PN-AAY-553 46394

# AN EVALUATION OF THE AID ROLE IN THE DEVELOPMENT OF HOUSING FINANCE IN THE DOMINICAN REPUBLIC

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1985

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# CHAPTER I

## EXECUTIVE SUMMARY

### Overview of Conditions in the Dominican Republic

The Dominican economy is extremely dependent on world markets due to its concentration on primary activities such as agriculture and minerals. Additionally, the country has labored under high unemployment rates, averaging 20% for the years 1974-1983, with underemployment even higher. Prior to 1974, the Dominican Republic was considered one of the brightest economic spots in Latin America because of increasing sugar prices, continued foreign investment and expansion of domestic credit. However, a severe drought in 1976, a drop in sugar prices and export earnings, and a sluggish construction and housing market slowed the economy down considerably.

In recent years, the Government has attempted to deal with the country's immediate financial problems by promoting investment, exports and employment while containing inflation. In early 1983 the Government began a rigorous structural adjustment program in cooperation with the International Monetary Fund (IMF) and undertook renegotiation of a major portion of outstanding commercial debt with foreign banks. This continuing financial crisis, along with associated scarcities and higher import costs, has resulted in increased unemployment, reduced private and public investment, and a cut back in government services. As a result, much of the population has suffered a decline in real living standards.

Further debt renegotiations, eventual agreement with the IMF, and additional development assistance will provide some balance of payments relief but future prospects still appear difficult. Inflation, successfully contained at about 7% in 1982 and 1983, is projected to exceed 30 percent during 1984 increasing already heavy economic pressures on the middle class and the poor and stimulating demands for wage increases.

Housing Finance in the Dominican Republic

Up until 1962 there was no structure for financing of the construction industry or housing. The only financial entities in existence were commercial banks and the Bank of Agricultural and Industrial Credit. When the political regime changed in the 1960's, the opportunity to install a housing finance system patterned after the U.S. savings and loan institutional model was used to create the Dominican savings and loan system. Since then it has become the major source of home financing in the Dominican Republic. It is composed of the Banco Nacional de la Vivienda (BNV), the National Housing Bank, and 17 savings and loan associations which at present comprises about 45 percent of all housing finance outstanding. The Agency for International Development through technical assistance, seed capital loans and housing guaranty loans played an important role in the establishment of the housing finance system.

The system incorporates two very powerful housing finance mechanisms that were patterned after U.S. models, namely FHA mortgage insurance and a secondary mortgage market operation. By 1984, the savings and loan system had established itself firmly as a prominent network of financial institutions that gathers approximately 35% of the savings generated in the Dominican Republic. In only twenty-two years, from nothing in 1962, the savings and loan system evolved from a state of non-existence to a system that can now depend on over 670,000 operating savings accounts.

The importance of the savings and loan system in housing finance cannot be oversited. Between the years 1972-1977, the savings and loan system (BNV and savings and loans) financed approximately 17,654 housing units, representing 51.8% of the total number of the units financed in the Dominican Republic. Total assets have also grown considerably since the creation of the system in 1962--from RD$1,7 million to RD$1,011.8 million in 1983 for both the BNV and the savings and loan system. This is an average annual growth rate of 38.2%. In the first five years alone, associations increased their assets by more than 14 times in the form of a large number of mortgage loans. In 1964, savings and loans made a total of 1,345 loans amounting to RD$7 million. In 1983, savings and loans made 47,234 loans

amounting to RD$921.6 million. This represents an average annual growth of 20.4% of the number made.

The other lendeers in housing finance are mortgage bankers and commercial banks in the private sector and INVI (Instituto Nacional de la Vivienda) and INAVI (Instituto de Auxilios y Viviendas) in the public sector. Ths informal sector also plays a significant role in providing shelter, especially in rural areas.

AID Inputs in the Development of D.R. Housing Finance System

The development of AID's housing objectives in the period from 1962-84 can be divided into three main periods:

Development Period 1962-1964

Housing Guaranty Program 1964-1974 (Initial Period Housing Guaranty Program 1974-84 increased emphasis on low-income beneficiaries)

The objectives of the development period were geared to the founding of a housing finance system, with all the attendant problems of setting up new institutions and introducing new services where they didn't exist before.

From 1964 to 1974 the objectives were similar to the Development Period, only most of the institutions had been formed and needed to increase their volume of operations to grow and develop in a healthy manner. In 1974 the U.S. Congress mandated that all U.S. AID programs should focus their benefits on lower income groups.

Throughout the 22-year period (1962-84), two clear AID objectives have been set forth.

- To stimulate the development of institutions and mechanisms to finance housing and thereby increase the production of housing in the Dominican Republic.

- To help create and then develop the institutions and mechanisms to permanently supply housing finance funds on an ongoing basis.

The major conclusion of this study is that AID was successful in achieving those objectives.

## Technical Assistance and Development Loans

AID and State Department personnel associated with the Alliance for Progress assisted in the original actions taken to develop a savings and loan system. Legislation was passed in June of 1962 and AID sent its first housing technical assistance team to the DR. Major recommendations included:

- that AID authorize a development loan to establish and pay for the operations of the BNV through June of 1964;
- that AID provide technical assistance in preparing the rules and regulations of the BNV;
- that AID finance the provision of an experienced savings and loan official who would assist the BNV and savings and loan associations.

All three recommendations were carried out and the BNV and savings and loan associations in Santo Domingo and Santiago were established. Personnel were sent to San Juan, Puerto Rico and Miami, Florida for training.

At the same time, a low-interest AID Development Loan of $2.1 million was provided, $2 million for the capitalization of the BNV and US$100,000 to be used for BNV start up expenses. This development loan along with a second one for 5 million dollars in 1966 were essential to the start-up of the system. Without these seed loans it would have been difficult for the system to get underway. Subsequently, the BNV/Savings and Loan System became self-sufficient supplemented by further assistance from AID. It did not require further financial resources for the GODR.

## The Housing Guaranty Program

The two AID Development Loans were instrumental in bringing the BNV and the savings and loan system to life but it was the subsequent HG Loans that gave the system a chance to survive by providing time in which to build its

savings mobilization programs and its technical expertise. The first HG was authorized in May 1964, for $4.6 million to finance 600 middle-income homes in a project in Santo Domingo built by a private developer. The Popular Savings and Loan Association was the administrator of the loan.

The next HG loan was structured similarly with the Popular Savings and Loan Association again the Administrator. However, by the time the next HG loan was authorized in 1969, AID had decided that the loans would go directly to the BNV (rather than private developers) who in turn would distribute funds to the builders and savings and loan associations.

The positive results of the first HG Loan were especially notable on the Popular Savings and Loan Association which gained a badly needed volume of loan activity as well as a great deal of stature, recognition and prestige in the community for funding such a large project by Dominican standards. This, in turn, helped its savings mobilization efforts as well as increasing demand for its mortgage loan services. The first two HG loans gave La Popular a tremendous boost in its early years and helped it to experience rapid growth and establish it as the dominant individual savings and loan institution and one of the most important financial institutions in the Dominican Republic.

In the technical area, housing design and construction standards, as well as techniques of construction management, proved to be immensely helpful to the development of the FHA Department within the BNV. Up to the time that AID got involved in housing in the Dominican Republic, housing projects (mostly small) used a very casual architectural and engineering approach. Most projects were developed from two-page sketches. With the arrival of AID, much more professional FHA-type procedures were introduced. Building codes and standards were developed along with a growing technical capability within the FHA Department. In many cases U.S. FHA forms and procedures were translated into Spanish, in others they were adapted to Dominican conditions. The net result, however, was to firmly establish professional level requirements for any housing project proposal.

All subsequent HG Loans were made directy to the BNV who distributed the funds through the savings and loan associations. This direct involvement with

the BNV rather than with a builder-developer helped in the institutional development of both the BNV and the savings and loan asociations. The BNV was able to channel funds through other associations and help them to grow as well.

For the system as a whole the increased mortgage lending activity HG Loans generated also created servicing fees and mortgage insurance fees which added significantly to the financial strength of the institutions. As was the case with La Popular, public acceptance generated by these loans transferred into increased savings mobilization. Public acceptance and confidence in new financial institutions are difficult characteristics to develop. The HG Loan Program through its financial inputs and association, was a critical factor in this area. The generation of domestic savings, the critical ingredient for future development, now began to take hold and grow at a rapid rate.

Secondary Market

In the first seven years of BNV's secondary market operation (until 1970) the effective savings were increased by approximatly 1.5 times annually. That is, for every peso deposited in a savings instrument, another peso and a half was added to the savings institutions' lendable funds. The principal reason the secondary market outstripped savings mobilization in these early years was, of course, due to the AID funds which were also being used by the BNV to buy the loans of the associations. Its is clearly demonstrated that using AID funds in this manner precipitated the formation of a secondary market.

During 1971 and 1972 this ratio of secondary market funds to savings dropped below 1. Subsequent drops in this ratio to approximately .7 were also due to the impact of mortgage banks, who entered the market heavily in the mid-1970's.

In any event, for their early period of 1963-70 the savings and loan system had a virtual monopoly on the use of secodary market funds provided by BNV and this, in turn, multiplied the effective impact of the early AID loans.

## Constraints on AID Housing Objectives

The last disbursements for an implemented HG Loan (008) were completed as far back as 1977. That loan was approved in November of 1972 and signed in April, 1973. In the interim HG-009 was approved, then de-authorized. There are a number of reasons which have resulted in the discontinuance of AID Housing Guaranty activity in the Dominican Republic.

The reasons fall into those caused by constraints can be clasified into general categories:

- external conditions developed outside the Dominican Republic
- and internal conditions developed inside the Dominican Republic

With regard to external conditions, the consensus is that there are four principal reasons:

- Worldwide economic difficulties beginning with the oil crisis in 1973.
- Eschange rate difficulties with balance of payments and debt service implications.

- High interest rates in the U.S.

- Strict low-income requirements associated with the HG Program which has made it less attractive to the savings and loan associations.

2. Internal Conditions

In considering internal conditions, the following constraints can be divided into those that became increasingly evident during the 70's through to the present and those that became more pronounced since 1980. They are as follows:

- Conditions affecting AID involvement in housing in the Dominican Republic since 1970.

- The GODR was reluctant to borrow externally for housing in the late 1970's even at favorable interest rates.

- As the savings and loan system became more self-sufficient, the need for AID assistance programs became less marginal, in contrast to the early and mid-sixties when it was absolutely essential.

- The relative weakness of public sector institutions concerned with low-income housing. INVI and INAVI have consistently demonstrated limited capabilities in responding to the shelter needs of the low-income sectors.

- The persistent lack of a comprehensive, consistent national shelter policy, within which a lower income program could be articulated.

b. Conditions becoming more pronounced since 1980

- High local inflation and interest rates, exceeding the 12% usury ceiling create significant problems for financial intermediaries and lending institutions.

- The lack of variable or adjustable mortgage instruments has created problems for mortgage lending institutions saddled with portfolios of fixed rate mortgages at lower rates.

- The relatively high liquidity in the savings and loan system. The problem has not been availability of funds in the 1980's but the difficulty in the proper placement of funds with a limited market of qualified or interested borrowers.

- Affordability or ability to repay loans on the part of low-income families is a real concern for financial intermediaries with fiduciary responsibilities. Low cost projects are considered by the savings and loan associations to be high risk.

- The lack of flexibility and diversification capabilities within the savings and loan system because portfolios are restricted to long-term home loans. Other, more lucrative shorter term loans or other revenue generating activities are not within allowable activities. The inclusion of diversified activities within a savings and loan association's portfolio could be balanced off with low-income housing components within that portfolio.

- In the past few years there has been a precipitous increase in construction costs within the Dominican Republic. At the same time there has been a lowering of disposable income as increases in the costs for food, clothing, health and education have exceeded increases in wages which have in general remained unchanged. This "drying up" of disposable income has lowered the effective demand for housing.

## LESSONS LEARNED AND CONCLUSIONS

In reviewing the antecedents and accomplishments of AID's housing program in the Dominican Republic, one is struck with two general overrriding conclusions within which most other conclusions fall. The first relates to the enormous success recorded by the first ten years of the AID Program. The second relates to the expectations and frustrations that were generated by that early success.

One of the first lessons learned was the effectiveness of taking advantage of political events. A change in government many times creates opportunities for new ideas, approaches and programs regarding housing. Such was the case in 1962 with the fall of Trujillo and the establishment of the Alliance for Progress.

The importance of individual contributions, especially in leadership roles, should be recognized. The motivation, talents and commitments of key individuals such as Gustavo Tavares Espaillat were involved in the establishment of the savings and loan system and can make or break a program as complex as that installed in the Dominican Republic. Without truly committed and properly supported individuals, the establishment of a housing finance system can easily bog down in bureaucratic and political problems.

The Dominican Republic in the early 60's was not unlike many less developed countries past and present. Institutional development was uneven with significant gaps occurring in both private and public institutions for housing. AID's contributions in structuring the BNV, savings and loan associations and INVI were substantical. These accomplishments in institutional development were perhaps the most significant accomplishments of a successful program.

The essential ingredient in the above mentioned institutional development process was the transfer of "know-how" through technical assistance. The raising of technical and professional skill levels was necessary to build the BNV and savings and loan system.

Two of the most significant institutional achievements we were the early establishment of the FHA mortgage insurance program system and the secondary mortgage operations market within the BNV and savings and loan system. The successful inclusion of rather sophisticated mortgage mechanisms is a significant accomplishment for the system.

The FHA mortgage insurance program proved to be one of the major strengths of the Dominican System. It provided security, stability and uniformity to the savings and loan associations and an orderly structure within which standards and quality could be improved. It gave a validity and strength to the mortgage document that then allowed it to be considered a credible investment grade financial instrument that could be later packaged and traded in secondary capital markets. To accomplish the structuring of the FHA mortgage program less than two years after the founding of the system was truly an outstanding accomplishment.

The successful development of a secondary mortgage market grew out of the FHA Insurance Program. It also grew out of the original concept of a BNV that would act as an intermediary for the savings and loan associations. After the FHA mechanism was in place procedures were established to move mortgage contracts from the savings and loan associations to the BNV and from the BNV or the association directly to the public. These packages of mortgage

contracts were purchased by commercial banks, insurance companies and private investors.

This refinancing of mortgages returned funds to the savings and loan associations who then made more mortgage loans. This replenishing cycle obviously multiplied the lending capability of the association and was a principal reason the system established itself so quickly among Dominican financial institutions.

In developing a sophisticated housing finance system, the proper training of individuals was essential and the role of this training was mentioned earlier.

The Dominican housing finance system was established with "mutual-type" savings and loan associations rather than those of the stock (corporation) variety. This pattern copied the predominant system of the U.S. at the time. The big advantage of the mutual system was that it was easier to sell to the public, to the community, and it was easier to collect the required deposits to start up a mutual-type association (RD$200,000 each).

The BNV finished up the job of organizing savings and loans in the communities. The idea that the savers or depositors owned the association and that the government was backing the system (through the BNV) gave this new idea credibility.

The relatively healthy condition in which the savings and loan industry now finds itself, in the admittedly difficult times the Dominican Republic is now experiencing, only reaffirms the soundness of the system. It also underscores the real and lasting value of the efforts that went into building the system. A measure of the stability of the system is also the relative ease with which it has absorbed changes and adapted to conditions.

The BNV/Savings and Loan System has evolved into a true quasi-public/quasi-private institution that incorporates the strengths of both sectors. The five member Board of the BNV is now made up of two members selected by the Government and two members selected by the savings and loan

associations. These four then agree on a president, the fifth member. The General Manager is appointed by the Board. Both sides have significant input, or veto power over the other. It seems to work quite well and has prevented the BNV from becoming overly politicized which is a danger for most public institutions in the Dominican Republic.

A strong identifiable characteristic of the BNV/Savings and Loan System has been its resourcefulness coupled with a keen instinct for marketing and promotion. It sold itself to the Dominican public convincingly. It promoted, it advertised, it served its customers better than its more conservative commercial bank competition. It has aggressively competed for savings and has consistently used its "differential" over bank savings accounts effectively. An outstanding amazing example of market penetration is that La Popular Savings and Loan collects more savings than the largest commercial bank. This was accomplished in a little more than twenty years:

The BNV/Savings and Loan System communicated an important, clear message to the public--that the "good life" was attainable by all sectors of the population--if they developed the habit of saving. This message reached a new, lower socioeconomic level of people that had never been reached before. The system helped them to change their living habits and helped them enter the middle class.

Although practically all of the HG Projects in the Santo Domingo area have been successful, this is not true in the secondary cities even though there is a burgeoning need for housing, especially in the low-income sector.

At present, the associations are of doing in-depth market demand analyses and affordability/cost recovery studies to avoid the marketing problems they have encountered.

The savings and loan business is one of the most "interest rate sensitive" businesses in existence. The most difficult situation that the Dominican system faced was that associations were holding "fixed rate mortgages in a highly volatile interest rate scenario. However, the System has survived. No doubt loans to nonresident Dominicans helped, but the usury

limits of 12% had not been revised. Recognizing that the system can only survive in this kind of situation for a limited period of time, it is searching for some relief by pressing for a change in mortgage instruments. Although a variable rate mortgage is apparently not politically feasible at this time, a renegotiable rate mortgage or Rollover Mortgage (3-5 years) is possible. Such a development would help the BNV/Savings and Loan System tremendously.

At the same time, since it has also been politically impossible to raise the 12% usury limit, other short-term solutions have been used. The use of "front-end" points, fees and commissions have helped but they also tend to put an added burden on the borrower.

The other area that the system is looking to for some relief is "diversification." Being restricted to long-term home loans acts as a constraint on income generation. If it had the ability to make shorter, more lucrative loans and investments, lending capabilities for home loans would also be enhanced.

In retrospect, one of the few negative lessons learned were the negative reactions from associations to AID imposed home-price restrictions on all loans made through the BNV. There was a general feeling that the BNV and the associations needed some time to establish themselves before they could afford to provide loans to lower income families.

Another negative experience has been the problem of arrearages by the Central Bank (Banco Central) on payments due U.S. lenders for previous HG Loans. The problem here is that the BNV/Savings and Loan System, as in the past, has made its payments in a prompt and timely manner. However, since the payments need to be made in dollars, these funds must pass through the Central Bank before reaching the U.S. lenders. The Central Bank has delayed in passing these payments through because of the balance of payments problem and the subsequent renegotiation of the GODR external debt with the International Monetary Fund.

In addition to the previous conclusions gleaned from past experience which are already noted, there are four recommendations which suggest themselves for possible consideration in developing future housing provisions for lower income families in the DR.

1. The concept of combining both public and private sectors in a HG Project is certainly not new, as has been demonstrated in the body of this report, but is recommended here again because it appears to be the best way to bring the skills and resources of the private sector to bear on the low income housing.

2. Recognize that the formative stage of development has occurred for the BNV/Savings and Loan System and that HG Loans should be looked at as supplements to a diversified savings and loan system. The BNV/Savings and Loan System has an acknowledged responsibility in assisting a national program for low-income housing. At the same time, a strong argument for getting favorable "diversification" legislation would be to incorporate low-income components in the institutions' mortgage portfolios.

3. Consider the concept of a blended HG Loan, wherein funds from a U.S. lender are blended with Emergency Support Funds of AID (if available) and local funds of the BNV/Savings and Loan System to form a package that together with government land might increase the feasibility of some low-income housing projects.

Applicability of the Dominican Experience to Latin America. Much of the report is applicable to other countries in Latin America because of similarities in the development of their housing finance systems. One of the principal institutions of the shelter sector throughout Latin America is the savings and loan system in each country. These systems all developed at about the same time with similar kinds of support and guidance from AID-Housing.

Three phases occurred:

a. Institution Building Stage
   i. Technical Assistance
   ii. Capital Assistance

b. Growth and Development Stage

c. Crisis Stage (late 1970's)

What then are some of the factors which influenced or impacted on the Dominican syste, that could be applicable to other Latin countries? The most prominent are listed below but there should not be construed as recommendations.

1. Development of an FHA-type insurance program, exclusive to the savings and loan industry.
2. Development of a secondary market mechanism.
3. A "differential" on rates payable for savings accounts.
4. Aggressive marketing and promotion of the image of a viable institution sensitive to the needs of middle and lower income people.
5. The necessity to have an adequate monetary correction mechanism in place or to adopt some form of variable rate mortgage instrument.
6. Avoid total control or politicization by the government. Regulatory body should seek public/private type institution with balance.
7. Seek some type of diversification attaining access to short-term lending and investment markets.
8. Develop a lower income shelter strategy within the savings and loan system that enhances its bargaining power with national governments and international lending agencies, including viable approaches for secondary cities.

11. Savings and loan institutions, when developing housing projects, should include a more comprehensive community development approach along with housing considerations.

# CHAPTER II

## BACKGROUND CONDITIONS AFFECTING HOUSING AND HOUSING FINANCE IN THE DOMINICAN REPUBLIC

### A. Overview of Economic, Political and Social Conditions

#### 1. Background

The Dominican Republic occupies the eastern two-thirds of the island of Hispaniola in the Caribbean; the western third forms the republic of Haiti. It has a total area of approximately 18,000 square miles, about the size of Vermont and New Hampshire combined with a coastline of more than 1,000 miles. The current population is about six million.

Under the 1966 Constitution, the Dominican Republic is a representative democracy whose national powers are divided among independent executive, legislative and judicial branches.

The President heads the executive branch of the government and is elected every four years. Legislative power is exercised by a bicameral Congress, a 27-member Senate and 74-member Chamber of Deputies. The highest court in the Dominican Republic is the Supreme court of Justice whose nine members are elected by the Senate. The country is divided into 26 provinces with the governor of each appointed by the President.

#### 2. The Urbanization Process within the Dominican Republic

Stimulated by rural poverty, internal migration to major Dominican cities has been accelerating in recent years. While overall annual population growth has been hovering around the 3% mark, urban population has been expanding at about a 6% rate. Over half of the population (over 3 million) now live in urban areas as opposed to 1.6 million in 1970 (39.8%) and 900,000 in 1960 (30.3%). Main destinations of this movement are the capital of Santo Domingo (1,500,000), Santiago (300,000) and a dozen other towns in the 50,000

to 100,000 range. Although the average income in cities is higher than in the country, this differential may be more apparent than real for the migrants, most of whom remain confined at the bottom of the income ladder.

Newcomers generally settle in rapidly growing marginal concentrations, deprived of most elementary urban services, erecting their own temporary dwellings with scrap materials, timber, tin and billboards. Illiteracy is high in these districts, social problems frequent and the lack of adequate sanitation causes heavy incidence of dysentery, typhoid and other diseases. In order to minimize distance from areas of potential employment, squatters have first occupied all kinds of used public land near the city center, often on flood-prone river banks or marshes, and are now forced to seek location in more remote peripheral zones. Approximate counts of these improvised dwellings put their number at over 200,000 units, possibly involving over 1.3 million residents.

3. The Economy

The Dominican economy is extremely dependent on world markets due to its concentration on primary activities such as agriculture and minerals. The export of sugar, coffee, cocoa, tobacco, ferronickel, bauxite and gold ore makeup a large percentage of export income, which is then used to finance imports and the accumulation of capital goods from the exterior. The economy was fairly stable until world oil prices began rising in 1973, which began an inflationary process the country has not yet been able to stem.

Additionally, the country has labored under high unemployment rates, averaging 20% for the years 1974-1983, with underemployment even higher. This is due in part to limited employment opportunities in the manufacturing field--which is characterized by high ratios of capital to labor and limited internal production of capital goods--and a high concentration of industry and commerce in Santo Domingo and Santiago. This has resulted in other regions suffering from low levels of economic development and migration of human and financial resources to the more attractive regions.

Prior to 1974, the Dominican Republic was considered one of the brightest economic spots in Latin America because of increasing sugar prices, continued foreign investment and expansion of domestic credit. Growth rates were still high (10-12%) and inflation was running at only 2.9%. Increased sugar prices staved off the effects of a quadrupling of petroleum prices in1974 and a boom in construction tempered additional increases in 1975. However, a severe drought in 1976, a drop in sugar prices and export earnings, and a sluggish construction and housing market slowed the economy down considerably.

It was in 1977 that the government began to have a balance of payments problem and was forced to rely on increased borrowing in the international money markets. Exports were down and imports up so that when major tropical storms struck in 1979 the country was already in an economic slowdown which was exacerbated by these storms. The Government adopted a series of measures for income redistribution, including an increase in the minimum wage, salary increases to persons earning less than $300 per month and an augmentation of the minimum wage for government workers. Up to that point, there had been no national plan to guide development in the country.

In recent years, the Government has attempted to deal with the country's immediate financial problems by promoting investment, exports and employment while containing inflation. In early 1983 the government began a rigorous structural adjustment program in cooperation with the International Monetary Fund (IMF) and undertook renegotiation of a major portion of outstanding commercial debt with foreign banks. Specifically, the government implemented austerity measures in late 1982 and 1983--including increased taxes, broad import bans, decreased credit, and increased transfer of import payments from the official to the parallel exchange market. However, the country continues to face extremely difficult economic conditions marked by continued low international prices for its commodity exports, high import demand, severe liquidity problems and slow economic growth.

This continuing financial crisis, along with associated scarcities and higher import costs, has resulted in increased unemployment, reduced private and public investment, and a cut back in government services. As a result,

much of the population has suffered a decline in real living standards. Since October, 1983, government apprehension over the social and political consequences of further adjustment measures under the IMF arrangement led to difficult, prolonged negotiations with the IMF.

Major monetary policy changes in recent years have been adopted by the government en route to obtaining IMF assistance. The Central Bank's Monetary Board raised interest rates on time deposits, financial bonds and mortgage bonds by averages of 1, 2 and 1.75 percentage points respectively while simultaneously freezing interest rates on loans. At the same time, the Central Bank raised the interest rate it pays to financial institutions for their legal reserves on deposit with the Central Bank to offset these deposit rate increases. The Monetary Board also approved the creation of a new financial certificate with 1-3 year maturities and interest rates equal to or exceeding U.S. Treasury notes. They can be sold in varying minimum denominations by commercial banks (RD$50,000) mortgage banks (RD$150,000) and savings and loan association (RD$100,000). The measures were designed to stimulate savings, increase the lending capabilities of financial institutions and reduce credit demand pressure on the Central Bank. Legislation was also approved in June 1983 to permit the registration of foreign investment in foreign currency instead of pesos.

In April, 1984, as a precondition to continuing the IMF program, the GODR took several further austerity actions including: (1) increasing the exchange incentive for traditional exports; (2) transferring all import payments except petroleum and old debt to the parallel exchange market; (3) ending new Central Bank increases in credit to the public sector. Not unexpectedly, these measures were followed by strong public protests.

Further debt renegotiations, eventual agreement with the IMF, and additional development assistance will provide some balance of payments relief but future prospects still appear difficult. Inflation, successfully contained at about 7% in 1982 and 1983, was projected to exceed 30% during 1984 increasing already heavy economic pressures on the middle class and the poor and stimulating demands for wage increases. Because of the severe financial problems the Central Bank has faced in the last several years,

remittances of dividends, royalties and other foreign investment returns (including HG Loan repayments) have been regularly in arrears.

## B. The Housing Sector 1960-84

### 1. Overview of Housing Finance in the Dominican Republic

Up until 1962 there was no structure for the financing of construction and industry. The only financial entities in existence were commercial banks and the Bank of Agricultural and Industrial Credit (an autonomous institution of the State). Under the Alliance For Progress, seed capital was provided by AID for the construction of social housing and assistance for governmental organizations geared toward housing. It was also used in the creation of financial intermediaries for housing of lower income sectors.

Other objectives of the public institutions created to produce housing were: the reduction of the growing housing deficit and urban deterioration; the utilization of a growing number of manual laborers; the stimulation of demand of goods and services, thus increasing the level of industrial jobs; the formation of a middle class to stimulate private incentive; and a redistribution of the national income through state-sponsored programs to limited income groups.

In order to achieve these objectives, the government converted or created several entities including the Institute of Social Services and Housing [Instituto de Auxilios y Viviendas (INAVI), 1961], the National Housing Institute [Instituto Nacional de Vivienda (INVI), 1962] the National Housing Bank [Banco Nacional de la Vivienda (BNV), 1962], the Corporation of Industrial Promotion [Corporacion de Fomento Industrial (C.F.I.), 1962] and the Institute of Cooperative Development [Instituto de Desarrollo Cooperativo (IDECOP),1963]. Additionally, approval was given in 1966 for the operation of financial societies (sociedades financieras), and mortgage banks (bancos hipotecarios) were authorized in 1971.

The main entities designed specifically to serve housing were INVI, INAVI, BNV and the mortgage banks. INVI and INAVI were created to finance and

implement housing for low-income groups and public-sector employees respectively, the Banco Nacional de la Vivienda was to assist in the creation of a private savings and loan system which would serve low- to middle-income housing, and mortgage banks were to finance the construction of housing and other types of building for a higher income segment of the population (a more complete description of the financial institutions follows in the next chapter).

The major source of home financing since its creation has been the savings and loan system composed of the Banco Nacional de la Vivienda (BNV), the National Housing Bank, and savings and loan associations, which at present comprises about 45 percent of all housing finance outstanding. Mortgage banks constitute about 20 percent of the outstanding mortgage loans. By contrast, INVI and INAVI represent less than 15 percent of total housing loans. This low level can be attributed largely to the policies of the government during the period between 1972-1978, when the Office of the President completely dominated the low-income market and became the largest source of low-income housing--a function which could have been carried out by INVI. INVI, however, was plagued with administrative problems and was not viewed as an efficient provider of housing finance.

One of the major obstacles in the delivery of housing finance has been the lack of a coherent governmental housing policy. The present housing finance institutions have tended to focused on middle and upper income housing at the expense of low-income families. The need in this market is great and consequently, much of the housing for lower income families has been produced through informal means and, in the rural areas, has produced more than 90 percent of all housing. To help remedy this situation, the government ordered a reorganization and redirection of INVI to become the main governmental agency responsible for providing housing solutions to a broader range of low-income groups. In the private sector, a 1979 savings and loan seminar resulted in the formulation of some policies aimed at providing more credit to low-income households.

So far, the effects of these changes in policy have not been clearly evident. Increases in interest rates and difficult economic times have made

it almost impossible for savings and loans associations to make loans to low-income persons who do not have the capacity to save or repay the loans. Recently, INVI has experienced other substantial problems due to its involvement in financing a massive middle income housing project (Invivienda) whose costs have skyrocketed. A recent change was made by the government to relieve INVI of the completion of that project and make it the sole task of a Government commission created especially for its completion.

2. Construction Industry (1962-1984)

The construction industry has made a considerable impact on the economy of the Dominican Republic, averaging 5.8% of the gross domestic product during the period 1962-1982 and representing almost 67% of the gross formation of capital. The dollar amount of construction rose from RD$27,550,700 in 1962 to RD$1,127,200,000 in 1982. This continued strength of the industry helped bolster the economy several times when it appeared the economy would register little or no growth at all due to increases in petroleum prices and increases in sugar prices.

Housing construction in the Dominican Republic has closely paralleled overall construction and has also contributed greatly to the economy. During the years 1962-1982, residential construction accounted for 25-30% of the total investment in construction. If equipment and related services are added, it is estimated that the investment in housing as a part of the total investment in construction fluctuates between 70-80%.

Part of the reason the construction industry did not fall victim to some of the country's economic cycles is due to its multifaceted nature. Not only is the industry involved in major government residential projects, but it also benefitted from major civil works and specialized engineering tasks; utilizing government, semiautonomous, private and informal entities. Despite the existence of various agencies, however, the construction industry is concentrated in a few large firms with a small number of domestic and foreign construction firms dominating the production sector, particularly the public works and nonresidential projects.

Although the construction sector has historically been a strong element in the Dominican economy, recent increases in prices have affected overall production. The formal residential construction sector, which has traditionally used wood frame walls and wooden roof trusses, has been forced to rely more on concrete block or reinforced concrete wall construction due to a government ban on the cutting of timber, which now must be imported. The informal construction sector has also moved toward concrete block and zinc roofing material due to the depletion of previously used local materials such as palm and cane.

Even with the reduction in overall production, the construction sector continues to be a major provider of employment. In 1962, the construction industry had a high rate of unemployment (estimated as high as 70%). It has averaged 20-25% over the last few years although with 40-45% underemployed. In 1978, construction employment represented approximately 7.6 percent of the total formal sector employment and has grown annually since 1970 at the rate of about 9.4 percent. In 1970, the construction industry employed 30,130 persons (2.8% of total employment), of which the housing sector supported 45%. In 1979, employment had increased to 56,764 (3.6% of total) with the housing construction industry representing 73% of that number. Salaries, however, have not kept pace with the rising cost of living.

The number of units of housing constructed during the ten-year period, 1960-70, according to census data, was 141,753 and this increased to 270,216 for the decade of the seventies. In the sixties, the formal sector accounted for only 21,000, or 15% of the total while the informal sector produced 120,753, or 85% of the total production for the decade. In the 1970s, however, formal sector production increased dramatically to 211,520 amounting to 78.3% of the production. If broken down by public and private sectors, the public sector accounted for 43,696 houses (74% of the sector and 16.17% of the total country production) and the private sector completed a total of 15,000 units (26% of the sector and 5.5% of the total country production).

Despite gains in the provision of adequate housing for the residents of the Dominican Republic, a serious shortage remains. This is due to the rising population growth rate and the increasing immigration to the urban areas.

Urban deficits are estimated at 13-23 percent, while rural are as high as 64 percent. It has been estimated that in order to satisfy the housing demand incurred because of population growth, an average of 32,900 units per year must be constructed. Between 1972 and 1977, the total number of units financed by the principal housing institutions and groups was 34,020--a five-year figure only slightly above what is now needed annually.

The informal sector plays a major role in the provision of rural housing, with estimates which run as high as 90% of all rural housing. It is also estimated that the informal sector produces at least 10,000 units per year in Santo Domingo alone. Typically, such houses are constructed out of local materials such as palm and cane as well as waste materials. There is little coordination between the formal and the informal sector.

## C. Government Housing Programs and Institutions

### 1. INVI (Instituto Nacional de la Vivienda)

INVI, The National Housing Institute, was created under Law Number 5892 in 1962, and charged with the implementation of the government's public housing policy. It was one of the institutions created as a result of a meeting of the governments of Latin America and the United States in 1961. INVI's basic functions are: (1) to formulate the national housing plan; (2) to execute its part of the national housing plan; (3) to promote participation of the private sector in the plan; (4) to provide, upon request, technical assistance in housing matters to individuals or groups (within its capabilities); (5) to promote self-help and mutual aid housing programs in both rural and urban settings; (6) to request from the executive branch the necessary appropriations for housing purposes; and (7) to coordinate other related activities.

INVI was created at the same time as the BNV and savings and loan system in 1962, and was designed to supplement the BNV/savings and loan system, especially in providing housing to the lower income groups. INVI's history can be described in three stages: the first comprising its first four years (1962-1965), where it accomplished two major programs with external

financing; the second from 1966 to 1978, where the Institute was virtually inactive, and the third from 1979 to the present, a period characterized by great institutional dynamism.

The two programs executed by INVI in the first stage were an emergency program financed by AID and another financed by the Interamerican Development Bank. The production of houses during this period was 2,176 units with an approximate investment of RD$4.0 million.

During the period from 1966-78 INVI was generally inactive. The only projects undertaken were those of urban remodeling. This is partially due to the impact of the Balaguer Administration, which assumed the task of financing the bulk of housing between 1972-1977. It financed approximately 10,790 units, or 31% of the total for the six-year period. Also in existence from 1966-1978 was a technical office of housing within the Presidency, which handled all public construction, including office buildings. INVI was reduced to the role of contractor, or provider of contractors, for the Presidency. During this time, INVI did not concentrate on low-income programs and competed directly with the private sector. Only 5,020 houses were produced by INVI in this twelve-year period with a total investment of RD$22 million.

The third period (1979 - present) has been characterized by a reorientation to construction and housing activities, with an announced concentration on the production of low-cost housing. This reorientation is aimed towards significantly reducing costs, distributing the production of housing throughout the country more equally and giving access to all professionals in the execution of the projects. It is also aimed at employing the full capacity of the construction industry, and contributing efficiently to the completion of the goals of the National Planning Office. Part of the motivation for this reorientation came about as a result of Hurricane David and Tropical Storm Frederick in 1979. The Government declared that it should be INVI's responsibility to reconstruct, build and rehabilitate existing housing stock, while also replacing destroyed homes.

Another result of the well coordinated response to the hurricane and tropical storm by INVI was the creation of a permanent commission representing

the principal public and private institutions which have housing programs for low-income families. Its purpose is to organize housing programs directed towards the needs of the low-income households. It is intended that the collaborative efforts of the public and private sector can be enhanced by INVI through the more effective utilization of both national and international financing. INVI itself plans to significantly increase its annual production during the 1980s. It's internal structure will be geared to fulfilling the following functions: design, construction and administration of low-cost housing programs. In order to do so, INVI has created three levels of Administration--Policy Director, Executive Director and Technical Operations. The Office of the Policy Director is responsible for the formulation of politicies, strategies and programs, and plans of the institution. It also regulates and controls the completion of goals, activities and programmed works. The Office of the Executive Director is charged with executing the programs set out by the Policy Director and to successfully program and complete its activities. This division also has technical and administrative subdirectors. The Technical Operations Office is charged with carrying out studies and the implementation of plans and programs of the institution.

In the last few years, a huge government project known as Invivienda has consumed most of INVI's resources, both human and financial. The project has developed many problems and has recently been transferred to an office within the President's Technical Secretariat. The project has been delayed because of skyrocketing construction costs, the inability of INVI to handle the increased workload, poor economies of scale, too many building types and real costs being too high for the intended market.

Regarding credit policy and sources of funds, persons wishing to be accepted to INVI's low-income housing programs must have established home and residence in the national territory, be in good physical and mental health, not be a property owner or, if so, only own substandard or inadequate property. They must be the head of a household responsible for the sustenance of a minimum three-person family. At present, the maximum amount financed by INVI is between RD$9,000 and RD$11,000 with financing terms of 15 to 25 years at 7.5% interest.

INVI's resources come from direct budget allocations, resources granted by specific law, its own mortgage operations and any other private-sector resource allocation. INVI is exempt from all taxes, national and local, as are all its contracts, real estate and judicial transactions and all persons acquiring housing directly form INVI. INVI has the power to contract out its projects to private firms or administer them directly through each stage. Its housing finance operations are two-fold: mortgage lending and conditional sale contracts.

In summarizing INVI's productivity, over the twenty-year period (1962-82), INVI produced 18,932 houses and was responsible for 38,772 "habitational solutions," which were basically the reconstruction of hurricane-damaged homes in 1979 and 1980. The total value of both was RD$2,177,160. Currently, INVI is engaged in a sites and services project with World Bank financing, which will take four years to complete and produce 7,883 habitational solutions (3,227 in Haina and 4,656 in Sabana Perdida). The amount involved is RD$41.8 million, of which the Dominican Government is providing 38% and the World Bank 62%.

2. INAVI (Instituto de Auxilios y Viviendas)

The Instituto de Auxilios y Viviendas (INAVI) was originally chartered in 1961 to create housing and social services for public employees and has been highly dependent on an inconsistent national housing policy over the past twenty years. It was recently ordered to cease carrying out housing and construction activities and to concentrate on social services and some housing finance for low-income public employees.

In the past, INAVI has financed housing above its RD$12,000 limit with financing terms of 25-30 years at 6 - 6-1/2% interest. During the 1970s, the average cost of housing constructed by INAVI was significantly higher (in some cases up to 10 times higher) than the average cost of houses constructed by other state institutions.

Under the current Administration INAVI is undergoing a policy change so that it will no longer construct housing but will continue to finance

low-income housing for public employees. In addition, INAVI will concentrate more on social services such as the provision of medical services and pension and retirement plans for its employees.

# CHAPTER III

## THE FINANCIAL SECTOR AND HOUSING FINANCE

### A. Organization of the Financial Sector

#### 1. The Central Bank

The Dominican Republic has a modern and flexible system of financial institutions. At the top of this system is the Central Bank. It is charged with the creation and administration of national monetary policy. In addition, the Central Bank issues currency, regulates the liquidity of the national financial system, administers the official legislation and directives relating to finance and allocates credit to stimulate appropriate economic development. This is done through a Monetary Board which has authority over the Bank itself. The Central Bank was created as an autonomous institution under Law Number 1529 on October 9, 1947.

#### 2. Commercial Banks

The commercial bank system is composed of sixteen institutions which are privately capitalized;eight with local capital, three with mixed capitalization (domestic/foreign) and five operate with foreign capital. There are two government-owned banks. The first institution was founded in 1912 with the most recent institution formed in 1982. As of 1983, these banks had average assets of RD$3,185.8 million, an increase of 11.8% over 1982.

Commercial banks offer passbook savings accounts and time certificates, but pay one percent less on passbook accounts and one-half percent less on deposits in certificates than savings and loans associations. Between the years 1977-1982, commercial banks captured an average of 46.58% of savings, compared to 49.85% for savings and loan associations and 3.54% for mortgage banks.

Commercial banks generally lend short-term and do not make a significant impact in the housing finance sector.

### 3. Development Banks

Development banks exist in both the private and public sectors and in some cases are quasi-public institutions such as the Banco Nacional de la Vivienda (BNV) the National Housing Bank. There are five main public development banks:

a. Banco Agricola de la Republica Dominicana
b. Corporacion de Fomento Industrial (CFI)
c. Caja de Ahorros para Obreros y Monte de Piedad
d. Instituto de Desarrollo y Credito Cooperativo
e. Banco Nacional de la Vivienda (BNV)

With the exception of the BNV, the above institutions specialize in financing agroindustry and servicing small to medium sized industries.

There are also some private development banks created under Law Number 292 of June 30, 1966. Their objective is to promote the economic development of the country through the granting of medium-sized, long-term loans to businesses dedicated to production or transformation activities of primary materials, or those connected to such activities. Between the years 1966-1982, these institutions operated under the name of financial societies, but were authorized to change their name in December, 1982 to _____. These institutions basically compete with other financial intermediaries in the securities market, although they do not use the same instruments for capturing funds. There are eighteen private development banks, sixteen of which are funded by Dominican capital and two by international capital.

## C. The Housing Finance System

### 1. The Banco Nacional de la Vivienda and the Savings and Loan System

#### a. Organization and Activities

The Banco Nacional de la Vivienda (BNV) is an autonomous state agency created by Law Number 5894 on May 12, 1962, to develop and execute a housing mortgage lending system. Its functions include:

a. Financial support, institutional promotion and supervision of private savings and loan associations;
b. Establishment and review of housing mortgage lending regulations;
c. Provision of insurance covering savings accounts of savings and loan associations;
d. Acting as a financial agent of and providing insurance to mortgages originated by INVI;
e. Provision of a general mortgage insurance (FHA) for mortgages originated by savings and loans associations under specifically designated situations.

The authorized capital of the BNV is RD$10,000,000 and the sole owners of the Bank are the Dominican Government and the savings and loan associations who subscribe for shares in proportions fixed by the law. Total outstanding obligations of the Bank cannot exceed twelve times its paid capital plus legal reserve.

The Administrative Council of the BNV regulates the organization and operations of savings and loans and may provide direct but limited financing of their operations. The BNV may borrow money by issuing appropriate debt instruments whereby providing a secondary mortgage market for the purpose of promoting the construction of housing.

Although the main activity of the BNV is, and has been, to support the savings and loan system through promotion, technical assistance, and regulation and supervision of their operations, the BNV also has a specific, but up to now little exercised, role relating to its function as a financial agent of INVI. The BNV could be required to collect mortgage payments on behalf of INVI (directly or through other banks or savings and loans). It could also insure mortgages originated by INVI and receive commissions for such operations. The BNV could also issue negotiable mortgage certificates guaranteed by INVI's mortgages, negotiate in national and foreign markets for INVI, and collect monies for INVI that special laws may require from firms or entities for housing purposes.

b. FHA (Fomento de Hipotecas Aseguradas)

The Fomento de Hipotecas Aseguradas (FHA) was created by Law Number 63 on September 11, 1963, to insure primary mortgage loans made by the savings and loan associations. The FHA is a department of the BNV and carries out the valuation of the land and the house. The FHA receives .5% of the total interest charged by the savings and loan to cover the mortgage guarantee. The insurance cannot exceed 90% of the assessed value of the house; for buildings in comercial areas or apartments the insurance can be for a maximum value of 50% of the assessed value.

The issuance of FHA policies has risen from 67 in 1964 to 39,792 through September 30, 1984. The average amount of insurance per mortgage has also risen from RD$5,451.7 to RD$15,234.

2. Savings and Loan Associations

a. Background

The savings and loan associations along with the BNV, comprise the savings and loan system. They are mutual, non-profit, private institutions whose operations are carried out under government regulations and protection. They attract funds through savings deposits, the issue of fixed or undetermined term certificates and sale of mortgages. These funds are primarily used in granting long-term mortgages for housing, but are also used to grant short-term mortgage loans to finance housing projects and personal loans guaranteed by savings accounts. Presently, there are 17 savings and loan associations operating 51 branches.

b. Mobilizing Savings

Savings and loans use three instruments to capture funds; time certificates, passbook savings and mortgage participation contracts. In 1982, the Monetary Board of the Central Bank authorized the use of a new instrument called a financial certificate. This certificate has higher yields than other certificates, with the investor receiving at least 14.5% interest if the

investment is for a term of three years at a minimum of RD$150,000. The amount can be diminished every six months to a minimum investment of RD$25,000. In the savings deposit and certificate market, savings and loans compete for funds with commercial banks, although they are allowed to pay higher yields. Savings and loans compete against mortgage banks with time certificates and against both mortgage banks and development banks in the mortgage security market.

c. Lending Criteria

The mortgage lending criteria for savings and loans has always been well-defined. Savings and loans never finance the total costs of a house, generally because borrowers have tended to be from the middle-income range and capable of saving. The amount financed has varied between 95% for a house valued at RD$5,000 to a low of 62% for housing valued at RD$60-65,000. Closing costs are between five and seven percent, but vary due to differing conditions and terms of financing.

In order to qualify for a loan from a savings and loan, an individual must have a savings account with one of the associations. A maximum of 25% of the total family income is considered for monthly payments. In some special cases, mainly to assist low-income households, savings and loans may provide mortgage loans for terms up to 40 years and insurance for up to 97% of the FHA valuation.

In 1979 the BNV and savings and loans determined additional measures were necessary to provide more credit to low-income households. It was decided that the BNV should provide leadership to savings and loans in preparing the social-economic studies which would form the basis for savings and loans to target low-income programs. It would also enable them to develop housing solution typologies appropriate to the needs and capacities of low-income groups and elaborate a new system of norms and standards appropriate to the low-income market. The proposed policy changes would have allowed savings and loans to reach down to the RD$200 per month level of income. However, to the general manager of the BNV (between 1978 and 1982), these changes were not only difficult to implement, but also required an

entire reorientation of the way of living of those they were attempting to help.

d. Growth and Expansion

Savings and loan associations have been very successful in the overall capture of funds, starting with RD$8 million in 1962 to RD$417.4 million in 1983, or an average annual growth of 34.7%. Over the years 1977-1982, however, the growth rates were not as substantial, mostly due to increasing inflation. This resulted in a slowdown in the rate with which families put their money in savings--a principal source of funds for savings and loan associations.

Total assets of the system (BNV and the savings and loans) have grown considerably since the creation of the system in 1962--from RD$1.7 million to RD$1,011. million in 1983. This is an average annual growth rate of 38.2%. In the first five years alone, associations increased their assets by more than 14 times. This asset growth has been turned back to the public in the form of a larger number of loans granted by savings and loans.

In 1983, savings and loans made 47,234 loans at a value of RD$921,604,410. This represents an average annual growth of 20.4% of the number of loans made.

Between the years 1972-1977, the savings and loan system (BNV and savings and loans) financed approximately 17,654 housing units, representing 51.8% of the total number of the units financed in the Dominican Republic. Between the year 1972-1982, the number of mortgage loans granted by savings and loans rose an annual average of 17.6% from 8,690 to 43,640. In 1964, savings and loans made a total of 1,345 loans at a value of RD$7,047,008.

By 1984, the savings and loan system has established itself firmly as a prominent network of financial institutions that gathers over a third or 35% of the savings generated in the Dominican Republic. In only twenty-two years, from nothing in 1962, the savings and loan system can now depend on over 670,000 operating savings accounts.

## 3. Secondary Mortgage Market

When the secondary market was created, its objectives were to promote the sale of mortgages through participation contracts in insured mortgages acquired by the BNV, and to issue and sell mortgage bonds with the collateral guarantee of investments in mortgages generated by the system and acquired by the BNV. The investor would buy an insured mortgage through a mortgage participation contract, through which the investor could buy all or part of the value of the mortgage.

The sale of mortgages in the secondary market is an important source in the capture of funds by savings and loan associations and plays a central role in the liquidity of the system. Savings and loans were the only intermediaries operating in the mortgage security market until the appearance of mortgage banks in 1977 who entered the secondary mortgage market promoting mortgage bonds. Since the arrival of mortgage banks in the marketplace, savings and loans have lost some of their importance in the capture of resources through the secondary mortgage market. Their participation in mortgage securities diminished from 82% in 1977 to 52% in 1981--partially due to the competition from the mortgage banks, but also because of the carelessness savings and loans displayed in the promotion and marketing of the instrument. Mortgage banks, on the other hand, raised their participation from 15.2% in 1977 to 42.0% in 1981. Financial societies (or development banks) had 2.41% of the share in 1977 and 5.93% in 1981.

Mortgages sold to third parties and the BNV have also provided a strong source of funds for savings and loans. Sales to investors increased from RD$766,511 in 1965 to RD$218,772,509, registering an average growth rate of 37.4%. The percent of total mortgages sold to third-party investors rose from 16% in 1965 to 77.2% in 1983--the remainder were sold to the BNV.

## 4. Role of Other Institutions

### a. Mortgage Banks

Mortgage banks were created as autonomous and decentralized credit institutions under Law Number 171 on June 7, 1971. It was not until December

of 1972, however, that the first mortgage bank began its operations. There are currently ten mortgage banks, nine of which are operating in Santo Domingo, and one in La Romana. Their principal objective is to promote and develop the construction industry through the financing of housing and the construction of parks, industrial centers, commercial centers, hotels, medical centers and other buildings. Mortgage banks compete in the capture of funds in the secondary mortgage market and time certificates, but are limited by paying one-half percent less than savings and loans on time deposits. Mortgage banks do not receive any help from the public sector and do not count on external funds. They also are not eligible to use FHA insurance on their housing loans.

Mortgage banks can make mortgage loans up to 85% of assessed value at 12% annual interest with closing costs at six percent. For industrial or commercial construction only 70% of the assessed value can be financed. The money for these loans is generated through mortgage bonds and deposits. Mortgage banks have averaged only 3.54% of all of the savings of financial intermediaries between 1977-1981 but have significantly increased their share of the secondary mortgage market, up from 15.2% in 1977 to 42% in 1981.

Although mortgage banks are able to provide financing for a wide range of construction projects, they have been particularly active in the housing market, concentraining on the middle to upper income groups.

The impact of the mortgage banks on the housing finance system in total has not been as great as it has been on the savings and loan system. For several years, mortgage banks and savings and loans were overlapping in the housing arena--both parties serving the middle to upper income households.

Althought overall competition for funds has been increased with the entrance of mortgage banks into the Dominican financial sector, the major competition is in the secondary market. This is mostly due to the fact that mortgage banks are more limited in their ability to capture deposits, but how they have a free hand in the secondary mortgage market. The impact on savings and loans, outlined above, has been significant.

Although mortgage banks have had a minor role in the financing of housing, they did make 1,062 loans totalling approximately RD$44 million between 1972 and 1977. Sixty-three percent of those loans were for single-family housing and about 18% for condominiums. During the 1970s, mortgage banks, in combination with commercial banks, financed 5,000 units or 33% of the total private sector. By 1982, however, the rate of growth of loans granted by mortgage banks increased by 32.3%, while the rates of growth for savings and loans in mortgage loans increased at a lesser rate.

While the mortgage banks have traditionally concentrated on housing valued over RD$30,000, in recent years they have increased their activity in the RD$12,000 to RD$15,000 range which is the middle-income group traditionally serviced by the savings and loan system. This lending activity has tended to focus in the Santo Domingo area (approximately 80 percent) and in Santiago (68 percent).

b. Commercial Banks

Savings and loans have fared very well in the financial marketplace in relation to commercial banks despite their relative newness to the financial marketplace. As of 1981, participation of savings and loans in the capture of funds represented 49.88% of the total; commercial banks had 46.58% and mortgage banks 5.46%. Regarding housing finance, their statistics are not very impressive for commercial banks, since they are not really interested in mortgage loans. During the years between 1972 and 1977, they loaned approximately RD$270 million for housing construction, with a maximum amortization period of seven years.

c. Insurance Companies

Insurance companies, formed under Law Number 126 of May 22, 1971, fulfill the function of financial intermediary through their investments in mortgage bonds, participation contracts, bonds and assets and deposits in the rest of the financial system. They invest in State-sponsored bonds and make loans to families. There are currently 50 such companies of which 23 are national, 11 from the United States, 7 from England, 3 Canadian, 3 Puerto

Rican, 2 from Holland and one from Brazil. Insurance companies do not make direct housing loans but play an important role in the secondary mortgage market, being a significant purchaser of mortgage bonds and participation certificates of the savings and loan system. They are especially active in trying FHA-insured mortgage packages.

# CHAPTER IV

## THE DEVELOPMENT OF THE HOUSING FINANCE SYSTEM AND AID INPUTS

### A. The Objectives of AID Housing Programs in the Dominican Republic

The development of AID housing objectives in the period from 1962 to 1984 can be divided into three main periods:

Development Period 1962-1964
Housing Guaranty Program 1964-74 (Initial Period)
Housing Guaranty Program 1974-84 (Increased emphasis on low income beneficiaries).

The objectives of the development period were geared to the founding of a housing finance system, with all the attendant problems of setting up new institutions and introducing new services where they didn't exist before. From 1964 to 1974 the objectives were similar to the Development Period, only now most of the institutions had been formed and needed to increase their volume of operations to grow and develop in a healthy manner. In 1974 the U.S. Congress mandated that all U.S. AID programs should focus their benefits on lower income groups, and, for the Housing Guaranty Program, it was required that solutions financed should be affordable to families below the 50th percentile of income distribution. In most developing countries families with incomes below the 50th percentile have absolutely low income and the Dominican Republic was not an exception.

Although some objectives have reflected policy changes and have evolved over the past 22 years, two clear AID objectives carry throughout:

To stimulate the development of institutions and mechanisms to finance housing and thereby increase the production of housing in the Dominican Republic.

To help create and then develop the institutions and mechanisms to permanently supply housing finance funds on an ongoing basis.

The agreement between the Government of the Dominican Republic and the AID Mission in the Dominican Republic in 1962 to allocate US$100,000 for the establishment of the National Housing Bank (BNV), stated:

> "Law No. 5897 of May 14, 1962, authorizes the organization of Housing Savings and Loan Associations, which will be private, non-profit entities whose object is to foment the creation of savings funds to be used for loans for construction, acquisition and improvement of housing.
>
> "The creation of Housing Savings and Loan Associations would also unify the objects of the State and private initiative in an effort to reduce the serious shortage of housing in both rural and urban zones."

What is of crucial importance to this entire study is that the above two primary AID objectives, to a significant extent, have been successfully accomplished.

Consistent with this AID view were some of the auxiliary objectives of the government:

a. reduce the growing deficit of housing,
b. reduce the deterioration of urban centers,
c. utilize labor and reduce unemployment,
d. stimulate demand for goods and services,
e. stimulate formation of a middle class to encourage private incentive,
f. redistribute national income through state-sponsored programs to limited income groups.

The goals were clear in 1962, and there was both agreement and a sense of urgency on the part of AID and GODR. This was especially true up through the mid-1970's, where the "Institutional Development" objectives of AID were predominant.

In the mid-1970's, due to directives specified by the U.S. Congress, there was a shift in objectives to "stress the importance of providing access to shelter credit to low-income groups." This new emphasis on lower income groups continues through to the present. The result of this was to create some changes in goals at roughly the midpoint of the 22-year history of AID's involvement in housing in the Dominican Republic to provide a greater emphasis on providing shelter for lower income groups and somewhat less emphasis on the institutional objectives of the savings and loan system.

B. Institutional Development: Technical Assistance in the Founding of the Savings and Loan System

It is not possible to examine the development of housing finance in the Dominican Republic without dealing with personalities to some extent because certain individuals played such an important role in the development of the system. One of the principal players was Manuel Pittaluga, a corporate lawyer for Tavares Industries during the 1950's and early 1960's. The chief executive of Tavares Industries, Gustavo Tavares Espaillat, was a close friend of Henrique Campos del Toro, the Chairman of the Board of First Federal Savings and Loan of Puerto Rico. During 1961, the U.S. government, through AID, inaugurated the Alliance for Progress and Rafael Pico was appointed the President's personal representative in the Dominican Republic.

When the Trujillo regime finally fell out of power in early 1961, the nation had a severe housing shortage and high unemployment. Gustavo Tavares contacted Rafael Pico and Enrique Campos del Toro who in turn reached the AID head of the Alliance for progress. All were interested in providing some assistance for housing in the Dominican Republic.

A meeting was called which included representatives from AID and the Inter-American Development Bank (IDB).Enrique Campos del Toro brought a

"draft" copy of savings and loan legislation (in Spanish) as used in Puerto Rico.

Manuel Pittaluga was asked to modify this Puerto Rican legislation for use in the Dominican Republic. Having spent some time in the U.S., he was familiar with the U.S. approach to housing, including an understanding of FHA operations and the secondary market mechanisms of Fannie Mae. The model used was the U.S. system adopted in 1932, which set up mutual savings and loan institutions with a Federal Home Loan Bank System. The structuring of the Banco Nacional de la Vivienda along the lines of the Federal Home Loan Board Bank included the future possibility of an FHA system and secondary market mechanism.

The implementation process moved surprisingly fast. Within six months the legislation was ready. Federal laws 5894 and 5897 were approved on the 12th of May, 1962, and 14th of May of 1962, respectively. Law 5894 created the BNV with extensive powers of regulation and authority. Law 5897 created the rules and regulations for the formation and operation of mutual-type savings and loan associations.

It is significant to note that another law quite vital to housing was passed two days earlier on May 10, 1962. This was Law No. 5892 establishing an autonomous National Housing Institute - INVI (Instituto Nacional de la Vivienda) whose responsibility was to implement a national program to provide adequate housing for low-income people. As was described in Chapter II, one of the original intentions of this legislation was that the BNV was to act as a financing agent for INVI.

However, the true integrated/cooperative relationship that was envisioned for the two institutions never came about. One of the big differences has been that the BNV, after an initial capitalization of $2 million from the GODR, never needed further monetary assistance from the GODR. INVI, on the other hand, has always depended on national budget allocation and as a result became much more "politicized" and "bureaucratized." This was one of the principal reasons for the different directions they took. Another reason was that INVI was adopted by the

Interamerican Development Bank as its vehicle in the Dominican Republic and the BNV/savings and loan system was adopted by AID.

As the initial legislation was being approved, during June of 1962, AID sent its first housing technical assistance team to the Dominican Republic which produced a "Report and Recommendations Concerning the Development of the Savings and Loan Industry in the Dominican Republic with AID Assistance." The major recommendations of the report included: authorization of an AID development loan to provide working capital for the operations of the BNV through June of 1964; provision of technical assistance to assist in preparing rules and regulations of the BNV; and provision of AID financing for the cost of an experienced savings and loan official who would assist the BNV and the savings and loan associations. Later in 1962 a second AID team was sent to assist in writing the operating regulations of the BNV.

The second key recommendation relative to technical assistance was also implemented later in 1962 with the appointment by AID of an experienced housing and savings and loan official as advisor to the BNV. This completed the opening chapter in the founding of the savings and loan system where technical assistance, both direct and indirect, both Dominican and U.S., proved to be so essential to the establishment of the Dominican Savings and Loan System.

Manuel Pittaluga was chosen to be the BNV's first General Manager. He was given a budget of US$100,000, some office space in the National Archives Building (which BNV used for 10 years) rules and regulations and the AID advisor. Pittaluga, who was the chief executive officer for the first 17 years of the BNV, called the provision of the AID technical assistance as "indispensable" during this period.

As the enabling legislation was passed, Gustavo Tavares Espaillat, with the cooperation of other interested Dominicans, organized and formed the first mutual savings and loan association. It was called "La Popular" and Tavares became the first President. A general manager was selected for the new association and another for a second association, the Cibao Savings and Loan in Santiago. These new managers were sent to First Federal of Puerto

Rico in May 1962 for one week of training. A few months later, in January of 1963, they were also sent (with assistance from AID) to Washington Federal Savings and Loan in Miami where they received further training in savings and loan operations. Subsequently it became standard operating procedure for all incoming Dominican savings and loan managers to pass through Washington Federal's training program.

## C. Using Development and Housing Guaranty Loans to Improve Shelter Delivery

The enabling legislation referred to in the previous section was enacted with the understanding that funding for the capitalization and assistance of such a system would be forthcoming.

During the spring of 1962, an agreement was signed between GODR and USAID to advance US$100,000 to the GODR to be paid in two equal payments on June 20 and July 20, 1962, to the newly formed BNV to use as operating funds until December 31, 1962. At the same time, solutions to longer term financing of the Savings and Loan/BNV System were being developed. A capitalization of US$2,000,000 for BNV was to be provided by the GODR, with a matching "soft" loan from AID. This resulted in a development loan from AID for US$2,100,000 at 3/4% interest over 40 years with a ten-year grace period and absorbed the US$100,000 advance for BNV expenses. The GODR capitalization ultimately came in the form of approximately 2/3 cash and 1/3 land. The AID development loan was authorized on November 2, 1962, and signed on February 1, 1963.

The $2.1 million loan was structured in the following way:

1. The AID loan went to the Central Bank at 3/4 of 1% interest with a 40-year amortization and ten-year grace period.
2. The Central Bank on-loaned to the BNV at 3% interest.
3. BNV loaned to the savings and loan associations at 7 1/2%
4. The savings and loan associations provided mortgage loans at 8-1/2% interest, which included a 1/2% FHA Insurance Fee, paid to the BNV.
5. This left the savings and loan association with a 1/2% service fee.

At the same time AID put conditions on the mortgage loans to be provided by the associations. These conditions were extended to all mortgage loans authorized by the associations including those funded by their own savings deposits. The limits were:

| Percentage of Total Mortgage Loans | Home Sale Price Limits |
|---|---|
| 10% | RD$10,000 |
| 25% | RD$ 7,500 |
| 65% | RD$ 5,000 |

It is interesting, to note that many Dominicans involved in the savings and loan business continue to feel that these restrictions, not only on AID money but on their own savings deposits, unnecessarily hampered their operations, their ability to grow, and muted the eventual success they did realize. Many of the early loan delinquencies were attributed to worker layoffs and their subsequent inability to make mortgage payments.

Nevertheless, the first AID development loan, along with the capitalization by the GODR were absolutely essential to the start-up of the system. Without them there would have been no system. The BNV/Savings and Loan System became self-sufficient through its own resourcefulness and further assistance from AID. It did not require further financial resources from the GODR.

By this time the Housing Guaranty Program (HG) of AID had been introduced. The first HG authorized in the Dominican Republic was on May 6, 1964, and signed on September 30th of that same year. It was not made to the BNV, but rather to a housing developer called COINFO (Compania de Inversiones y Fomento). The administrator of the loan was to be the La Popular Savings and Loan Association. The amount authorized was $4.6 million dollars although only $3,331,690 was disbursed and the lender was the Chase Manhattan Bank. The purpose of the loan was to build 600 middle-income homes in a project called Los Prados in Santo Domingo. The loan terms by chase were 5-1/4% annual interest with a 20-year amortization.

The AID policy at this time was to structure loans from a private U.S. lender directly to a private developer as was done by the Federal Housing Administration (FHA) in the United States. Asociacion La Popular was brought in to manage and to service the individual loans. However, since all such loans required BNV mortgage insurance, they eventually went through the BNV. This placed a great deal of responsibility on the fledgling La Popular and helped it to build staff and experience, but it was not a role (construction lending) in which it had experience. The association, La Popular, did a good job under the circumstances.

The next HG-Loan was structured in a similar way with Connecticut General Life Insurance as the lender. By the time the next HG loan was authorized in 1969, AID had decided that the loans would go directly to the BNV (rather than private developers) who in turn would on-lend.

Although the first HG loan eventually went into default due to COINFO mismanagement and the effects of the 1965 Civil War, in many other respects the project accomplished a great deal through its involvement with the La Popular Savings and Loan Association. (Unfortunately, in December of 1968, AID had to pay the Chase Manhattan Bank US$657,800 because of COINFO's insolvency and its inability to repay).

The positive results of this first HG Loan were especially notable on the La Popular Savings and Loan Association which gained a badly needed volume of loan activity as well as a great deal of stature, recognition and prestige in the community for funding such a large project by Dominican standards. This, in turn, helped its savings mobilization efforts as well as increasing demand for its mortgage loan services. Both of the first two HG loans, which totalled approximately $5.5 million, gave La Popular a tremendous boost in its early years and helped it to experience rapid growth and establish it as one of the most important financial institutions in the Dominican Republic.

In the technical area, assistance in housing design and construction standards, as well as techniques of construction management, proved to be immensely helpful to the development of the FHA Department within the BNV. Up to the time that AID got involved in housing in the Dominican Republic,

housing projects (mostly small) used a very casual architectural and engineering approach. Most projects were developed from two-page sketches. With the arrival of AID, much more professional FHA-type procedures were incorporated, requiring specific steps in design detail backing up rigorously developed cost estimates.

Building codes and standards were developed, along with a growing technical capability within the FHA Department. In many cases (U.S.) FHA Forms and Procedures were translated into Spanish, in others they were adapted to Dominican conditions. The net result, however, was to firmly establish professional level requirements for any housing project proposal. This significantly raised operating standards for architects and engineers and housing developers in the Dominican Republic. Due to the tremendous value of FHA Insurance, FHA standards became the new standards, or norms, for project development in the Dominican Republic.

At about the time the second HG Loan was being considered and processed, the second and last of the Development Loans for housing was authorized for the BNV. The loan agreement was signed on March 29, 1966, for 5 million dollars at 2-1/2% interest amortized over 40 years with a ten-year grace period. It allowed funds to be profitably pushed through the BNV and savings and loan associations. The presence of the AID long-term advisor to BNV had a positive effect on the structuring of conditions for this loan. The adivsor recommended that AID remove restrictions on BNV money and loosen the limit requirements on AID funds. These recommendations were adopted and after this was in effect the savings and loan system began to grow rapidly.

It is generally accepted by key people in the Dominican Savings and Loan System that the two AID Development Loans were instrumental in bringing the BNV and the savings and loan system to life. It was the subsequent HG Loans that gave the system a chance to survive--gave the system valuable time in which to build its savings mobilization programs, its technical expertise and become self-sufficient.

We have already mentioned the loans HG-003 and HG-004/005. There were three more HG Loans made:

| Loan | Signed | % Interest | Amount |
|---|---|---|---|
| HG-003 | 9/30/64 | 5.25 | 4,600,000 |
| HG-004/5 | ——— | —— | ——— |
| HG-006 | 4/30/69 | 7.25 | 6,000,000 |
| HG-007 | 11/08/72 | 7.50 | 860,000 |
| HG-008 | 4/15/73 | 7.50 | 4,000,000 |

They were all made directly to the BNV who distributed the funds through the savings and loan associations. This direct involvement with the BNV rather than with a builder-developer had several favorable institution-building effects on the BNV as well as the savings and loan associations. The BNV could now channel these funds through other associations, as well as La Popular, to help them as La Popular had been helped previously.

For the system as a whole the increased mortgage lending activity these HG Loans generated also created servicing fees and mortgage insurance fees which added significantly to the financial strength and managerial capability of the institutions. As was the case with La Popular, public enthusiasm generated by these loans transferred into the savings mobilization area. Public acceptance and confidence are difficult characteristics to develop in new financial institutions. The HG-Loan program made critical, significant contributions in this area as has been attested to by the management of the BNV and the associations involved. The generation of domestic savings, the critical ingredient for future development, now began to take hold and grow at a rapid rate.

There were three other important aspects to the HG Loans 006, 007 and 008. The two original development loans and the first two HG Loans (003, 005) had been concentrated in the city of Santo Domingo. The last three HG Loans specified that BNV use approximately half of their resources for projects

outside of Santo Domingo (Table 4.1 illustrates this change). This provided needed economic support to smaller cities while enabling the savings and loan associations and home construction trades in other regions to develop more fully.

With HG-006, AID also specified a 25% Dominican participation requirement which brought the total value of the mortgages financed up from $6 million to $8 million. In HG-008, AID required a 33% Dominican participation, which raised the effective outreach of the program from $4 million to $6 million.

The other significant characteristic of these HG Loans was that because of the price limits imposed on homes mortgaged, the BNV and the savings and loan associations were obliged to more consistently serve the needs of lower income families than they probably would otherwise have done. Although these restrictions created some difficulties, as mentioned previously, they also demonstrated that with the proper planning and effort, the low-income requirements could be met.

Table 4.1

HG LOANS IN THE DOMINICAN REPUBLIC

| HG Loan | Year | Location | Project | No. of Units | Loan Amounts |
|---|---|---|---|---|---|
| 003 | 1964 | Santo Domingo | Los Prados | 420 | $3,331,690 |
| 005 | 1965 | Santo Domingo | La Augustina | 357 | 2,118,036 |
| 006 | 1970 | Santo Domingo | San Geromino | 355 | 6,000,000 |
| | " | " " | Popular | 116 | |
| | " | " " | Encarnacion | 68 | |
| | " | " " | Antillas | 91 | |
| | " | " " | Los Prados II | 118 | |
| | " | " " | Los Arrecifes | 27 | |
| | " | " " | El Portal | 93 | |
| | " | " " | El Retiro | 122 | |
| | 1971 | " " | Antillas II | 42 | |
| | " | " " | Atala III | 80 | |
| | " | " " | Los Arrecifes II | 18 | |
| | " | " " | La Augustina II | 70 | |
| 007 | 1973 | Bonao | Yuna | 511 | 860,000 |
| 008 | 1974 | San J. Maguana | Elena | 44 | 4,000,000 |
| | " | Santiago | El Ensueno IV | 75 | |
| | " | La Romana | Quisqueya III | 400 | |
| | " | Santo Domingo | Atlantica III | 26 | |
| | 1975 | Santiago | Santiago | 64 | |
| | 1976 | La Romana | Quisqueya IV | 200 | |
| | | | TOTALS | 3,297 | $16,309,726 |

The total number of dwelling units financed by these HG Loans was 3,297 and the total HG Loan amounts in dollars was $16,309,726. The two development loans financed approximately 800 homes in additional to covering initial BNV operating expenses. Thus the total financing provided to the system is almost $23.5 million as shown in Table 4.2.

Table 4.2

| Aid Loans | Amount | No. of Units Financed |
|---|---|---|
| Development | $7,100,00 | 800 (est.) |
| Housing Guaranty | 16,309 | 3,297 |
| TOTAL | $23,409,726 | 4,097 |

To more fully appreciate the quantitative impact of AID-Housing Loans to the savings and loan industry during its 22 years' history from 1962 to 1984, it is useful to compare the total lending activity of the system, using both domestic funds and AID Funds. This comparison is set forth in Table 4.3 and expressed graphically in Figure 4.1.

What becomes evident is the enormous importance of AID funding in the first eight years of operation, from 1962 to 1970, after which the system's capacity to generate savings became the driving force behind the tremendous growth of the 1970-80 decade. To illustrate, the annual growth rates in numbers of mortgage loans vary from 16 to 27% during that period, with the growth rate of 1980-84 varying from 8 to 16%.

At the same time it must be recognized that there was another engine (in addition to AID loans and savings funds) contributing to the enormous growth of the system. That was the contribution of the secondary market. It took the domestic savings which were generated as well as the AID loans and multiplied this by turning that money over in the secondary market which was in turn reinvested in housing loans. The multiplier effect is evident from the growth rates experienced.

Table 4.3

ACCUMULATED NUMBER OF DWELLING UNITS
FINANCED PER YEAR, BY DOMESTIC AND AID FUNDS
DOMINICAN SAVINGS AND LOAN SYSTEM

| Year | Cumulative Total No. of Units Financed | Cumulative No. of Units Funded Domestically | Cumulative No. of Units Funded by AID | Percentage Funded by AID |
|---|---|---|---|---|
| 1962 | -- | -- | -- | * |
| 1963 | -- | -- | -- | * |
| 1964 | 1,345 | 425 | 920 | 68% |
| 1965 | 1,464 | 174 | 1,290 | 88 |
| 1966 | 2,020 | 660 | 1,360 | 67 |
| 1967 | 3,648 | 2,228 | 1,430 | 39 |
| 1968 | 4,442 | 2,935 | 1,507 | 34 |
| 1969 | 5,483 | 3,906 | 1,577 | 29 |
| 1970 | 5,583 | 3,016 | 2,567 | 46 |
| 1971 | 7,076 | 4,299 | 2,777 | 39 |
| 1972 | 8,690 | 5,913 | 2,777 | 32 |
| 1973 | 10,676 | 7,388 | 3,288 | 31 |
| 1974 | 12,896 | 9,063 | 3,833 | 30 |
| 1975 | 15,782 | 11,885 | 3,897 | 25 |
| 1976 | 19,253 | 15,156 | 4,097 | 21 |
| 1977 | 22,528 | 18,431 | 4,097 | 18 |
| 1978 | 26,399 | 22,302 | 4,097 | 16 |
| 1979 | 30,709 | 26,612 | 4,097 | 13 |
| 1980 | 35,614 | 31,517 | 4,097 | 12 |
| 1981 | 39,682 | 35,585 | 4,097 | 10 |
| 1982 | 43,638 | 39,541 | 4,097 | 9 |
| 1983* | 47,234 | 43,137 | 4,097 | 9 |
| 1984 | 51,000 (est.) | 46,903 | 4,097 | 8 |

*Does not include US$100,000 from AID for BNV Operating Funds.

In an attempt to evaluate this multiplier effect, it is necessary to examine the relationship between the respective value of total loans to the value of loans sold on the secondary market. This is done in Table 4.4.

As demonstrated, in the first seven years of secondary market operation (until 1970) the effective savings were increased by approximately 1.5 times annually. That is, for every peso deposited in a savings instrument, another peso and a half was added to the savings institutions' lendable funds. The principal reason the secondary market outstripped savings mobilization in these early years was, of course, due to the AID funds which were also being used by the BNV to buy the loans of the associations. It is clearly demonstrated that using AID funds in this manner precipitated the formation of the secondary market.

During 1971 and 1972 this ratio of secondary market funds to savings dropped below 1. Subsequent drops in this ratio to approximately .7 were also due to the impact of mortgage banks, who entered the market heavily in the mid-1970's.

In any event, for their early period of 1963-70 the savings and loan system had a virtual monopoly on the use of secondary market Funds provided by BNV and this, in turn, multiplied the effective impact of the early AID loans.

Table 4.4

COMPARISON OF SAVINGS GENERATED AND
FUNDS GENERATED BY SECONDARY MARKET
DOMINICAN SAVINGS AND LOAN SYSTEM

| Date | Amount of Savings* RD$ | Funds Generated By Sale of Mortgages Secondary Market RD$ |
|---|---|---|
| June 30, 1963 | 1,223,882 | -- |
| " " 1964 | 2,318,754 | 1,880,418 |
| " " 1965 | 3,085,824 | 3,386,904 |
| " " 1966 | 4,182,395 | 5,721,367 |
| " " 1967 | 4,349,487 | 9,216,386 |
| " " 1968 | 6,516,515 | 11,933,560 |
| " " 1969 | 10,246,435 | 13,772,876 |
| " " 1970 | 14,434,394 | 16,320,914 |
| " " 1971 | 21,896,133 | 19,753,889 |
| " " 1972 | 29,533,339 | 29,654,068 |
| " " 1973 | 44,658,550 | 38,184,527 |
| " " 1974 | 65,918,356 | 45,159,698 |
| " " 1975 | 81,715,880 | 64,692,841 |
| " " 1976 | 99,392,437 | 81,723,921 |
| " " 1977 | 121,612,414 | 103,758,910 |
| " " 1978 | 152,990,842 | 129,069,243 |
| " " 1979 | 182,313,627 | 149,738,877 |
| " " 1980 | 246,695,192 | 167,690,249 |
| " " 1981 | 296,523,176 | 175,503,393 |
| " " 1982 | 353,595,211 | 221,872,831 |
| " " 1983 | 393,597,239 | 256,724,304 |
| " " 1984 | 444,365,170 | 301,842,933 |

*Includes Passbooks and Certificates of Deposit

## D. Ongoing Technical Assistance to Improve Operations

### 1. Standards and Procedures

Starting with the first consultants in September, 1962, who developed the initial operating regulations for the BNV, there has been a long and steady process of technical knowledge transfer to the BNV from AID. Later with the arrival of the resident advisor, there was a steady development of standards and procedures.

As was related earlier, the Dominican FHA System was patterned after the U.S. FHA. For approximately the first ten years of BNV operations there was constant interchange of ideas and data with either U.S. people coming to the Dominican Republic or BNV officials going to the U.S. The development of minimum housing standards, forms and processing procedures were a few of the tools developed.

As was stated previously, the technical level of acceptable design and analysis work by engineers and architects was raised measurably. Procedural manuals were developed to codify these standards.

Another area of significant importance for the BNV and individual savings and loans was the development of standards and procedures for the examination and supervision of savings and loan associations by the BNV. The Federal Home Loan Bank Board (FHLBB) under a Participating Agency Service Agreement (PASA) funded by AID provided technical assistance to the BNV from August of 1975 through January of 1982.

The work accomplished under this agreement was the following:

a. Structured the Regulatory Function
   - i. Organized Department of Examination and Supervision
   - ii. Trained staff
   - iii. Prepared manuals on examination and administration
   - iv. Established reporting and information system

v. Established independent Audit Program

vi. Prepared new regulations

b. Developed Uniform Accounting Procedures

c. Implemented Standard Financial Reporting System

d. Computerized Information System

e. Developed Planning Program for BNV

f. Prepared detailed studies dealing with regulatory activities

g. Developed a system for evaluating savings and loan association performance and operations

h. Developed a rating system for savings and loan associations.

2. Training

All of the previously mentioned technical assistance, from the (first long-term advisor in 1962 to the assistance by the FHLBB, had a large training element. Much of the transfer of "know-how" was done in a training mode--where someone was being taught to do or understand something.

Probably the five most significant areas of training where AID funds contributed substantially were:

a. On-The-Job Training at Washington Federal in Miami

b. Development of the FHA Function

c. Development of the Secondary Market

d. Development of the Examination and Supervision Function

e. Development of IDAP (Instituto Dominicano de Ahorro y Prestamo - The Savings and Loan Institute)

Relative to the Washington Federal Training, this was discussed earlier in the chapter. It was essential to expose people to an operating association as most had no previous savings and loan experience. This was a very effective training program, both because there was no language barrier (many of the Washington Federal staff spoke Spanish) and because of the dedication and enthusiasm of Washington Federal personnel.

The early FHA training for BNV was done by personnel of the US' FHA. They helped establish the FHA Trust within the BNV working with local staff. Subsequently, specific training programs took place in the U.S. for the BNV FHA Department Managers.

The development of a secondary market mechanism within the BNV was largely the work of the early resident advisor. His long experience with the U.S. mortgage markets and Fannie Mae enabled him to install the system and teach the staff to run it properly.

Installation of the Examination and Supervision Department of BNV was discussed previously with the significant input of the FHLBB during the years 1975-1982. An internal audit function was established in this department.

Approval for the formation of IDAP (Instituto Dominicano de Ahorro y Prestamo) was granted on the 17th of January, 1975, by the Board of BNV. IDAP was to function as a separate department within the BNV structure. Actually, serious discussions to form a Savings and Loan Training Institute began in 1972 when the increasing needs of the savings and loan system became more evident. The further development of existing and incoming human resources was essential if the system was to keep pace with its enormous growth. At the same time, its very success was attracting competition.

AID also recognized this growing need in the Dominican Savings and Loan System and commissioned The Institute of Financial Education to do a feasibility study on the subject. The result of this and further studies and recommendations was the formation of IDAP.

The original structure included three divisions:

a. Administrative and Personnel Operations
b. Research and Publications
c. Training
    i. Courses
    ii. Seminars

Later this was expanded to include a fourth division:

d. Accounting and Systems.

It is clear that the evolution of IDAP followed the growing needs of the personnel operating the Dominican Savings and Loan System. IDAP functioned as a department within the BNV, the regulatory body, rather than being affiliated with the trade association representing the industry as in the U.S. However, due to the rapid growth of the savings and loans systems, the BNV, with the assistance of AID, moved to fill the need.

## E. Improving The Access of Low-Income Families to Home Mortgages

Perhaps the most difficult concept for AID to promote in the housing sector in the Dominican Republic has been that of expanding the provision of housing finance to low-income families. There were many barriers that needed to be crossed in the mentality of the Dominicans involved in the formation of the savings and loan system, mainly, and most importantly, because it had never been done before. Eventually, some of the AID loans were flexible enough on this issue to enable the Dominicans to accept them and implement them successfully.

As was discussed earlier in the chapter, the first AID development loan for $2.1 million included restrictions on how not only these funds but all BNV funds could be used.

| Loan Distribution | Home Sales Price Limits |
|---|---|
| 10% | RD$ 10,000 |
| 25% | RD$ 7,500 |
| 65% | RD$ 5,000 |

The Dominicans felt these conditions too restraining. They felt that since the entire loan program was somewhat of an experiment AID had the right to put some conditions on how the AID funding was used. However, they felt that putting such restrictions on their own funds, most of which came from

savings deposits, was excessive. When some of these early loans became delinquent, the Dominicans felt justified in their opinions.

AID modified its requirements somewhat with regard to low-income conditions on the next few loans, allowing them to be oriented more towards middle-income groups. The position of the resident advisor was that this was a fledgling institution, just getting started and to impose too many difficult restrictions would be counterproductive. At that time, typical financing for homeownership in Santo Domingo required downpayments of 50 percent or more, with loans being made for not more than five years at interest rates of ten percent or more.

Just by introducing lower down payment requirements, lower interest rates and longer term financing, the loans made by the savings and loan associations were serving to stimulate homeownership and make adequate housing more affordable than heretofore.

It was, therefore, accepted that the pilot demonstration features would provide an excellent demonstration of how the housing requirements of a heretofore unserved income group can be satisfied by utilizing long-term mortgage financing and small down payments. It was also intended to demonstrate that volume production, volume marketing and volume mortgage servicing can be a more economical way of producing and delivering housing.

Los Prados, the project built with the first HG-Loan 003, did in fact prove that point. The project was immensely successful, despite the fact that the developer (COINFO) went bankrupt for reasons out of AID's control. It succeeded in that it taught the Dominicans how to produce and finance a housing project for hundreds of moderate-income families. This had not been done before. The dwelling designs were good, simple, but attractive. As the neighborhoods began to take shape, pride in them developed. Improvements were made. It is still, at this time in 1984, a very desirable place to live.

With the urging of AID to reach out further toward the lower income sectors, the BNV developed the following mortgage loan criteria:

1. 25% of total family income as a figure to determine maximum amortization payments
2. 3% downpayment with 97% mortgage financing
3. 40-year amortization schedule (normal is 20 years)
4. Mortgage recipient must have established a savings account with ending association.

With the succeeding HG Loans (005, 006) AID pushed to reach out even further into the lower income sector by revising the designs of the dwelling units, making them smaller and closer together and more economical to produce. By then, of course, some experience had been gained in producing, delivering and servicing large projects.

However, in 1966 and 1967 mortgage collection delinquencies began to rise, although actual foreclosures were quite low. An AID-sponsored study recommended stricter collection procedures and tighter controls which proved to be enough to significantly decrease the delinquencies. The important lesson learned here was that to the overwhelming majority of these mortgage recipients, the home they now owned was the biggest and best investment of their lives. To lose that investment was unthinkable and mortgage payments must be made. After the stricter collection procedures recommended in the study were enforced collections improved.

Another example of how low-income sector objectives of AID were met is the La Romana Project on the eastern end of the island. AID interest in the area began in 1967 with a feasibility study for a cooperative housing project called "Papagayo." This project was eventually funded and successfully completed some years later when the sponsors completed their requirements.

In the meantime, the small savings and loan association called La Romana began negotiating with the Gulf and Western Corporation who had substantial industrial, commercial and real estate holdings in the area. With the potential of qualifying for HG Loan funds, La Romana Savings and Loan set out to structure a project which would fit the requirements of all concerned.

Gulf and Western wanted to provide better housing for its growing work force. It agreed to donate the land for a project to be called Quisqueya. The design phase began and project costs were developed factoring in AID income limitations on affordability. Gulf and Western agreed to supply the deserving candidates who were within those income limitations and also agreed to provide the downpayments of over RD$1,000 each as a bonus to the employees. Gulf and Western also agreed to assume partial responsibility for some of the mortgage payments, again as an ongoing subsidy to its employees. The final figures were as follows:

| | | |
|---|---|---|
| Sales Price (finished home) | RD$7,301 | |
| Total mortgage | 6,300 | |
| w/savings and loan | 2,500 | Mortgage paid by Gulf and Western |
| | 3,800 | Mortgage paid by Employees |

Two hundred units were constructed in the first Quisqueya Project which was underwritten by HG-008 in 1974. The original project was so successful that another 200 units were added. In the second project some of the units were smaller and the total average cost dropped to RD$6,994 per unit or RD$307 less than the first Quisqueya Project despite inflation. The HG Loan amounted to RD$1,260,000 for Quisqueya I and RD$1,242,000 for Quisqueya II.

Three significant added benefits came out of these projects and the Papagayo Project (200 self-help units) which was done in 1976. First, it put La Romana Savings and Loan on the map, so to speak. In two years, 1974-1976, the number of savings accounts increased from 1,470 to 2,475. During that same period its assets tripled from RD$1,753,000 to RD$5,535,000. These projects thereby enhanced and stabilized the finances of the association and gave it prestige and stature within the community. By June, 1984, savings accounts had grown to 12,709 and assets to RD$26,292,000. In a community of 110,000 inhabitants its has become a very important financial institution specializing in home loans.

The second significant benefit is the stimulation to the development of the community of La Romana. For example:

1. A new school was built in 1977, the first intermediate school in the region
2. The first public hospital was built in 1977
3. A new Vocational School was built in 1978

The third significant development was that La Romana Savings and Loan and the BNV continued to develop low-income housing on their own, without HG Loans. They financed Quisqueya III (60 units) in 1980and then Quisqueya IV in 1983 (78 units). Quisqueya IV also won the BNV Annual Award for the best Low-Income Project of the year. The units sold for RD$7,800 each. By way of comparison, the original Quisqueya I units which sold for RD$7,301 are now worth more than RD$27,000.

Two other HG examples, however, illustrate the inherent difficulties in developing low-income projects in secondary and smaller communities. In an effort to increase its outreach to communities outside of Santo Domingo, AID proceeded with HG-007 in Bonao where a project known as Falconridge was planned. This was a low-income project to be done with INVI as the constructor and lender for project. Subsequently AID required that BNV be the lender and insurer of the project with INVI doing the construction.

Bonao is a community built around the Falcondo "ferronickel" industry and the homes to be built were for the Falcondo employees. This project was started in 1973 with a HG authorization of up to $3.5 million dollars to build 500 three-bedroom rowhouses at RD$6,000 to RD$8,000. Unfortunately, the worldwide petroleum crisis arrived at that time and the oil price increases made the fuel intensive technology of Falcondo uneconomical. Serious labor problems in addition to design errors stopped the project after only 125 units were completed and only $860,000 dollars of the HG loan disbursed. The outstanding amount was de-authrozied.

In HG-008, AID required that half of the units would have to be built outside of Santo Domingo. The result was that those projects within Santo Domingo were completed as planned. Those in some of the smaller communities experienced more difficulties because they could not adjust to employment irregularities in the work force. The market demand for housing in those

smaller communities was much softer, as the potential market is much thinner. Unemployment and under-employment were being experienced all over the Dominican Republic, but in Santo Domingo the potential market was so large that "new" buyers were readily available when the original buyers lost their jobs or didn't qualify. The projects in some of the smaller communities experienced difficulty in selling out.

## F. Constraints on AID Housing Objectives

There are overriding reasons why disbursements for the last implemented HG Loan (008) were completed as far back as 1977. That loan was approved in November of 1972 and signed in April, 1973, which was more than ten years ago. In the interim HG-009 was approved, then de-authorized. What happened? What were, and are some of the principal inhibiting factors to the continuation of the AID Housing Program in the Dominican Republic?

These constraints can be classified into general categories:

- External conditions (developed outside the Dominican Republic)
- Internal conditions (developed inside the Dominican Republic)

### 1. External Conditions

With regard to external conditions, the consensus is that there are four principal reasons:

a. Worldwide Economic Difficulties beginning with the oil crisis in 1973. The Dominican Republic has never really recovered from that crisis since it imports all its oil. Balance of payments and economic development difficulties have plagued it since then. Unemployment has been at 20% and underemployment at 20% for at least the last four years.

b. Exchange Rate Difficulties with balance of payments and debt service implications. The value of the Dominican peso (RD$) has steadily deteriorated vis-a-vis the U.S. Dollar, making loans in dollars increasingly unattractive. The exchange rates also prohibit using imported construction materials, used especially in multistory structures.

c. High Interst Rates. Current and past high inflated interest rates for U.S. Dollars through HG Loans have exceeded the 12 percent usury ceiling set by Dominican Law, or have exceeded the rates at which funds could be generated locally, resulting in negative real interest rates for borrowers.

d. Strict Low-Income Requirements on use of AID funds as mandated by U.S. Congress. Low-cost housing is considered a high-risk operation, which only amplifies the existing financial problem for the potential borrower of HG funds.

2. Internal Conditions

In considering internal conditions, the following fourteen (14) principal constraints can be divided into those that became increasingly evident during the 70's through to the present and those that became more pronounced since 1980 to the present. They are as follows:

a. Conditions affecting AID involvement in housing in the DR since 1970.

1) The Balaguer administration, in the late 1970's had a great reluctance to borrow further for housing, even at a very favorable interest rate.

2) The centerpiece of AID's housing delivery system, the savings and loan system, considered itself a middle-class institution and did not want to move into lower income housing.

3. As national political and economic stability established itself after 1965, and the savings and loan system became self-sufficient, the need for AID assistance became marginal, in contrast to the early and mid-sixties when it was absolutely essential.

4. The relative weakness of public sector institutions concerned with low-income housing. INVI and INAVI have consistently demonstrated only limited capabilities in confronting the shelter needs of the low-income sectors.

5. The persistent lack of a comprehensive consistent national shetler policy, within which a lower income program could be articulated.

6. The perception within the Dominican Republic, savings and loa system that HG Loans, especially those outside of Santo Domingo ,were risky, and dangerous and difficult, requiring much supervision and control. There also was only limited staff available for this added work.

b. Conditions becoming more pronounced since 1980

Since 1980, the following constraints to a continued HG Loan Program have become more apparent.

7. High local inflation and interest rates, exceeding the 12% usury ceiling create significant problems for financial intermediaries and lending institutions.

8. The lack of variable or adjustable mortgage instruments has created problems for mortgage lending institutions who are saddled with portfolios of fixed rate mortgages at older, lower rates.

9. The relatively good liquidity in the savings and loan system. The problem is not the availability of funds at this time, the difficulty is in the proper placement of funds, with a limited market of qualified or interested borrowers, because of the availability of subsidized relatively high standard houses being built under the Invivienda Project.

10. Affordability or ability to repay loans on the part of the low-income sector is a real concern for financial intermediaries with fiduciary responsibilities. Low-income projects are considered high risk witl dim prospects.

11. The lack of flexibility and diversification capabilities within the savings and loan system because portfolios are restricted to long-term home loans. Other, more lucrative shorter term loans or other revenue generating activities are not within allowable activities. The inclusion of diversified activities within a savings and loan portfolio could be balanced off with low-income housing components within that portfolio.

12. In the past few years there has been a rapid increase in construction costs within the Dominican Republic. There has also been a correspondingly inverse lowering of disposable income among Dominicans as costs for food, clothing, health and education have also grown far in excess of wages which have, in general, remained unchanged. This "drying up" of disposable income for housing has limited interest in any new HG Loans.

## CHAPTER V

## LESSONS LEARNED AND CONCLUSIONS

In reviewing the antecedents and accomplishments of the AID-Housing's program in the Dominican Republic, one is struck with two general overrriding conclusions within which most other conclusions fall. The first relates to the enormous success recorded by the first ten years of the AID Program. The second relates to the expectations and frustrations that were generated by that early success.

They are as follows:

1. The critical and absolutely essential nature of AID assistance in housing during the 60's and early 70's is universally acknowledged. The AID Housing Program was clearly effective and successful. The Dominicans fully recognize and appreciate this. The formula for assistance that evolved, appears to be one that could be used again, under similar circumstances.

2. The AID-Housing experience of the last six years has been frustrated by the inability to mesh with the changing conditions and circumstances occurring within the Dominican Republic.

One of the first lessons learned was the effectiveness of taking advantage of political events. A change in government many times creates opportunities for new ideas, approaches and programs regarding housing. Such was the case in 1962 with the fall of Trujillo and the flowering of the Alliance for Progress. There was an enormous decision-making vacuum created with Trujillo's fall and a great need to reestablish a suppressed middle class and middle-class institutions. Housing received a top priority and AID was there to help formulate programs and fill a need.

The importance of individual contributions, especially in leadership roles, should never be taken for granted or neglected. The motivation, talents and commitment of key individuals such as Gustavo Tavares Espaillat and Manuel Pittaluga can make or break a program as complex as that installed in the Dominican Republic. Without truly committed and properly supported

individuals, a housing finance program can easily flounder or become a victim of political tides or intrigues.

The Dominican Republic in the early 60's was not unlike many less developed countries (LDC's) past and present. Institutional development was uneven with significant gaps occurring in both private and public institutions for housing. AID made major contributions in structuring the BNV, savings and loan associations and INVI. These accomplishments in institutional development were perhaps the most significant accomplishments of a successful program. There is no more important role for AID provides the groundwork and assisted in developing the structure and blueprints for these institutions to flourish and become self-sufficient.

The essential ingredient in the above mentioned institutional development process was the transfer of "know-how" through technical assistance. The raising of technical and professional skill levels was necessary to build the BNV and savings and loan system. It was fortunate that Manuel Pittaluga was knowledgeable about the U.S. system. That was an important base from which to build. His understanding of the U.S. home financing structure and his ability to interpret it in the original enabling legislation, foreseeing a mortgage insuring function, was a huge first step. The AID-sponsored resident advisors and other short-term advisors had a base upon which to build. The successful flow of technical assistance from First Federal Puerto Rico and Washington Federal of Miami to the FHLBB and FHA was made possible by the AID program.

Two of the most significant results which demonstrate the value of this example of institution building were the early effective development of the FHA Mortgage Insurance System and Secondary Market System within the BNV and savings and loan system. The FHA Mortgage Insurance System proved to be one of the secret strengths of the Dominican System. It provided security, stability and uniformity to the savings and loan associations and an orderly structure within which standards and quality could be improved. It gave a validity and strength to the Dominican mortgage document that then allowed it to be considered a serious, credible financial instrument that could be later packaged and traded in secondary capital markets. To accomplish this

structuring of FHA less than two years after the founding of the system was a major accomplishment.

The successful development of a secondary mortgage market grew out of the FHA Insurance Program. It also grew out of Manuel Pittaluga's original conception of a BNV that would act as an intermediary for the savings and loan associations. Specifically, the May, 1962 Enabling Legislation established methods of transferring mortgage loans to third parties. After the FHA mechanism was in place procedures were established to move mortgage contracts from the savings and loan associations to the BNV and from the BNV or the association directly to the public. These packages of mortgage contracts were purchased by commercial banks, insurance companies and private investors.

This refinancing of mortgages returned lendable capital to the savings and loan associations permitted them to make more home mortgage loans. This replenishing cycle obviously multiplied the lending capability of the associations and was a principal reason the system established itself so forcefully, so quickly, among Dominican financial institutions.

It is worthwhile to note that the first secondary market instruments to be used were"mortgage bonds" issued by the BNV. This credit instrument consisted of a pooling of a given number of mortgages in the BNV's portfolio and the issuance of coupon bonds, in fixed amounts, against their total value; the bonds had interest coupons attached which were paid semiannually.

Later a second and more popular credit instrument was developed called the "mortgage participation contract" which covers the sale of mortgages in the mortgage portfolio of savings and loans and at the BNV. Through this contract the investor acquires, by law, the rights of the mortgagee and the right to receive payments on the principal of the mortgage loan. Although the mortgage participation contract transfers the mortgage title to the investor, administration of the mortgage is retained by the savings and loan or the BNV. Thus the investor is not bothered with details of mortgage servicing and the savings and loan earns an administrative fee.

In developing such a sophisticated housing finance system, the proper training of individuals was essential. The Dominican experience in this area was excellent. People were sent abroad to witness how things were done. A long-term advisor/trainer was provided to give guidance. Short-term/trainers were used as needed. A training institute or center was established to standardize and replicate the training.

In addition to the importance of technical assistance, there was another equally essential ingredient in AID's involvement in the Dominican Republic called "seed capital." The first soft-loan of $2.1 million dollars (3/4% interest--40 years) was decisive. It energized the system. The second seed loan of $5 million and the HG loans were enormously important, but the first seed loan was critical.

The seed loan accomplished its objectives of funding not only the BNV operations, but pumped back into the fledgling savings and loan associations the badly needed capital to make mortgage loans. In this regard it operated as an early version of the secondary market, replenishing the meager monetary resources of the associations until their savings programs could establish themselves.

The Dominican housing finance system was established with "mutual-type" savings and loan associations rather than those of the stock (corporation) variety. This pattern copied the predominant system of the U.S. at the time. The big advantage of the mutual system was that it was easier to sell to the public and to the community and it was easier to collect the required deposits to start up a mutual-type association (RD$200,000 each).

Gustavo Tavares Espaillat opened the first account and personally collected other initial deposits and pledges from friends. He then went house to house to put together the required RD$200,000 to start up La Popular Savings and Loan in Santo Domingo. He did the same in Santiago where he formed the Cibao Savings and Loan Association. Since he had some of his own money involved in these initial savings accounts, since there was to be no more return for him than for anyone else and since there was to be no profit except to provide home mortgages to the community, the concept had merit.

The Government was also involved through the BNV Board of Directors which it named. The idea that each community in the Dominican Republic was to set up their own mutual-type savings and loan attracted enough support to start the first two associations. The "seed loan" from AID then came into play. The BNV finished up the job of organizing savings and loans in the other communities. The idea that the savers or depositors owned the association and that the federal government was backing the system (through the BNV) gave this new idea credibility.

As had been previously mentioned, the Dominican Savings and Loan System was developed along the lines of the U.S. model. One of the biggest differences has been the consolidation into the BNV of functions which are more dispursed than they are in the U.S. For example, the BNV incorporates the functions of the:

1. Federal Home Loan Bank Board
   a. Policy
   b. Regulations
2. Federal Home Loan Banks
   a. Examination and Audit
   b. Supervision
   c. Lender - Bank of Last Resort
3. FSLIC (Federal Savings and Loan Insurance Corporation)
   a. Deposit Insurance
4. FHA (Federal Home Administration of HUD)
   a. Insuring of Mortgages
   b. Minimum Housing Standards
   c. Inspection and Auditing Control
   d. Project Evaluation
5. Secondary Market Institutions
   a. FNMA (Fannie Mae - FHA-Insured Mortgage Packages kept in Portfolio)
   b. FHLMC (Freddie Mac - Mortgage Participation Certificates)

6. A Training Institute

a. Training of BNV Personnel

b. Training of Savings and Loan Association Personnel
(has stopped since 1979)

On the private side of the system, the associations are organized into a trade association called the League of Savings and Loan Institutions, similar to counterpart organizations in the U.S. In general, the U.S. model appears to have been a good one to follow for the Dominicans and Savings and Loan System is acknowledged to be institutionally.

The relatively healthy condition that the savings and loan industry now finds itself, in the admittedly difficult times the Dominican Republic is now experiencing, only reaffirms the soundness of the system. It also underscores the real and lasting value of the efforts that went into building the system, to which AID contributed. A measure of the stability of the system is also the relative ease with which it has absorbed changes and adapted to conditions.

The BNV/Savings and Loan System has really evolved into a true quasi-public/quasi-private institution that incorporates the strengths of both sectors. There is a five member Board of Directors for the BNV. Originally, four were selected by the Government, and these four selected a fifth, the Board President. So, in effect, during the early years, the Government had total control, but a formula had been included in the original structure whereby the member associations (the private sector) could buy out half of the Board membership (2) by proportionally replenishing the original capital (RD$2 million) of the Government. The savings and loan associations bought one seat in 1977 and another in 1979 with a 40% capital contribution of RD$800,000. The Board of the BNV is now made up of two members selected by the Government and two members selected by the savings and loan associations. These four then agree on a president, the fifth member. The General Manager or CEO of the BNV is then appointed by the Board. Both sides have significant input, or veto power over the other. It seems to work quite well and has prevented the BNV from becoming overly politicized which is a danger for most public

institutions in the Dominican Republic. The system was fortunate in the early years in that, although the Government had total control, it had the same CEO for 18 years who provided a stable leadership that was characterized by high professional standards and a minimum of "politicization." This standard of professionalism and the sharing of power between the public and private sector has been one principal reason the system has survived as well as it has.

A strong identifiable characteristic of the BNV/Savings and Loan System has been its resourcefulness coupled with a keen instinct for marketing and promotion. It sold itself to the Dominican public convincingly through promotion and advertising. It has aggressively marketed for savings and has consistently used its "differential" over bank savings accounts effectively. In an amazing turn of events and an amazing example of market penetration La Popular Savings and Loan collects more savings than the largest commercial bank! This was accomplished in a little more than twenty years:

| Institution | Savings Mobilized from Public September 30, 1984 |
|---|---|
| La Popular S&L | RD$118,000,000 |
| Royal Bank of Canada | 82,000,000 |
| Banco Popular Dominicano | 80,000,000 |

The image that the BNV/Savings and Loan System created and promoted was that it was part of the community it assisted and was identified with the emerging middle class in the Dominican Republic. This new middle class had one key characteristic: homeownership, and the BNV/Savings and Loan System provided the means.

The BNV/Savings and Loan System also communicated another important, clear message to the public--that housing was attainable by all sectors of the population if they developed the habit of saving. This message reached a new, lower socioeconomic level of people that had never been reached before. The system helped them to change their living habits and helped them enter the middle class.

The system was resourceful enough that only three years after its founding it sold its first mortgage on the secondary market. As was discussed earlier in the report, the key to the savings and loan system's growth was the secondary market mechanism that multiplied the effective impact of savings mobilization and borrowings from AID. For example, to illustrate the continued importance of the secondary market, at this time La Popular's total savings mobilization is duplicated by another RD$120,000,000 received from the secondary market.

The system guards its exclusive FHA insurance program closely. It continues to be the backbone of its secondary market success as it gives a unique security and strength to its secondary market offerings.

To illustrate the credibility and adaptability of the system, it is worthwhile to note how it has survived through the difficult period of the last three years. Two-thirds of the savings mobilized by the system have come from abroad--outside of the Dominican Republic, from Dominicans living and working in the U.S. and elsewhere. At the same time, approximately two-thirds of the mortgage loans granted have also gone to Dominicans living and working abroad who have invested in homes in the Dominican Republic. Many of these transacations have been expedited from savings and loan representative offices set up in key cities of the United States and elsewhere. This has resulted in a very effective outreach program for the system.

The net effect of the system's successful savings mobilization programs has been to minimize it's dependence on loans from AID and make it independent of the GODR budget. Not only has the system not needed additional liquidity, but there has been an obvious reluctance (now precluded) to accept loans in dollars while having to repay in inflation weakened pesos (RD$). The Dominican Government, on the other hand, has a severe balance of payments problem, and welcomes any foreign exchange coming into the country. Although the GODR has agreed to assume the risk of any foreign exchange fluctuations (borrowing in dollars and lending to the BNV/Savings and Loan System in pesos), there exists the problem of locating appropriate projects for the HG Program.

The HG Projects in the Santo Domingo area have generally been successful. They have been effectively monitored by the BNV and the savings and loan associations and the market for homes in Santo Domingo is large enough to guarantee that all homes will be sold. This is not true in the secondary cities. This point of softness in effective demand in secondary cities was illustrated by some of the difficulties experienced by HG Loans 007 and 008.

At present, the approach of doing in-depth market demand analyses and affordability/cost recovery studies is correct if the previous difficulties are to be avoided. The success of the La Romana HG project testifies to the soundness of the program when that element of economic stability is present. The Gulf and Western Corporation provided that continuity and stability. It is, however, difficult to replicate the circumstances in the La Romana situation.

It appeared, however, that all the necessary ingredients were in place for HG-009 Tripartite Project, with the employers (National Council of Businessmen), labor unions (Consejo Obrero) and the GODR cooperating in a joint effort to provide housing for low-inocme workers. One of the key elements was an interest rate subsidy. But when the U.S. rates went up in 1982, the Consejo Obrero backed out because it did not want to take a chance on interest rates. The BNV would not assume that responsibility either. When rates subsided to the point where everyone was comfortable again, the GODR started its highly subsidized INVI program called INVIVIENDA which depleted the HG-009 market. The loan was subsequently de-authoried.

The HG-009 experience only reemphasized that the economic feasibility of housing projects is highly sensitive to:

1. interest rates (because projects are so highly leveraged with borrowed funds)
2. marketability and cost recovery.

It is clearly evident that any future HG Programs will have to face these issues and satisfactorily resolve them.

The above two issues are ones that face the BNV/Savings and Loan System almost daily. The savings and loan business is, after all, one of the most "interest rate sensitive" business in existence. It lives by the "spread" or "gap" between what money costs and what it returns. One of the most difficult situations that the system had to adapt to was that it was stuck with "fixed rate" mortgages in a highly volatile interest rate scenario. The strength of the system is demonstrated by the fact that it has survived this period of disintermediation. No doubt loans to nonresident Dominicans helped, but the usury limits of 12% have not been revised. Recognizing that the system can only survive in this kind of situation for a limited period of time, the associations are searching for some relief to this fixed rate disintermediation trap by pressing for a change in mortgage instruments. Apparently a Variable Rate Mortgage is politically not feasible at this time, but a Renegociable Rate Mortgage or Rollover Mortgage (3-5 years) is possible. Such a development would help the BNV/Savings and Loan System tremendously.

At the same time, since it has also been politically impossible to raise the 12% usury limit, other short-term palliatives have been used to relieve the disintermediation. The use of "front-end points," fees or commissions have helped in this area, but they tend to put an added burden on the borrower.

The other area that the system is looking to for some relief is "diversification." At present the associations are restricted to long-term home loans which are currently a constraint on income generation capability. If the associations had the ability to make shorter term higher interest loans and investments, subsequent lending capabilities for home loans might also be enhanced.

In retrospect, one of the few problem areas from the early years (60's) was the negative reaction resulting from AID imposed home-price restrictions on all loans made through the BNV. Most everyone involved felt that the BNV and the associations needed some time to become established before providing a high percentage of loans to the lower income sectors. The idea that such requirements were also imposed from outside of the Dominican

Republic also rankled. Fortunately, the AID long-term advisor to BNV intervened in the subsequent loans and helped to ease these requirements.

Later, during the early 70's when the U.S. Congress mandated an even more strict low-income orientation to the AID loan programs, this problem reappeared. By this time the BNV/Savings and Loan System was established and there was sufficient strength and capability within the system to search for and develop some projects that met the strict HG requirements. However, this remained a problem in the eyes of many Dominican savings and loan people.

This AID concentration (requirement) on the lower income sectors highlighted three important and not unrelated realities regarding low-income housing in the Dominican Republic:

1. that there was a lack of any coherent, National Housing Policy that a low-income program could be related to;
2. that INVI, the housing institution whose area of responsibility was the lower income sector, was not doing its job properly;
3. that the BNV/Savings and Loan System was limited in what it could do when faced with the above.

The most notable exception to this scenario was the very positive performance by INVI in the aftermath of hurricanes David and Frederick in 1979 which left hundreds of thousands homeless. At that time INVI built 11,000 units suitable for low-income families and helped repair an additional 38,000 units. AID emergency funds contributed $2.2 million dollars to this effort.

Another negative lesson has been the problem of "arrearages" by the Central Bank (Banco Central) on payments due U.S. lenders for previous HG Loans. The problem here is that the BNV/Savings and Loan System, as in the past, have made it's payments in a prompt and timely manner. However, since the payments need to be made in dollars, these funds must pass through the Central Bank before reaching their destinations in New York, Boston, etc. The Central Bank has "delayed" in passing these payments through because of the country's balance of payments problem and the subsequent renegotiation of it's external debt with the IMF (International Monetary Fund).

Since these loans are "guaranteed" funds (by AID), the Central Bank feels these are the easiest loans to delay payments on. What is unfortunate in this scenario (apart from accrued penalty fees that have to be paid and the damaged reputation of the GODR as a borrower) is the fact that any future HG Loan Program is put in jeopardy.

Again in retrospect, in addition to the previous conclusions gleaned from past experience which are already noted, there appear to be four recommendations for future consideration by those interested in promoting housing and especially housing for lower income sectors.

1. The concept of combining both public and private sectors in a HG Project is certainly not new, as has been demonstrated in the body of this report, but is mentioned here as the "right" approach, one that has worked, and almost worked (HG-009). It is recommended here again because it appears to be the best way to bring the skills and resources of the private sector into essentially a public-sector problem. It appears that AID could continue to play an effective role of bringing this combination about.

2. To recognize that the formative stage of development and early HG Loans has passed for the BNV/Savings and Loan System and that HG Loans should be looked at as "supplements" to diversified savings and loan portfolios. The BNV/Savings and Loan System obviously has an acknowledged responsibility in assisting a national program for low-income housing. At the same time, a strong argument for getting favorable "diversification" legislation would be to incorporate low-income components in the institutions' mortgage portfolios.

3. To consider the concept of a "blended" HG Loan, wherein funds from a U.S. lender are blended with ESF (Emergency Support Funds) of AID (if available) and local funds of the BNV/Savings and Loan System to form a package that together with government land might make some low-income housing projects feasible.

# CHAPTER VI

## GENERAL APPLICABILITY TO LATIN AMERICA AND OTHER REGIONS

### A. Latin America

Since the language of the Dominican Republic is Spanish (was the first Spanish colony in the New World) and whose development has closely followed other countries in South and Central America with similar culture and political histories, it is considered a "Latin" country despite the fact it is somewhat isolated in the Caribbean. The participation of AID-Housing in the development of its housing finance systems parallels that of other Latin countries in the America.

1. Applicability of the Dominican Experience. Much of the previous report is applicable to other countries in Latin America because of similarities in the development of their housing finance systems. One of the principal institutions of the shelter sector, throughout Latin America, is the savings and loan system in each country. These systems all developed at about the same time with similar kinds of support and guidance from AID-Housing.

Three phases have occurred:

a. Institution Building Stage
   i. Technical Assistance
   ii. Capital Assistance
b. Growth and Development Stage
c. Crisis Stage (late 1970's)

What then, if any, are some of the lessons learned from the Dominican experience that are applicable to other Latin countries? The most prominent are the following:

1. Development of an FHA-type insurance program, exclusive to the savings and loan industry.
2. Development of a secondary market mechanism.
3. A "differential" on rates payable for savings accounts.

4. Aggressive marketing and promotion of the image of a viable institution sensitive to the needs of middle and lower income people.
5. The necessity to have an adequate monetary correction mechanism in place or to adopt some form of variable rate mortgage instrument.
6. Avoid total control or politicization by the government. Regulatory body should seek public/private type institution with balance.
7. Seek some type of diversification attaining access to short-term lending and investment markets.
8. Develop a lower income shelter strategy within the savings and loan system that enhances its bargaining power with national governments and international lending agencies, including viable approaches for secondary cities.
11. Savings and loan institutions, when developing housing projects, should include a more comprehensive community development approach along with housing considerations.

2. Nonapplicability of the Dominican Experience. Relative to other savings and loan system in Latin America, the Dominican system is relatively stronger institutionally. Other systems, lacking viable FHA and secondary market components as well as access to expatriates living in the U.S. are much more vulnerable. In many cases the market penetration for savings has not been as extensive in other countries.

In addition, since the financial structures of Latin American housing finance and savings and loan systems have developed along lines determined by their government policies, there is a diversity in priorities. There is as well, diversity in the individual economic and sociopolitical circumstances facing each country. These realities, more than anything else, determine the applicability of the Dominican example.

B. Caribbean Area

The relevance of the Dominican experience is not as profound to other countries in the Caribbean area, since they are for the most part, either English or French-speaking. Other Caribbean nations carry their inheritance of colonial institutional traditions, as in the case of Jamaica with its Building Societies, that date back to the past century. So the institutional development and growth stages experienced by Latin countries during the 1960's under AID guidance would not be exceedingly relevant.

However, the crisis stage of the last four years is one in which many parallels can be drawn. The problems of relatively small developing countries, highly dependent on the economic tides of the international marketplace, are a reality they all share. Small island nations with relatively high population densities and limited resources are among the first to feel the economic pinch of dropping international markets.

Their problems are also similar in the shelter sector. They all have sizable housing deficits and have difficulty in putting together viable housing programs for the lower income sectors of their population. This is due to "affordability" and "cost recovery" problems as well as available resources.

Some lessons of the Dominican experience are therefore applicable to other Caribbean countries. To the list of eleven (11) recommendations for Latin countries (pp. 86-87) perhaps Item (e) would not apply since most have some sort of variable rate mortage mechanism in place. The other ten (10) recommendations are to a greater or lesser degree, highly applicable.

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