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FINAL

INSTITUTIONAL ASSESSMENT OF EL SALVADOR'S FONDO SOCIAL PARA LA VIVIENDA (FSV)

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EXECUTIVE SUMMARY

This evaluation recommends that FSV be an Implementing Agency for future HG funds. FSV's interest in HG funds was found to exist, only if the interest rate it pays for them does not exceed 7%, the overall return on its loan portfolio. AID would therefore have to mix the 14% HG with 2% ESF funds in order to bring the interest rate down to this level.

In addition to the three PP institutional objectives which these funds are likely to help achieve, they are expected to address a major problem. Housing prices are rising so much faster than income levels of the below median income population that within a year or two, below median income households will not be able to afford the type of housing they currently purchase, given FSV's current lending terms.

The HG/ESF scheme proposed is therefore the following:

- HG/ESF funds are loaned to FSV @ 7% by the GOES. FSV independently, or with the assistance of a construction management consultant, then on-lends to builders for construction of housing for specific income levels.

- The terms given the builders would be 10%, 1 year, instead of the 16%-20%, 1 year market rate terms.

- FSV would be required to guaranty that all or a specified % of the savings from this interest rate discount would be passed on to the purchaser of the unit.

- In addition, FSV would be required to show that it is actively pursuing with the builders it selects, alternative housing products- e.g., apartments; smaller or lower quality units. That is, a concerted initiative to develop and gain market acceptance of products that will remain affordable to below median income borrowers in the near future will represent the policy concession that AID will receive from FSV in exchange for these funds.

- Upon completion of these products, FSV would be required to finance them to specified income levels of contributors or non-contributors, the option being left to FSV.

This recommendation to go with FSV is based on the following conditions that were found to prevail:

- FSV is the market as far as sources of long term finance at terms affordable to the below median income. It originates approximately 4000 below median income loans. The next most active institution, IVU, only originates about 300.

- FSV operating procedures are well-defined and efficient. An aggressive, well-trained management team is on top of maintaining a responsive loan origination, credit review, processing, and collections system. Operating problems are regularly analyzed and goals toward resolving them realisticaslly set.

- FSV has the most extensive track record as far as working at least with the salaried sector of the below median income population.

- FSV is financially sound. The spread between 7%, the return on its loan portfolio, and 1.5%, its cost of funds, is very favorable. It more than absorbs its operating problems, such as high administrative costs and loan delinquency.

The one concern I have is that FSV's operating style is not systems oriented. It is highly personalized, based on the excellent capability of a small corps of managers. They are dedicated to mobilizing the rest of FSV: under-trained, overstaffed, and un-motivated. If these managers leave FSV, an institutional trend that is common in El Salvador today, the whole picture could abruptly change. This evaluation could go out-of-date very fast.

Another concern is that FSV's financial strength is vulnerable. Being a wealthy parastatal in a bankrupt country, its Board of Directors has the power to earmark what FSV is collecting for non-FSV activities.

FSV is found to be an eligible Implementing Agency. It satisfies the Conditions Precedent spelled out in the Implementation Agreement. It is considered likely to be an effective promoter of the institutional objectives specified in the PP.

For what I am recommending, except for the concessions specified above, it is unlikely that AID will obtain other concessions from FSV as far as modifying its operating procedure or interest rate policies. FSV collects $1 million a month from its contributors @ 1.5%, and another $1 million a month from its loan portfolio without conditions!

Yet, it should be emphasized that FSV shares AID's desire to adjust interest rates upward for below median income households, as long as the terms remain affordable- payments not exceeding 30% of income. What it doesn't share with AID is the desire and belief that significantly lower cost housing products are out there or can be developed, that will be of any interest to its below median income contributors.

FSV is also willing to explore increasing lending to below median income families in secondary cities.

What follows are a few more key details about FSV operations.

FSV originates about 5,000 loans per year mainly for first home purchase to the employees of private sector companies, mainly for first home purchase. The funds for these loans come from a mandatory savings mechanism. It requires that every employer deduct .5% from each employee's paycheck and that the employer contribute, in the name of each employee, 5% of his salary. This mechanism is in effect for the first 700 Colones per month of salary earned.

The employer forwards these contributions to FSV through Instituto Salvadoreno de Seguro Social, which turns the funds over to FSV, usually with a two month time lag. The employee is entitled to these funds upon retirement, permanent disability or death. In the meantime, these funds earn interest @ .5% per year.

198,000 employees and 11,000 employers are in the FSV system. 70% of the employees are at or below median income- approximately 750 Colones per month. 40,000 employees, or 20% of the total number of contributing employees, have FSV loans outstanding. FSV is mandated to lend to non-contributors but has elected not to do so until a larger % of its contributors have participated in its lending program.

While interest rates on FSV loans range from 4% to 13%, loans to its below median income clientele (66% of its loans in 1985) are in the 4% to 7% range, closer to 4%. FSV maintains these relatively low rates to keep loans affordable to below median income borrowers, who tend to buy houses presently costing 18,000 to 25,000 Colones.

FSV maintains that it is struggling with runaway housing prices that increase 25% annually and stagnant income levels. The average loan in 1985 was 19,000 Colones, and today the average is about 25,000 Colones. FSV is also adamant in insisting that its below median income contributors are not interested in purchasing lower cost (i.e., lower quality, inferior location or smaller) units.

Some of FSV's strengths are summarized above. The weaknesses are mentioned below in order to provide the balanced picture. However, it should be kept in mind that the types of problems found in FSV also prevail across the institutional map of housing in El Salvador, from IVU to FNV to ANDA. Consequently, if AID wants to influence housing policy through the public or private institutions currently in place, the problems that are found in FSV come with the territory, no matter who the implementing agent for HG 006 is.

The main problems found were:

- Excessive loan and contributor delinquency. No track record to date in effective loan portfolio administration.

- Highly over-staffed, and, in many cases undertrained, with management finding it politically difficult to reduce workforce. FSV originates about 20 loans a day, manages a 40,000 loan portfolio, and administers several cash management functions- e.g., receipt of contributions collected by Social Security, several bank accounts. For this level of activity, there are 408 person fulltime employees, with an annual administrative budget of 12 million Colones, or about $7,000 per day.

- Interest rates below what other institutions offer, but primarily to above median income borrowers.

- Political involvement in setting operating policies, practices and goals. These functions are the responsibility of the Assembly of Governors, headed by the Minister of Public Works, with the Ministers of Planning, Labor, Economy and Treasury as members. Lack of technical expertise of its members and delays in reviewing/approving policies have been problematic. Such an arrangement has the potential for trouble in politically volatile El Salvador!

- No branch network.

- Little interest in promoting low cost housing products or new technologies that will lead to lower costs. It sees its role in too limited a manner, given the housing price/affordability crises that is emerging. It is exclusively oriented towards "financing demand-" whatever is currently available in the market that its clientele is most interested in.

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1. DEFINITION AND FUNCTION:

FSV was started in 1973 as a parastatal credit corporation. It operates as an autonomous agency under the Ministry of Public Works. It was established in response to the view that existing housing finance institutions were neglecting the private sector working class.

Its function is to provide credit for homeownership by maintaining a continuous flow of resources via a mandatory savings mechanism.

The mandatory savings mechanism in effect requires employers to make direct payments to FSV for each employee, equivalent to 5% of each employee's monthly gross earnings. Each worker is required to supplement this payment with a monthly payment equivalent to .5% of gross earnings. This mechanism is in effect up to 700 Colones per month. If, for example, an employee earns 900 Colones per month, this 5%/.5% scheme only applies to 700 Colones per month of salary.

The employee recovers his and his employer's 5% contributions, plus accrued interest @ .5% per year which each employees account earns, upon retirement, death or permanent disability.

FSV offers four types of loans to its worker contributors: home purchase, home construction and home improvement. FSV has also purchased entire housing projects on a "turnkey" basis from developers that were built with construction financing from the savings and loan system.

FSV is authorized to refinance mortgage credit obtained elsewhere by workers, but has done so only on a special case basis- e.g., temporary loss of employment, reduction in income or a loan obtained elsewhere currently exceeding 30% of income. FSV believes that if these restrictions were lifted, refinancing would consume a significant portion of its lending. FSV has decided to continue to exclusively focus on providing credit to contributors who are first-time home buyers, who do not have access to alternative home financing sources.

Each active employee contributor is entitled to apply for an FSV loan if he has been an active contributor for at least six months, does not currently own a house (this requirement is waived for home improvements), and is judged by FSV to have the capacity to p... back the loan.

FSV can legally originate loans to non-contributors but has not done so, electing to address exclusively the housing finance needs of contributors. They are fully utilizing FSV resources.

2. SIZE AND SCOPE OF OPERATIONS:

2a. Number of active contributors:

Currently, there are 11,240 employer contributors and 197,600 employee contributors:

	1984	1985	May, 1986
Employers	11,032	11,129	11,240
Employees	183,860	190,063	197,600

Approximately 60% of the employer and 70% of the employee contributors are located or work in the San Salvador Department. This distribution verifies that most private sector employer/employee operations are located in urban areas.

2b. Size of loan portfolio and magnitude of lending activity:

The loan portfolio consists of 38,736 loans valued at 628 million Colones and has been growing rapidly:

	1983	1984	1985	1984-85 % Inc.
Number of Loans Outstanding:	30,558	34,721	38,786	12%
Value in Millions Of Colones:	492	558	628	13%

The return on the loan portfolio is 6.82%, up from 6.79% in 1984.

At yearend 1985, 20% of the employee contributors had received FSV loans. By May 1, 1986, 40,379 contributors had received loans.

4,565 loans were disbursed in 1985, an 8% increase over the 1984 loan approval level of 4,246. 99% of these loans were for the purchase of homes. Home improvement loans have not been pursued by the clientele, because once a house is purchased, the owner does not have the funds for home improvements.

Construction loans are not frequently applied for due to the prohibitive construction costs at present, which FSV finds are increasing by about 25% per year. In addition, FSV finds that there is very little urban land on the market in San Salvador that is available for purchase by individuals.

The dark side of this picture is that loan as well as contributor delinquency continues to be a major problem. FSV is aggressively trying to alleviate this problem, but its success is uncertain on account of economic and political trends external to FSV. This issue is further analyzed below in Section 5c.

2c. Financial performance:

A strong performance continues, primarily due to a 13% increase in the balance of employer/worker contributions, which helped to fuel the 12% expansion in the number of loans outstanding:

	(Millions of Colones) 1984	1985	% Change
Revenues			
- Interest from loan portfolio & bank accounts:	38	43	
- Other:	1	4	
Subtotal:	39	47	21%
Costs			
- Financial:	19	25	
- Administration:	11	11	
Subtotal:	30	36	20%
Profit:	9	11	22%
Returns To Contributors:	2	3	

For every 100 Colones of revenue generated, 23 Colones of profit was earned.

Other developments that have contributed to this performance has been the substantial reduction in the inventory of unsold units from 1978-83 "turnkey" housing projects and a 4 million Colon reduction in the debt outstanding to external sources (Venezuelan

Investment I .d and CABEI). As a resul of the former development, productive assets as a % of total assets has increased from 82% to 88%.

In 1986, FSV plans to sell the 43 million Colones of land it had purchased for future development but has remain unused. The current value of these lands is estimated at 56 million Colones.

2d. Operations:

FSV is headquartered in San Salvador. In addition to the San Salvador office, it has two branches, one in Santa Ana, the other in San Miguel. In addition, six employees travel to contributor sites on a regular basis to solicit loan applications.

A key component of FSV operations is the Department of Promotion and Commercialization. It analyzes where, among its contributor base, there should be demand for home credit and then contacts and sometimes visits the appropriate employers. The employers are interested in this outreach activity for they can sell this service as an incentive to their work force.

The Department of Promotion and Commercialization also maintains a consolidated list of houses for sale by location, from below 20,000 Colones to 50,000 Colones, to assist potential home purchasers locate appropriate. It therefore plays a critical role in being the link between the housing construction sector and FSV contributors in the market to purchase a house.

The employer/employee contributions are collected for FSV by the Instituto Salvadoreno de Seguro Social (ISSS). Employers deposit these contributions in selected banks in which ISSS has a collection system. The employee contributions are automatically deducted from his paycheck to assure his participation.
The loan application process takes 40 calendar days, down from three to six months a few years ago.

FSV has 408 employees. It is over-staffed, and management is aware of this problem. However, laying off employees without major cause is difficult in a parastatal organization. Management continues to try to chip away at this problem by offering early retirement, imposing a hiring freeze except for a few selected special projects, and providing extensive training opportunities.

3. STATISTICAL AND POLICY HIGHLIGHTS OF IMPORTANCE FOR AID POLICY REVIEWERS:

3a. Annual cost of funds and return on loan portfolio:

All of its funds at present come from contributors, which cost 1.5%. FSV pays .5 to the contributors and 1% to the Instituto Salvadoreno de Seguro Social (ISSS) as a commission for collecting the contributions. Over the 1981-84 period, FSV borrowed from Salvadoran as well as from international lenders in the 10-12% range, to help pay for its "turnkey" housing project commitments:

Source of Debt	Amount Borrowed In Colones (Millions)
Venezuela Investment Fund	42
CABEI	32
ISSS (Seguro Social)	15
Banco Salvadoreno	10
Various local s & l's	7
	106

FSV's current policy is no more borrowing.

The cost of funds for 1985 therefore is:

	Colones (Millions
- 1.5% per year paid for contributions made in 1985 and in years prior to 1985 that have not been returned to the contributors:	3.4
- Interest paid on loans FSV has outstanding with international and local banks/organizations:	5.4
A) TOTAL FINANCIAL COSTS:	8.8
B) AVERAGE VALUE OF LIABILITIES IN 1985:	629.4
C) COST OF FUNDS (A/B):	1.4%

The return on the loan portfolio was 6.82% in 1985. If the 45 million Colones of time deposits in banks and savings and loan associations is factored in, the return on invested assets is 8% For 1984, the figures are 6.79% and 7.5% respectively and for 1983, 6.77% and 7%..

With such a low cost of funds, FSV has a favorable spread, despite the fact that all of the loans that it originates have below-market interest rates.

3b. Interest rates applied to beneficiary loans and cross subsidy strategy:

Starting in April, 1986, the following lending standards were put into effect:

Monthly Income In Colones	Interest Rate	Years To Repay	Maximum Loan Amount In Colones	% of Lending
420 - 450	4%	25	to 20,300	11%
451 - 675	5%	24	20,400 - 27,100	28%
676 - 900	6%	23	27,200 - 32,600	27%
901 - 1,125	7%	22	32,700 - 36,900	21%
1,126 - 1,350	8%	21	37,000 - 40,400	8%
1,351 - 1,575	9%	20	40,500 - 43,900	7%
1,576 - 1,800	10%	20	44,000 - 47,000	3%
1,801 - 2,025	11%	20	47,100 - 49,500	2%
2,026 - 2,250	12%	20	49,600 - 50,000	2%
Over 2,250	13%	20	to 50,000	3%

The % of lending column (last column) quantifies FSV's policy that of the total number of loans it will originate, 66% will be to below median income contributors.

<u>Note</u>: median income as of June, 1985: 733 Colones per month.

Prior to April, the range was 6% to 10%, and there was no lending policy as to what percentage of loans made should go to the various income categories:

Monthly Income In Colones	Interest Rate	Years To Repay	Maximum Loan Amount In Colones
Plan Especial *	4%/5%	25	14,000 - 17,000
391 - 500	6%	21-22	To 18,000
501 - 600	7%	20-24	18,000 - 19,000
601 - 700	8%	20	19,100 - 19,500
701 - 800	9%	20	19,600 - 20,000
Over 800	10%	20	20,100 - 30,000

* Sale of inventory of housing project units that FSV could not sell.

The system s arted in April of assigning a % of total loans made to each income category is FSV's method of assuring that below median income contributors receive a proportionate share of the loans that are originated, based on the % of contributions that they make. This system is also intended to ensure FSV that the return on its loan portfolio will be maintained at about 7%. The lenders that actually pre-qualified for loans versus the loan % standards are:

Monthly Income In Colones	Policy: % of Total Number Of Loans To Be Made	Actual % Of Loans That Pre-Qualified: Jan-Mar, 1986
420 - 450	11%	27%
451 - 675	28%	27%
676 - 900	27%	21%
901 - 1,125	21%	8%
1,126 - 1,350	8%	7%
1,351 - 1,575	7%	3%
1,576 - 1,800	3%	2%
1,801 - 2,025	2%	2%
2,026 - 2,250	2%	1%
Over 2,250	3%	2%

When the actual % of loans originated to a particular income group exceeds the policy or standard % set, FSV does not stop making loans to that income category. It simply notifies the Department of Promotion and Commercializatiion to focus its activities on improving demand in those income groups that fall below the % targets that it has set.

In April, FSV lowered the interest rate that it will charge to most below median income borrowers from 6% to 4%, because it found that its lowest income contributors applying for loans were having an increasingly serious affordability problem. During 1985, the average loan originated to the various income categories were:

Monthly Income In Colones	Average Size Of Loan In Colones For Purchase Of A Home
To 400	17,175
400 - 500	18,221
501 - 600	18,719

Monthly Income In Colones	Average Size Of Loan In For Purchase Of A Home
400 - 500	18,221
501 - 600	18,719
601 - 700	19,317
701 - 800	19,775
Over 801	20,869
Overall average loan size:	19,968

FSV believes that current housing prices are already 25% above last year's prices, and that the average loan size this year will jump to 25,000.

In addition to lowering the below median interest rate from 6% to 4%, the higher income contributors that were originally charged 10% were charged 11%-13%, and the maximum loan amount was increased from 20,000 to 50,000 colones.

3c. Distribution of employee contributors by income:

1983:

Monthly Income In Colones	Employee Contributors	%
To 300	24,518	13%
301 - 550	79,210	42%
551 - 750	39,605	21%
751 and above	45,262	24%
	188,595	100%

Note: The income categories used to break down contributions by income levels were different in 1983 and 1984 and could not be easily converted.

1984:

Monthly Income In Colones	Employee Contributors	%
To 450	20,225	11%
451 - 675	51,481	28%
676 - 900	49,642	27%
900 and above	62,512	34%
	183,860	100%

The distribution of employee contributors by income level is not availabl[illegible] for 1985 or 1986.

3d. Distribution of beneficiaries by income:

TO DATE:

Monthly Income In Colones	Interest Rate	Loans Originated To Date As Of Yearend 1985 Number	%
Plan Especial	4%	815	2%
To 400	5%	7,847	20%
401 - 500	6%	13,071	34%
501 - 600	7%	7,304	19%
601 - 700	8%	3,512	9%
701 - 800	9%	2,082	5%
801 and above	10%	3,843	10%
Home Improve.	10%	312	1%
		38,786	100%

BY YEAR:

Monthly Income In Colones	Interest Rate	<---Loans Originated--->			
		1984	%	1985	%
Plan Especial	4%	--	--	8	--
To 400	5%	106	2%	8	--
401 - 500	6%	2,548	60%	2,417	53%
501 - 600	7%	543	13%	707	15%
601 - 700	8%	425	10%	527	12%
701 - 800	9%	156	4%	316	7%
801 and above	10%	468	11%	582	13%
		4,246	100%	4,565	100%

Monthly Income In Colones	Interest Rate	Loans Originated Jan To March 1986	%
Plan Especial	4%	561	40%
To 400	5%	6	1%
401 - 500	6%	293	21%
501 - 600	7%	139	10%
601 - 700	8%	96	6%
701 - 800	9%	60	4%
801 and above	10%	251	18%
		1,396	100%

This data indicates that FSV lends predominantly to below mediar income households earning in the 400-700 Colones per month range Included in this strategy are loans to above median income contributors at interest rates that are closer to the market rates. Also to be noted are the changes made in April, 1986, ir which the 6% category was dropped to 4%, the 10% category raised to 10% to 13%, and targets were set as to the % of total loans t be originated to each income category. The details are presente above in Section 3b. These changes represent FSV's present cros subsidy strategy.

As a point of reference, interest rates in another group of financial institutions, the s & l's, are as follows:

Size Of Loan in Colones	Interest Rate Charge
To 40,000	16%
40,000 - 60,000	18%
Over 60,000	21%

15 years, 10% down payment. 20 to 25 years have been given to borrowers who purchase houses that they finance but are difficul to sell.

It is unclear whether these rates can be interpreted as "market rates" as taken in the traditional sense of the term. The AID

Housing Officer in El Salvador said that these rates were set artificially high by the Government to discourage the production of units affordable to households above the 70th percentile in terms of income.

3e. Geographic distribution of beneficiaries:

San Salvador:	80%
Rest of Country:	20%

This data should be looked at within the context that 60% of all FSV contributors reside and work in San Salvador. The conclusion therefore reached is that contributors in San Salvador are more likely to apply for and receive an FSV loan than their counterparts not residing and working in San Salvador.

3f. FSV objectives versus HG 006's institutional objectives:

FSV's mission is to make long term loans for house purchase, construction, improvement or loan re-financing to its active employee contributors for the types of housing for which it feels there is a demand. All of its interest rates are artificially low- i.e., below the 16-21% market rates presented above in Section 3d. The below-median income borrowers get a lower rate (4% - 7%) than the above median income borrowers (8% - 13%), a form of cross subsidy. The overall rate for the entire portfolio is 6.82%.

AID HG's objective to rationalize interest rates so that parastatal credit institutions are not undercutting the rates charged by other financial institutions is not being met by FSV (e.g., s & l's @ 16%; IVU @ 12%).

FSV's response to this limitation is sound. The below median income contributor base could not afford loans that carry market rate interest rates and still purchase the same shelter product. As a result, the savings and loan system does not make housing purchase or construction loans to these income levels. FSV's feeling is that there would be no market for finished housing units that would be affordable to the below median income at market rate interest rates. This problem is most clearly illustrated in the following example.

At present, if FSV gives a 25,000 Colon loan to a borrower earning 700 Colones/month (median income being 733 Colones) @ 6%, 23 years, PITI payments would amount to 26% of his income. If this loan were given to him at 16%/15years, the rate charged by the savings and loans, PITI would consume 56% of his income.

At 16%, 15 years, the largest loan that this borrower could afford if he is only allowed to allocate 30% of his income towards PITI would be 13,500 Colones. FSV's belief is that currently, there is no housing product in this price range for which there would be significant demand.

A non-conventional analysis to what the effective interest rate being charged to FSV borrowers was conducted. Since mandatory 5.5% contributions on earnings up to 700 Colones per month that pay .5% per year are a requirement for FSV loans, this below market interest rate, compared to what they could be earning in a savings account at a financial institution (i.e., 8%), was factored into these interest rates.

This additional cost of a loan to the borrower makes the effective interest rate paid by the borrower slightly higher. For example, a borrower with a 700 Colon per month income who applies for a 25,000 Colon loan will be given 6%, 23 year terms by FSV. If the difference between the .5% that his 5.5% contributions earn at FSV and the 8% they could be earning in a savings account paying a market interest rate is factored into the cost of the loan, the effective interest rate becomes 8.59%.

The full analysis is presented below in Annex B. Even with this imputed fee factored in, FSV's rates are artificially low.

FSV stated that it is willing to raise interest rates as much as possible to achieve interest rate parity with the savings and loans, as long as PITI payments do not exceed 30% of borrower's income for the housing product for which there is a demand by its clientele- 3 bedroom 40 square meter house with kitchen/bath.

Two to three points could presently be added to many loans to below median income. However, this latitude will not be available, if housing prices continue to escalate at rates far above the increase in income levels, as FSV is predicting.

Other options that FSV is willing to experiment with include:

- Increasing the years to pay back the loan to 40 years;
- Indexing each loan to the borrower's income so that the interest rate charged will always result in his PITI payments being 30% of his income.

FSV realizes that even these changes would not get them to 16%. Directly promoting the development of less expensive housing products is not an area that FSV sees itself qualified or interested in undertaking. It sees its experience, capability and skills as strictly the lending business in the form of "financing the demand of its contributors," <u>not</u> house construction or marketing.

It believes that the seven savings and loans, having extensively worked with developers, would be suitable candidates to promote such a strategy. FSV does not feel that it has leverage with the savings and loans in directing them towards actively promoting this strategy, unless it had on deposit with them at least 300 million Colones, as opposed to the 15 million Colones it has on deposit with them today.

Low income families are not the exclusive target of FSV's operations, although 70% of its borrowers happen to be below median income. One of HG 006's institutional objectives is: redirection of resources to low income families. FSV is meeting this goal, while institutions such as the savings and loans which charge market interest rates make very few housing loans to below median income on affordability grounds, given the housing product available in the market for which there is demand for as far as obtaining a loan.

AID HG's other institutional objective to extend shelter services to low income families in secondary cities is partly being met by FSV. While FSV's charter permits it to originate loans to non-contributors, senior management has chosen to limit lending activities to its contributors until a higher percentage of them have obtained loans (currently 20%). 60% of employee contributors happen to work and reside in the San Salvador metropolitan area. It has branch offices in Santa Ana and San Miguel. No further branch offices have been open due to the thin contributor base.

3g. Sources and uses of funds:

(Colones Are In Millions)

Sources *:	1983 Colones	%	1984 Colones	%	1985 Colones	%
Contributions:	59	30%	61	51%	66	52%
Loans Paid Back By Borrowers-						
Interest:	24	12%	29	24%	34	27%
Principal:	9	5%	12	10%	15	12%
Interest From Time Deposits:	--	--	1	--	2	2%
External Loans (FIV/CABEI)**:	42	22%	3	3%	--	--
Other***:	61	31%	13	11%	11	9%
	195	100%	119	100%	128	100%

Footnotes:

* A source that doesn't appear in these figures is the

Government's $10 million non-reimbursable capital base contribution that it made when FSV was formed in 1973.

** Between 1981 and 1984, FSV borrowed 42 million Colones from the Venezuelan Investment Fund and 32 million Colones from CABEI. The outstanding balance for these loans stand at 67 million Colones at yearend 1985.

*** Includes loans to FSV from Social Security (Instituto Salvadoreno de Seguro Social- ISSS), Banco Salvadoreno and from the savings and loan system.

1983 was the last year that FSV borrowed heavily, primarily to meet its obligations on "turnkey" housing projects purchases. As a result, contributions weren't as dominant a funding source as they are today. As mentioned above, this venture has been discontinued.

Uses:	1983 Colones	%	1984 Colones	%	1985 Colones	%
	(Colones Are In Millions)					
Investments-						
Housing Project Purch:	106	55%	36	32%	--	--
Housing Loans:	12	6%	28	24%	54	52%
Construction Proj.:	21	11%	1	1%	--	--
Other:	4	2%	3	3%	--	--
Administration:	11	6%	12	10%	12	12%
Return Contrib.:	2	1%	2	2%	3	3%
Loan Repayment:	18	8%	22	19%	26	26%
Other:	22	11%	12	10%	9	9%
	196	100%	118	100%	104	100%

Note: The sources and uses of funds do not reconcile because of the available capital that FSV starts off with at the beginning of each year. For example, in 1985, available capital at the beginning of the year was 3.8 million Colones and at yearend, 30 million Colones.

3h. 1986 projections

FSV is projecting another active year in which the number of loans originated will be 7% above 1985:

Sources of Funds:	Colones (millions)
Funds on hand at the beginning of 1986:	30
Contributions collected:	69
Principal & interest from loan repayments:	59
Interest from funds deposited in financial instit.:	3
Other:	11
	172

Uses Of Funds			Colones (millions)
Loans originated-	3,500	home purchase * loans:	104
	127	home improve. loans:	3
	1,104	loans involving sale of inventory:	22
	167	refinancing loans:	5
	4,898	loans	134
Servicing of external debt:			9
General administration:			13
Return of contribution (1,500 cases):			4
Other:			9

* Of the 3,500 home purchase loans, 1,700 will be for amounts between 25,000 and 50,000 Colones.

3i. Relationship with s & l system:

No ties are presently in effect, except for the fact that of FSV's 45 million Colones of cash, current account and 60 day to one year time deposits in financial institutions, 15 million Colones are deposited in the seven s & l's at rates ranging from 13% to 15%.

Up to 1984, FSV was involved with the s & l's in that it purchased large groups of houses on a turnkey basis from developers who obtained the financing to build these projects from the s & l's. As a requirement for financing, the s & l's required that the developers obtain formal purchase commitments from FSV.

3j. Relationships with other organizations/agencies:

FSV does not have the resources or capability to collect employer/employee contributions. The Instituto Salvadoreno de Seguro Social (ISSS) manages the mechanism, whereby employers deposit their mandatory FSV contributions as well as those of their employees in any financial institution. ISSS collects these deposits, transferring them on with financial reports to FSV about two months after the contributions are received. FSV pays ISSS 1% of what is collected for this service.

Except for the Salvadoran and international institutions mentioned above in Sections 3a and 3g from which it borrowed between 1981 and 1984, it does not work with other agencies or organizations.

PRONAVIPO (Programa Nacional De Vivienda Popular) was mentioned as an organization with which FSV might share some common ground. FSV management is aware that it is an AID funded organization to promote the development and acceptance by the below median income public of 6,000 to 11,000 Colon housing products, including sites and service type solutions. However, nothing more was known, and no lines of communication have been established or are planned.

4. MANAGEMENT AND ORGANIZATION:

FSV has 408 employees, 375 of which work in the operational departments summarized below that report to the General Manager. The organizational structure in effect is described below:

A. Assembly Of Governors: The final authority in charge of setting policy and operating goals. Headed by the Minister of Public Works, its members include representatives from the

Planning, Labor, Economy, and Treasury Ministries. It meets twice a year.

B. Board Of Directors: It implements the Assembly of Governors decisions. It consists of two member of the Assembly of Governors, one labor and one business leader, the two of which are appointed by the Board of Governors.

C. President: He is responsible for the supervision and coordination of all activities. The Office of the President has a staff of 11, including a small audit unit.

D. General Manager: He is responsible for all financial management functions and personnel administration. The following Departments, report to him:

- Technical Advisory: This department was abolished in 1985 on account of FSV exiting from the housing project business in 1984. It was responsible for reviewing, approving and supervising housing projects that FSV has committed to buy. Most of the 47 person staff moved into the Property Valuation and House Repair Departments.

- Operations (95 employees): It reviews credit applications and assists contributors in the market to purchase a house with loan application procedures and locating appropriate houses o consider purchasing.

- Finance (88 employees): It is responsible for accounting, loan portfolio administration, and verifying that payments are being made by employers and employees registered with FSV.

- Administrative (177 employees): It is responsible for all support functions- security, personnel, maintenance, etc. Included in this division are 80 guards, holdovers from the days when FSV had a large inventory of unsold houses that had to be guarded against vandalism.

- General Management (34 employees): Planning, data processing, special studies and legal services are provided.

E. Supervisory Council: This three member council supervises the relationship of the FSV's operations to the laws and regulations governing the institution.

Approval of FS 's budget is handled by th Ministry Of Finance (Ministerio de la Hacienda).

5. ISSUES AND PROBLEMS:

a. Housing project exposure: This problem, which is discussed above has finally come to an end, with FSV selling off in April, 1986, the last of its inventory of not-sellable housing product at 4%, 30 year terms and management committing never to venture again beyond what it knows- loan underwriting.

However, I feel that the details of why this problem occurred are important to document here, because it some valuable lessons for AID as well as for FSV to learn, if these two organizations might work together in the future.

Until recently, recently, FSV was committed to purchase some or all of the units making up housing projects built by developers. From 1981 through 1983, 19,296 of these housing project units, worth 340 million Colones, were purchased. To meet these purchase commitments, FSV had to borrow 75 million Colones from abroad at high interest rates and also once from Social Security.

Construction financing was liberally provided by the S & L's, once the developer obtained a "purchase feasibility certificate" from FSV indicating the Fund's approval of the project and its intention to purchase a specified number of units. FSV intended to eventually resell these purchases to workers with FSV accounts. In recent years, 65% of the units built with S & L financing were purchased by FSV.

As of a year ago, FSV had an inventory of 2,000 units resulting from these projects with a $30-35 million market value, that it was unable to sell. This problem was caused by:

- Contractor inefficiency and their lack of concern about the marketing aspects of their projects. Several projects incurred overruns, resulting in the final selling price of the units being 22,000 - 30,000 Colones, instead of the original 15,000 - 18,000 Colon range planned.

- Consumer dissatisfaction, given the price: 15,000 -18,000 Colones. Based on an FSV survey of its contributors, the units were found to be too small. The average size was 34 square meters, enough for 2 bedrooms, when they were looking for 40 square meters, enough for 3 bedrooms. This expectation was based on what families (average size: 6) were already living in on a rental basis

In addition, the building materials were found to be too low quality, and the houses frequently did not come painted inside, nor did they have a wall around the "jardin," (costumbre).

Adding insult to injury, their locations were frequently found to be unacceptable. The developers, in their effort to minimize costs, usually built in areas too far from San Salvador (16 - 32 kilometers), that had little to no acces to public transport, and was not well served in terms of street lights and access to drinking water.

Another mistake many builders made was to construct houses in secondary cities along the same lines as the ones built in the San Salvador metropolitan area. Secondary city consumers prefer the use of more traditional materials (e.g., adobe, thatch) and are used to smaller sized houses. Furthermore, with secondary city salaries far below San Salvador, the 15,000-18,00 price was too expensive.

Overpayment by FSV for the units in that their value frequently declined between purchase and sale to a contributor.

B. Delinquency

The Problem:

FSV continues to face two forms of delinquency that have prevailed at high levels for so long that you wonder wheth this problem has become institutionalized. Delinquency on its loan portfolio as well on employer/employee contributions are serious problems:

Loan Portfolio Delinquency

Year	<---Number Of Loans---> Delinquent	Outstanding	Delinquency Rate
1983	13,541	30,558	44%
1984	17,110	34,684	49%
1985	19,699	38,786	51%

FSV pointed out that from December to January of this year, the number of delinquent loans declined 4% to 18,819.

Year	<--Colones (Millions)--> Delinquent	Outstanding	Delinquency Rate
1983	20	492	4%
1984	30	558	5%
1985	40	628	6%

Loan delinquency, broken down by income groups in terms of number of loans and Colones for 1985 is summarized below:

1985:

		<--Number Of Loans-->		<--------Colones------>	
Income Levels (Colon)	Interest Rate	Number Of Delinquent Loans	% of Total Delinquent Loans	Delinquency In Colones (Millions)	% Of Total Delinquency In Colones
To 300	4%	491	2%	1	2%
301-400	5%	4,290	22%	7	17%
401-500	6%	6,283	34%	9	23%
501-600	7%	3,638	18%	7	19%
601-700	8%	1,698	9%	4	11%
701-800	9%	1,105	6%	4	3%
801-1500	10%	2,194	11%	8	20%
		19,699	100%	40	100%

This data indicates that the FSV's delinquency problem lie mainly with its below median income borrowers, the target group to which it originates most of its lending. The following aging of the loan portfolio's 1985 delinquency shows how seriously delinquent many loans are:

1985

Months Delinquent	Delinquent Loans	%	Delinquency In Colones (Millions)	%
< 4 Months	5,010	25%	2	5%
4 - 6 Months	2,377	12%	1	3%
> 6 Months	12,312	63%	37	92%
	19,699	100%	40	100%

What is happening is when an employee changes jobs, he doesn't notify his new employer of his outstanding FSV loan and then proceeds not to continue paying it. What is needed is an information system that is cross referenced with the government, whereby, when an employee starts a new job, the FSV computer automatically indicates his loan outstanding, based on his contributions, which get picked up by his new employer.

Contributor Delinquency *

Year	Colones (Millions)
1983	17
1984	18
1985	n/a

* Finer detail, such as employer versus employee and numbers of employers and employees are not available at FSV. FSV tries to obtain more detail from ISSS, the agency that collects contributions, but ISSS has not cooperated, according to FSV.

It is difficult to determine how much of this problem is due to the political and economic conditions of the country and how much is due to the fallout of being over-staffed, having unproductive personnel, and having inadequate computer based tracking systems. Other contributors to this problem, according to FSV, include:

- The growing unemployment rate;
- Granting loans in previous years without adequate credit review;
- Employers not notifying FSV when they go out of business;
- The low priority FSV gave in the past to administering the outstanding loan portfolio
- The impact of the civil war, primarily in secondary

cit s. At yearend 1985, 636 uses with a loan value of ... million Colones had been abandoned.

The feeling that I came away with was that while FSV understands the various causes, it is uncertain as to what is really driving the delinquency problem.

FSV's Current Response To The Problem:

A team of loan portfolio specialists, consisting of a team of eight lawyers, five collections agents and 10 messengers is being mobilized. The goal is to reduce loan delinquency 20% by yearend.

When a delinquent borrower is found, if he acknowledges his delinquency, FSV has been flexible in negotiating acceptable terms based on the borrower's financial circumstances, including partly paying off delinquency with the .5% contributions that he has put into the FSV system to date.

FSV recently set up a contributor delinquency unit with ISSS that, starting in June, will pursue contributor delinquency and improve ISSS to FSV reporting.

C. <u>Over-staffing and quality of personnel</u>

The Problem:

FSV has 408 employees to administer a 40,000 loan portfolio, a loan operation that originates about 20 loans per day, revenue from contributions sent to it by ISSS, its loan portfolio and its bank accounts. This grossly over-staffed position is an indicator of trouble. Other indicators include:

- 80 construction site guards on the payroll after abandonment of direct construction activities.
- Most of the 47 person Technical Advisory Department staff going to other departments when this department was abolished and the housing project function eliminated.
- When obtaining information from management for this review, none of the financial planning staff to which tasks were assigned completed the work correctly or in a timely manner, resulting in the manager having to tabulate the required information himself. The talent pool is very thin.

FSV is parastatal in character in that it has bright, well-trained and aggressive management directing operations but is bu 'ened down by bloated, unm . ivated staff that seem to show a unresponsive, slow-moving, incompetent manner. Administrative costs are therefore high- 12 million Colones per year.

I do not feel comfortable with the fact that the Assembly of Governors, which sets FSV's policies and operating goals, consists of Ministry officials, including the Minister of of Public Works. Setting policies and operating goals is a function that professional managers should be directing, not political appointees or officials. El Salvador's politically volatile tradition, they should be cut out of the management activities of FSV to ensure reasonable standards of technical performance and fairness.

The Assembly Of Governors has also adversely affected operations by not having time to assemble to review and approve technical guidelines and policies. For example, the new lending standards implemented in April, 1986, were prepared and ready for review and approval 8 months before the Assembly of Governors actually convened to to review and finally approve them.

Due to the low productivity of FSV personnel below the manager level, I do not believe that FSV in its present form could survive financially if it did not have automatic access to such volumes of cheap money and had to compete on an equal basis with private sector financial institutions. Administration costs alone are close to $7,000 a day- for an operation that originates 20 loans a day and has a 40,000 loan portfolio!

FSV's Current Response To The Problem:

Senior management has been offering early retirement and providing extensive training opportunities. Except for special projects, a hiring freeze has been imposed.

A comprehensive, quantitative financial planning process is in place, in which goals that have to be met by yearend by specific departments and divisions are carefully spelled out. Resources required and who is responsible for each area of a particular goal are meticulously documented and quarterly monitored.

D. Rapidly escalating housing prices

The Problem:

Housing prices have increased by 25% over last year, while income levels have not changed. The average FSV loan that was for 18,956 Colones in 1985 will be for 25,000 colones in 1986. Many of its below median income contributors that try to finance the purchase of a house are therefore expected to have affordability problems. In addition, the higher loan amounts leave FSV without adequate funds to originate the 4,900 of loans that it set as its goal for 1986.

FSV's Current Response To The Problem:

To address the affordability problem, FSV is looking into modifying its lending terms, such as increasing the number of years to pay back the loan.

To increase its capital base, FSV is lobbying to get the 700 Colones per month ceiling on employer/employee contributions removed. The 5%/.5% contribution only applies to the first 700 Colones of income. This lobbying effort is not expected to succeed, on account of the strong resistance that private sector companies are showing.

The idea of using the borrower's .5% contributions plus accrued interest to make a partial balloon payment at the end of the loan was suggested as a scheme to make housing more affordable. FSV rejects this mechanism, because it is not in its best interest to return contributions at an earlier date than an employer's retirement, disability or death.

E. Artificially low interest rates

The Problem:

As discussed above in Sections 3d and 3f, FSV's interest rates which run from 4% to 13%, but with its lending more concentrated in the 4% - 7% range (average: 6.82%), are below the 16%/15 year/10% down terms offered by other financial institutions such as the savings and loans.

FSV can undercut the market and survive financially, because its cost of funds are basically 1.5% - once its debts are paid off. Furthermore, it is politically mandated to take care of the housing related credit needs of the private sector worker population at modest, affordable rates.

An analysis which looks at FSV's interest rates from an opportunity cost perspective to arrive at the conclusion that its effective rates are actually higher than its nominal rates but not at parity with the market rates is presented in Appendix B.

FSV's Current Response To The Problem:

FSV does not expect to offer market interest rates and terms if it is to provide loans to its below median income clientele. However, it is looking into to raising all loans by 3 points, 1 point every five years. It is also considering indexing its future loans so that the borrower pays 30% of his income towards his loan repayment, regardless of interest rate. FSV is therefore able to share in future salary increases.

F. Unutilized land

The Problem:

From 1974 to 1979, FSV purchased 48 million Colones of land for housing projects. This land has sat idle for over 10 years, representing an unutilized asset. FSV initially paid too much for this land. As a result, the 48 million Colones of land purchased is estimated to only have a current market value of 56 million Colones.

FSV's Current Response To The Problem:

FSV has received permission from the Government to sell the land. Before selling it to the private sector, it must keep it available for 90 days (to June 30, 1986) for government agencies to submit bids. So far, the Department of Defense and the Ministry of Housing have shown interest in about 10 million Colones of this land.

G. No branch network, lack of public information as to FSV's lending program and insufficient/untimely data

The Problem:

The contributor in San Salvador who wants to obtain an FSV loan is limited to one FSV location as far as applying and for a loan and making a loan payment. 50% of the borrowers make loan payments independently of their pay-check, having changed employers, not notifying the new employer of the FSV debt. While loan payment can be done at any bank, the borrowers still prefer to go directly to FSV.

There seems to be a lack of consumer oriented published information as to current FSV lending policies and eligibility requirements.

For a large scale lender such as FSV, records and data bases are not fully computerized, resulting in manual records regarding some borrower and loan portfolio characteristics.

Another manifestation of this problem is FSV not being able to directly collect from contributors, subcontracting this function out to ISSS, whose performance to date is questionable, given contributor delinquency and the two month lag between when the funds are collected and when FSV actually receives them.

FSV's Current Response To The Problem:

FSV has recently established a mobile unit, consisting of a corps of 7 to 10 loan application and credit review specialists. They visit places of employment, based on constant telephone soliciting, to start the loan application process.

They are also part of a newly formed Information Unit whose purpose is to educate the contributor clients as to what is available through FSV, the procedures to obtain loans and housing available.

To improve its loan processing and the usefulness of its data base, FSV is in the midst of computerizing its accounting and other internal systems- e.g., expanding storage capacity of its current NCR system, purchase of a CRT terminal for the Loan Department, purchase of two microcomputors.

No action is being take to take over the contribution collection function from ISSS. This project should be high priority in that FSV could save the 1% of collections that it pays ISSS as a fee for its collections service and would have immediate access to the funds as oppose to the two month lag it currently experiences. Furthermore, FSV, with its aggressive management, might make more headway in pursuing the growing contributor delinquency base.

H. <u>Lack of the actuarial base to specify reserves to be set aside for return to contributors</u>

The Problem:

FSV is required by law to have an ongoing plan based on actuarial studies that specifies the magnitude of reserves that should be put aside each year for return to contributors due to retirement, death or permanent disability. Since the amount that has been returned to date is minuscule, FSV has not yet gotten around to specifying reserve requirements.

FSV's Current Response To The Problem:

FSV recently had an IDB consultant undertake the required actuarial analysis. His conclusions as to reserves that should be set aside were found to be excessive and were not implemented. This important project remains on the back burner.

I. Lack of initiative in seeking out or promoting low cost housing products to its below median income borrowers

The Problem:

FSV presently has tunnel vision towards the housing market. It sees itself strictly as a lending operation. It is not interested and does not feel qualified to get involved in working with builders on affordable construction standards, marketing, or re-educating them to take more of an interest in what is affordable to the below median income. Yet, it worries about how quickly housing prices are going up in relation to income and that it might not be able to provide credit to the below income contributors in the near future.

FSV expects the average loan in 1986 to be for 25,000. Given the 30% of income for PIT criteria, a 700 Colones/month borrower could only afford a 29,000 Colon house @ 6%, 23 years.

FSV does not feel that there is substantial interest on the part of its contributors towards such minimal housing products. It feels that this is one of the lessons it learned from its 1978 - 1983 turnkey housing project experience. Furthermore, in conducting a contributor survey of housing needs and preferences, the finding was that the 18,000 to 25,000 Colon type solution is what they expect.

FSV's Current Response To The Problem:

Nothing of substance. No effort has been made to take a macro approach to the problem and set up working ties with low cost builders or organizations such as PRONAVIPO (discussed above in section 3j). The strategy at present is to stay away from issues not directly related to loan underwriting. It sees itself as strictly "financing contributor demand," not intervening in the housing market to make it work better for its contributors.

J. Loan agreements signed with contributors, but contributors not following through and actually borrowing

The Problem:

A contributor would apply to FSV for a loan for a certain amount. If FSV approved the loan, the contributor would then go out into the market to find a house for the amount of the loan approved. If he didn't find a house he wanted to buy, FSV was caught with the funds. At yearend, 1985, 30 million Colones of commitments made by FSV that were not drawn down by contributors as expected remained unutilized.

FSV's Current Response To The Problem:

FSV changed its system of granting loans. A loan applicant now has to present a house sale contract before FSV will act on deciding to originate the loan. This problem is continuing, but in smaller magnitude. The contract frequently doesn't go into affect until the house is built which can take 4 to 8 months, leaving FSV with committed but unutilized funds.

6. RECOMMENDATIONS FOR FSV PARTICIPATION AS AN IMPLEMENTING AGENCY FOR HG 006 AND FOR FUTURE HOUSING FUNDED OR GUARANTEED BY AID

A summary of FSV's key strengths and weaknesses that I feel AID should bear in mind in whatever final decision it comes to are presented below:

Strengths

A. Its access to and familiarity with below median income urban households who, as private sector employees, belong to the FSV system.

B. Effective loan solicitation, credit review and loan processing, backed by state-of-the-art computer systems that are just coming on line.

C. Aggressive, well-trained management that has a realistic understanding of FSV's problems and is trying to resolve them. "Critical areas" to resolve are regularly analyzed and spelled out, followed up by a plan of action.

D. A comprehensive financial planning process in place, in which goals are quantified and clear assignments made to departments and divisions for reaching these goals, followed up by a quarterly monitoring system.

Weaknesses

A. Excessive loan and contributor delinquency.

B. Inability to collect contributions, resulting in ISSS doing the job for 1% of what is collected. ISSS reporting to FSV is below par as has been its pursuit of contributor delinquency.

C. Over-staffed. Below the manager level, not well-trained, motivated or productive. Being a parastatal, management's hands are tied as far as resolving this problem.

D. Not full service oriented. Only interested in financing demand. Other aspects of housing indirectly related to finance, such as seeking out lower cost, more affordable housing products FSV avoids. This tendency is perhaps due to it getting burned by the turnkey housing projects which it purchased for its contributors from 1978 to 1984.

E. Below market interest rates. Although market rates would make the size of loans FSV has been giving to below median income, there is still 2 to 3 points of affordability until most of its borrowers are paying 30% of their income for PITI.

F. No branch network.

G. Political involvement in setting operating policies and goals. The Assembly of Governors, which has these responsibilities, is staffed by Ministry officials. This arrangement has the potential to cause trouble, particularly within the relatively unstable context of El Salvador.

I have developed two sets of recommendations below. The first is a piecemeal, band-aid recommendation that has a short timeframe in mind. The second represents what I feel really should be done, but admittedly, may be too ambitious and radical for the circumstances. It represents a long term housing strategy that I am unsure could be realistically presented to the Government without AID providing substantial economic support.

<u>a. Short-term, band aid recommendation:</u>

If AID is looking for a vehicle to provide funding for low income housing on a quick turnaround, emergency basis, <u>FSV is acceptable.</u> It is a technically competent, responsive loan underwriter as far as soliciting loans, conducting credit reviews and processing the loans. It regularly originates housing loans to households that are the target population of the HG program;

is willing to try to originate more loans in secondary cities; and is willing to move interest rates slightly higher- to the point of existing housing product still being affordable.

How effective it is on loan portfolio management is unclear, given the serious delinquency problems in its outstanding loan portfolio.

AID should specify in its Implementation Agreement that prior to disbursement FSV show an agreed upon rate of progress in reducing loan delinquency over a two month period to be eligible to receive the HG funds.

In addition, while market rate terms cannot be provided for the housing product that it is currently financing for below median income contributors, request that, regardless of income, PITI be indexed to the 30% of income ceiling. In other words, being tied into the employer of the borrower, when the borrower's income increases, FSV would raise his PITI.

Obtain an agreement in principal from FSV, whereby the low cost housing products being developed by builders or organizations such as PRONAVIPO, while not ideal products from the perspective of FSV contributors, should be accepted as eligible for FSV loans.

Require FSV to deviate from its current policy of strictly "financing demand"- i.e., whatever comes through the door that, from a financial and administrative perspective, is eligible. Require FSV management to periodically meet with whomever AID and the GOES identify as a source of low cost housing.

Require FSV to promote the product to its contributors and provide the loan. If there is still no demand from its contributors, FSV should be required to go outside the contributor population and lend to below median income borrowers that AID identified organizations find who are interested in buying the product and are financially eligible borrowers.

Require FSV to make a commitment to originate a specified amount of below median income loans to secondary city residents, at least in proportion to each major city's share of the urban population. This commitment would address one of HG 006's key institutional objectives- expansion of shelter services to low income families in secondary cities.

Require FSV to open a savings account program paying market interest rates. Have FSV use the condition that if a contributor has a certain minimum deposit in this savings account for a specified amount of time, he would be eligible for preferential loan terms - e.g.,a discount on the interest rate of his loan would be applied. Other incentives could also be developed.

Instead of the saver depositing his savings elsewhere, FSV could mobilize his savings and, thereby, have more capital for its lending.

FSV is not likely to accept these conditions for $1Ø million of HG money. $1Ø million is not a large amount, given the size of its operations. It collects over $1 million per month from its contributors without conditions. I recommend that AID should therefore negotiate for as many of these conditions as possible. Based on those which FSV rejects, AID should put together an FSV technical assistance program.

b. Long-term structural recommendation:

I find that FSV's weaknesses outweigh its strengths. The key problem that I feel FSV management cannot resolve is the over-staffed, unproductive workforce that makes FSV very expensive to run. Its 12 million Colones per year administration budget converts into an administration cost of almost $1Ø,ØØØ per workday.

For an institution that originates about 2Ø loans per workday and processes monthly payments for 4Ø,ØØØ outstanding loans, such a cost is excessive. Even with such a high overhead, serious problems such as mortgage delinquency prevail.

FSV is set up to achieve political goals and ignore many of the economic realities. FSV has hired too many people that it cannot get rid of, and the personnel, by and large, do not have the motivation or skills to be productive. The fact that it cannot set up and run its own contributor collection system, provides below market interest rates that aren't even 3Ø% of income, and cannot control delinquency with so many people on the payroll are cases in point. How can there be 8Ø guards on the payroll, and management saying that nothing substantive can be done?

The structural change that I therefore recommend involves reducing government economic intervention in housing finance by selling FSV to private investors. The group that should take over what FSV does today should be profit and efficiency-oriented and also willing to promote FSV's social goals. What AID should look for is a bank or a group of financial institutions with, if possible, a well established network of offices throughout the country.

This institution or group should have:

- A loan underwriting and collections track record;
- Reasonable administration costs/staffing levels;
- Not have Ministers on their Board of Directors;
- Be willing and able to do more in the below median income housing sector than just "finance demand."

What I have in mind is working with other organizations to develop and promote markets for low cost housing products. Also, it should have the ability to collect contributions without assistance from ISSS, and keep contribution delinquency at reasonable levels.

This institution should be required to keep the FSV related collections, loan origination practices and standards, and records separate from the rest of its business. Its operating rules as far as what it could lend for, who is eligible, resources, etc. would remain the same.

Specific targets regarding interest rate/terms, magnitude of lending to below median income contributors, delinquency would be annually set and monitored by a Board of Directors, with a minority representation by Government officials. The intention of Government participation is to assure that FSV's social goals are maintained.

It is unlikely that such an investor group that could afford to buy FSV exists. In that case, a probationary management contract should be given to such an institution or group of institutions. FSV employees would then be transferred to other government agencies. After a trial period, performance would be reviewed and the contract either continued or terminated, with the option to re-mobilize FSV or try out another group.

The details regarding the timely implementation of such a recommendation are the subject for a subsequent study or TDY:

- Define technical objectives sought by privitizing FSV.
- Determine who might be interested and the conditions they would require. Identify alternative arrangements.
- Specify procedures for selling FSV or hiring a management contractor staff to operate FSV.
- Estimate the FSV selling price or contract management cost. Specify how purchaser or contract management performance will be monitored, regulated and evaluated, and by whom. Indicate the schedule that this supervisory activity would follow.
- Draft conditions, institutional and Government relationships and contract specifications between the Government and the purchaser or management contractor.
- Assemble budget and lay out all logistical steps.
- Prepare a full schedule.
- Present plan and to the Government.

What I have presented here is just the outline for a substantive strategy to pursue. I intuitively feel that the long run benefits will outweigh the pain and peril involved in this privatization initiative.

VERIFICATION OF AFFORDABILITY OF A RANDOM SAMPLE OF FSV LOANS TO BELOW MEDIAN INCOME HOUSEHOLDS

Assumptions:

- The interest rate charged a borrower is based on his monthly income, as specified below from FSV documents:

Monthly Wages		Interest	Monthly Wages	Interest
200-250	Colones	4%	500-600	7%
250-400	Colones	5%	600-700	8%
400-500	Colones	6%	700-800	9%
			> 800	10%

  The median of each of these income ranges is what is used to estimate the income of each borrower randomly selected for mortgage analysis.

- The median monthly income was 630 Colones up to June 20, 1985, after which, it became 733 Colones per month.

- A loan is affordable if the PITI doesn't exceed 30% of monthly income. Also assumed is that the borrowers have negligible debt beyond the FSV loan.

- FSV estimated insurance insurance to be 7% of P & I. Property taxes are handled and paid directly by the homeowner, independant of the lender. Therefore, it has not been factored into PITI.

NOTE: From the print-outs reviewed, the following was found:

1. The mortgages that FSV has originated since 1983 are not well distributed geographically. Most of these loans are for housing in the San Salvador department.

2. There are very few 4% and 5% on these print-outs. It was learned from FSV that 4% and 5% loans were only originated in special situations- e.g., liquidation of FSV's inventory of units from the "turnkey" projects that it could not sell. In April, 1986, in response to rising housing prices, the income groups who had been receiving 6% loans will receive 4% loans.

The loan analysis that follows as Table I confirms the eligibility of FSV mortgages from the perspective of being affordable and most of the borrowers being below median income.

TABLE I

MORTGAGES ORIGINATED PRIOR TO JUNE 20, 1985:

	LOAN #	LOAN AMOUNT (COLONES)	INTEREST RATE	YEARS	MONTHLY PAYMENT IN COLONES: P & I	T & I	TOTAL	EST.MO. INCOME OF BORROWER	PITI AS A % OF INCOME
1.	83-08370-0	19804	9%	21	175	12	187	750	25%
2.	83-08472-0	18000	7%	22	134	9	143	550	26%
3.	84-01100-6	19804	6%	25	128	9	137	450	30%
4.	83-09039-4	18000	6%	25	116	8	124	450	28%
5.	84-00569-9	18000	6%	25	116	8	124	450	28%
6.	84-01363-8	18000	8%	21	148	10	158	650	24%
7.	84-01235-3	19804	10%	20	191	13	204	850	24%
8.	84-01375-5	19804	10%	20	191	13	204	850	24%
9.	83-00398-5	19190	8%	21	157	11	168	650	26%
10.	83-00958-4	18000	5%	25	105	7	113	375	30%
11.	83-01355-0	19190	8%	21	157	11	168	650	26%
12.	83-02518-0	19000	7%	22	141	10	151	550	27%
13.	84-00298-6	18000	6%	25	116	8	124	450	28%
14.	84-01429-1	19804	6%	25	128	9	137	450	30%
15.	84-00493-1	19804	9%	21	175	12	187	750	25%
16.	84-00491-8	19500	8%	21	160	11	171	650	26%
17.	84-00348-5	19600	9%	21	173	12	186	750	25%
18.	84-01354-6	18000	7%	22	134	9	143	550	26%
19.	84-01494-8	18800	7%	22	140	10	150	550	27%
20.	84-01488-1	17100	5%	25	100	7	107	375	29%
21.	84-03749-0	19500	8%	21	160	11	171	650	26%
22.	83-03496-2	15685	6%	25	101	7	108	450	24%
23.	84-03749-0	19500	8%	21	160	11	171	650	26%
24.	83-03496-2	15685	6%	21	110	8	117	450	26%
25.	84-04149-0	18215	7%	22	135	9	145	550	26%
26.	85-01630-1	17915	6%	25	115	8	124	450	27%
27.	83-03203-0	19050	10%	25	184	13	197	850	23%
28.	83-06517-6	19806	10%	20	191	13	205	850	24%
29.	83-06145-4	19806	10%	20	191	13	205	850	24%
30.	83-04645-1	19606	6%	25	128	9	137	450	30%
31.	84-02220-9	17875	6%	25	115	8	123	450	27%
32.	83-00689-5	20500	10%	20	198	14	212	850	25%
33.	83-01271-2	20000	10%	20	193	14	207	850	24%
34.	84-01288-7	15000	10%	20	145	10	155	850	18%
35.	83-02123-5	19500	8%	21	160	11	171	650	26%

MORTGAGES ORIGINATED PRIOR TO JUNE 2Ø, 1985:

LOAN #	LOAN AMOUNT	INTEREST RATE	YEARS	MONTHLY PAYMENT IN COLONES P & I	T & I	TOTAL	EST.MO. INCOME OF BORROWER	PITI AS A % OF INCOME
36. 83-Ø1Ø26-9	19876	6%	25	128	9	137	45Ø	3Ø%
37. 83-ØØ581-3	19876	6%	25	128	9	137	45Ø	3Ø%
38. 83-Ø851Ø-2	19876	5%	25	116	8	124	375	33%
39. 83-Ø3Ø24-4	17789	1Ø%	25	162	11	173	85Ø	2Ø%
4Ø. 83-Ø64Ø3-8	18ØØØ	7%	2Ø	14Ø	1Ø	149	55Ø	27%
41. 83-Ø7645-5	195ØØ	6%	22	133	9	143	45Ø	32%
42. 83-Ø8819-Ø	21988	8%	25	17Ø	12	182	65Ø	28%
43. 84-Ø1951-4	2ØØØØ	6%	21	14Ø	1Ø	15Ø	45Ø	33%
44. 84-Ø2996-2	1779Ø	6%	25	115	8	123	45Ø	27%
45. 85-ØØØ55-Ø	188ØØ	7%	22	14Ø	1Ø	15Ø	55Ø	27%
46. 85-Ø1226-Ø	1876Ø	7%	22	139	1Ø	149	55Ø	27%
47. 85-Ø1829-9	195ØØ	8%	21	16Ø	11	171	65Ø	26%
48. 83-Ø1785-Ø	195ØØ	9%	21	172	12	185	75Ø	25%
49. 83-Ø21ØØ-2	16Ø69	6%	25	1Ø4	7	111	45Ø	25%
5Ø. 83-ØØ393-6	172ØØ	5%	25	1Ø1	7	1Ø8	375	29%

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MORTGAGES ORIGINATED AFTER JUNE 2Ø, 1985:

LOAN #	LOAN AMOUNT	INTEREST RATE	YEARS	P & I	T & I	TOTAL	EST.MO. INCOME OF BORROWER	PITI AS A % OF INCOME
1. 85-Ø2596-1	181ØØ	1Ø%	2Ø	175	12	187	85Ø	22%
2. 85-Ø4116-2	18758	6%	25	121	8	129	45Ø	29%
3. 85-Ø313Ø-4	18765	8%	21	154	11	165	65Ø	25%
4. 85-Ø3388-1	18758	1Ø%	2Ø	181	13	194	85Ø	23%
5. 85-Ø3863-1	19884	8%	21	163	11	175	65Ø	27%
6. 85-ØØØ62-6	2Ø829	1Ø%	2Ø	2Ø1	14	215	85Ø	25%
7. 86-Ø26Ø1-7	2Ø119	6%	25	13Ø	9	139	45Ø	31%
8. 85-Ø2267-Ø	19928	9%	21	176	12	189	75Ø	25%
9. 85-Ø2762-8	19928	6%	25	128	9	137	45Ø	31%
1Ø. 85-Ø3545-6	21ØØØ	1Ø%	2Ø	2Ø3	14	217	85Ø	26%
11. 85-Ø4618-2	2ØØØØ	6%	25	129	9	138	45Ø	31%
12. 85-Ø3923-4	17915	9%	21	158	11	17Ø	75Ø	23%
13. 85-Ø3486-5	18889	7%	22	14Ø	1Ø	15Ø	55Ø	27%
14. 85-Ø2311-9	19ØØØ	7%	22	141	1Ø	151	55Ø	27%
15. 85-Ø3325-4	195ØØ	8%	21	16Ø	11	171	65Ø	26%
16. 85-Ø319Ø-6	15Ø48	6%	25	97	7	1Ø4	45Ø	23%
17. 85-Ø232Ø-Ø	18Ø3Ø	6%	25	116	8	124	45Ø	28%

TABLE I. (Continued)

MORTGAGES ORIGINATED AFTER JUNE 20, 1985:

	LOAN #	LOAN AMOUNT (COLONES)	INTEREST RATE	YEARS	MONTHLY PAYMENT IN COLONES: P & I	T & I	TOTAL	EST. MO. INCOME OF BORROWER	PITI AS A % OF INCOME
18.	86-00056-0	22775	8%	21	187	13	200	650	31%
19.	85-03441-1	18000	7%	22	134	9	143	550	26%
20.	85-02840-4	21000	10%	20	203	14	217	850	26%
21.	85-02049-2	20500	10%	20	198	14	212	850	25%
22.	85-02234-4	18000	6%	25	116	8	124	450	28%
23.	85-04596-0	19288	6%	25	124	9	133	450	30%
24.	85-04595-9	18429	8%	21	151	11	162	650	25%
25.	85-04369-0	18429	7%	22	137	10	147	550	27%
26.	85-03687-1	19200	8%	21	158	11	169	650	26%
27.	85-03349-9	19702	9%	21	174	12	186	750	25%
28.	86-00086-0	20000	9%	21	177	12	189	750	25%
29.	86-00153-1	21100	10%	20	204	14	218	850	26%
30.	85-04484-6	19470	6%	25	125	9	134	450	30%
31.	85-04317-9	18000	6%	25	116	8	124	450	28%
32.	85-04158-0	20700	10%	20	200	14	214	850	25%
33.	85-02292-2	18000	7%	22	134	9	143	550	26%
34.	85-03397-3	20000	9%	21	177	12	189	750	25%
35.	85-03558-5	19725	6%	25	127	9	136	450	30%
36.	85-03054-1	19000	7%	22	141	10	151	550	27%
37.	85-03572-1	19500	8%	21	160	11	171	650	26%
38.	85-03089-1	18000	6%	25	116	8	124	450	28%
39.	85-04013-0	19400	10%	20	187	13	200	850	24%
40.	85-04261-9	19400	8%	21	159	11	170	650	26%
41.	85-04174-0	19400	8%	21	159	11	170	650	26%
42.	85-02497-0	18000	6%	25	116	8	124	450	28%
43.	85-02496-9	18000	9%	21	159	11	170	750	23%
44.	85-02566-0	17225	6%	25	111	8	119	450	26%
45.	85-02381-2	17225	7%	22	128	9	137	550	25%
46.	85-03571-0	17225	7%	22	128	9	137	550	25%
47.	85-02392-0	17225	6%	25	111	8	119	450	26%
48.	85-04598-4	22800	8%	21	187	13	200	650	31%
49.	85-03544-4	22600	10%	20	218	15	233	850	27%
50.	85-02437-4	16937	6%	25	109	8	117	450	26%

ANNEX B

Date: May 15, 1986
To: Joe Lombardo
From: Samuel Peck
Subject: Analysis of the effective interest rate paid by the average FSV borrower that you requested

EFFECTIVE INTEREST RATES CHARGED BY FSV TO AN AVERAGE BELOW INCOME BORROWER, ASSUMING THAT THE DIFFERENCE BETWEEN WHAT HE RECEIVES FROM FSV ON HIS CONTRIBUTIONS AND WHAT THEY WOULD RECEIVE IF DEPOSITED IN SAVINGS ACCOUNTS PAYING MARKET RATE INTEREST RATES IS FACTORED INTO THE COST OF THE LOAN TO THE BORROWER

1. Assumptions (1985 Data)

a. Interest rate on a loan given by FSV to a 700 Colon per month borrower: 6%

b. Average income in Colones of a borrower paying the average interest rate received: 700 C/Mo. = 8400 C/Year

c. Average mortgage size and terms for this borrower: 25000 Colones
6.00%
23 Years

d. Average number of years that this borrower pays into the FSV system until retirement, death or permanant disability, at which point principal + interest (@ .5% per year) is returned: 25 Years

e. Market interest rate on savings: 8.0%

f. The borrower's annual income does not change over the period in which he is contributing to FSV. He receives only one FSV loan during this period. The loan is not called or altered if he leaves the FSV system before the loan is fully paid off. Nor do other factors such as interest rates on savings accounts chasnge over time for purposes of this analysis.

g. FSV contributions per contributer consists of the following:

	% of Salary
Employee's contribution:	0.5%
Employer's contribution:	5.0%
	5.5%

These contributio earn .5% per year. Empl er plus employee contributions, and the interest earned, are given to the employee upon retirement, death, or long term disability.

h. Computation of the cost of the loan in addition to the interest rate paid on the loan: What FSV pays on mandatory contributions versus what these contributions could be earning if deposited in a savings account in a financial institution.

Year	Annual Income	Contribution As A % Of Income: Employer-5% & Employee-.5%	Employee Balance That Earns Interest	Interest Received 0.5%	Interest Received 8.0%	Difference = Additional Cost Of The Loan
1	8400	462	462	2	37	35
2	8400	462	924	5	74	69
3	8400	462	1386	7	111	104
4	8400	462	1848	9	148	139
5	8400	462	2310	12	185	173
6	8400	462	2772	14	222	208
7	8400	462	3234	16	259	243
8	8400	462	3696	18	296	277
9	8400	462	4158	21	333	312
10	8400	462	4620	23	370	347
11	8400	462	5082	25	407	381
12	8400	462	5544	28	444	416
13	8400	462	6006	30	480	450
14	8400	462	6468	32	517	485
15	8400	462	6930	35	554	520
16	8400	462	7392	37	591	554
17	8400	462	7854	39	628	589
18	8400	462	8316	42	665	624
19	8400	462	8778	44	702	658
20	8400	462	9240	46	739	693
21	8400	462	9702	49	776	728
22	8400	462	10164	51	813	762
23	8400	462	10626	53	850	797
24	8400	462	11088	55	887	832
25	8400	462	11550	58	924	866
						11261

2. Calculation of Effective Interest Rate Paid

	Colones
a. Interest + principal paid over the life of a loan with the following terms: 25000 Colones, 6.00%, 23 Years	46150
b. Additional cost of a loan = an imputed fee resulting from the .5% the borrower is paid by FSV for his contributions versus the interest that these contributions would receive if they were deposited in a savings account:	11261
TOTAL PRINCIPAL + INTEREST + IMPUTED FEE LOAN PAYMENTS OVER THE LIFE OF THE LOAN:	57411
c. Number of monthly payments over the life of the loan:	276

d. Monthly payments with the following conditions-

Total payments over life of the loan:	57411	
Divided by:		
Total number of monthly payments:	276	
		208

e. Effective interest rate with the following conditions-

Monthly payments:	208	
Loan amount:	25000	8.59%