



# RHUDO/CA

REGIONAL HOUSING AND URBAN DEVELOPMENT OFFICE FOR CENTRAL AMERICA

## Progress Evaluation of the USAID/Panama Private Sector Housing Guaranty Program (525-HG-014)

by  
*Lopa Purohit*  
&  
*Carlos Chacón*

*The views herein are those of the authors and do not necessarily reflect those of the  
United States Agency for International Development*

**H. EVALUATION ABSTRACT (do not exceed the space provided)**

The USAID Panama Private Sector Housing Guaranty Program aims to increase the delivery of low-cost shelter financed through private sector institutions. This mid-term evaluation covers the first \$14 million tranche of a Housing Guaranty loan authorization of \$25 million. It assesses the impact of the Program on shelter conditions in Panama and the delivery of low-cost shelter by the private sector institutions involved in the program. The purpose was to identify the achievements and constraints to date and recommend actions to be taken by USAID to improve the program. Finally, the evaluation looks at sustainability issues and attempts to identify the inputs needed to assure the continuation of housing programs for below-median income families by Panama's private sector. The major findings and conclusions are:

- ☐ Streamline and Revise Administrative Processes for obtaining project approval and review mortgage registry procedures to reduce the time it takes mortgages to be registered.
- ☐ Develop New Financial Market Instruments and Programs
- ☐ Explore the option of Developing a Secondary Market Facility
- ☐ Move forward with disbursing HIG funds remaining under the Program.

The evaluators noted the following lessons:

- ☐ USAID housing programs, using HG funds, are capable of reaching large numbers of families below the median income level by financing mortgages to creditworthy borrowers.
- ☐ There is a diminished content of policy reform in non-sovereign projects and therefore leverage, as a tool to further policy goals of the program, may have to be exercised in other areas of the program. An example is to maximize the leverage of borrower contributions resulting from the dollar transaction.
- ☐ Private sector financial institutions are unlikely to continue to participate actively in low-income lending programs, unless they are able to tap long-term sources of funds.

**I. EVALUATION COSTS**

1. Evaluation Team  
Name                      Affiliation

Contract Number QR  
TDY Person Days

Contract Cost QR  
TDY Cost (US\$)

Source of  
Funds

2. Mission/Office Professional  
Staff Person-Days (estimate) \_\_\_\_\_

3. Borrower/Grantee Professional  
Staff Person-Days (estimate) \_\_\_\_\_

# A.I.D. EVALUATION SUMMARY PART I

(BEFORE FILLING OUT THIS FORM, READ THE ATTACHED INSTRUCTIONS)

**A. REPORTING A.I.D. UNIT:**

(Mission or AID/W Office)

(ES# )

**B. WAS EVALUATION SCHEDULED IN CURRENT FY ANNUAL EVALUATION PLAN?**

yes  slipped  ad hoc

Eval. Plan Submission Date: FY \_\_\_ 0 \_\_\_

**C. EVALUATION TIMING**

Interim  final  ex post  other

**D. ACTIVITY OR ACTIVITIES EVALUATED** (List the following information for project(s) or program(s) evaluated; If not applicable, list title and date of the evaluation report)

Project #	Project/Program Title (or title & date of evaluation report)	First PRDAG or equivalent (FY)	Most recent PACD (mo/yr)	Planned LOP Cost ('000)	Amount Obligated to Date ('000)

**E. ACTION DECISIONS APPROVED BY MISSION OR AID/W OFFICE DIRECTOR**

Action(s) Required

Name of officer  
responsible for  
Action

Date Action  
to be  
Completed

(Attach extra sheet if necessary)

**F. DATE OF MISSION OR AID/W OFFICE REVIEW OF EVALUATION:** mo \_\_\_ day \_\_\_ yr \_\_\_

**G. APPROVALS OF EVALUATION SUMMARY AND ACTION DECISIONS:**

Signature Typed Name	Project/Program Officer	Representative of Borrower/Grantee	Evaluation Officer	Mission or AID/W Office Director
	Date: _____	Date: _____	Date: _____	Date: _____

# A.I.D. EVALUATION SUMMARY PART II

## J. SUMMARY OF EVALUATION FINDINGS, CONCLUSIONS AND RECOMMENDATIONS (Try not to exceed the 3 pages provided)

Address the following items:

- Purpose of activity(ies) evaluated
- Purpose of evaluation and Methodology used
- Findings and conclusions (relate to questions)
- Principal recommendations
- Lessons learned

Mission or Office: USAID/PANAMA Date this summary prepared: July 19, 1996  
 Title and Date of Full Evaluation Report: PROGRESS EVALUATION OF THE USAID/PANAMA PRIVATE SECTOR HOUSING GUARANTY PROGRAM (525-HG-014)

The U.S. pledged \$75 million for the housing sector as part of a side letter to the Panama Canal Treaty of 1977. The delivery mechanism was the Housing Guaranty (HG) under which the first \$25 million loan (HG-011) was authorized in 1979 and completely drawn down. The second \$25 million (HG-012) was authorized in 1983 and later reduced to \$10 million. The third phase was originally authorized in 1986, as HG-013, but because of ensuing political and economic developments was put on hold and was not reactivated until 1992 HG-014. This third phase, better known as the Private Sector HG, was to be channeled exclusively through private sector banks. Banco General, the largest Panamanian private bank, was the first to sign an Implementation Agreement under HG-014 and has drawn down \$14 million in two tranches of \$7 million each under the project. The loans have gone to finance homes for below-median income families in Panama. Two other Banks, Banco del Istmo and Banco FEDPA have signed Implementation Agreements, but have yet to borrow funds under the project.

The goal of HG-014 is to improve the quality of life for below-median income urban families through increased access to affordable shelter and employment opportunities in the construction industry, while the project purpose is to increase the delivery of low-cost shelter financed through private sector institutions, thereby expanding and strengthening the role of the private sector in meeting the shelter needs of Panama's median- to low-income population. In addition, a \$300,000 grant was authorized for technical assistance and training to support the housing activities.

In addition to the physical shelter outputs, the project contemplated a number of policy and institutional outputs or objectives, which can be summarized as follows: (a) increased participation of mortgage banks involved in lending to low-income families (b) a greater amount of private sector resources for low-cost housing being mobilized (c) an increase in the efficiency with which low cost housing is produced in Panama's low-income housing sector.

To date significant achievement have been made towards the project goals and outputs. A total of 1,435 units have been built under the project (838 mortgages under the first borrowing and an additional 597 mortgages made with the second borrowing). Since USAID estimated that 2,000 units would be built under the HG, it can be concluded that significant progress toward the project output has been made. In keeping with the parameters of the program, all units built were affordable to families with income below the median of \$585.00 per month.

The project is achieving steady progress towards its policy objectives. As a direct result of the program, Banco General is actively participating in lending for low-cost housing. Banco del Istmo has also begun to participate in lending to low-income families in anticipation of borrowing funds under the project.

The second objective of mobilizing a greater amount of private sector resources for low-cost housing is also being achieved. The program has facilitated the successful participation of banks and developers into the housing delivery process. Banco del Istmo, under the assumption that HG funds are imminent have packaged mortgages and brought in private sector developers to begin construction on low-income units.

The third objective of increasing the efficiency with which low-cost housing is produced in Panama's low-income sector is also being achieved. Banks and a number of developers have formed strong working relationships and rely heavily on each other to carry out their respective roles in a highly efficient manner. Developers report that

they prefer to work with private sector banks rather than government-owned banks and this change has increased the efficiency of the housing delivery process.

The project has produced considerable improvement in the shelter conditions of low-to median income families. HG beneficiaries reported better living conditions as well as significant improvements in the availability of urban services such as sewerage, water and sanitation services. Families expressed strong satisfaction with the design of their homes and the efficiency with which their loan applications were processed. The program has played an important role in placing a product in the private market that is both accessible and affordable to the below-median income population.

Banco General and developers identified working with public regulatory agencies as their number one problem faced in implementing of the project. Examples are the bureaucratic obstacles the developers face in getting permission to initiate construction and other approvals for blueprints and project proposals, and the slow and cumbersome procedure to register mortgage deeds at the Public Registry Office. Hurdles such as these are the the major reason additional developers have been reluctant to get into the low-cost housing construction business.

Banco General has successfully reinvested payments made on loans into additional housing loans for low-income families. However, the Bank has indicated that its ability to continue to serve this market will depend on the availability of long-term funds in the market. Long-term sources of funds are non-existent in the local capital market. While Banks are actively seeking long-term funds, they are not highly optimistic about accessing these funds in the near future.

In the coming months and year, USAID must address policy and development issues that will affect the sustainability of the project.

There is a need to explore new financial market instruments and develop techniques to capture long-term savings. RHUDO/Guatemala or USAID/Panama should consider sponsoring a workshop that brings experts together to share lessons learned in resource mobilization, tapping potential funding sources, including ways of accessing long-term debt from foreign capital markets.

The technical assistance funds that remain under the project should be used to hire outside expertise to conduct a feasibility study for developing secondary a market institution or wholesale facility to provide long-term liquidity to Panama's private retail financial system.

## ABSTRACT

The purpose of this report is to communicate the findings of a mid-term evaluation of the USAID Panama Private Sector Housing Guaranty Program in light of the expected goals, purposes, and objectives as enunciated in the program design documentation. The evaluation covers the first \$14 million tranche of Housing Guaranty loan authorization of \$25 million. The evaluation assesses the impact of the Program on shelter by the private sector institutions involved in the program. It identifies the achievements and constraints to date and recommends actions to be taken by USAID to improve the program. Finally, the evaluation looks at sustainability issues and attempts to identify the inputs needed to assure the continuation of housing programs for below-median income families by Panama's banking sector. The evaluation covers the period from the execution of the first Implementation Agreement to the time of the present evaluation (March 1996). Lopa Purohit, Office of Environment and Urban Programs/USAID Washington and Carlos Chacon, Regional Housing and Urban Development Office for Central America (RHUDO/CA) carried out this assignment.

## TABLE OF CONTENTS

---

EXECUTIVE SUMMARY .....	i
PROGRESS EVALUATION OF THE PRIVATE SECTOR LOW-COST SHELTER PROGRAM (525-HG-014).....	1
1 Background.....	1
1.1 Historical Context .....	1
1.2 Economic Context .....	2
2 Summary of Goals, Purposes, Inputs, and Outputs.....	4
2.1 Project Goal.....	4
2.2 Project Purpose .....	4
2.3 Project Inputs .....	4
2.4 Project Outputs.....	4
3. Purpose of the Evaluation and Methodology .....	5
4 Grant Component.....	5
5 Program Design .....	6
5.1 Role of the Administrator .....	6
6 Conditions Precedent .....	7
7 Assessment of Project Achievements .....	7
7.1 Project Implementation. ....	7
7.1.1 The Administrator Mechanism .....	8
7.2 Major Achievements .....	9
7.2.1 Physical Achievements.....	9
7.2.2 Institutional and Policy Achievements.....	9
8 Impact of the Program on the Housing sector.....	11
8.1 Impact on the Beneficiaries.....	11
8.2 Changes in the Private Sector Financial Institutions.....	12
8.3 Other Changes in the Housing Sector .....	13

9	Program Obstacles/Constraints .....	15
9.1	Government Approvals.....	15
9.2	Failure to Address Policy Issues .....	16
9.3	Program Oversight .....	16
9.4	External Factors .....	17
10	Sustainability of the Program.....	17
10.1	On completion to the HG .....	17
10.2	Tapping Potential Sources of Long-Term Funds.....	18
10.3	Prospects for a secondary mortgage market.....	19
10.4	Housing Sector Lending Policies .....	20
11	Program Relevance.....	21
12	Lessons Learned .....	23
13	Recommendations.....	24

## ANNEXES

1. List of Contacts
2. List of Documents Consulted

## EXECUTIVE SUMMARY

---

The U.S. pledged \$75 million for the housing sector as part of a side letter to the Panama Canal Treaty of 1977. The delivery mechanism was the Housing Guaranty (HG) under which the first \$25 million loan (HG-011) was authorized in 1979 and completely drawn down. The second \$25 million (HG-012) was authorized in 1983 and later reduced to \$10 million. The third phase was originally authorized in 1968, as HG-013, but because of ensuing political and economic developments was put on hold and was not reactivated until 1992 HG-014. This third phase, better known as the Private Sector HG, was to be channeled exclusively through private sector banks. Banco General, the largest Panamanian private bank, was the first to sign an Implementation Agreement under HG-014 and has drawn down \$14 million in two tranches of \$7 million each under the project. Two other banks, Banco del Istmo and Banco FEDPA have signed Implementation Agreements, but have yet to borrow funds under the project.

The goal of HG-014 is to improve the quality of life for below-median income urban families through increased access to affordable shelter and employment opportunities in the construction industry, while the project purpose is to increase the delivery of low-cost shelter financed through private sector institutions, thereby expanding and strengthening the role of the private sector in meeting the shelter needs of Panama's median- to low-income population. In addition, a \$300,000 grant was authorized for technical assistance and training to support the housing activities.

In addition to the physical shelter outputs, the project contemplated a number of policy and institutional outputs or objectives, which can be summarized as follows: (a) increased participation of mortgage banks involved in lending to low-income families, (b) a greater amount of private sector resources for low-cost housing being mobilized (c) an increase in the efficiency with which low cost housing is produced in Panama's low-income housing sector.

To date significant achievements have been made towards the project goals and outputs. A total of 1,435 units have been built under the project (838 mortgages under the first borrowing and an additional 597 mortgages made with the second borrowing). Since USAID estimated that 2,000 units would be built under the HG, it can be concluded that significant progress toward the project output has been made. In keeping with the parameters of the program, all units built were affordable to families with income below the median of \$585.00 per month.

The project is achieving steady progress towards its policy objectives. As a direct result of the program, Banco General is actively participation in lending for low-cost housing. Banco del Istmo has also begun to participate in lending to low-income families in anticipation of borrowing funds under the project.

The second objective of mobilizing a greater amount of private sector resources for low-cost housing is also being achieved. The program has facilitated the successful participation

of banks and developers into the housing delivery process. Banco del Istmo, under the assumption that HG funds are imminent have packaged mortgages and brought in private sector developers to begin construction on low-income units.

The third objective of increasing the efficiency with which low-cost housing is produced in Panama's low-income sector is also being achieved. Banks and a number of developers have formed strong working relationships and rely heavily on each other to carry out their respective roles in a highly efficient manner. Developers report that they prefer to work with private sector banks rather than government-owned banks and this change has increased the efficiency of the housing delivery process. The project has produced considerable improvement in the shelter conditions of low-to median income families. HG beneficiaries reported better living conditions as well as significant improvements in the availability of urban services such as sewerage, water and sanitation services. Families expressed strong satisfaction with the design of their homes and the efficiency with which their loan applications were processed. The program has played an important role in placing a product in the private market that is both accessible and affordable to the below-median income population.

Banco General and developers identified working with public regulatory agencies as their number one problem faced in implementing of the project. Examples are the bureaucratic obstacles the developers face in getting permission to initiate construction and other approvals for blueprints and project proposals, and the slow and cumbersome procedure to register mortgage deeds at the Public Registry Office. Hurdles such as these are the major reason additional developers have been reluctant to get into the low-cost housing construction business.

Banco General has successfully reinvested payments made on loans into additional housing loans for low-income families. However, the Bank has indicated that its ability to continue to serve this market will depend on the availability of long-term funds in the market. Long-term sources of funds are non-existent in the local capital market. While Banks are actively seeking long-term funds, they are not highly optimistic about accessing these funds in the near future.

In the coming months and year, USAID must address policy and development issues that will affect the sustainability of the project.

There is no need to explore new financial market instruments and develop techniques to capture long-term savings. RHUDO/Guatemala of USAID/Panama should consider sponsoring a workshop that brings experts together to share lessons learned in resource mobilization, tapping potential funding sources, including ways of accessing long-term debt from foreign capital markets.



The technical assistance funds that remain under the project should be used to hire outside expertise to conduct a feasibility study for developing secondary a market or wholesale facility to provide long-term liquidity to Panama's private retail financial system.



## **PROGRESS EVALUATION OF THE PRIVATE SECTOR LOW-COST SHELTER PROGRAM (525-HG-014)**

---

### **1 Background**

#### **1.1 Historical Context**

The U.S. pledged to make available \$75 million of funds under the USAID Housing Guaranty (HG) Program as a part of a side letter to the 1977 Panama Canal Treaty. These loans, which were intended to help finance homes for below median income families, in Panama, were to be provided in three tranches. The first loan (HG-011) was authorized in 1979 and funds were completely drawn down. In total, HG-011 financed the production of 5,700 service lots, homes and apartments plus over 7,000 home improvement loans. The second \$25 million (HG-012) was authorized in 1983 and later reduced to \$10 million in 1986. Because of ensuing economic and political developments, loan borrowing was not allowed to begin again until 1991. HG-012 was reactivated in 1992 and finally completed in August 1994. HG-012 produced 3,005 low cost housing solutions through Banco Hipotecario Nacional (BHN) and Caja de Ahorros, both government-owned banks.

The Private Sector Low-Cost Shelter Housing Guaranty is the third phase of the \$75 million commitment. This \$25 million HG and related \$675,000 development grant were first authorized in 1986 as HG-013. Shortly thereafter, the political crisis in Panama erupted and the HG was put on hold and the grant was deauthorized. It was not until the political and economic situation eventually stabilized in 1991 that a decision was made to reactivate the HG as HG-014, with some modifications made to the original design. The grant was also reauthorized, however, with a reduced funding of \$300,000. These HG funds were to be channeled exclusively through private sector banks.

HG-014 finally got underway in April, 1992 with the signing of the first Implementation Agreement (IA). Banco General, the largest Panamanian private bank, was the first to sign an Implementation Agreement under HG-014 and has drawn down \$14 million in two tranches of \$7 million each under the project. A second Implementation Agreement was signed in October 1993 with Banco del Istmo, which has made a commitment for approximately \$5 million under the project, but has not yet drawn down funds. A third agreement was signed in February 1994 with Banco FEDPA. However, Banco FEDPA has yet to request a borrowing under the project.

The first Implementation Agreement and the supporting documents thus form the basis for this present evaluation, which covers the HG-014 implementation period from the date of the signing of the first IA to the present.

## 1.2 Economic Context

Since 1990, Panama has adopted policies which have produced a broad-based economic recovery following the severe economic and political crisis of the 1987 to 1989 period. Real GDP has averaged around 7% per year, inflation has remained below 2 percent and the unemployment has declined from 20 percent to 14 percent. The impressive growth in construction activity (construction grew and average of 50% annually, having its best year in 1991 with an increase of 117%), the commercial expansion in the Free Zone of Colon (FZC), and a steady growth in the financial services have been the main factors contributing to the sustained economic growth.

With a GNP of US\$2,442 (1994) and a low inflation rate (1.1 on the average for 1990-1994), the Panamanian economy is one of the most prosperous in Latin America. Further, nonexistent exchange risks, a steady investment growth in FZC, the widening of Panama Canal, and the transfer of assets to Panamanian authorities in 1999, the economic outlook for Panama in the short and long-term is promising.

### **Panama's Financial Sector**

At the end of 1994 the private banking system comprised of 107 banks, with 19 banks starting operations during the past five years while 24 banks ceased operations. Banks have experienced a sharp recovery in their domestic market operations, with private sector deposits expanding from \$2 billion (34 percent of GDP) in 1990 to \$4.6 billion (61 percent of GDP) in 1994 and credit to the private sector growing from \$2.2 billion to \$5 billion over that period. The recovery reflected the restoration of confidence and return of capital flight following the resolution of the political crisis, the rapid economic recovery, competitive interest rates on deposits, and lending rates which were being reduced due to competition among banks. Despite these developments, the recovery of the banking system has been constrained by existing legislation which has not permitted the introduction of new financial instruments and banking innovations such as cash management accounts, certificates of deposit, banker acceptances, private sector bonds and electronic transactions.

Regarding the public financial institutions, the National Bank (BNP) as experienced steady improvements in its position over the years, with reductions in non-performing assets and efforts to contain costs.

Together with the accumulations of public sector deposits in the BNP, the trends of broad money and credit permitted a further strengthening of the net foreign assets of the banking system by \$550 million (about 8 percent of GDP) in 1994, with the BNP accounting for more than one fourth of the increase.

## **Panama's Housing Finance System, Policies and Laws**

The National Mortgage Bank (Banco Hipotecario Nacional, BHN) has been the main conduit for low-cost housing finance in Panama. Its purpose is to provide financing to the national housing programs administered by Housing Ministry (Ministerio de Vivienda, MIVI). BHN is also the oversight authority for the National System of Housing Savings and Loans (Sistema Nacional de Ahorro y Prestamo para la Vivienda, SNAP). Most importantly BHN provides liquidity to SNAP institutions as well as mortgage guarantees. The BHN focuses its activities on low-cost housing. In 1993, the BHN financed only 137 loans for B2.4 million. At the end of 1993, the BHN has B135 million in outstanding mortgage debt.

In 1991, the number of savings and loans institutions contracted from six to three. The remaining institutions are Chiricana de Ahorro y Prestamo, Interiorana de Ahorro y Prestamo and SAVISA. In 1993, these institutions originated 60 loans for B1.1 million. The total amount of mortgage debt held by these institutions at the end of 1993 was B10.01 million.

The Housing Ministry's (Ministerio de Vivienda, MIVI) purpose is to plan, coordinate and implement national housing policy and urban development. In 1991, the GOP created National Council of Housing (Consejo Nacional de la Vivienda, CONAVI) which operates under the direction of MIVI is responsible for implementing housing policy and operating FONDAHVI, the Shelter Savings Fund, and established the basis to develop a National Housing Policy. These measures show that government is assuming more of a conductive role in the sector than it has in the past.

However private sector lending, without guarantees or subsidies, is a very small segment of the low-cost housing finance market in Panama. Banks and savings and loans institutions only provide finance to middle and upper income groups.

The Preferential Interest Rate Mortgage Law (passed in 1985 and reformed in 1990 and 1995 respectively) has significantly increased the ability of Panama's below-median families to afford housing. Panama's current market lending rate is 11.75 percent. The rate is variable and is re-evaluated on a quarterly basis by the National Banking Commission. Banks normally offer mortgage loans for 20 years and require a minimum downpayment of 10 percent. The current preferential rate for mortgages less than \$25,000 is 6.75 percent, that is five points below the market rate. The law gives banks the option to charge borrowers a discounted interest rate and claim tax credit for the five points towards its annual income taxes. The program's existence has been justified on the grounds that this lower income segment of the population does not file income taxes and therefore is unable to deduct interest paid on mortgages from their taxes.

## 2 Summary of Goals, Purposes, Inputs, and Outputs.

### 2.1 Project Goal

The stated goal of the project is **to improve the quality of life for below median-income urban families through increased access to affordable shelter and the creation of employment opportunities in the construction industry.**

### 2.2 Project Purpose

The purpose is **to increase the delivery of low-cost shelter financed through private sector institutions, thereby expanding and strengthening the role of the private sector in meeting the shelter needs of Panama's low-income urban population.**

### 2.3 Project Inputs

The project inputs for HG-014 consist of **\$25 million in housing guarantees and \$300,000 in technical assistance and training.** Local counterpart financing was calculated at 20 percent of the mortgage loan. Beneficiary downpayments were required to be at least 10 percent of the sales price of each unit. The total amount of resources (not including TA and training) to be dedicated to the project was set at \$34.7 million.

Program inputs can be summarized as follows:

HG Resources:	\$25,000,000
Local Bank Resources	6,250,000
Beneficiary Downpayments	3,472,000
Total resources	\$34,722,000

### 2.4 Project Outputs

The physical output is estimated to be 2,000 new housing units to be built with the total program resources, assuming a unit cost in the range of \$14,100 to \$22,300. (Note: the Project Paper Supplement (dated May 28, 1991) states a targeted unit cost of \$12,000, but Project Implementation Letter (PIL) 2 (dated March 8, 1995) updated median income levels and raised sales price ceilings).

Institutional outputs include increased participation of mortgage banks in lending to low-income families, greater private sector resources for low-cost housing mobilization and an increase in the efficiency with which low-cost housing is produced in Panama's private sector.

### 3. Purpose of the Evaluation and Methodology

Section 7.02 of the Implementation Agreement calls for an evaluation as an integral part of the project. The purposes of the evaluation are to assess progress towards the objectives of the project, and to identify and evaluate problems and constraints which may have inhibited attainment of the objectives and to provide recommendations to overcome the constraints associated with the project. The evaluation is also intended to assess the development impact of the project.

The evaluation was conducted in February 1996 by two urban development specialists. To obtain evidence on project impacts, the authors examined numerous external and internal sources of information including documents such as the HG-014 project paper and supplement, project implementation agreements, PILs, sector assessments, USAID Panama Action Plan, mission semi-annual reports on the HG, project files and contractor scopes of work. External sources included Bank's computerized list of mortgages financed by HG funds. The authors interviewed 10 program officials and knowledgeable observers as well as project beneficiaries. (For a list of documents reviewed and persons interviewed, see Annex 1 and 2).

### 4 Grant Component

The development issues to be addressed by the technical assistance included the need to increase the involvement of the private sector financial institutions in long-term mortgage lending and reducing construction costs. Technical assistances (TA) and training inputs in the form of long-term and short-term advisors and training was expected to complement and support of the Program. More specifically, the TA resources were to be used for the following: a long-term advisor to be funded for eighteen months was envisioned to assist in the Program's start-up, monitoring its outputs and coordinating short-term technical assistance activities related to long-term development issues and policies. The advisor would work with GOP agencies, private banks and contractors to initiate studies in policy reform activities with regard to improving housing finance and production systems particularly for low cost shelter. The advisor would also be available to work with the relevant ministries, developers associations and commercial banks to promote lower costs through most appropriate construction standards, reduced fees in transfers of titles and proposals to mobilize long-term resources for investment in housing. The cost of the long-term advisor was estimated to be \$200,000 for eighteen months.

Up to \$100,000 was budgeted for short-term technical assistance studies concerning options to reduce housing production costs, including construction costs (building materials) and administrative costs, by streamlining procedures for project approvals and permitting construction. Short-term technical assistance was also to be used to study ways of increasing the flow of domestic funds to long-term mortgage lending.

The long-term advisor, in actuality, provided services under both HG-012 and HG-014 during an 18 month period. The advisor drafted required documentation to reactivate HG-012 and HG-014 programs. The advisor reestablished contacts in key public and private sector institutions for both HGs. The advisor oversaw the implementation of both programs and counseled on specific issues such as selection of the Administrator for HG-014.

The short-term technical assistance consisted of legal advice (\$11,200) to determine the legality and validity of implementation and contractual documents in Panama and issuance of an opinion on procedures used by the national registry to allow transfer of mortgage guaranties to the HG-014. The legal advisor also advised the Administrator regarding default of payments, prepared the guaranty agreement to be signed by participating banks and USAID and provided other legal services as requested by USAID. A portion (\$27,759) of the short-term technical assistance budget was used to pay part of the salary of the project management officer for HG-014 in the mission. The balance \$26,400 is yet to be spent.

## **5 Program Design**

### **5.1 Role of the Administrator**

A program administrator was contracted to manage and oversee certain aspects of the program and protect USAID’s interests in the event of default. The use of an intermediary was thought to facilitate project implementation. The Administrator, Banco Continental, a Panamanian Bank, was selected by USAID in consultation with borrower. The role of the Administrator was clearly defined by the IA. The Administrator was to certify the borrower institution’s qualifications and eligible expenditures and to authorize the US lender (with USAID’s concurrence) to disburse HG funds to the Bank upon the presentation of eligible mortgages. The Administrator was also to receive loan payments from the Bank and remit the payments to the lenders, monitor the mortgage loan portfolio to ensure that the loan terms and conditions were met and in the event of default to manage the loan portfolio of the defaulting institution in accordance with the terms of the Implementation Agreement.

Since the HG was designed without a host country guaranty, the Administrator was charged with managing the use of financial safeguards put in place to insure against potential losses resulting from non-payment by the borrower. Since Panama uses the US dollar as national currency an all loans are denominated in US currency, there was no exchange rate risk. The safeguards are fully described in the project paper supplement and the IA. In the event of default, the Administrator would have the authority to instruct the Panamanian Recorder of the Deeds to transfer the entire mortgage portfolio of the defaulting institution to the Administrator, who would in turn pass to USAID. The Administrator on behalf of USAID would have the legal authority to cure all defaults should they occur.

## **6 Conditions Precedent**

Section 4.03 of Article IV of the Implementation Agreement contains two conditions precedent to earmarking of resources and selection of a Lender under the HG program. One, the borrower is required to provide to USAID certification by the external auditor of the borrower that they have met the eligibility criteria set forth in Section 5.02 “Eligibility Standards for Borrowers”. Second, evidence that the borrower (s) has deposited with the Administrator (Banco Continental) a non-refundable commitment fee in the amount of 1% of the proposed borrowing.

Action: Banco General met these CPs on two different occasions, in October 1993 and May 1995 for each of their \$7 million borrowings. Banco del Istmo is ready to deposit a commitment fee and start the process of complying with the CPs. An interview with a key executive at Banco FEDPA indicated that it is not in position of requesting a borrowing at this time.

Section 4.04 of Article IV of the Implementation Agreement contains the conditions precedent to disbursement. The borrower or Administrator shall provide to USAID all documents required by the terms of the loan agreement to satisfy conditions precedent. The borrower or the Administrator must submit a request and certificate for disbursement, a legal opinion attesting to the validity of the IA, the loan agreement, the Paying and Transfer Agency Agreement stating that they have been duly authorized, executed, and delivered by the borrower(s) and constitute legal, valid and binding obligations. Also, the borrower is required to submit evidence that it has submitted an irrevocable letter of credit or other payment guaranty for the benefit of USAID in an amount equal to the first semi-annual payment under the loan agreement or deposited with the Administrator (Banco Continental).

Action: These CPs were met by Banco Continental in January 1994 and August 1995 for each of their \$7 million borrowings.

Section 4.05 relates to the terminal date for completion of conditions precedent. All conditions specified in section 4.03 must be met by the borrower within two years of the date each signed the IA.

Action: Banco General complied with the CPs for the first two borrowings under this HG.

## **7 Assessment of Project Achievements**

### **7.1 Project Implementation.**

The signing of the Implementation Agreement with Banco General in April 1992 marked the starting date for the revised HG-014. On October 1993, a second agreement was signed with Banco del Istmo, which has made a commitment for approximately \$5 million, but has

not yet borrowed under the project. In the Fall of 1995, Banco del Istmo indicated to USAID/Panama its intention to pay a commitment fee of \$60,000 in order to earmark \$6 million and select a HG lender. Because of the uncertainties of future borrowings for pre-credit reform HG loans, the Mission requested the Banco del Istmo to hold off until the former receives word from USAID/Washington to move forward with the program. Prior the signing of the Implementation Agreement with Banco General, the process of reactivating the HG-014 (which was done along with HG-012) involved re-establishing relationships with HG counterparts, setting up the Administrator mechanism, drawing up the necessary contractual documents and negotiating the IA. This is particularly worth nothing because a substantial amount of the technical assistance approved for supporting the HG was expended on reactivating the HG which led to the signing of the first Implementation Agreement.

After the signing of the Implementation Agreement, Banco General moved towards satisfying CPs required for earmarking HG resources, selection of lender and subsequent disbursement. Banco General drew down \$14 million under the Project, through two \$7 million loans made in January 19, 1994 and August 11, 1995. Upon satisfaction of the CPs, the two disbursements were made on a reimbursement basis for eligible expenditures incurred. In accordance with the terms of the Implementation Agreement, the value of the mortgages (eligible expenditures) was to exceed the HG loan by a ratio of at least 1.25 to 1.00. The borrower, Banco General, requested an extension for the delivery of eligible expenditures of \$2 million in mortgages. Mission reviewed the request and determined to waive the ratio for 180 days following the closing date of the loan. This decision was made in place of placing the \$2 million in escrow.

PIL No. 3 dated 6/16/95 provided the Banco General with a waiver postponing the delivery of the \$2 million in secured mortgages to USAID by 2/11/96.

PIL No. 5 dated 2/23/95 provided Banco General with a thirty day extension for the delivery of \$2 million in mortgages as requested in a subsequent letter from the borrower. At the time of the evaluation, Banco General indicated that the promissory notes were to be delivered to the Administrator before deadline indicated in PIL 5.

### **7.1.1 The Administrator Mechanism**

The Administrator, Banco Continental, has worked well as an intermediary mechanism in the implementation of HG-014. Banco Continental maintains solid working relations with the borrower bank, Banco General. Banco Continental reports that it has not experienced any problems in carrying out its function as an Administrator for the program. the factors that have contributed to the success of the mechanism are the following: Banco Continental

and Banco General are no direct competitors in the market, as the former serves a corporate client base and the latter retail lending institution. Both Banks share common board directors and possess similarities in the amount of capital they own. Banco Continental indicated that the “mutual respect” for the other’s financial position market has facilitated the dealings between the two banks.

## **7.2 Major Achievements**

### **7.2.1 Physical Achievements**

Under the project, the goal of improving the quality of life for below-media income urban families through increased access to affordable shelter is being achieved. A total of 1,435 units have been constructed under the project (838 mortgages under the first borrowing and an additional 597 mortgages constructed with the second borrowing). Since USAID estimated that 2,000 units would be built under the HG, the figure 1,435 indicates that significant progress toward the project output has already occurred. All houses built under the HG have been affordable to families with the income below the median, as adjustable periodically, which today is calculated at \$585 monthly (PIL 2 under the HG-014 was issued to update the median income levels and corresponding sales price ceilings of housing units applicable to the project). New ceilings now range from \$14,100 to \$22,300 in the principal urban center of the country. For example, a house valued at \$16,000 is affordable to a family with a monthly income of \$550. The term of the mortgages is 20 years and the downpayment is normally a minimum of ten percent. More employment opportunities have been created in the construction industry, but this output is deemed more a by-product of the project than a direct output. An increase in the production of low-cost housing from the project has created significant job opportunities in the construction sector.

### **7.2.2 Institutional and Policy Achievements**

HG-014 was oriented towards achieving three major policy objectives, however the fact that the policy objectives are long-term in nature should be taken into consideration when making an assessment of progress achieved in these areas. Furthermore, only one Bank has borrowed funds under the project, so drawing conclusion with regard to the private sector delivery of low-cost housing in general may be a bit premature. Nevertheless, there are valid points that can be stated and come preliminary conclusions that can be drawn from the experience,

- Increased participation of the mortgage banks involved in lending to low-income families.
- A greater amount of private sector resources being mobilized for low-cost housing.
- An increase in efficiency with which low-cost housing is produced in Panama.

In each of these policy areas, the program achievements are described fully in the following paragraphs.

**Increased participation of mortgage banks involved in lending to low-income families.**

As a direct program, Banco General is actively participating in lending for low-cost housing. The program has supported approximately \$20 million investment in low-income housing. The \$20 million investment constitutes the borrowed funds (\$14 million), eligible expenditures requirements, beneficiary downpayments and local counterpart financing. The project is achieving steady progress towards its stated policy objective. Our interviews indicate that Banco del Istmo has also begun actively participating in lending to low-income families in anticipation of borrowing funds under the project. Banco del Istmo has a large network of branches thereby enabling them to reach borrowers and monitor projects fairly closely. Banco FEDPA, the cooperative bank, is in a strategic position to participate in lending to low-income families because of its relationship to the networks of cooperatives. However, as it is a fairly young bank, it does not anticipate moving into mortgage lending for a couple of years. The FEDPA Bank official interviewed did not seem to know why the Bank signed the Implementation Agreement when it had no immediate plans to enter the mortgage financing business.

**A greater amount of private sector resources being mobilized for low-cost housing.**

Banco General has been the only bank that has borrowed funds under the HG, but signs indicate that a greater amount of private sector resources are being directed into low-cost housing. The program has facilitated the participation of banks and private sector developers into the housing delivery process. Banco del Istmo, under the assumption that HG funds are imminent have been making mortgages for low-cost housing and have called upon private developers to begin construction on the low-income units. Interviews with the project implementation officer in the Mission and developers indicate the steady growth in demand for low cost housing coupled with the demand tapering off in the upper income housing market has prompted private developers to focus their efforts on lower income housing.

**An increase in the efficiency with which low-cost housing is produced in Panama's low-income sector.**

On one level, an increase in efficiency is measured in quantitative terms – that is housing production efficiency or output per unit of input. The original project paper states that building materials and labor inputs cost much more in Panama than in neighboring countries, therefore making housing production inefficient. Developers agree that the cost of building materials is high, but have also indicated that they have mastered ways to reduce its costs and operate on the basis of economies of scale. Furthermore, developers indicate that the cost of building materials have not impeded their efforts in the housing delivery process.

The Program's technical assistance activities were originally designed to address the inefficiencies in the process for receiving permits and approvals as well as lowering the cost of production of local building materials. However, technical assistance was not used to address these issues, and therefore it can be argued that little progress has been achieved in increasing efficiency of housing production systems. Issues related to increasing efficiency in housing production are discussed in further detail in Section 9.2 of this report.

On a more qualitative level, an increase in efficiency is taken to mean the level of interaction between the different players in the housing market. In this respect, there has been an increase in the efficiency with which low-cost housing is produced in Panama. Banks and developers have formed strong working relationships and rely heavily on each other to carry out their respective roles in a highly efficient manner. The developers are responsible for purchasing sites and preparing project plans. They also follow the normal approval process for residential construction, obtaining permits from all the required institutions. Each developer is also responsible for securing its own construction financing. The developer is also responsible for the sale of the units, although the lending institution must qualify buyers. The mortgage lender has control over the technical approval and supervision of projects and the qualification of borrowers in accordance with Program beneficiary criteria. Interviews with developers have shown that they prefer to work with private sector banks rather government banks (as they have on previous occasions) and that change has impacted positively on the efficiency of the delivery process.

## **8 Impact of the Program on the Housing sector**

### **8.1 Impact on the Beneficiaries**

For the most part, the project has had a considerable impact in improving the shelter conditions of low to median income families. The HG financed homes are located about twenty minutes outside of Panama City. Most of the beneficiaries interviewed were previously living in the city itself and now have moved out to Nuevo Arraijan or Ciudad Vacamonte, areas situated roughly 10 to 15 miles outside the city. Beneficiaries reported that at first they were apprehensive about moving "across the bridge", but later bought into the advantages of living in these areas. A housing market research piece prepared by an independent consultant indicated that people were interested in moving to areas outside of the city because they could live on larger plots, it was cheaper, and less congested. The homes are detached single family units, ranging from 55 to 68 sq. meters in size (the 5 meters sells for \$16,000, while the 8 square meters sells for \$20,000). A four person family whose combined income is approximately \$500 per month is typically able to afford and \$18,000 home. The location of the houses has been a major factor in making these homes affordable to this segment of the market. In this respect, beneficiaries seem to feel that they are not making a major in moving out of the city. Beneficiaries, in many cases, work in the city and therefore have to commute (by bus) on a daily basis. These smaller towns do not offer wide range amenities that the city offers, but the towns are growing

rapidly with influx of new residents and basic services such as health care, and schools are in close proximity to the homes.

The local consultant who was to be contracted for the purpose of conducting baseline studies of the HG beneficiaries was not available during the time of the evaluation so we were not able to collect statistical data on the financial impact (e.g. impact on income, travel costs) of the program of the families. The interviews conducted did, however help to capture program impact at the people level.

We randomly selected and interviewed members of five families whose homes were financed by the HG program. In the interviews conducted with beneficiaries, householders reported that they are living more comfortably because of increased space and are able to raise their kids in a healthier environment. Out of the five families that were interviewed, three of the families were previously living in downtown Panama in single rooms, sharing common bathroom with two or three other tenants, paying an average monthly rent of \$50. The three families now have an average monthly payment of \$100. Families recognized a tremendous improvement in living standards as the new house has two bedrooms, a bathroom, kitchen and living-dining room. The families interviewed reported notable improvements in the availability of urban services such as sanitation, sewerage and continuous water supply. In most instances families did not have access to all urban services in their former home. All five of the beneficiaries expressed a strong feeling of emotional and physical security of which they had been deprived in their previous home.

Regarding customer satisfaction, families were happy with the developers' work on the design of their home as well as the efficiency with which the bank handled their loan applications.

The program has played an important role in helping to place a product in the private market that is both accessible and affordable to the below median income population.

Even though there is not a deliberate policy on gender equity in program implementation, it is interesting that women are accessing to credit and property through the program. The evaluation team examined a list of 787 mortgage loans (representing 55% of the total number of loans financed under the program up to now) and found that 47% of the houses are registered to the name of a woman.

## **8.2 Changes in the Private Sector Financial Institutions**

Private sector financing for long-term mortgages for low-cost housing has been scarce not only because of a lack of access to long-term funds, but also because of the perception that the risk of lending to this group is too great and the administrative costs too high to justify serving this market. Prior to the HG program, Banco General did not seriously consider low-cost housing as a prospective market. The Bank's participation in the program has demonstrated that low-income families can and will pay mortgage loans and represent a

clientele as depositors and recipients of other type of loans. The attitude of the Bankers in beginning to change, in part due to USAID program and continuing dialogue between USAID and the private sector.

In the interview with Banco General, the key executive indicated that experience has shown that the overall credit record of the target income group has been just as good as other income brackets and risks to lending to this group have not been substantial enough to justify turning its back on this segment.

Banco del Istmo has also indicated that their experience has shown that low income borrowers are creditworthy clients. In essence, the program has to some degree succeeded in showing the private sector that low-income borrowers are, for the most part, good credit risks. Banco General's key executive did indicate that the Bank would find it difficult to downmarket further. The beneficiaries should be able to demonstrate a steady stream of income needed to service the loan. Therefore, it is unlikely that private banks will lend to lowest income brackets and residents in the informal sector. Banco General remarked that the program is a market-driven program and the continued growth in demand in the segment of the low income sector that they have been serving under the program is likely to be the market it will continue to serve in the future.

The program has enabled the Banks to finance mortgages to a large segment of the below-median income households, but in the interviews with the Banks, they mentioned that if it were not for the government sponsored preferential interest rate program, it would be unlikely that mortgages would be affordable to the below-median income segment. The program essentially gives participating banks the option to charge borrowers with a discounted interest rate for mortgages on houses within specified sales price bracket. For example, for houses valued up to \$25,000, borrowers can receive five percent discount and for houses valued up to \$62,000, borrowers can receive a four percent discount. In other words, if the reference interest rate (computed by the National Banking Commission) is 11% and the discount is 5 points, then the borrower pays a 6% interest rate on its loan and the Bank will apply the 5 points towards their income taxes. The banks are, in essence, able to obtain tax credit towards its annual income taxes. The program's existence has been justified on the grounds that this segment of the population does not file income taxes and therefore is unable to deduct interest paid on mortgages from their taxes. A more in-depth discussion and implications of the preferential interest rate is detailed in Section 9.2 of this report.

### **8.3 Other Changes in the Housing Sector**

Private sector developers first entered the low-cost housing market in 1987. At least five major developers have initiated or are already working in low-cost housing projects and see an increasing percentage of their future activities tied to serving the growing market for low to moderate income housing. This is because developers are realizing that they can

make a profit in serving the lower-end of the market and also because demand for housing at the upper end of the income scale, to some extent, is tapering off.

The main private sector developer, ECONOPLADE, has been specializing in the below-media income market since 1958. Other developers realize the potential with serving this segment and as a result have followed ECONOPLADE's lead. The availability of HG funds has allowed private sector banks to work with developers in the housing delivery process. Prior to Banco General's involvement, developers worked with state-owned banks in the below-median income market. Developers complained of the government banks' lackadaisical attitude, inefficient loan procedures in the housing delivery process. Since Banco General has participated, private sector developers have indicated that working with the private sector banks has increased the efficiency with which they are able to deliver low cost housing. Their clients are able to get loans approved quicker, and developers can start construction soon after. Working with the private sector banks has enhanced the developers ability to deliver housing on a more efficient basis. In this regard, the HG Program has had a positive rippling effect across the housing sector.

The program has been a contributing factor in facilitating the change underway in the Panamanian housing sector from a public sector provision of housing to a private sector-driven delivery of low-cost shelter. The program has played an important role in bringing the private sector into the delivery of housing and has succeeded in convincing these players they can serve this market. However, experience has shown that the private sector players (the banks and the developers) face many administrative hurdles, some of which are discussed in detail in the next section of this report.

Panama's Housing Ministry, MIVI, to some extent, is still in the business of housing production, and visits to housing sited financed by MIVI speak to the abhorrent conditions in which people reside. Box units are built on partly serviced sited with open sewerage systems and intermittent water supply. Householders reported that they would have to close off streets and demonstrate from time to time to get services. The housing solutions are termed by an observer as a "minimum solution" to the housing deficit problem. It is interesting to note that householders' monthly payment was about \$40.00 for twenty years, while the average monthly payment for HG financed households ran about \$100 per month for the same length of time.

We were unable to meet with officials from MIVI to discuss housing policy issues, however we did review recent policy proposals that reflected the central government's support for the private sector delivery of low-cost housing. MIVI officials have commenced a dialogue with Banks to facilitate and promote the private sector driven housing solutions for low-income families.

A recent policy proposal put forth by the FONDAHVI, the Residential Savings Fund, if put into effect, would also impact lending policy. In its proposal, FONDAHVI lays out a strategy to support the private sector in its efforts to participate in lending to low-income

families. The government’s approach is to leverage resources of the private sector banks by helping borrowers with their downpayments on their mortgages. In effect, the banks would finance 85% of the sales price of the house and the government would kick up to 15% for borrower downpayment.

The proposal runs into problems in that it is not clear in its purpose and goal. In its on-going dialogue with banks about the proposal, the government has indicated that it is not willing to guaranty the loans that are financed under the program. The government’s argument is that it is providing liquidity to the Bank. The Bank’s position is that the government should decide whether its purpose is to provide some guaranty to the bank or its purpose is to provide liquidity to the Bank. Liquidity, in the Bank’s opinion, is a separate issue and the minuscule amounts of funds proposed does not constitute liquidity.

In sum, housing policy is in a transition, having elements of both private and public sector delivery. In an effort to respond to political demands, it has retained a role as a direct lender and developer for low-cost housing. On the other hand, in line with current stated housing policy, it has taken a more conducive and facilitating role in the sector that it had in the past.

## **9 Program Obstacles/Constraints**

### **9.1 Government Approvals**

Banco General and private sector developers identified working with public regulatory agencies as the number one constraint they faced in the implementation of the project.

One of the most significant bottlenecks that the Bank has faced in project implementation was registering mortgages. In an interview with Banco General, the key executive indicated that in one case the bank has to hire six people for 10 days to get their mortgages for the first set of loans registered. The public registry procedures are archaic and simply do not have capacity or technology to carry out functions in a timely and efficient manner.

Developers have also faced constraints in getting permits to initiate construction and other approvals for blueprint and project proposals. Developers have indicated that they have a handle on rising construction costs, but the administrative hurdles pose a major constraint to their work. These hurdles are also identified as the main reason why other developers are reluctant to get into the business. These administrative roadblocks have also driven developer costs up. For example, in the interviews with developers, the indicated that they would have to wait up to 10 months (after purchasing the land) for the necessary government approvals to initiate construction. Developers also complained of the

tendency for housing ministry and public works to delay decisions in general, thus slowing the process and driving up costs for developers.

## **9.2 Failure to Address Policy Issues**

The long-term development and policy issues that were identified in the project paper supplement were not adequately addressed in project implementation and therefore may impact the long-term sustainability of the project. For example, in interviews with banks, both banks indicated that the greatest obstacle to serving this market in the future is the lack of access to long-term funding. Technical assistance and training was allocated to help private sector banks to identify and develop new techniques to capture long-term savings and tap other long-term sources of funding so as to narrow the gap between saving and lending terms. TA was to work with all relevant counterpart to develop proposals to mobilize long-term sources for investment into housing. However, as noted earlier, most of the long-term TA was used to reactivate the HG, and re-establish relationships with counterparts and provide other administrative support for the HG, and not to work with counterparts on long-term policy and development issues.

As stated in the project paper supplement, TA was targeted to work with banks and contractors to initiate studies in policy reform activities to strengthen the housing finance and production system of low-cost shelter. For example, TA was to foster a dialogue between private sector and public regulatory agencies to reduce housing production costs by revising procedures for project approval, streamline procedures. A series of studies were to be conducted to determine how the costs could be reduced. Technical assistance was also designed to address the cost of housing production, by reducing the costs of building materials, thereby making housing more affordable to the low-income population. Instead, some of the short-term TA was used to fund part of the salary of the project implementation officer for the HG in the Mission.

These long-term policy and development issues has attracted much attention at the time the project was originally conceived, and the technical assistance was proposed to provide an analytical basis for change and an organizational structure to implement it. However, over the years, the policy content of the program has diminished and subsequently these development issues were not addressed.

## **9.3 Program Oversight**

The HG itself is not an agenda item for the mission, but rather a side activity or what the Mission terms as a “target of opportunity”. The low priority given to the HG together with the absence of a “policy advocate” for the HG in the Mission has resulted in littler dialogue on policy and programmatic issues with Banks and other counterparts beyond the day-to-day management of the HG.

The long-term technical assistance advisor, Xavier Vela, contracted for 18 months (from September 30, 1991 to March 31, 1991) drafted documentation to fully reactivate HG-012

and HG-013 programs, established and maintained contact with officials in public and private sector institutions involved with housing, provided general advice on the implementation of the programs as well as specific counseling on individual issues such as the selection of the Administrator.

Also in line with the contractor's scope of work, the advisor maintained liaison with the AID Regional Housing Office (RHUDO) coordinating technical input to the redesign and management of the housing guaranty program. The advisor consulted regularly with the Mission and the RHUDO and provided contractor reports accordingly.

The contractor's scope of work also called the advisor to coordinate the provision of short-term technical assistance and submit recommendations on the revisions to construction standards and new housing finance mechanisms. However, to the best of evaluation team's knowledge, studies of specific policy issues were not prepared for the Mission.

The long-term technical advisor was successful in carrying out all the groundwork to reactivate and administer the Program, and implementing mechanisms to ensure efficient and smooth operation of the Program.

#### **9.4 External Factors**

Just prior to time of the evaluation, Congress has issued a draft policy on HGs as a response to the recent GAO Report on the Housing Guaranty Program. The policy stipulates that USAID shall not move forward with future borrowings for pre-credit reform HGs. Pre-credit reform HGs are those HGs that were structured as an off-budget activity without any annual appropriations for reserves (those loans authorized before the passage of the Credit Reform Act in 1990). The Panama Private Sector HG is a pre-credit reform HG and therefore is subject to the draft policy. Pre-credit reform loans are being reviewed on a case-by-case basis and until a decision is taken, the Private Sector HG, along with other pre-credit reform HGs have been put on a temporary hold.

### **10 Sustainability of the Program**

#### **10.1 On completion to the HG**

As indicated in section 6.2, the goal and the physical output of the project is being achieved. To a certain extent, significant progress has been achieved toward the project purpose of increasing the participation of mortgage banks involved in lending to low-income families. The HG program has demonstrated that private sector institutions can participate in the delivery of low-cost shelter.

Some of the elements in the groundwork for ensuring sustainability of the project have been laid. Because the terms of the mortgages loans are 20 years and the term of the Hg is 30 years, the Bank have been able to reinvest loan payments into additional housing for

low-income borrowers. The 10 year old grace period on repayment of the principal coupled with the difference in terms of the Hg loan and the mortgages has substantially increased the impact of the program beyond that of the initial loan amount. In this regard, USAID has promoted the sustainability of the program by including this element in the program.

But the Banks have indicated that their ability to continue serve this market once HG funds have been loaned out will depend largely in the availability of long term funds in the market. Banco General is actively looking at other sources of long-term funds. It is negotiating a deal with International Finance Corporation (IFC) for a 10 year line of credit tailored for housing and also beginning a dialogue for a line of credit from the Inter-American Development Bank (IDB). It is also exploring the possibility of doing private placements with foreign banks.

Banco del Istmo has also expressed some reluctance to participate in lending to low-income sector without long term funds on its books. As Banco del Istmo packages its loans, one of its greatest concerns is that AID funds will not be forthcoming. Banco del Istmo is exploring the possibility of accessing international capital markets for funds. In an interview with the Mario de Diego Jr., the former National Banking Commission Director, de Diego indicated that there are no long-term funds available in the local capital market. The best case is medium-term funds (3-5 years). According to de Diego, the mortgages financing that Banks are able to do right now is because of the availability of HG money. In Banco del Istmo's case, it has been able to retain stable core deposits and trustworthiness that it has built with its client base which has afforded it the ability to do long-term financing based on medium term funds. It is unlikely that it can continue to lend on this mismatch of funds.

Banco FEDPA, the third bank to sign the Implementation agreement is a young banks that is trying to diversify its portfolio, but it is also faced with the inability to access long-term funds.

## **10.2 Tapping Potential Sources of Long-Term Funds**

Pension funds, are generally thought of as natural source of long-term funds. The principal stakeholder of the pension funds in the social security system which, in Panama, has a history of political corruption. Social security which is Panama's largest saver does not support the private sector and has not contributed at all to the production of low-cost housing. Even though social security does not have the infrastructure for loan processing, it carried out all the functions of a retail lender by providing loans to the medium- to high-income segment of the population. Additionally, social security has also refinanced loans from other banks, but doesn't present any prospects for financing low-cost housing.

The former banking commission director seem to think that it would make sense to allow a banks like Banco Nacional de Panama (BNP) or other private banks to handle social

security funds for housing finance or get publicity solicited bids from private funds to manage these funds, but that not the direction in which it is headed.

There are proposals, however, in the works to create private pension funds. The regulations have not been drawn yet and may also be difficult as people are against privatization of social security. These are private retirement funds that would, in effect, supplement social security. The proposal is along the lines of the pension funds in Chile and Panamanians are currently seeking advice from Chilean advisors in this area.

Another opinion which makes use of a new law are funds created by private companies to guarantee funds to pay severance and seniority benefits. As companies establish these funds, the amount of money available should increase resulting in a possible source of long-term funds.

Another possibility is to explore foreign markets for long-term sourced funds. A Panama bank is working on an international issue which is essentially a credit-asset backed security that is backed by credit card finance. Perspectives are good and if successful, it could open the path for more foreign issues such as the issuance of mortgaged-backed bonds or securities. Since Panama uses the dollar as its currency, accessing foreign markets may be a possible option as the exchange risk associated with issuing debt in international markets is non-existent.

To ensure sustainability of the program, banks must continue to explore the possibilities of generating long-term sources of funding. Only in this way can the private sector banks continue to make finance available to the below-median income households.

### **10.3 Prospects for a secondary mortgage market**

In general, there are structural problems with developing a secondary mortgage market. Panama lacks institutional investors and reliable long-term sourced funds in its capital markets. Certainly, the US model of Fannie Mae and Freddie Mac are too ambitious and far too complex for the Panamanian context. A secondary mortgage market is only feasible under certain conditions, such as when there are large investors with pools of long-term savings and they are allowed to invest in mortgages, the mortgage instrument is standardized and laws are supportive of securitization. While Panama may not possess all the preconditions for a secondary mortgage market, it may have the potential to develop some sort of secondary market mechanism or facility. Panama has a well-developed primary market and a growing capital market. Panama has a relatively predictable rate of inflation needed to mobilize long-term savings, improve the affordability of mortgage loans and the attractiveness of mortgage assets. If properly established, a secondary mortgage facility can serve as a conduit to facilitate the creation of a secondary mortgage market. A conduit can create an incentive for mortgage lenders to standardize mortgage instruments, expand the investor base for mortgages, increasing the availability of funds

and management of risk, and facilitate the development of markets for mortgage-backed securities or debt securities.

Private sector banks and other officials also seem to indicate that prospects of developing some sort of secondary market-type system is worthy of analysis and further exploration.

#### **10.4 Housing Sector Lending Policies**

The preferential interest rate law/program for low-income borrowers discussed earlier in the report is likely to have long-term implications for lending policies and therefore deserves closer review.

There is some debate about whether the preferential interest rate program has the distortionary effects of an interest rate subsidy. All parties interviewed in Panama (the banks, the project implementation officer for the HG, the former banking commission director) seem to feel that the program is a worthy one and without the subsidy, housing would be unaffordable to the low-income segment of the population. The program's existence has been justified on the grounds that this segment of the population does not file income taxes and therefore is unable to deduct interest paid on mortgages from their taxes. The law has significantly expanded demand for home ownership by increasing accessibility. Advocates of the program assert that more economic activity has been generated as a result of it, government reaps a social benefit, and low-income borrowers have access to affordable housing. Furthermore, the taxes foregone are collected in other areas by way of taxing construction activity and additional profit.

Under the preferential mortgage rate law, a family can borrow about 40 percent more than it could under market interest rates. For example, a family earning \$585 per month that could buy a house worth \$15,000 at the market interest rate would now be able to buy a house valued at about \$22,000 at 6.75 percent.

The overriding question is then whether this sort of program is sustainable over the long run. Continued growth in demand spurred by the subsidy is likely to outstrip the supply of funds. Subsidies are conventionally used to assist the poorest segment of the population, however the preferential interest rate program does not operate in this fashion. The subsidy here is likely to channel funds to the higher segment of the low-income market, thus pushing those at lower levels of income out of market. The existence of the subsidy is also allowing the banks to make larger loans and developers to produce larger units than they would without the program.

One option is to administer a one-time capital subsidy that would be provided to borrowers as part of the downpayment on the house. A one-time capital subsidy would eliminate the distortionary effects associated with an interest rate subsidy. Banco General normally uses the borrowers' presentation of downpayment as an indication of the borrowers' savings track record and creditworthiness as the typical low-income borrower does not usually

possess a proven track record of creditworthiness. So if the government is helping the borrower with a large percentage of its downpayment, then the Bank is not able to gauge the borrower ability to repay its loan. The official at Banco General indicated that there is a world of difference, in terms of creditworthiness, between the borrower who presents 2 percent as a downpayment and the borrower who is able to put up 15 percent as his downpayment.

The program is still being debated, and the Banco General is willing to work with the government on it as long as it comes up with an acceptable proposal. Other options of providing a one-time capital subsidy include subsidizing infrastructure, subsidizing the price of the house (i.e. paid to the developer at the same time as the loan), or applying the subsidy as a second mortgage that the government would get back if the unit were sold or get repaid after the first mortgage is paid.

## 11 Program Relevance

The project was originally conceived in 1985 at which time the objectives stated in the USAID/LAC Bureau's FY 1985 Congressional Presentation was to increase the rate of construction of low-income housing in Central America by 25 percent by the end of 1989. The USAID/Panama's belief was that with the help of Panama's private sector, this goal would be met before 1989. There has already been a significant increase in the production of low-cost housing in Panama under previous housing guaranty programs.

As stated in Section 1 of this report, the HG was put on hold because of the instability and not reactivated until 1991.

At the time this evaluation was conducted, interviews with Project implementation officer in USAID/Panama Mission and review of the current USID Panama Action Plan indicate that HG-014 falls out of the scope of the Mission's current action plan (1996-1997) and strategic objectives.

The principal justification for the USAID/Panama program is to facilitate the transfer of ownership, control and operation of the canal to Panama. Based on justification, strategic objective one is centered upon strengthening civilian government institutions and encouraging greater citizen participation as a way to strengthen confidence in Panama's ability to operate and maintain the canal and associated territories in the year 2000 and beyond. The other strategic objective is to protect the canal watershed and other natural resources threatened by deforestation and other environmental destruction.

USAID/Panama has clearly stated in its Action Plan for 1996-1997 that it will no longer target Broad-Based Economic Growth as a Specific Objective. It will, however, "continue in a modest way to facilitate Panama's effort to dismantle trade barriers as well as its efforts to encourage private investment".

USAID/Panama views the HG as a side activity and refers to the “Increased Availability of Low-Cost Housing” as a “target of opportunity” in its current Action Plan. It is an activity that is essentially off the books.

The program does contribute to furthering economic growth, one of the current development strategies supported by USAID, by providing increased opportunities for large numbers of people to participate in the formal financial sector, thus permitting them to contribute to as well as benefit from national economic growth.

## 12 Lessons Learned

USAID housing programs, using HG funds, are capable of reaching large number of families below the median income level by financing mortgages to creditworthy borrowers.

There is a diminished content of policy reform in non-sovereign projects and therefore leverage, as a tool to further policy goals of the program, may have to be exercised in other areas of the program. An example is to maximize the leverage of borrower contributions resulting from the dollar transaction.

Private sector financial institutions are unlikely to continue to participate actively in low-income lending programs, unless they are able to tap long-term sources of funds.

## 13 Recommendations

**Streamline and Revise Administrative Processes for obtaining project approval and review mortgage registry procedures to reduce the time it takes mortgages to be registered.**

It is important for the Mission to work with public regulatory agencies on capacity building in these areas for continued participation of the private sector lending institutions and developers in low-income housing programs.

**Develop New Financial Market Instruments and Programs**

RHUDO/Guatemala or USAID/Panama should consider sponsoring a workshop that brings experts together to share lessons learned in resource mobilization, explore potential funding sources, including ways of accessing long-term debt from international capital markets.

**Explore the option of Developing a Secondary Market Facility**

The technical assistance funds that remain under the project should be used to hire outside expertise to conduct feasibility study for developing a secondary market institution or wholesale facility to provide long-term liquidity to Panama's private retail financial system.

**Move forward with disbursing HG funds remaining under the Program.**

Once Congressionally-mandated restrictions on pre-credit reform loan borrowings are removed, the mission should press forward with the Program.

## **ANNEXES**

**List of Contacts**  
**ANNEX 1**

---

1. Banco Continental, Vicente A. Pascual, Investment and Trust Officer.
2. Banco General, Francisco Sierra, Vice-president of Treasury  
and Miguel Preciado, Project Manager
3. Banco Del Istmo, Luis Cucalon, Manager/Consumer Division  
and Berta Martinez, Deputy Manager/Consumer Division
4. Banco FEDPA, Arcinio Rios, Deputy Manager
5. The Private Asset Management Co., Mario de Diego Jr., Vice-president
6. USAID/Panama, Felipe Frederick, Project Manager
7. USAID/Panama, Joe Carroll, Chief/Office of Democratic Governance
8. RHUDO/Guatemala, Ronald Carlson, Director
9. ECONOPLADE, German Ruiz, Director
10. ECONOPLADE, Javier Cardoze, President

List of Documents Consulted  
ANNEX 2

---

1. USAID/LAC, “Panama: Project Paper Supplement: Private Sector Low Cost Shelter”, (525-HG-013) Washington D.C. 5/28/91.
2. USAID “Implementation Agreement Among Panamanian Mortgage Banks and the Administrator and the United States of America for Private Sector Low-Cost Shelter”, Project 525-HG-013, 4/14/92.
3. USAID Project Implementation Letters (PIL 1 -5)
4. USAID/ Panama “Panama Action Plan 1996-1997”, March 1995.
5. USAID/LAC, Panama: Project Paper: Private Sector Low Cost Shelter” Project, 525-HG-013, 10/15/86.
6. Banco General, “Schedule of Mortgage Loans Presented to Administrator in Request for Disbursement” 11/1/94.
7. RHUDO/Guatemala, “History and Results of USAID Housing and Urban Programs”, September 1994.
8. USAID/Panama, “Statement of Work for Program Management Advisor”. 9/30/91.
9. USAID/Panama, “Financial Status Report”, 1/31/96.
10. Mission Semi-Annual Reports on the HG.
11. Mission Project Files (memos, reports)