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**UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT**  
**REGIONAL HOUSING AND URBAN DEVELOPMENT OFFICE**  
**FOR SOUTH AMERICA**

**ANALYSIS OF THE PROCESS AND IMPACTS**  
**OF THE USAID GUARANTY PROGRAM**  
**"NATIONAL HOUSING SYSTEM"**

**Project 518-HG-007**  
**Ecuador**

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## **ABSTRACT**

**USAID's Regional Housing and Urban Development Office for South America (RHUDO/SA) contracted a consultant to analyze the impacts of USAID's National Shelter Delivery System Project -- a Housing Guaranty loan and grant in Ecuador. This program's results have been notable, including structural transformation of the housing finance system in Ecuador, the generation of public policies and new financial instruments allowing for long-term housing lending, and a transformation of the Ecuadorian housing institutions.**

## **EXECUTIVE SUMMARY**

On January 15, 1986 the Ecuadorian Government and the United States Agency for International Development (USAID) signed an agreement to implement the National Shelter Delivery System Project in Ecuador. This project, 518-HG-007, combines a housing guaranty loan and a technical assistance grant.

This agreement has two principal purposes: a) to increase the availability of low-cost housing in Ecuador through fostering private sector participation in shelter programs, and b) to confront the major constraints in the housing sector, including: the inability of the public sector to efficiently utilize resources destined to low-cost housing, and the absence of long-term financing that would stimulate the private sector to produce low-cost solutions more efficiently.

The program was designed to have the Government of Ecuador:

- \* Change its policies to increase the efficiency of the use of government housing resources and increase the private capital resources for housing and basic urban services to low-income families. The new policies will facilitate medium and long term financing.
- \* Formulate an urban development policy that coordinates the programs in the sector in order to increase the availability of land and serviced lots for this target population.
- \* Coordinate the activities of the housing and service provision sector institutions, enabling the sectors to work closely together to address national needs.

The consultant looked at these program objectives as the basis for his analysis of the program's development during its implementation, and to see the impact that the program has had on Ecuador. Specifically, the consultant sought to determine:

- \* if efforts carried out to date for structural transformations and changes in the institutional and financial management of the sector corresponded to the program's goals;
- \* the impact, for both USAID and Ecuador, of institutionalizing a housing finance system which incorporates not only housing refinance, but has the goal of increasing financing for basic services and infrastructure projects.

The analysis sought to determine conceptual transformations in Ecuador's housing refinance system; the structural changes at the institutional and operative levels; and the ensuing changes resulting from the redefinition of roles of the sector's main actors.

As well, the study focussed on qualitative impacts of the process, to establish whether or not efforts undertaken to date are valid and justifiable for both Ecuador and USAID's Regional Housing and Urban Development Office.

**Noteworthy changes achieved by the program include:**

**A. Conceptual changes:**

**The GOE has accepted and recognized they should act as a facilitator for housing solutions, formulating policies that motivate private initiative and organize the actors in the sector to provide housing solutions.**

**Both the GOE and the private sector have recognized that informal private initiative plays an important role in housing solutions, and therefore deserves special attention from the GOE.**

**The program has achieved the true incorporation of Housing Cooperatives in the housing finance system and stimulation of credit unions, Savings and Loans, and Private Banks to participate in housing finance.**

**The GOE created a new ministry for housing and urban development, incorporating already existing public entities.**

**The program has enabled the government to define its role, to begin to create a secondary housing market, and to recognize the importance of housing in the family and national economies.**

**B. Institutional changes:**

**The government created the Ministry of Urban Development and Housing, incorporating the National Housing Board, the Ecuadorian Housing Bank, and the Ecuadorian Institute of Sanitary Works. The Ministry is functioning.**

**The government has redefined the roles of the GOE housing institutions, taking them out of the direct production of housing and focussing their efforts on planning, coordination and support for the sector. These government entities are now set to give private entities the responsibility for operations, in both the generation and financing of housing solutions.**

**The GOE has transferred the Financial Fund for Housing (the program implementation agency), to the Ecuadorian Housing Bank, to be used to refinance mortgage portfolios.**

**C. Diffusion of Concepts:**

**The most important program advance to date has been the diffusion of the refinancing concept, which will stimulate private financial entities to have a role in housing finance.**

**D. Creation of a Housing Finance Mechanism:**

**The legal framework has been totally restructured to allow the issuing of mortgage-backed securities to generate increased financing for housing.**

**Mechanisms were established to correct for interest rates and inflation, including the Constant Value Unit.**

**The evaluation revealed that the program has had a significant impact on public policies which have allowed for the transformation of the role of the institutions in the sector. The program has also achieved the corresponding changes to the economic system which will allow for a housing financing system to function properly.**

**Finally, USAID's quality program management which has handled numerous variables, and acted at opportune moments has made the achievement of these successes possible.**

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## **STATEMENT OF PURPOSE**

On January 15, 1986, the Ecuadorian government and the United States Agency for International Development (USAID) signed a Housing Guaranty Agreement (518-HG-007) outlining a housing program to be administered by the Ecuadorian government, with USAID assistance.

The purpose of the agreement is to increase the supply of low-cost housing in Ecuador by providing support for private-sector participation in Ecuador's National Development Plan housing programs. The stated objectives are:

- a) to help the Ecuadorian government implement reforms to: protect the shelter financing system from inflation; protect the resources available to the housing sector; raise domestic investment capital; and encourage the private sector to participate in providing and financing housing solutions;
- b) to help the Ecuadorian government design and reform the policies, standards, institutions and operations of a new shelter financing system that will ensure efficient turnover of the resources available for housing.
- c) to promote the implementation of viable long-term credits that will make housing accessible to low-income families and make it possible for the financial institutions to recover investments in real terms.

USAID's Guaranty Program has an authorization of \$35 million U.S. private sector borrowed resources, of which the Ecuadorian government has \$10 million.

Originally the Guaranty Program included establishing a **FINANCIAL FUND FOR HOUSING** in Ecuador's Central Bank to increase the flow of housing sector resources, encourage private-sector contractors and financing institutions to participate, and increase the supply of low-cost housing solutions such as housing improvement loans, serviced housing lots with services, and basic units.

The agreement was designed to address the foremost problems of Ecuador's housing sector: the public sector's lack of capacity to utilize funds earmarked to increase the housing supply, and the absence of the long-term financing that would encourage the private sector to produce low-cost housing more efficiently.

To overcome these problems, the Ecuadorian government should:

- a) change its policies to include medium- and long-term finance strategies, which will increase efficiency of government funds earmarked for the housing sector and attract more private capital to provide low-income families with housing and basic services.
- b) put together an urban development policy and coordinate programs, with more emphasis on increasing the availability of housing lots and basic services for this target population group.

- c) **coordinate housing institutions responsible for providing basic services, so that each institution bases its activities on the entire sector's interests rather than solely its own.**

**Basically, USAID was to collaborate with the Ecuadorian government in structural changes that would make it possible to establish a viable, sustainable shelter financing system based on raising local resources and involving the private sector in meeting the nation's housing needs.**

**Between 1986 (when the program began) and 1993 (when this evaluation was conducted): the implementing agency was changed from the Ecuadorian Central Bank to the Ecuadorian Housing Bank (BEV) within which a housing refinancing unit (HRU) was created; significant changes were made in the sector's institutional structure; and changes were made as well in the financial arena, in both the public and private sectors.**

**To evaluate the program's development and impact to date, the consultant was asked to document whether or not endeavors in the different program areas (structural changes, conceptual modifications, and institutional and financial management) have had their intended effect, as well as to determine their significance for both for Ecuador and USAID. One of the program's basic goals to evaluate was the institutionalization of a shelter financing system, including a refinancing component, in order to increase the supply of low-income housing and help finance basic infrastructure services.**

## **ECONOMIC, POLITICAL AND SOCIAL CONTEXT**

By the mid-1980s, the Ecuadorian economy had managed to recover from its first adjustment experience, begun in 1982, to cope with the effects of the international crisis.

The main economic indicators were promising: surpluses in the balance of payments and the non-financial public sector, inflation on the order of 24% and tending to drop, and annual economic growth around 4% (1.5% per capita) with good prospects for picking up.

However, in 1986 and 1987, this recovery was hit twice, so hard that the Ecuadorian economy and society were tossed into the most severe crisis in recent years.

International oil prices skidded in 1986, from a 1985 average of 25 dollars per barrel to about 13, which cost nearly one billion dollars in public-sector export revenues.

On March 5, 1987, Ecuador's eastern Amazon region was shaken by earthquake movements that damaged the pipeline carrying crude oil from the oilfields to the Pacific export harbor. Petroleum production and exports were cut off for nearly six months, and repairs were expensive.

The initial repercussions of this loss of resources in the external and public sectors' financial situation were soon passed on to the rest of the economy.

In 1988, a new adjustment program centered on increasing the exchange rate, domestic fuel prices and public utility rates, as the basic mechanisms to cope with the external and public deficits; salaries were used as an anchor against runaway inflation. After a quantitatively heavy increase in cost factors, they were regularly adjusted --gradually and pre-announced--hence the label of "gradualism".

From the demand side, public spending was restricted and monetary policy was also restrictive. Structural reforms were also implemented to enhance the economy's overall productivity, and make up for these losses in the medium and long term.

This policy made it possible to regain external and public-sector equilibrium by 1990, although not quite to 1985 levels. Inflation slowed until the first quarter of 1990; then, gradual exchange-rate and fuel-price adjustments became the flywheel holding inflation steady at about 50% for almost three years. Growth eased up to nearly 5% in 1991.

However, in 1991 the adjustment policy ran out, especially in regard to public spending and cost-factor anchoring through salaries. Heavy social and political pressures led to major wage increases and more open-handed government spending.

The public deficit swelled alarmingly to 7% of the Gross Domestic Product by mid-1992. Economic activity continued to accelerate early that year to over 5%; imports increased sharply, depleting the international monetary reserve. This greater demand drove the annual inflation rate back over 50%.

**In August 1992, the new government took office, and announced its adjustment program on September 3. Its core purpose was to curb inflation through severe public-spending cutbacks and exchange/monetary policy in accordance with the fiscal situation and inflation-fighting aims.**

**Almost a year of this program succeeded in slowing inflation. After a very sharp upturn due to the original impact of cost factors, inflation decelerated and is estimated at 32 to 35% as of December 1993, much lower than at any time in the previous three years. The cost of the adjustment program has been an economic recession induced by the marked contraction of demand. The government predicts that 1993 will end with a 2% growth rate (versus 2.3% population growth).**

**The loss of external resources due to the 1986-87 crisis, along with the 1988 adjustment program, led to waning domestic spending, particularly investment. Both public and private-sector construction investment has plummeted.**

**Home-buying --largely in the private sector-- depends on family income level and distribution, home construction pricing, and the availability and conditions of financing. All three factors have combined to slow housing construction.**

**Family income fell in real terms by 20% between 1985 and 1989. The minor recovery since 1990 has not yet regained 1985 levels. From the home-buying standpoint, even more crucial than income erosion has been the decrease in family saving, which had been the mainstay of home financing. Fading income and virtual vanishing of long-term savings --along with the non-existence of any systems to shield long-term deposits against inflation-- have been the most important factors limiting home construction during these last few years.**

**Housing prices have soared, but not because demand has expanded (it has not). Interest rates have also increased financial costs and the exchange rate, thereby driving up the cost of imported construction input factors, machinery and equipment.**

**Housing loans, measured in real terms, dropped to about one third of 1985 levels; this trend accelerated in 1988. The inflationary recession sapped family income, discouraged long-term or any other savings, and continually hiked cost factors. This has reached a critical point, since there have been no mechanisms in place to efficiently raise medium- and long-term resources to finance this sector.**

**Ecuador has been applying traditional methods for medium/long-term financing, all developed under premises of macroeconomic stability and able to work only as long as such stability prevails. However, inflation changed the rules of the game: it is now necessary to consider the behavior of variables that used to be stable, but which have proven through experience that they are not.**

**Moreover, the generation and application of public policy, conceptual and functional-operational structures for Ecuador's housing and urban development sector were based on a reality that changed entirely during the Program. Even so, the Agreement signed in 1986 already envisioned the need to implement reforms, to design and**

**implement policies, institutions, norms and mechanisms to make long-term borrowing affordable for low-income families and recoverable in real terms.**

**The Ecuadorian political context, during the Program, has included three governmental administrations (Febres-Cordero, Borja, and Durán-Ballén). However, certain parameters of political action have remained constant, resulting ultimately in the acceptance of a need for fundamental transformations in the sector -- precisely what the Agreement called for under the Program.**

**Political stability has enabled the government to pay greater attention to this problem (above all these last two years), to listen more carefully to suggestions from multilateral and bilateral international donor agencies, and to take the first steps toward creating and consolidating the country's shelter financing system.**

**This process must match the country's context with a modernization process that restructures the housing finance market. This is an indispensable pre-requisite.**

**Within financial system modernization and restructuring processes throughout Latin America and the rest of the world, the concept of second-story financial institutions has found increasing acceptance. They operate fundamentally to correct inefficiencies and high costs of resource mobilization --the common denominator in most public development banks-- and to provide the mechanisms called for under the new terms of financial liberalization, including de-regulation of housing-market financial institutions.**

**Public development banking must be different, with greater participation by the private financial sector, so that healthy competition will grow among existing institutions, and other financial intermediaries may appear. This will lay the foundation for public development banking to fulfill its aims of serving a broad range of the population, according to established priorities, through an agile, efficient financial system.**

**This is precisely what the government of Ecuador has been working toward, despite a high percentage of policy-makers and decision-makers who steadfastly resist changes in the State's role in development.**

**Ecuador's economic crisis --fundamentally the housing and urban development sector crisis during the last few years-- has had a high social cost, hitting the labor market hard, increasing urban unemployment and under-employment, since most building manpower --the least skilled workers-- can find jobs only in construction.**

**In 1990, the urban labor force was 35.8% of the country's urban population; the unemployed urban work force was 6.1% (under-employed, 49.8%). In Quito and Guayaquil, these figures were 9% for unemployment and 40% for underemployment, respectively.**

**Therefore, in the short and medium term, one of the Ecuadorian government's top priorities must be to generate employment, above all urban employment. The**

**housing and urban development sector plays a major role in employment generation. However, the sector can not drive economic recovery without restructuring.**

**The social consequences of the economic crisis, despite political stability, have left their mark indelibly on the supply of housing and basic urban services.**

**Poverty rates are increasing, most families cannot afford to participate in the housing market, and there is no structure adapted to these circumstances through which existing financial resources could flow. The necessary transformation must incorporate new concepts, restructure the sector institutionally and organizationally, and put new rules in place, streamlining the roles of housing-sector actors.**

## **METHODOLOGY**

**This study was to analyze:**

- a) the conceptual, institutional, organizational and operational transformation process within Ecuador's shelter finance system; and**
- b) the impact of this transformation process: institutions comprising the system, the roles they play. Have they broadened housing solutions for low-income families?**

**The consultant, pursuant to the terms of reference, elicited information through interviews and by reviewing available documents on the Program's objectives, and the prevailing conditions in Ecuador.**

**The interviews and review of documents have emphasized conceptual transformations in Ecuador's shelter finance system, structural modifications (institutional, organizational and operational) and the generation of new arrangements based on redefined roles for the sector's stakeholders.**

**The Program's impact has been assessed qualitatively, to ascertain whether the efforts made to date have been justified, and judge their significance for Ecuador and for RHUDO/SA. Results and impacts have been portrayed over time, in order to interpret processes on the basis of their development.**

**Three types of documents have been analyzed:**

- a) contracts between the Ecuadorian State and USAID;**
- b) a variety of research reports;**
- c) legislation and other norms used to support or formalize transformations made in the system; and**
- d) internal records of USAID/Ecuador and RHUDO/SA.**

**To document the project and its impact, open-ended interviews of major actors reconstructed the institutional memory of actions taken, challenges addressed, and difficulties encountered.**

**This information was then processed according to a methodological analysis scheme designed to classify it by spheres of action, and then create integrated scenarios for the different variables. This was deemed the most appropriate way to be able to interpret the situation as a whole.**

## **ANALYSIS OF THE PROCESS**

The process pursued during the Program has been analyzed through four components: conceptual, institutional, organizational and operational transformations.

### **1. TRANSFORMATIONS IN THE CONCEPTUAL FRAMEWORK**

In the form of Ecuador's housing finance system, the aim was to make the system over as a whole, not only the financial component. This is evident from the Program's objectives. Funds would be used as an impetus for change.

The conceptual framework includes the philosophical and practical principles guiding each stakeholder in the system. These principles were then used to analyze the public bureaucratic structure and the type and degree of private participation. These concepts include the system's organizational structure, legal norms, and financial arrangements suited to the country's economy.

The Program hinges upon: redefinition of the Government's and private sector's role; re-structuring the financial market; and fostering an understanding of the role of housing in the national and household economy.

### **THE GOVERNMENT'S ROLE**

- a) The State facilitates solutions to housing problems, making use of the free play of market forces.

The idea is for the government to move away from actual home-building and concentrate on generating and overseeing the creation of a climate conducive to more efficient, complementary interaction of supply and demand; to encourage savings and better use of domestic resources; and motivate the formal and informal private sector to act effectively within the system.

As a facilitator, the government can implement fiscal measures, regulations and such to promote and guarantee adequate growth for cities and agriculture; elicit input from local governments and beneficiaries to formulate concrete policies and plans; involve the informal housing sector; encourage the construction and materials production industry; foster and supervise the development of financial intermediaries; help stabilize financial parameters; and directly support the most underprivileged sectors of the population.

- b) As a motivator, the State can grant special incentives for activities that it wishes to encourage and, in extreme cases, act directly to present examples for the private sector to help generate shelter solutions for the neediest population.
- c) As a regulator, the government issues norms regarding landholding, land use, and the issue of permits for land development; minimum requirements for

construction and urban infrastructure; and the means to enforce these standards.

## **THE ROLE OF PRIVATE INITIATIVE**

Formal and informal private initiative must be properly organized: formal stakeholders include producers of materials, developers of urban infrastructure, builders, financial institutions (banks, savings and loans, cooperatives), and non-governmental organizations (NGOs); the informal grouping include associations of neighbors, neighborhood groups and other such *ad hoc* entities in informal settlements.

Rules for participation must be clearly enunciated, so that all players clearly understand how to participate. The Program aims to help the State clarify such rules.

## **ORDERING OF THE FINANCIAL MARKET**

This development of the financial markets affecting shelter solutions includes: strengthening of first-story institutions that provide credits directly to end users; redefinition of the role of existing financial institutions; creation of a second-story financial fund for housing to mortgage; and mechanisms to ensure real-value investment and payback.

The elements of yield, maintenance of value, security of credit and collateral, negotiability, flexibility, and adequacy of housing loans must emerge from the crisis and become a true "system".

## **UNDERSTANDING OF THE ROLE OF HOUSING IN THE NATIONAL AND HOUSEHOLD ECONOMY**

Shelter solution production must be viewed as an economic activity that will help reactivate the nation's economy. Housing is an asset with a market value. Homebuilding creates wealth, and boosts the country's gross domestic product.

Housing has special social significance, because it provides the physical foundations for the family group to form and develop. For low- and medium-income families, the home is their main investment.

Therefore, housing should not be seen as a right, but as a necessity that must be fulfilled. The State is obliged to establish the legal, financial and operational conditions that will enable the low end and medium income groups to gain access to housing.

## **RESULTS OF THE ANALYSIS**

**This analysis will examine two levels of systemic organization: the Ecuadorian housing system, and the shelter finance subsystem. In this paper, "System" generally refers to the latter.**

**The systemic approach implies that various components pursue clearly defined activities (specific roles); their inter-relationships and inter-dependence enable them to exist without exhausting institutional capacity.**

**The Ecuadorian housing system concept is based on an empirical reality: the government, private sector and citizenry fulfill their obligations and exercise their rights under freedom and democracy. Their products give form to policies, institutions, organizations and operational norms that make it possible to generate dwelling and basic service solutions.**

**The Ecuadorian housing system comprised, prior to the process analyzed herein:**

- a) Government institutions responsible for policy, orientation and regulation of shelter production and for direct construction and financing. At the central government level: the National Housing Board (JNV), the Ecuadorian Housing Bank (BEV), the Ecuadorian Sanitation Institute (IEOS), and the Ecuadorian Social Security Institute (IESS).**
- b) Formal private-sector entities: housing cooperatives, credit unions and savings and loan associations and, in some cases, commercial banks; building and development firms; producers of building materials; and NGOs that provide technical assistance to low-income families.**
- c) Informal private sector: grassroots community groupings and independent citizens.**

**The government used to perform its own duties and some of those that should logically fall to private initiative, paternalistically and sometimes aggressively intervening. As well as setting policy and overseeing/regulating the system, the government itself would build homes, directly competing with the private sector, and finance these homes at subsidized interest rates, to the detriment of the shelter finance market, discouraging private financial organizations.**

**Two phases may be clearly identified in the transformation of the Ecuadorian housing system:**

**The first phase (1986-1990) covers the administration of Febres-Cordero and most of Borja's. Incorporation and reinforcement of the concepts promoted by HG-006: Shelter is not just a finished house; dwelling solutions also include serviced lots, services themselves, and basic/minimum housing units. Generation of basic urban services is a fundamental stage in solving problems.**

**During this first phase, the Financial Fund for Housing was located in the Central Bank of Ecuador. This mechanism would enable private entities (particularly saving and loan associations) to borrow for private-enterprise projects of the type mentioned above.**

**The JNV and BEV both oversaw the shelter construction/ financing sector and carried out their own projects, with the high bureaucratic overhead that this type of public endeavor entails.**

**The Central Bank of Ecuador, in addition to its monetary functions, also acted as a development bank.**

**Savings and loan associations and private banks granted shelter financing only to middle- and upper-class families.**

**The process during this first phase achieved no significant conceptual changes, for the following reasons:**

- a) The government continued to act both in overseeing the sector and in generating actual shelter solutions.**
- b) Private initiative was not really encouraged by the Financial Fund for Housing. The problem was not the intention, but the lack of efficiency in handling transactions due to slow, complicated Central Bank red tape.**
- c) There was still hesitance in accepting the concept that very low-income families, if given a serviced lot or basic unit, can continue developing it and successfully meet their own housing needs.**
- d) Because the Central Bank was so slow in handling loans, some companies were driven by financial costs to bankruptcy when they risked their own capital in projects oriented toward the Program's target population.**
- e) Housing cooperatives were not really granted access to Financial Fund for Housing loans, and savings and loan associations were mainly concerned with surviving amidst the country's inflationary recession.**
- f) Roles were not clearly defined for the sector's players. Clear policies were not established, and governmental institutions continued to perform activities that should be handled by private initiative.**
- g) The informal sector, a component of private initiative that actually generates over 50% of the country's shelter solutions, was systematically ignored.**
- h) Indirect subsidies through interest rates were maintained through direct State intervention as the JNV and BEV continued to generate shelter solutions.**

**The ultimate outcome of this first phase, as a consequence of the failure to change concepts, was that the program did not move forward as expected either in the use of funds, and public policy changes.**

**However, the second phase (1991-1993 -- the end of the Borja administration and beginning of Durán-Ballén's) was highly successful in terms of conceptual transformation. Public policy wholly redefined and restructured the system, transforming institutions and organizations and generating more adequate operational arrangements.**

**The most significant changes involved:**

- a) The State has accepted its role as a facilitator. It makes policies, encourages private initiative and regulates the actors involved in solving housing problems. This, in turn, will have tremendous repercussions on structures and operations.**
- b) The role of private initiative has been recognized. The role the informal private sector plays in solving housing problems is recognized and will now be given particular attention from the government.**
- c) Housing cooperatives are now truly part of the shelter financing system, and savings and loan associations and private banks have been encouraged to participate actively.**
- d) The new Ministry of Urban Development and Housing incorporates the JNV to make policies and the BEV to finance them.**
- e) The government's subsidiary role (through the BEV) in solving the housing program has been defined and accepted.**
- f) The secondary market has been defined, and delegated to the BEV, along with the Financial Fund for Housing.**
- g) The role of housing in the national and individual family economy has been defined and recognized.**

**The ultimate outcome of this second phase is that it completely changes the conceptual framework, through the expression of public policies that redefine the system in ways conducive to achieving the Program's goals in this field.**

**The progress made during this second phase has not yet significantly encouraged the use of funds, but does lay the groundwork for the system's structure and reorganization. This will generate new financial mechanisms needed to operate under inflation. So, this should lead to the use of Program funds.**

## **2. TRANSFORMATIONS IN THE INSTITUTIONAL FRAMEWORK**

**Institutional transformation --as a consequence of new concepts that generate new public policy-- involves role redefinition for every component of the system.**

**To build a new shelter finance system, institutions operating in the sector, both public and private, must radically change their behavior.**

**The State is phasing out the operational functions it has attempted to perform without success. It is no longer directly or indirectly promoting, constructing and financing all at once. Now, it is taking its rightful place as the Coordinator of the housing sector: defining policy, creating the financial and operational conditions that will enable private economic actors to respond to shelter demand.**

**Thus, the new institutional structure will attempt to address the problem (Ecuador's shelter deficit is estimated at one million dwellings) through the united efforts of public and private stakeholders. Each will play its own role according to the transformed conceptual framework.**

**The first Program phase accepted Ecuador's existing institutional configuration: the Financial Fund for Housing was located in the Central Bank of Ecuador; the government acted through the JNV and the BEV, and saving and loan associations, credit unions and commercial banks were expected to be able to use the funds.**

**However, in reality, the inflationary recession and Central Bank bureaucracy stifled the Program after a few initial attempts by the saving and loans and some private developers.**

**During the second phase, conceptual changes led to the creation of the Ministry of Urban Development and Housing, which comprises the JNV, BEV and IEOS.**

**The Ministry oversees (plans, coordinates and backstops) the sector's activities so that private institutions will generate shelter solutions in both the short and long term.**

**The Financial Fund for Housing has been transferred to the BEV, and a housing refinancing unit has been created. The participation of commercial banks, savings and loan associations, and housing cooperatives has been encouraged.**

**The results have included:**

- a) **The Ministry of Urban Development and Housing was created by Executive Decree No. 3, published in Official Registry No. 1 (August, 1992). This decree makes the Minister president of the JNV, BEV and IEOS boards of directors, and a full member of the board of directors of the State Bank (Banco del Estado -- ex-Banco de Desarrollo).**

**The Ministry has three under-secretariats: Urban Development, Housing, and Environmental Sanitation (the latter covered by IEOS).**

- b) **The BEV was created in 1961. Now, as part of the Ministry, its institutional aims have been redefined: restructuring, reduction of personnel, concentration of operations, administrative modernization. Financially, it has become a**

second-story banking entity, and some assets unrelated to its functions have been privatized. Programs already under way have been completed, savings operations are being supported, and private-sector involvement in low-income shelter construction and financing is being encouraged.

- c) The JNV was created in 1973 to program, coordinate and direct national housing policy: as the housing promoter/ implementer/ authority and regulator/ supervisor of BEV activities. It is now completing such programs in primary shelter production.
- d) The IEOS was created in 1965, originally under the Ministry of Public Health. Now, under the Ministry of Urban Development and Housing, it will provide basic urban and rural sanitation works, environmental control and health infrastructure.
- e) Savings and loan associations, with lengthy experience in receiving savings and administering mortgage loans, will be reinforced in their role as financial intermediaries, through the projected Law of Financial Institutions. They will be supervised and audited by the Superintendency of Banks (previously the BEV and JNV oversaw S&Ls).
- f) Credit unions, housing cooperatives, and other community organizations and NGOs are now being recognized as major stakeholders in this sector.
- g) Private banks, through their new financial arrangements, are beginning to become involved in the system, which appeals to them in business terms.

In particular, the Constant Value Unit (UVC) will be the key to private banks' involvement in the housing market, and its long-term loans.

### 3. TRANSFORMATIONS IN THE ORGANIZATIONAL FRAMEWORK

These transformations involve the organization and operation of the system in response to institutional transformation. This new way of organizing the shelter finance system is based on the implicit transformations in public housing agencies (mentioned above).

Building a new shelter finance system has entailed a radical change in the behavior of public and private institutions operating in this sector.

The State should move from operational functions to directing the sector, defining policies and creating the financial and operational conditions that will make it possible for private economic actors to work together and actively respond to dwelling demand.

Logically, this never happened during the Program's first phase, but the second phase has seen significant efforts to reorganize the shelter finance system. Four fundamental elements, acting individually and complementing each other, will optimize benefits for social groups that need housing:

- the constant value unit
- removal of hidden (interest-rate) subsidies
- refinancing
- the issue of shelter securities.

The Constant Value Unit (UVC) is an accounting unit. Its worth in local currency varies periodically as a function of changes in the Consumer Price Index. This is indispensable during periods of inflation, to balance financial entities' lending/borrowing operations, and to preserve the real value of investments.

During the Program's first phase, shelter finance entities, according to traditional financing methods, could not operate due to inflation, since it undermines borrowers' payment capacity and distorts repayment schemes. Therefore, the UVC is the starting-point in restoring the flow of housing loans to the market.

The Ecuadorian State used to subsidize interest rates for the lower class (most of the population), with the assumption that the private sector took care of the upper and middle classes.

Inflation strangled mortgage financing, and this in turn starved shelter production.

Investors had to charge higher interest rates and shorten repayment periods, in an attempt to recover their outlay in real terms. These defensive measures by lenders severely deteriorated the borrowers' ability to pay.

The new system is based on the recognition that hidden subsidies and below market interest rates are not only ineffective but actually interfere with the development of other, non-subsidized financing.

However, since the people least able to finance their own housing needs will still need financial assistance, a policy of effective support will provide direct subsidies for purchases.

This type of subsidies (still under study at this writing) will not only avoid the above shortcomings, but offer the following advantages:

- a) they clearly benefit needy families, on a strictly enforceable basis of their particular situation;
- b) financially, they reduce the balance to be mortgaged and consequently make it possible for monthly debt service payments to cover market-level interest rates,
- c) they commit government resources only during the year they are granted, simplifying public finance,
- d) politically, they make it clear to beneficiaries exactly what contribution they have received from the State.

The refinancing function aims to accelerate private investment turnover by discounting their shelter portfolios. This is one of the Program's key purposes, and the reason for creating the Financial Fund for Housing. The Fund, originally operating in the Central Bank of Ecuador and currently in the BEV, will subsequently be transferred to the Shelter Refinancing Corporation which is now under study.

The function of housing refinancing has finally been understood: it will free private entities from having to wait out the duration of the mortgage to recover their investments, and supply them with fresh resources for new investments, due to this mechanism's multiplier effect. Most importantly, the government can guide the sector toward the country's top-priority objectives, particularly toward providing housing for the lowest-income groups.

Finally, inflation-corrected assets should make it possible to issue liabilities corrected for inflation. The idea of freely circulating securities, backed by financial institutions, and authorized by the country's financial and monetary authorities, has now been accepted.

Ecuador's shelter financing system will receive the medium- and long-term investment needed to finance housing solutions. Housing securities will give refinancers greater freedom of action and domestic capital will become available, both generating funds for housing *per se* and invigorating the securities market.

#### 4. TRANSFORMATIONS IN THE LEGAL FRAMEWORK

During the Program's first phase, no significant transformations occurred, excepting the Monetary Regime Law (toward the end of phase one) which marked the beginning of the system's transformation. The changes that both underpin and generate the new laws and regulations have been made during the second phase:

- a) Executive Decree No. 3 of August 11, 1992, which created the Ministry of Urban Development and Housing.

This legal-institutional instrument established the country's new shelter system.

- b) Securities Market Law, May 26 1993.

This provides the legal framework for the securities market, and the Constant Value Unit.

- c) Monetary Regime Law, published in Official Registry No. 930, May 7, 1992.

This law --the outgrowth of a lengthy effort signalled the beginning of the system's transformation process. It leaves the Central Bank of Ecuador with its rightful functions, but eliminates those pertaining to a "development bank," and turns the Banco de Desarrollo into the Banco del Estado, with fiscal responsibilities.

**It reformulates the monetary system, updating it to meet present-day national and international requirements. It establishes mechanisms for coordination between monetary and fiscal policies, so that neither will imbalance or otherwise harm economic policy.**

- d) Draft Law of Financial System Institutions, which aims to regulate the creation, organization, activities, operation and dissolution of private financial system institutions, as well as the organization and functions of the Superintendency of Banks, which supervises and monitors the financial system.**
- e) The financial and economic feasibility study for the creation of a Shelter Refinancing Corporation, which would transfer second-story functions from the BEV to a private or mixed public and private organization with total operational independence.**

**The second phase has witnessed a total reworking of the legal environment. This has resulted from a long-standing process of discussion between the authorities of the Government of Ecuador and USAID, whereby the latter has attempted to support the former's efforts to achieve the desired transformations.**

Table No.1

## TRANSFORMATION IN THE ECUADORIAN SHELTER SYSTEM

YEAR	INSTRUMENT	MAIN ACTIONS
1986	Agreement for the implementation of Guaranty Program HG-007 an the Ecuadorian Government	<p>Medium and long-term gials are set for the transformation of Ecuador's housing system.</p> <ul style="list-style-type: none"> <li>* implementation of reforms in the shelter finance system</li> <li>* design and implementation of policies and reforms: norms, institutions, operations</li> <li>* implementation of viable long-term loans with real recovery of investment</li> </ul> <p>The Financial Fund for Housing was created in the Central Bank of Ecuador ( BCE )</p>
1992	MONETARY REGIME LAW May 7, 1992	<p>Activity of the BCE was oriented towar monetary policy.</p> <p>Ecuadorian Banco de Desarrollo was changed to Banco del Estado, oriented towar fiscal policy activities.</p>
	EXECUTIVE DECREE August 11, 1992	<p>Ministry of Urban Development and Housing ( MINVU ) was created.</p> <p>Ecuador's shelter system and the institutional roles were redefined.</p> <p>The IEOS became part of MINVU as the Under-Secretariat of Enviromental Sanitation.</p> <p>The Financial Fund for Housing was transferred from the BCE to the BEV and the shelter refinancing unit was created.</p>
1993	SECURITIES MARKET LAW May 26, 1993	<p>Created the legal framework for securities market operation.</p> <p>Constant Value Unit was created.</p>
	Draft Financial System Law was prepared	<p>Will regulate the creation, organization, activities, operation and dissolution of private financial system institutions.</p> <p>Organization and operation of the Superintendency of Banks will be reordered ( to include supervision of savings and loan associations ).</p>
	Feasibility study to constitute SHELTER REFINANCING CORPORATION prepared.	<p>Separates the second-story function ( discount of mortgage loans ) from the BEV and transfers that function to a private or mixed public and private agency.</p>

## **IMPACT ANALYSIS**

An analysis of the impact the HG-007 Program will have to show whether USAID/RHUDO/SA efforts have achieved the results expected by USAID/RHUDO/SA and by the Ecuadorian government, in the fields of conceptual, institutional, organizational and operational transformations of Ecuador's shelter finance system.

Throughout the Program and until this writing, USAID/RHUDO/SA (working with various Ecuadorian institutions) has provided the Ecuadorian government with specific technical assistance, and maintained an ongoing dialogue, in support of the definition, structuring and orientation of changes.

In the first phase, the outcomes cannot be called successful, except toward the end, when the new Monetary Regime Law was passed, laying the foundation for the second-phase transformation.

Results were more evident during the second phase, not only due to their diversity and complexity, but also because both parties' stated goals began to materialize.

The impact analysis covered these three elements:

- a) objectives fulfilled,
- b) fundamental transformations achieved in the Ecuadorian State,
- c) lessons learned by USAID.

The Program is not an end in itself, but basically a tool that both parties are using to accomplish more far-reaching aims.

## **OBJECTIVES FULFILLED**

Two levels of objectives may be identified: (i) specific achievements in the financial, public policy and credit realms; (ii) transformation of the system as a whole, through modification of concepts, institution-building and reorganization of the system.

The consultant's conclusion is that both levels of objectives have been quite successfully fulfilled. This is borne out by the following evidence:

- a) **Financial Domain**
  - To eliminate the negative effects of inflation:  
The Constant Value Unit is the tool required to achieve this.
  - To protect resources that are available to the housing sector:

The State now has a structure in which the system's institutional, financial and organizational resources have some degree of autonomy, although they are

framed within economic policy. This protects them, legally and financially, under the new legislation.

- To promote the mobilization of Ecuadorian capital:

The Securities Market Law establishes the framework and mechanisms to achieve this.

- To create incentives for private-sector involvement in providing and financing shelter solutions:

The changes in concepts that are expressed through the new public policies, which define the role for each player in this sector, and the laws and regulations enacted to transform the system, private initiative now has a level playing field and clearer rules, for both the provision and financing of shelter solutions.

These mechanisms will encourage private participation; private reaction to these incentives will be observed in the medium and long term.

#### b) The Public Policy Domain

- To assist the Ecuadorian government in policy design and implementation:

USAID/RHUDO/SA has worked intensively for the Ecuadorian State, and a substantial change in housing-sector policy has been achieved.

- To reform institutions, norms and operations, thereby generating a new shelter financing system:

Reforms at these three levels have been completed. The shelter financing system may now be expected to operate within the context of moderate to high inflation which still persists in Ecuador.

#### The Credit Domain:

- To implement long-term credit mechanisms that will make housing affordable for low-income households:

The system's new structure and the UVC make it possible to grant long-term housing credit. Moreover, if a system of direct, transparent subsidies is established, accessibility will be even greater.

- To make it possible to recover investments in real terms:

This is ensured by the use of the Constant Value Unit.

#### d) Modification of Concepts

- To redefine roles for the sector's various stakeholders:

This has been achieved for the system as a whole through public policy statements by the Ministry of Urban Development and Housing, which define the roles of the State and of private initiative, and public-sector roles have been redefined through changes in the various institutions comprising that sector.

- To establish a second-story bank as the government's responsibility, initially, and possibly as a private activity in the future:

Transfer of the Financial Fund for Housing from the BCE to the BEV and creation of the shelter refinancing unit, as well as studies regarding the creation of the Shelter Refinancing Corporation all support this aim.

- To understand the economic role of housing at the national and household levels:

Policy statements by the current government of Ecuador, reflected by the media, clearly evince the acceptance of this concept. However, more importantly, the inclusion of the Minister of Urban Development and Housing on the Board of Directors of the Banco del Estado is a clear sign of the changing concept.

#### e) Institutional and Organizational Formation of the System

This study's process analysis clearly reveals the radical transformation that the system has undergone in both fields.

### FUNDAMENTAL TRANSFORMATIONS ACHIEVED IN THE ECUADORIAN STATE

Here is where the consultant feels that the greatest achievements have been made, because the fundamental changes tend to uphold public policy as expressed in institutional and organizational transformations; it is well known that operational instruments can change with the economy and the degree to which a viable shelter finance market develops sustainably over time, solving housing problems.

These transformations include:

- a) Acceptance and expression in practice that the State's role must to facilitate, motivate and regulate the housing and urban development sector.
  - b) Structuring of the basic elements to make production and financing of dwelling solutions viable for middle- and lower-class population sectors.
- availability of lots, to ensure open supply, free of speculation, to land that may be developed with basic urban services;

- **facilitation of the construction process through close collaboration with the under-secretariats of Urban Development, Housing and Environmental Sanitation;**
- **basic conditions of mortgage credit, ensuring potential investors' interest, in both the primary and secondary market (yield, maintenance of value, security of credit and collateral, negotiability, flexibility, adaptability).**
- c) **Facilitation of private initiative in primary financing (savings and loan associations, private commercial banks) and secondary financing (the planned creation of the Shelter Refinancing Corporation).**
- d) **Acceptance of the principle that State subsidies for lower-income households must be direct and transparent, rather than concealed in interest rates or otherwise.**

### **LESSONS LEARNED BY USAID**

**The long, complicated process entailed by these transformations of Ecuador's shelter finance system, with its longer-term implications for transformation of the Ecuadorian shelter system, was based on consideration and management of an extensive range of political, economic, financial, social and cultural variables, some generated in the national context, others internationally.**

**The combination of those variables, during the historical points in time characterizing the Program's actual two phases, has conditioned the degree of success so far. However, more importantly, an understanding of each variable's specific weight at its given time, and taking advantage of favorable circumstances at those times, is definitely what has made possible the fulfillment of the Program's goals.**

**In other words, the consultant feels that RHUDO/SA's capacity for Program management, entailing the handling of these variables and accurate interpretation of opportunities, has brought the Program where it is today, and makes it possible to expect that the funds will be used within a new institutional framework.**

**This "management capacity" comprises several elements:**

- a) **clear definition of specific goals and objectives;**
- b) **establishment of policies for the office and strategies well-suited to current circumstances;**
- c) **maintenance of constant dialogue with national counterparts, always in the attitude of respectful collaborators, not in a way which would have generated resistance;**
- d) **use of specific technical assistance, training, and dialogue at the appropriate times;**

- e) **generation of perception among national counterparts that USAID is providing assistance within their own search for greater and better levels of development, according to its own possibilities;**
- f) **the understanding that the use of Program-provided funding was not an end in itself, but a tool to ensure the presence of USAID in the transformation process, and a tool for the Government of Ecuador in order to ensure that these transformations would have the necessary funds to enable the new system to begin operating.**

**This is the main lesson learned by USAID: success does not depend on the amount of the funding, but on how the Agency develops adequate, timely "management capacity", because the funds are actually a tool for achieving more significant aims.**

**Another important lesson is to understand that transformation processes such as the one pursued by this Program depend on the capacity to perceive and handle the many complex variables that appear in the system and its setting. In other words, on developing capacity to adapt to internal and external structural changes, without losing sight of original goals.**

## **CONCLUSIONS**

An analysis of Program management lead to the following conclusions:

1. **The action process was based on a clear understanding of the medium- and long-term goals and short-term objectives stated in the Program documents, and on an attitude of paying attention to transformations occurring around the Program. The degree of success is rooted precisely here, because --despite variations in the country's economic, political, social and cultural context-- RHUDO/SA always kept current developments in mind.**
2. **Another important element has been the understanding that use of Program funds was not an end in itself, but rather a tool to ensure USAID's presence in the transformation process and a tool enabling the Ecuadorian Government to fund the new system's initial operation.**
3. **Additionally, a direct relationship with the country's political decision-makers was a key to understanding a process such as this one. If this working strategy had not been used consistently, the same success might not have been attained, particularly when the process involved three successive government administrations.**
4. **Of special importance was the perception --not always easy-- of how environmental variables changed. Clearly, the Program began when the country started to suffer through its worst crisis, variables became unstable, and prediction of political, economic and social behavior became difficult.**

**The consultant feels that the handling of this Program merits in-depth study, as an example of persistence and consistency in the pursuit of goals, despite a varying, diverse environment.**

5. **The timely use of training activities and dialogue on policies, at a very low cost, proved to be effective tools for helping to create the necessary conditions for the desired conceptual, institutional, organizational and operational changes.**

**The value of such tools for program support is not always understood. They are quite significant, precisely when attempting to foster conceptual changes to trigger other processes, which are not easy to measure and evaluate (not the case of HG-007).**

6. **This success in Ecuador shows what is possible, even amidst adverse environmental conditions, when managers clearly understand the direction they want to move, have clearly delineated their goals and objectives and act accordingly.**

**The transformations that the government of Ecuador finally achieved, and those still to be accomplished (system of direct, transparent subsidies, greater incentives for private initiative, operation of second-story banking, and effective performance by**

state institutions of their role), will ultimately determine how the funds still available in the Program will be used.

The opportunity remains to again use these funds as a tool to get shelter activity going in Ecuador --which has a huge deficit-- and for the housing securities market to begin operating, to mobilize national resources to help solve this deficit in the medium term. The purpose is to achieve a self-sustaining shelter finance system.

Finally, it is clear, from the present analysis, that USAID's goals go far beyond the scope of this Program: democratization of national economies, with open access to all social stakeholders in the search for greater levels of development, creating conditions to favor prompt, timely service for the lowest-income families in the population, without distorting healthy, balanced market conditions.

## **RECOMMENDATIONS**

On the basis of these conclusions, a number of recommendations can be made:

1. The lessons learned through the management model applied in the Program makes it evident that a long-term mentality prevails. This consultancy strongly recommends that this same approach be maintained in other programs carried out in Ecuador and elsewhere.

Activities in basic sanitation and the environment, natural or man-made disaster prevention, and municipal development and reinforcement would be greatly enhanced if approached under this forward-looking vision, without losing sight of the ultimate purposes.

2. Direct relationship with national counterparts, above all with political decision-makers, is crucial to continue and uphold modifications in the environment (necessary conditions) for the Program.
3. Officials responsible for specific programs or projects should develop or strengthen their capacity for perceiving changes in environmental variables, and should therefore make regular reviews of these variables, to glean the information that feeds the capacity for adaptation and timely decision-making.
4. Due importance must continue to be given to training and policy dialogue activities. This must be done in a timely fashion, at a high technical and professional level of design and organization, since a number of important elements remain to be achieved: the secondary market and reorganization of subsidies.

In many countries of the region, conditions are ripe for conceptual, institutional, organizational and operational change, especially when the processes of democratization, free trade, governmental rationalization, and incentives for private participation have gotten a foothold, partly due to the action of international assistance agencies, and partly because the circumstances call for these changes.

**The role of USAID must consequently consist of cooperating in the creation of circumstances that will trigger the transformation process.**

**This has been the role played so far by HG-007, and it would not be advisable to abandon a successful management mode just when the efforts are beginning to bear fruit.**

**Future results will be Ecuador's responsibility.**

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## **INTERVIEWS**

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