAVI contributors by lottery. While no profile is available of current "Fonavistas", it is reasonable to assume that a large

number of housing beneficiaries are middle-class. The GOP's view over the last four years has been that the middle class is also caught in an economic "crunch" and needs help, which in many ways is true. Nevertheless, massively-subsidized public housing is the wrong way to help the middle class. Government-supported shelter programs should benefit families below the median income level.

Although it may be impossible to eliminate housing subsidies entirely while inflation remains in the triple-digit range, every effort should be made to reduce them as much as possible. At minimum it is necessary to begin by making housing subsidies explicit. Before further projects are initiated, the projected annual subsidy resulting from the proposed terms should be estimated. This should serve as a basis for discussion within the housing sector and among the key economic planning institutions. Beyond this, there are several steps that can be taken:

- Indexing, discussed above, will help reduce implicit subsidies that build up because of the declining real value of capital recovered from shelter sector investments.
- Interest rates must be raised as much as possible consonant with affordability.
- Other financing terms can be adjusted. Down payments can be made bigger and mortgage terms made shorter to reduce the interest rate subsidy on the mortgage amount and generate more funds for immediate reinvestment.
- In individual projects, opportunities should be taken to charge differential per m<sup>2</sup> prices for different types of units (e.g. commercial vs. residential and larger, better-located units vs. smaller, less well-located ones). This provides a chance to cross-subsidize the lowest-cost units without damaging the overall financial viability of the project.
- The prices charged for shelter solutions, whether they involve infrastructure upgrading, sites and services, or home improvement loans, should reflect the true cost of the original investment. This means that a) land, labor, and materials must be valued at their market costs and b) the value of cost escalation during construction must be factored in.

### 3. ENACE

- ENACE has been effective in seeing to it that the construction programs of the government are executed, but it actually does nothing that couldn't be done by other existing agencies or private sector construction firms. ENACE should be eliminated, and its contracting and supervision functions folded into BANVIP and/or delegated to the other institutions involved in FONAVI-funded programs.
- As a prelude to closing down ENACE, studies should be conducted of 1) the steps required to finish administering its existing portfolio, 2) the potential for selling off its unallocated assets to generate funds for future projects, and 3) the best means of writing off its unproductive portfolio.

#### 4. Municipalities

- As suggested above, BANVIP should identify municipalities which may be capable of participating directly in a shelter program, initially as an executing agency and perhaps later as a financial intermediary. Procedures should be designed to permit BANVIP to coordinate smoothly with municipalities. Initial projects done with municipalities could be kept small to minimize the risk and make the task easier. Infrastructure would appear to be the most feasible type of project with which to start.
- Technical assistance should be provided to municipalities that participate in shelter programs.

#### 5. Shelter Cost Reduction

Part of making carefully-focused public sector shelter programs effective is insuring that costs are kept low enough to reach the target population of low-income families.

Some scope exists for reducing shelter costs by reducing physical standards, especially for infrastructure. Supposedly low-cost shelter projects are still being built with such features as excessively wide streets and underground electrical lines. Current infrastructure specifications treat all urban and rural areas as homogenous, with no attempt to differentiate between income levels or different settlement types. There is a need for:

- Feasibility studies on cost reduction ideas which will result in concrete proposals for changes in specifications.
- Changes in norms to legitimize the introduction of progressively increasing levels of services over time.

At best, changes in physical norms could achieve shelter cost reductions of 20 to 25 percent. These potential economies are greatly overshadowed by the burden of financial costs in shelter construction today. A few months' delay in project execution, which is a normal occurrence, can raise costs by 30 to 50 percent due to inflation and interest charges on borrowed money. There are several aspects to the problem of project delays:

- Administrative bottlenecks in the project review and approval process are a major problem. Delays are caused by the multiplicity of agencies involved at various levels of government and by the excessive documentation required. The entire structure for construction permitting should be overhauled and streamlined. New regulations should obligate public agencies to perform the various stages of the process within specified time limits.
- Project execution is often inefficient. The "formula polinomica", intended to compensate builders of publicly-financed projects for cost increases beyond their control, gives no incentive for speedy work. In many cases the economies of purchasing materials early in the project are not taken advantage of. Another factor contributing to inefficient construction is ENACE's exemption from the formal approvals process. This has resulted in ENACE projects being built without the required assurance of infrastructure from utility agencies. Finally, the Banco de Materiales has found that its clients often use materials inefficiently because of lack of technical knowledge. These problems, and many similar ones, should

be the targets of concerted attack. Regulatory reform is needed to provide incentives to builders for rapid, on-time performance and to insure coordination between agencies. Technical assistance is needed to help informal builders use materials more economically.

Construction costs vary greatly among Peru's main geographic regions. A project carried out in the Costa costs 50 percent more in the Sierra and 150 percent more in the Selva. The main reasons are transportation costs, lack of skilled workers and managers outside the Costa, the more adverse climate and terrain conditions in the Sierra and Selva, and the unfamiliarity in these regions of some materials and construction processes. To help mitigate these cost differentials, technical and administrative capacity in construction should be developed in the interior through training programs. Also, the use of local materials and construction techniques should be encouraged.

#### 6. Urban Infrastructure

Apart from the lack of financing, the principal bottleneck to meeting shelter needs is the shortage of infrastructure, especially water and sanitation. In 1981, one third of housing in Lima and 45 percent of housing in other urban areas lacked piped water. Sewer service was lacking in 39 percent of dwellings in Lima-Callao and 64 percent in other urban areas. Electricity served all but 14 percent of units in Lima-Callao but did not reach 52 percent in other urban areas. In rural areas formal public services are almost nonexistent. While AID has helped finance secondary infrastructure networks and household connections through HGs, it has neither the authority nor the resources to finance major installations (e.g. storage or treatment facilities) or primary networks. It had been expected that the World Bank would provide financing for expansion of SENAPA's basic capacity, but disagreements over tariff policy and sectoral management issues have prevented projects from being realized.

Peru must begin immediately to explore ways to reach agreement with external donors on new financing for basic infrastructure. This will require a willingness to raise tariffs to more realistic levels and to improve management in water and other infrastructure sectors.

### B. FACILITATING INCREASED PRIVATE SECTOR EFFORTS IN SHELTER DELIVERY

#### 1. Mutuales (Mutual Savings and Loan Associations)

At present the Mutuales are almost completely out of the housing market because high inflation makes long-term credit for housing acquisition almost universally unaffordable. Traditional housing loans, which accounted for 100 percent of the Mutuales' combined portfolio in 1977, now make up only 35 percent. Of the current housing portfolio, 70 percent is financed through FONAVI funds, which means that only 10 percent of the Mutuales' portfolio is housing finance from their own resources. In short, the Mutuales have survived financially by shedding their original housing identity. At the moment, the Mutuales are providing modest-sized home improvement loans under current AID programs, and this should continue in the future. Further assistance to the Mutuales should require implementation of an indexing mechanism.

To insure the viability of the Mutuales, it is urgent to:

- Resolve the legal contradictions in which they find themselves; e.g. legitimize their de facto entry into non-housing credit markets.
- Pass new legislation, which has been pending in Congress for three years, allowing the Mutuales to institute management reforms.

In the medium run, the following measures should be considered:

- Open the S&L system to savings in dollars to help it compete in the financial market.
- Prepare a new strategic plan for the system which takes into account the realities of the market.

## 2. Tenure Regularization

Legalization of tenure in low-income urban settlements promotes private investment. Legal tenure provides households the security to invest in upgrading their dwellings, thus stimulating the construction industry. Legalization also opens access for households to formal credit, promoting growth of the financial market.

Since 1961, when the government first officially recognized the need to legalize rather than eradicate informal settlements, the responsibility for "regularization" has passed through 11 public agencies. Because of this lack of continuity and fragmentation, the titling process has been very slow. A recent study showed that as of 1980 only 14 percent of families in pueblos juvenes needing legal titles had obtained them. Legalization of informal settlements is now in the hands of municipalities, and at least the municipality of Lima appears to be speeding up the process. Efforts to speed up the legalization process, especially in cities other than Lima, must continue.

## 3. Reduced Public Sector Role

Elimination of high-cost public housing projects for the middle class and reduction (with eventual elimination) of subsidies for public sector programs will help put the private sector on a more competitive footing with respect to pricing and provide greater opportunities for private initiative to occupy positions in the housing market.

## 4. Legal and Administrative Reform

Streamlining the project review and approval process as recommended in A.5 above should also make it easier for private developers and builders to function as providers of shelter. A review of laws and regulations governing subdivisions, building codes, and land use should be carried out to identify and eliminate ambiguity, overlaps, and contradictions that hamper private initiative. This does not imply that regulations over land development and construction should be eliminated; rather, that it is necessary to find ways of protecting the public interest without destroying the private sector's incentives to play an appropriate role in meeting shelter needs.

## 5. Rental Housing

Rental housing accomodates about one third of urban residents in Peru, or around 4.4 million people. Recent studies indicate that the quality of the rental housing stock has been deteriorating substantially because landlords do not invest in improvements. Also, almost no new rental housing has been built in recent years. The existing rent control regulations are a major cause of these problems. Legislation to change rent regulations has been pending for two years, but has not been passed. There is an urgent need for changes that will provide incentives for increasing the supply of rental housing.

## C. IMPROVING THE EFFICIENCY OF FINANCIAL INTERMEDIATION IN THE SHELTER SECTOR

### 1. Maintenance of Value

Some form of indexing must be implemented within the housing finance system and, ideally, the financial system as a whole, in order to lessen, and eventually eliminate, the decapitalizing effect of inflation. It is true that with inflation at well over 100 percent per year, long-term loans at positive real interest rates for housing acquisition are almost totally unaffordable at the present time. However, this does not mean that partial steps are useless. One example of a maintenance of value issue that can and must be addressed is the preservation of FONAVI in some form.

FONAVI: In 1980 and 1981, FONAVI captured over S/.30 billion per year (in 1980 constant value). In 1984, the real (1980) value of funds captured was only about S/.10 billion, a two-thirds drop. One reason for the decline is that the income limits from which FONAVI contributions are calculated have not been raised, while real incomes and the number of contributors have declined. In addition, FONAVI loans carry very low interest rates (three percent), resulting in rapid erosion by inflation of the value of funds recovered. Finally, the number of contributors to FONAVI has been decreasing as the amount of formal sector employment declines.

There are various alternatives for approaching FONAVI, including changing its structure completely (which may require changing its name). The basic problem, though, is to prevent its decapitalizing itself out of existence. FONAVI currently represents the only domestic source of shelter funds available in Peru. Not only is it being used to finance housing construction, it is also being channeled into upgrading loans through the Banco de Materiales and to water, sanitation, and electricity connections in low-income areas in cooperation with the utility companies.

At a minimum, it will be necessary to:

- Devise a formula for raising the base from which FONAVI contributions are calculated so as to keep up with, at least, the wage and salary index.
- Raise interest rates on FONAVI loans.

Beyond these basic measures to keep the fund alive, the feasibility of converting it into a real financial fund--a form of forced saving program--should

be examined. This would involve increasing the contributions obtained from employees (they presently pay only 0.5 percent of their incomes), paying interest to contributors (which FONAVI does not do now), and raising interest rates on FONAVI loans further to maintain an adequate spread. The main advantage of this approach is to increase the volume of resources available to FONAVI. The main disadvantage is that it is almost impossible to make such a scheme financially attractive to employees under present market conditions.

**Indexing:** Indexing systems should be extended to all housing finance institutions. In principle all deposits and loans should be indexed. The wage and salary index is the most frequently mentioned basis for starting an indexing system under current conditions. An alternative is to offer indexed loans based on some combination of graduated payments and variable interest rates (perhaps with "balloon" payments). For the moment, while inflation remains high, "full" indexing is incompatible with credit affordability, as the experience of BCH demonstrates (see Technical Report). It may be advisable to begin the indexation program by experimenting with several types of arrangements in BANVIP and FONAVI programs. The best results of these initial trials can form the basis for broader application.

In summary, any new housing program undertaken with government support should be channeled through an indexed financing mechanism; however it is recognized that "full" indexing is a long-term goal. The immediate need is to implement partial indexing systems in key programs, including those of BANVIP, FONAVI, and the Banco de Materiales.

## 2. Banco de la Vivienda (Housing Bank)

The Banco de la Vivienda has the advantage of stable sources of captive funds; it does not compete for deposits on the open market. The fastest-growing part of its operations in the last three years has been direct lending using FONAVI, AID, and its own funds. In 1983 FONAVI accounted for 50 percent of BANVIP credits for the year and 45 percent of accumulated loan placements; however, BANVIP has no control over FONAVI, whose disposition is directed by the Ministry of Housing. Without FONAVI, BANVIP's return on capital was 0.7 percent in 1983, and the Bank is being seriously affected by decapitalization pressures: its assets fell in real value by 25 percent from 1982 to 1983.

- In the medium term, BANVIP must substantially improve its management control over FONAVI (or whatever FONAVI evolves into). This entails, among other things, keeping current registers of contributors, maintaining complete financial records, and implementing a system, which may include indexing, to maintain the value of the fund. It also means clarifying the apparently uncertain legality of transferring FONAVI funds to other institutions (e.g. the Banco de Materiales and SENAPA). There is nothing wrong with this practice in principle, but it appears to be inconsistent with FONAVI'S statutes.
- BANVIP's role as a setter of financial policy in the housing sector should be restored. It should have the capacity to allocate resources among various programs and the responsibility for maintaining maximum financial soundness in housing sector operations.

- BANVIP should phase out its direct lending and move towards operating strictly as a second-tier financing organization. Direct lending should eventually be carried out exclusively by institutions like the Banco de Materiales, the Mutuales, and the Banco Central Hipotecario.
- The mechanisms by which BANVIP works with the public utility companies should be streamlined to achieve better cooperation. Also, BANVIP should begin working directly with selected municipalities on shelter and infrastructure projects. At the outset, the municipality's role may be limited to implementation (as is the case with the utilities now); at a later stage, municipal governments could begin to serve as financial intermediaries.

### 3. Banco de Materiales (Materials Bank)

The Banco de Materiales has experienced extraordinary growth since its founding in 1980. Its program has been relatively successful and should receive continued support. As a condition of renewed assistance, the BM should design and begin phasing in an indexing system to mitigate the decapitalizing effects of inflation. In the medium term, steps should be taken to:

- Improve the BM's internal management and procedures. Financial indicators for 1982-83 do not indicate growth in efficiency to match the BM's expansion of operations; in fact efficiency seems to be declining. For example, operating costs are unconscionable, having reached 72 percent of income in 1983. It is essential for the BM to improve its financial controls quickly, while it is young, to set a good base for the future. BANVIP should assist the BM in reviewing its financial record-keeping and accounting, with the objective of making the BM capable of publishing complete annual reports on a timely basis.
- Reach greater numbers of lower-income families with "Type C" loans that do not require stable formal employment or a mortgage guarantee.

For the longer run, consideration should be given to the potential for turning the BM into a true financial organization by enabling it to capture savings in the financial market and making it accountable for its own financial viability.

### 4. FONAVI

The original hope that FONAVI funds would be used to leverage growth in the housing finance sector have never been realized. Since its inception FONAVI funds have been used almost exclusively for direct housing construction programs of the government. This has frustrated not only other housing finance institutions but also FONAVI contributors not interested in official housing programs.

In addition to the immediate priority steps (outlined above) to prevent FONAVI from being totally decapitalized, there should also be a reform of FONAVI's financial regime to allow it to obtain a rate of return sufficient to capture other savings and mix them with its own funds, as permitted by its enabling laws.

### 5. Banco Central Hipotecario (Central Mortgage Bank)

In 1975 the BCH controlled 41 percent of the savings market. In mid-1984 it controlled only 16 percent, reflecting the tremendous drop in competitiveness of housing finance institutions. Financial indicators show a general decline, with a 33 percent drop in real asset value between 1982 and 1983.

BCH has been the first institution to use indexation for deposits and credits. The experience has been negative because, on the credit side, the increments in payments, based on the consumer price index, have outpaced capacity to pay. This has been a major factor in raising BCH's delinquency rate to 16 percent of the value of loan placements. This underscores the difficulty of attempting to institute "full" indexation under current conditions.

The BCH has great potential for financing shelter programs for low and moderate income families. To help BCH regain its preeminent role in housing, it will be necessary to:

- Provide BCH with competitive terms for capturing savings (e.g. opening to dollars; decontrol of interest rates).
- Revise the indexing system to maintain the affordability of loans and avoid additional delinquencies.

#### **D. ESTABLISHING AN ONGOING PUBLIC-PRIVATE SHELTER POLICY ANALYSIS AND FORMULATION CAPABILITY**

Establishing a mechanism for shelter policy analysis and formulation has three major purposes: 1) To promote coordination of government and private sector policies and programs in support of shelter objectives; 2) To relate shelter policies to the nation's overall economic development strategy, and 3) To help bring legal and regulatory coherence to the shelter sector. It is essential that representatives of the private sector participate in this policy analysis and formulation mechanism. Relevant private sector groups may include not only the construction industry and land developers, but also housing cooperatives and communal associations.

##### **1. Housing Policy Group**

One possibility is to create a high-level Housing Policy Group which would formulate policy for the shelter sector. This group should be independent of other institutions and should consist of high-ranking representatives of the Housing Ministry, INP, the Finance Ministry, BCR, BANVIP, BCH, the Mutuales, the Banco de Materiales, SENAPA, CAPECO, and possibly others. The decisions of the Housing Policy Group should be binding on the respective organizations.

##### **2. Technical Secretariat**

The Housing Policy Group should be supported by a permanent Technical Secretariat consisting of a very small and high-quality staff of economists, financial analysts, legal experts, and other specialists. The Secretariat should have the capacity to undertake rigorous investigations of policy questions, and its capabilities should include housing market surveys and analysis, evaluation of the impacts and effectiveness of legal and regulatory instruments, and institutional finance analysis. It would be desirable to consider making the Technical Secretariat independent of other ministries or institutions and having it report directly to the Housing Policy Group.

##### **3. National Housing Plan**

As a focus for its work, the Housing Policy Group could be made responsible for producing a short-medium term (3-4 years) National Housing Plan. The

Plan would emphasize the creation of an appropriate framework for public and private shelter activities; it would de-emphasize physical output targets. The main components of the Plan, which would be updated regularly, should include:

- A clear statement of the roles of the various housing sector institutions, in terms of the markets they should serve and the types of operations they should be involved in.
- A realistic estimate of the resources which will be available to each institution.
- An agenda of fiscal and monetary policies needed to enable the institutions to carry out their functions.
- An investment program for shelter solution production and financing.
- A plan and investment program for complementary infrastructure (water, sanitation, drainage, electricity, roads, and community facilities).
- Complementary measures in the areas of 1) improving the productivity of the construction industry (in terms of value added per worker), 2) improving the efficiency of building materials production, 3) making infrastructure standards more affordable, and 4) preventing delays in publicly-supported construction projects.

#### 4. Alternative Structure

If it is not feasible to set up a Housing Policy Group and independent Technical Secretariat as suggested above, a more modest scenario could be considered, as follows: Technical policy analysis units could be established in one of the government agencies (e.g. the Housing Ministry or BCR) and in CAPECO or some other private sector organization. Seminars would be held to bring together public and private representatives to discuss issues and prepare joint resolutions or recommendations. It may be possible to structure a series of public-private "Ad Hoc Commissions" on various aspects of the shelter sector which would be in charge of recommending policy changes and program initiatives.

#### 5. Ministry of Housing

With the creation in recent years of ENACE, SENAPA, INADUR, and ININVI as independent institutions, the Ministry of Housing has lost most of its direct implementation, technical assistance, and normative functions. In some cases, the Ministry continues to do work that duplicates that of one of the new organizations. For example, both the Ministry's Direccion General de Edificaciones and ININVI are responsible for promulgating building codes and standards, but it is unclear how the work is divided between them or which has ultimate authority.

A study should be conducted to identify the existing relationships between the Ministry of Housing and other government agencies and to recommend measures for rationalizing the Ministry's role and internal operations.

### III. SUMMARY OF SHELTER POLICY AGENDA

The attached chart summarizes the preceding policy issues and recommendations, ranking them by priority into three categories: immediate, medium-term, and long-term.

## SHELTER POLICY AGENDA RECOMMENDATIONS

CATEGORY  
LIMITING AND  
FOCUSING PUBLIC  
SECTOR SHELTER  
PROGRAMS

## IMMEDIATE PRIORITY

Subsidies

- Before undertaking new public shelter programs, estimate the projected annual subsidy resulting from the proposed financing terms and subject the estimate to discussion within the housing sector and among key economic planning institutions.
- Raise interest rates in the housing sector as much as possible consonant with affordability to reduce interest rate subsidies.
- Where possible, increase down payments and reduce amortization periods to reduce the interest rate subsidy and generate more funds for immediate reinvestment.
- In individual projects, apply differential plot prices in order to cross-subsidize lowest-cost units without damaging the overall financing soundness of the project.
- In pricing shelter solutions, reflect the true value of the original investment by 1) valuing land, labor, and materials at their real market costs, and 2) factoring in the value of cost escalation during construction.

Targeting of Public Shelter Sector Programs

- Terminate public sector programs for construction of single-family houses, apartments, or core units. Focus public sector shelter programs on sites and services, infrastructure upgrading in low-income areas, and building materials loans.
- The Government should support a large-scale program of lots without services ("lotes tizados") in principal cities.

Infrastructure

- The Government must begin immediately to explore ways to reach agreement with external donors on new financing for basic infrastructure, especially water supply. This will require a willingness to raise tariffs to more realistic levels and to improve management in infrastructure institutions.
- Devise an investment strategy and plan for the water supply sector, which has been underfunded and which lacks a coherent set of policies and objectives.

## MEDIUM-TERM

ENACE

- Eliminate ENACE's housing construction functions and fold its contracting and supervision functions into BANVIP and/or delegate them to other institutions involved in projects.
- As a prelude to closing ENACE, conduct studies of 1) steps required to finish administering its existing portfolio, 2) potential for selling off its unallocated assets, and 3) best means of writing off its unproductive portfolio.

Reducing Shelter Costs for Affordability

- Conduct feasibility studies which will result in concrete ideas for changing design specifications to lower costs.
- Change norms to legitimize the introduction of progressive levels of services over time.
- Overhaul and streamline entire structure for construction permitting. Obligate public agencies to perform the various stages of the process within specified time limits.
- Reform regulations governing control of public construction projects to provide incentives to builders for rapid, on-time performance.
- Develop technical and administrative capacity in construction in the Sierra and Selva through training programs.
- Encourage use of local materials and construction techniques in the interior regions of Peru.

PERU

SHELTER POLICY AGENDA RECOMMENDATIONS  
(CONTINUED)

CATEGORY	IMMEDIATE PRIORITY	MEDIUM-TERM
FACILITATING INCREASED PRIVATE SECTOR EFFORTS IN SHELTER DELIVERY	<u>Mutuales (Savings and Loans)</u> <ul style="list-style-type: none"><li>• Legalize the Mutuales' de facto entry into non-housing credit markets.</li><li>• Pass new legislation allowing mutuales to institute management reforms.</li></ul>	<u>Mutuales (Savings and Loans)</u> <ul style="list-style-type: none"><li>• Open the savings and loan system to savings in dollars and loosen interest rate controls to help it compete in the financial market.</li><li>• Prepare a new strategic plan for the system which takes into account the realities of the market for capturing funds and placing loans.</li></ul>
	<u>Reducing Public Sector Role</u> <ul style="list-style-type: none"><li>• Eliminate high-cost public housing projects and phase out subsidies for public shelter programs to place private sector on more competitive footing in housing market.</li></ul>	<u>Tenure Regularization</u> <ul style="list-style-type: none"><li>• Continue vigorous efforts to legalize established informal settlements in Lima and institute effective legalization programs in other cities to promote private investment in housing construction and finance.</li></ul>
		<u>Rent Control</u> <ul style="list-style-type: none"><li>• Reform rental housing legislation to reduce negative impact of rent control by providing incentives for increasing the supply of rental housing.</li></ul>
		<u>Reforming Legal/Administrative Structure</u> <ul style="list-style-type: none"><li>• Streamline project review and approval process to make it easier for private developers and builders to function as providers of shelter.</li><li>• Review laws and regulations governing subdivisions, building codes, and land use to identify and eliminate ambiguity, overlaps, and contradictions hampering private initiative.</li></ul>

PERU  
SHELTER POLICY AGENDA RECOMMENDATIONS  
(CONTINUED)

CATEGORY  
IMPROVING THE  
EFFICIENCY OF  
FINANCIAL  
INTERMEDIATION  
IN SHELTER

IMMEDIATE PRIORITY

Maintenance of Value

- Implement some type of indexing system in loans of key shelter programs, including BANVIP, FONAVI, and the Banco de Materiales.
- Devise a formula for raising the income base from which FONAVI contributions are calculated so as to keep up with, at least, the wage and salary index.
- Raise real interest rates on FONAVI loans to match the prevailing rate for Mutuales.

MEDIUM-TERM

Maintenance of Value

- Extend indexing systems to all operations (loans and deposits) of housing finance institutions. The wage and salary index is the most frequently-mentioned basis for an indexing system under current high-inflation conditions.

Banco de la Vivienda

- Substantially improve BANVIP's management control over FONAVI, including better control over contributions and implementation of a system to maintain the value of the fund.
- Restore BANVIP's role as setter of financial policy in the public shelter sector. BANVIP should have capacity to allocate public shelter resources among various programs and responsibility for maintaining maximum financial soundness in housing sector operations.
- Improve cooperation between BANVIP and the public utility companies.
- Involve BANVIP directly with selected municipalities. At the outset the municipality's role may be limited to implementation (as is the case with the utilities now).

FONAVI

- Reform FONAVI's financial regime (interest rate structure) to allow it to obtain a rate of return sufficient to borrow from external sources and mix with its own funds, as permitted by its enabling laws.

Banco de Materiales

- Improve internal financial management and controls, focusing on limiting operating costs and achieving efficiency in financial operations.
- Reach greater numbers of lower-income families with "Type C" loans.
- Provide technical assistance to borrowers for more efficient use of materials.

Banco Central Hipotecario

- Permit BCH to capture savings in dollars and loosen interest rate controls to help restore its competitiveness.
- Improve technical quality of management and provide flexibility to respond to market conditions.
- Revise indexing system to maintain affordability of loans and avoid delinquencies.

LONG-TERM

FONAVI

- Explore feasibility of converting into a real financial fund with contributions from employees and to pay a rate of return to cover the objective would be to increase volume of resources available to

BANVIP

- Phase out direct lending and move operating strictly as a second-tier organization.

Banco de Materiales

- Study potential for turning BM financial institution by enabling capture savings and making it a for its own financial viability

PERU  
SHELTER POLICY AGENDA RECOMMENDATIONS  
(CONTINUED)

CATEGORY  
ESTABLISHING  
AN ONGOING  
PUBLIC-PRIVATE  
SHELTER POLICY  
FORMULATION  
AND ANALYSIS  
CAPABILITY

MEDIUM-TERM

Housing Policy Group and  
Technical Secretariat

- Consider creating a high-level Housing Policy Group to formulate shelter policy. Group would be independent and consist of high-ranking representatives of government bodies and private groups. Group's decisions would be binding.
- Support Housing Policy Group with small, highly qualified Technical Secretariat composed of economists, financial analysts, legal experts, etc. Desirable for Secretariat to report directly to Policy Group.

Housing Plan

- Focus Housing Policy Group on producing short/medium term National Housing Plan emphasizing creation of appropriate framework for public and private shelter activities. Main components of Plan would be realistic financial resource estimates and guidelines for effective operation of financial intermediaries; clear statement of roles of shelter institutions; agenda of fiscal and monetary policies to support shelter; investment program for public sector shelter actions; investment program for complementary infrastructure; and additional measures addressing construction productivity, building materials, infrastructure standards, and streamlining public sector implementation.

Alternative Structure

- If Housing Policy Group/Secretariat not feasible, consider establishing housing policy analysis units in a government agency and in a private sector organization. Bring two together in seminars to discuss issues and prepare joint resolutions or recommendations. Examine possibility of structuring public-private commissions to recommend policy changes and program initiatives.

Ministry of Housing

- Conduct study to recommend measures to reduce duplication of effort between Ministry and other institutions and to rationalize the Ministry's role and internal operations.