PD-AAQ-013
ISN 36767

UNCLASSIFIED

CLASSIFICATION

PROJECT EVALUATION SUMMARY (PES) — PART I

1. PROJECT TITLE	2. PROJECT NUMBER	3. MISSION/AID/W OFFICE
PRIVATE SECTOR SHELTER PROGRAM (EMERGENCY HOUSING PROJECT)	522-HG-007	Tegucigalpa

4. EVALUATION NUMBER (Enter the number maintained by the reporting unit e.g., Country or AID/W Administrative Code, Fiscal Year, Serial No. beginning with No. 1 each FY)

☐ REGULAR EVALUATION ☐ SPECIAL EVALUATION

5. KEY PROJECT IMPLEMENTATION DATES

A. First PRO-AG or Equivalent FY 81

B. Final Obligation Expected FY N/A

C. Final Input Delivery FY 87

6. ESTIMATED PROJECT FUNDING

A. Total $ 25,075,000

B. U.S. $ 25,075,000

7. PERIOD COVERED BY EVALUATION

From (month/yr.) 9/81

To (month/yr.) 9/84

Date of Evaluation Review 10/84

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

A. List decisions and/or unresolved issues; cite those items needing further study. (NOTE: Mission decisions which anticipate AID/W or regional office action should specify type of document, e.g., airgram, SPAR, PIO, which will present detailed request.)	B. NAME OF OFFICER RESPONSIBLE FOR ACTION	C. DATE ACTION TO BE COMPLETED
8. Actions		
Authorize the borrowing of the remaining $10 million of the $25 million program, if the following conditions are met:	LEE HOMO	By Nov. 30, 198
1. The GOH has demonstrated its institutional and financial support for FINAVI by:		
a. developing a financing plan to provide for FINAVI's continued operation and permit it to meet its debt obligations, including the repayment of the first Housing Guaranty loan;		
b. assisting FINAVI by requiring the purchase of core housing units by other GOH institutions such as INVA, INJUPEN, and INPREMA which have waiting lists of eligible beneficiaries; and		
c. obtaining Congressional approval of the issuance of the GOH guarantied, tax-exempt bonds for FINAVI or other method of refinancing.		

9. INVENTORY OF DOCUMENTS TO BE REVISED PER ABOVE DECISIONS

☐ Project Paper ☐ Implementation Plan e.g., CPI Network ☐ Other (Specify)

☐ Financial Plan ☐ PIO/T

☐ Logical Framework ☐ PIO/C ☐ Other (Specify)

☐ Project Agreement ☐ PIO/P

10. ALTERNATIVE DECISIONS ON FUTURE OF PROJECT

A. ☐ Continue Project Without Change

B. ☐ Change Project Design and/or

[X] Change Implementation Plan

C. ☐ Discontinue Project

11. PROJECT OFFICER AND HOST COUNTRY OR OTHER RANKING PARTICIPANTS AS APPROPRIATE (Names and Titles)

Elmer Lizzardo, Executive Director, FINAVI
Marcial Flores, Financial Director, FINAVI
Ricardo Acosta Pinto, Director of Operations, FINAVI
Lee Homo, Assistant Director for Central America
Joe Lombardo, Housing Officer, RHUDO/LA

12. Mission/AID/W Office Director Approval

Signature [illegible]

Typed Name

Anthony J. Cauterucci

Date

AID 1330-15 (3-78)

2. FINAVI has demonstrated its ability to provide effective and dynamic leadership to coordinate the project implementation process by:

   a. establishing a separate implementation unit for the Emergency Housing Program with sufficient authority to insure decisive and timely decisions are made regarding the implementation of the project;

   b. establish a separate accounting for the Emergency Housing Program and for its other activities;

   c. authorize a strategy to divest itself of the remaining units in the program, including specific plans:

      i. to implement an aggressive marketing plan along the lines suggested by Dr. Arenas in his report (attached);

      ii. to develop a contingency plan to auction unmarketable sites and units;

      iii. to present other eligible mortgages held by FINAVI in lieu of waiting to sell all units in the five original projects under this program;

      iv. to implement an aggressive sales effort as projected and document the physical construction program underway so that AID can reinstate Planeta as an eligible project;

      v. pursue institutional block sales of the units as discount prices to public and private entities; and;

      vi. develop cash-flow projections to reflect the sales and refinancing strategy.

3. Summary

The Private Sector Shelter Project (522-HG-007) was developed and authorized in 1981. The $25,000,000 Housing Guaranty program was to establish a functional system for expanded private sector involvement in the provision of shelter affordable by the urban poor in Honduras. Additional funds, $75,000 for technical assistance and the lempira equivalent of $817,500 in local currency generations, were also provided. The Project was conceived to support a part of a larger effort, initiated by the GOH and known as the Emergency Housing Program (EHP), to deliver 25,000 low-cost units over a several year period. The implementation of the AID project was originally projected to construct 6,721 units; but was later cut back to the current target of 6,291 when delays and changes in GOH policies resulted in higher construction costs. Elementary schools are to be constructed on each project site with the local currency funds and $1,000,000 of the HG.

The implementation of the Project is a year and one-half behind schedule as of September 30, 1984. Presently, the construction is complete on 66% of all units originally planned and only 12% of the units have not been started. However, only 41% of the units planned have been sold. The major implementation problems have been: (1) changes in GOH policies regarding subsidy of the land development costs, with concomitant increases in sales prices resulting in reduced demand; (2) improper site selection procedures and project design whereby vertically integrated private sector suppliers, developers, and finance institutions were able to unload idle land and materials without having to accept appropriate market risks; and (3) FINAVI's failure to insure that the contracts between the private sector and that institution were structured adequately to protect FINAVI in the initial contracts, and later, the lack of effective and dynamic leadership to deal effectively with the resultant problems of implementation. If the evaluation recommendations regarding the management of FINAVI and the marketing of the units are implemented, then the revised outputs could be realized by March 1987.

School construction will begin soon on four of the five sites, but a legal dispute between the developer and the GOH over the land for the fifth school has prevented a timely construction start.

Due to project design errors, such as poor site selection and the size of each sub-project, this project has proved slow in implementation and costly to the GOH. The Project has, however, contributed greatly to realization of the Project goal of providing access to new or improved shelter to the urban poor of Honduras by: (1) the sheer size of the construction effort, which when completed, will represent nearly 27% of the low-cost units available between 1980 and 1987 to low-income families in Honduras; and (2) the demonstration effect of the potential of the private sector to produce low-cost units in large quantity over a relatively short period of time, which has resulted in greater GOH commitment to mobilizing the private sector for such purposes.

As of September 30, 1984, 20,400 persons have received new units under the Project and an estimated 6,900 person years of direct and indirect employment have been generated. It is expected that by the end of the Project, some 34,600 persons will have benefitted from improved shelter conditions and nearly 11,800 person years of direct and indirect employment will have been generated.

The major unplanned effect of the Project has been the negative impact the program has had on the financial position of FINAVI. The financial failure of FINAVI could seriously impede the functioning of a viable FHA and secondary mortgage market in Honduras. Furthermore, this failure could reflect negatively on AID and the HG program, by association with the EHP, resulting in private sector reluctance to participate in future programs for low-cost shelter. This would be unfortunate, especially since the experience of this Project has resulted in more adequate project design in the 522-HG-008 Project, whereby the private sector will carry the entire risk from the site development through the marketing of the units. This change in project design from that of the current HG-007 Project will force the private sector to respond appropriately to private market conditions.

The major recommendations to improve the implementation of the current Project are: (1) greater GOH financial and institutional support for FINAVI; (2) the implementation of a plan by FINAVI to provide the initiative and leadership to insure flexible and timely decision-making during project implementation; (3) the implementation of an aggressive marketing plan to assist FINAVI divest itself of the EHP at the earliest possible date.

14. Evaluation Methodology

The evaluation had been planned for some time, especially in light of the sales problems encountered in the Project. It was scheduled to take place after FINAVI met the sales goal set by AID for July 1, 1984. Its purpose was to take stock of the implementation process before permitting FINAVI to go ahead with the second borrowing of $10 million to complete the program. The work on the evaluation was begun in September 1984 with the arrival of RHUDO marketing expert Valentin Arenas, and financial consultant, Frank Connor. The marketing consultant and RHUDO visited all the project sites and interviewed all the sales agents and key personnel of both the savings and loan associations and FINAVI, as well as the board of directors of the latter. The financial consultant worked with FINAVI's director and staff to develop financial analyses of the impact of the options open to FINAVI. The timing of the evaluation, at the very time of the imminent loss of FINAVI's capital, prompted an intense internal evaluation within FINAVI itself.

The consultants concentrated their efforts on the sales problems and recommendations to facilitate the marketing efforts as well as the financial implications of the recommendations. To accomplish their task, the consultants worked with FINAVI, the savings and loan associations, and the sales agents. To provide an objective viewpoint, the final evaluation report was prepared by Joe Lombardo from the RHUDO/LA office in Panama based on the work of the two consultants, FINAVI's response, and his own analysis. Guidance and supervision for the evaluation was provided by RHUDO/ROCAP and the Mission.

15. External Factors

Several factors have combined to affect adversely the progress of the implementation of the Project. First, there was a change in GOH policy regarding the development costs of the infrastructure and building permits. Initially, the sub-projects to be developed under the Emergency Housing Program (EHP) were to be exempted from building permit fees and taxes. The major utilities were to be provided by SANAA and ENEE at little or no cost to the developers. These cost savings were to be passed on to the purchaser in the form of lower sales prices. When the current administration of the GOH took office in 19[illegible], however, this policy was reversed. As these cost increases took place during a period of continued economic decline in Honduras, and combined with project design problems such as poor site selection and overbuilding in the San Pedro Sula area, they resulted in reduced effective demand for the houses.

Second, the GOH failed to provide some of the interim financing promised to FINAVI and delayed in authorizing refinancing of FINAVI's debt to the central government. The Mission Director twice intervened at the highest levels of the GOH but only now has the Executive Branch of Government recommended a bond issue to the Honduran Congress. The Central Bank has now refinanced FINAVI, but the Ministry of Finance has not formalized its assistance in meeting FINAVI's obligations.

Third, the structure of at least part of the private sector and its relationship to FINAVI under this program resulted in ineffective marketing strategies and resultant delays in sales activities. The private sector institutions involved in three of the five sub-projects, for example, are characterized by vertical integration through interlocking directorates among suppliers, builders/developers, and the savings and loan associations. While RHUDO imposed objective inspectors protected against obvious construction fraud, this situation nevertheless resulted in potential conflicts of interest and allegations of misappropriations of funds advanced by FINAVI to HONDUCAS, the principal developer of these three sub-projects. Apparently HONDUCAS was using the advances to pay off its creditors, many of whom had substantial interests in HONDUCAS. In the case of the sub-project Planeta, representing nearly 25% of the total units to be constructed by the Project, the situation with HONDUCAS resulted in a construction stoppage of over a year, until FINAVI forced HONDUCAS to sign the project over to FINAVI to liquidate HONDUCAS' debt.

Fourth, neither the S&Ls nor the developers were required to pay for interest on the 80% construction financing, while FINAVI was required to repay an interim loan of $5,000,000 from the Central Bank at 9% interest to pay interest on the HG advance of %7,500,000, and to provide guarantees to pay suppliers for construction material advances made by them to the developers. This has resulted in interest payment obligations by FINAVI of up to 19%, with no commensurate interest income from private sector sub-borrowers. The current debt obligation by FINAVI to Banco Continental alone is approximately $4.25 million as of September 30, 1984. The savings and loan developers have had a lack of incentive for the private sector to rectify construction, site, or marketing problems. As the GOH's EHP was originally designed, the problem would have been even worse, as 100% construction financing was contemplated. The situation in the case of Planeta, representing 25% of the program, became serious enough to force AID in 1982 to declare the sub-project ineligible for AID HG financing until the situation was corrected. To date the project is still ineligible. These conflicts of interest and lack of private sector risk in the program resulted in poor site selection in all three of the projects involving HONDUCAS (Planeta, San Jorge and La Mora II) which together represent nearly one third of the entire program. These initial site and construction errors resulted in poor sales and promotion, with more than 90% of the units unsold in each of these three sub-projects. The HONDUCAS unsold units represent 46% of the total of completed units.

A fifth factor has been positive for FINAVI. Project design required that the savings and loan associations accept the credit risk and mortgages insurance through FINAVI's FHA program. Although FHA protects against total loss, the two associations involved are experiencing sufficient losses on houses which cannot easily be resold to motivate them now in late 1984 to see themselves as partners with FINAVI in the effort to liquidate the inventory. While this evaluation did not review credit policy, the large number of mortgages requiring foreclosure in the San Pedro Sula area cannot be explained as a result of a sloppy application of credit standards. Rather, it seems to be a consequence of the current economic situation in this area which has caused breadwinners, including project beneficiaries, to lose their employment.

Finally, in the face of the above problems, FINAVI has not demonstrated sufficient leadership to act in a timely and appropriate manner to rectify the problems. FINAVI has been slow to act, and then only with continued prodding by AID, to promote the sales activities of the sub-projects. It has taken nearly two years for FINAVI to reach the point of meeting AID's conditions to reinstate Planeta. In addition, only after AID threatened to withdraw its participation in the EHP, did FINAVI take action such as reduced sales prices on the less desirable sites, installment payments for downpayments, and graduated payment mortgages, which resulted in FINAVI being able to reduce its unsold inventory by one-half within four months. However, FINAVI's failure to act decisively at an earlier date has virtually bankrupted the institution.

16. Inputs

The basic inputs for the Project as described in detail in the Summary include a $25,000,000 Housing Guaranty loan to provide the long-term financing for the program, technical assistance, a GOH counterpart, and local currency generations approved in September 1984.

The construction activities were initiated with an interim loan, $5,000,000 repayable at 9% interest over six months, by the Central Bank to FINAVI in March 1981. Subsequently, this debt has been rescheduled to provide for a fifteen year repayment with a three year grace period. With these funds construction began in May of the same year on the first 2,500 units. By the time of PID submission, over 4,500 units were under construction in San Pedro Sula.

The magnitude of the construction effort and the lack of long-term financing led FINAVI to request assistance from AID in June 1981. The HG was authorized on September 29, 1981 and the Implementation Agreement signed on October 15th of the same year. The Loan Agreement was signed on December 31, 1981, at which time $15,000,000 were contracted. In January 1982 the first disbursement took place, with cumulative disbursements amounting to $12,470,319 and $2,494,666 remaining in the escrow account as of September 30, 1984. All disbursements have been consistent with the Implementation Agreement. The Implementation Agreement specifies that FINAVI should set up separate accounts for the EHP; separate books exist, but not in a form which permits the analyses provided by standard accounting practice. It is recommended that this be accomplished as soon as possible, with AID technical assistance if required.

The pace of disbursements has been constrained only by the slowness in sales, and the failure of FINAVI to meet all of the required conditions for AID to reinstate the eligibility of Planeta. The contracting of the remaining authorization of $10,000,000 has been conditioned on assurances that FINAVI will be capable to implement the remainder of the program. That FINAVI is able to respond appropriately to the market conditions of the Project is demonstrated by the fact that, after AID threatened to close out its involvement in the Project, FINAVI was able to come up with marketing strategies sufficient to reduce its unsold inventory by one-half within a four month period. However, to prevent a recurrance of the previous state of affairs, conditions precedent to the second borrowing should include evidence: (1) of GOH financial and institutional support for FINAVI; and (2) that FINAVI is able and willing to provide the initiative and leadership required to insure flexible and timely decision-making to promote implementation of the Project.

All of the HG fee-income funded technical assistance has been completed, and all indications are that it has contributed significantly to improving the project implementation process. Specific technical assistance was provided in the areas of marketing, financial and technical project management, institutional management, and information systems development. There are still technical assistance needs, however, especially in the areas of computer software. Moreover, technical assistance may be required to assist FINAVI in setting up an implementation unit for the EHP.

17. Outputs

Progress in achieving the output targets for the Project has been very slow. The original PACD was to be March 15, 1983. After more than double the original life of the project, only 65% of the units are completed and barely 41% have been sold (see Table I).

TABLE I

PROJECT OUTPUT STATUS
(number of units)

SITE	PLANNED UNITS	FINISHED UNITS	UNITS SOLD	UNITS UNSOLD
Planeta	1,520	1,008	158	1,362
Satelite	2,359	1,733	1,569	790
C.A.O.	1840	829	807	1033
San Jorge	278	278	25	253
La Mora II	294	294	24	270
Total	6,291	4,142	2,583	3,708
Percent	100.00	65.84	41.06	58.94

As indicated by the data in Table II, Planeta, San Jorge and La Mora II have the greatest concentration of unsold units. Although San Jorge and La Mora II only account for 9% of the total planned units, they together represent over 14% of the unsold units to date. If Planeta is included in the analysis, then together these three projects account for one-third of the total planned units; but their unsold units represent 50% of all unsold units. On the other hand, Satelite and Centro America Oeste represent 38% and 29% of the 6,291 planned units, respectively; yet, their unsold units only amount to 21% and 28% of the total unsold units, respectively.

TABLE II

UNSOLD UNITS BY SUB-PROJECT
(percentage of units)

SITE	OF TOTAL PLANNED FOR SUB-PROJECT	OF TOTAL UNSOLD UNITS (3,708)	OF TOTAL PLANNED FOR PROGRAM (6,291)
Planeta	89.61	36.73	21.65
Satelite	33.49	21.31	12.56
C.A.O.	56.14	27.86	16.42
San Jorge	91.01	6.82	4.02
La Mora II	91.84	7.28	4.29
Total	72.42	100.00	58.94

The major problems with meeting the implementation targets are related to the validity of project design assumptions concerning the effective demand for the units, changes in GOH policies that affected the sales price of the units, the depressed Honduran economy, and the lack of effective leadership in FINAVI to deal appropriately with the issues. A general discussion of these implementation problems is found in the section on External Factors, above.

To promote further implementation of the program requires an aggressive and flexible marketing strategy as well as effective leadership in FINAVI and strong GOH support for the program. For marketing efforts to be successful, it will be necessary to reduce prices further for units in hard-to-sell sites, such as San Jorge and La Mora II; arrange for convenient public transportation to San Pedro Sula from the more remote sites; complete infrastructure to prevent flooding for those projects built on flood plains; provide more flexibility in the graduated payment mortgages by lowering the initial interest rate and thereby making the monthly payments more attractive; provide financing for additions to the basic units to widen the market appeal of the projects, etc. When some of these options were tried earlier in 1984, FINAVI was able to reduce substantially its inventory of unsold units. However, FINAVI will have to improve its management of the marketing efforts of the private sector by insuring that all contracting of firms is on terms that permit FINAVI to reward successful marketing efforts, and to cancel contracts where the results are unsatisfactory. Moreover, FINAVI has already begun to seek institutional buyers to be able to sell the projects or portions of them in blocks. Although no deals have been finalized as yet, these efforts should be encouraged to dispose more rapidly of the unsold inventory.

The main reason for individual and institutional sales not producing better results has been the high cost of the units relative to their effective demand. A deal is near closing on 180 units in La Mora II with Cementos de Honduras, now that the FINAVI board of directors has authorized a price reduction consistent with the weak market demand. Even after a reduction in the sales price for the San Jorge units, however, demand still has not materialized. The sales agent, Inversiones Hondurenas recently withdrew from the sales effort until an even lower sales price can be negotiated with FINAVI. A written contract with Inversiones Hondurenas as the sales agent for Planeta is pending a market demand study on that project. These issues can only be resolved by effective and decisive leadership in FINAVI.

To promote the marketing effort, Dr. Valentín Arenas, the marketing consultant, recommended an initial sales offer with substantially reduced prices and more favorable interest rates for a three or four month period to test the market response. The financial consultant's analysis of the impact of the EHP on the financial condition of FINAVI indicates that an acceleration of sales, even at lower prices and interest rates, will have less of a negative impact on FINAVI than holding the inventory for future sale at full cost. It is even questionable whether without an aggressive and concessional promotional campaign, some of the projects would sell at all. FINAVI plans to present to A.I.D. other eligible mortgages already held by that institution in lieu of a portion of the units in the original five sub-projects.

If the recommendations made by Dr. Arenas are followed, it is expected that the sales targets indicated in Table III can be met. This would imply that the EHP could be closed out by March 1987. Since the projections are based on individual sales, it is possible that the sales effort could be accelerated if institutional buyers could be found. However, the eligible mortgages would still have to be presented for discount by A.I.D. Should the sale of the units continue to stagnate even at greatly reduced prices, FINAVI must be prepared to unload the units at auction.

TABLE III

SALES TARGETS FOR EMERGENCY HOUSING PROGRAM

SITE	SALES PER MONTH	NUMBER OF MONTHS
Planeta	50	27.24
Satelite	74	10.68
C.A.O.	74	13.96
San Jorge	10	25.30
La Mora II	20	13.50
Total per month	228	

All five schools had been bid as of September 30, 1984. The Ministry of Finance has elected to use the funds provided from local currency generations first. However, the issuance of the orders to start construction was delayed when the director of the school construction unit was fired on September 28th, and the Office of Budget required a request to establish a new budget line item for the local currency generations to be submitted by the inexperienced new director. The bid on the fifth school expired when the Procuradora of the GOH refused to permit payment for the land for the school. Municipal ordinances require a land set-aside for schools and other community facilities. As of this date, the matter is in court.

AID's technical assistance efforts have resulted in improved technical and financial control systems being implemented within FINAVI. Short-term training was provided in Puerto Rico for 12 FINAVI employees in FY83. In FY84 short and long-term training offered by A.I.D. was initially given approval by FINAVI. Due to the required commitment of funds required for continued salary payments and travel costs, however, FINAVI was not able to take advantage of the AID training offer in FY84. The Chief of the Finance Division went to Puerto Rico to earn an M.B.A. with a specialty in finance but returned when he discovered that the Puerto Rican coordinator of A.I.D.'s training activities was not able to offer graduate training in Spanish as requested by A.I.D. More recently, efforts have been made to institute a management-by-objectives system at FINAVI. However, this effort will require some follow-up technical assistance, at least on an informal basis by AID, to insure its implementation.

18. Purpose

The purpose of the Project is to establish a functional system for expanded private sector involvement in the provision of shelter affordable by the urban poor in Honduras. While the private sector has demonstrated the capability of producing a large number of units in a relatively short period of time, this has not translated into a sustainable delivery system. The specific indicators of purpose accomplishment in the Project Paper will probably be met by the end of the project in 1987. However, these production indicators will not reflect the development of an adequate system which could continue with new projects, given new resources.

The private sector, having been exempted from most of the risks in the program, has not suffered substantially because of the delays it has caused in both construction and marketing. The nature of the contracts between the developers and savings and loan associations has resulted in nearly 100% of the risk in the program being transferred to the public sector.

At this stage of the project implementation it is too late materially to alter this situation. If procedures had been followed to provide for appropriate technical and financial controls to ensure good site selection, unit design, and control of funds with the private sector having to carry its share of the risk, then the project would have resulted in an effective delivery system for low-cost housing. The project has, however, clearly demonstrated that the private sector is able to mobilize quickly resources for production in quantity.

19. Goal

The goal of the Project is to provide access to new or improved shelter to the urban poor of Honduras. It was expected that the Project would contribute to the production increase of 300% per year in the number of new housing units available to the urban poor. While exact annual figures are not available at this time, and it is unlikely that the 300% figure has been reached, the Project has certainly contributed to a substantial increase in the number of units available.

Table IV demonstrates the impact of that the Project will have on the production of new low-cost shelter in Honduras over the life of the Project. Overall, the Project is estimated to represent nearly 27% of all new low-cost construction, and 32% of all recent AID new construction projects. Moreover, the impact of the AID program is evidenced by the contribution of the Housing Guarantee financed projects for low-cost shelter solutions in Honduras, representing 85% of all new construction. When upgrading programs are included, AID programs represent over 95% of all low-cost shelter solutions in the country (see Table V).

TABLE IV

Estimated Contribution of the Project to New Low-Cost Shelter in Honduras: 1981-1988

Program	No. of Families Reached	% of Total Families Reached
522-HG-007	6,300	26.93
Other AID	13,600	58.14
Other GOH	3,400	14.92
Total	23,390	99.99

TABLE V

Estimated Contribution of AID HG-Financed Programs to Low-Cost Shelter Solutions in Honduras: 1980-1987

Program	No. of Families Reached	% of Total Families Reached
AID	65,390	95.06
Other GOH	3,400	4.94
Total	68,790	100.00

Notwithstanding the failure of the Project to produce a sustainable private sector delivery system, the demonstration effect on the production side has contributed to the GOH continuing its support for private sector low-cost housing developments. This continued interest is evidenced by the support given to the private sector component of the 522-HG-008 project development process and the increased reliance of the public sector institutions like INVA on private sector production of housing.

20. Beneficiaries

As of September 30, 1984 the Project has benefitted 3,708 below median income families, by providing them access to improved new shelter. With an average family size of 5.5 persons per family, there are nearly 20,400 direct beneficiaries of the Project. Approximately 2,300 persons years of direct and 6,900 person years of indirect employment have been generated by the construction activities. By the end of the project, 6,291 low-income families will have benefitted, representing 34,600 direct beneficiaries through improved shelter conditions, and 3,900 person years of direct and 11,800 person years of indirect employment benefits will have been generated as a result of the the construction activities.

The direct beneficiaries of the shelter have been provided access to improved shelter at affordable prices. Prior to this Project, below median income families had few options for acquiring improved new housing. They either had to wait for a unit to be made available by the public sector institutions such as INVA or attempt to construct the house themselves. Since the public sector has traditionally not been able to deliver sufficient units to meet even current demand, the waiting period for a house produced by that sector could span several years. Contract or self-help construction has often meant that the unit might not be served adequately by basic infrastructure and/or public services and facilities — eg. bus service, proximity to schools, etc. — due to the location of the lots. Moreover, all the units purchased under this program carry with it a clear and free title to the property, on a lot with sufficient space to expand the unit as the beneficiary's resources permit.

21. Unplanned Effects

The major unplanned effect of the Project has been the negative impact it has had on the financial condition of FINAVI. FINAVI has responsiblity to pay on all of the long- and short-term debt obligations under the program, amounting to 80% of the costs of construction (plus the interest due on the capital borrowed until conversion of the interim financing to long-term debt paid by the mortgagors.). Due to the structure of the contracts between FINAVI and the private sector on the one hand (construction financing to the private sector at 0% interest to be converted to long-term mortgage financing by FINAVI upon sale of the unit), and the structure of the debt on the other (an estimated 11% on the variable rate HG loan, 9% to the Central Bank, and 19% to Banco Continental and other creditors), FINAVI has been experiencing consistent and severe losses over the life of the project. Within the first couple of weeks of October 1984, FINAVI will have exhausted 100% of its capital, leaving it in a state of virtual bankruptcy.

While FINAVI has made great strides over the last six months to divest itself of the unsold inventory of completed units, the financial burden of its having to continue to carry thousands of as yet unsold units has crippled the institution. Even the formal and informal relief provided to FINAVI by a restructuring of its current debt with the Central Bank, INJUPEN, and Banco Continental, and the informal grace period on the HG loan as the Ministry of Finance assumes all the payments without enforcing collections from FINAVI have not been sufficient to maintain a minimum level of equity in FINAVI. Moreover, even though CONSUPLANE, the Central Bank and the Ministry of Finance have approved the issuance of government-guarantied, tax-exempt bonds for FINAVI, the Honduran Congress is yet to pass the measure.

The lack of timely GOH support for FINAVI during its financial crisis led to several years of interim financing dependent on 19% loans, construction delays, and a collapse of internal decision-making. Delays by FINAVI's Executive Directors in obtaining authorization to adjust sales prices and mortgage rates, as well as the authority to negotiate institutional sales of blocks of units, combined to exacerbate the financial burden on FINAVI. Unless immediate and substantial relief is provided by the GOH to FINAVI, its future participation in shelter activities in Honduras is very much in doubt.

If FINAVI should go under, it will also reflect back on AID and the Housing Guaranty Program, especially since the HG-007 Program is the direct cause of FINAVI's current financial crisis. The spector of a major institution going out of business and the association of that failure with major AID financing could seriously impair AID's credibility in the country. Although AID was not responsible for the initial structure of the program, it did accept and approve the site and unit designs for the projects already under construction as well as the inter-institutional structure of the financial side of the transaction. This project was already underway at the time the GOH urgently requested A.I.D.'s support and the record shows that A.I.D. was aware that marketing would be a problem. The technical assistance offered, however, was not sufficient to overcome some of the other unanticipated factors described above. It appears that the financial structure of the program was deliberately obscured by FINAVI's Executive Director at the time. The contractual documents never specifically state that interim financing will be provided at 0% interest, but instead refer to a Board of Director's resolution which again refers to another document which delegated the decision to FINAVI's Executive Director.

Moreover, the failure to rescue FINAVI will seriously impede the functioning of a viable FHA and secondary mortgage operation in Honduras. These functions have become vital to the continued operations of the savings and loan system. Due to the lack of liquidity in FINAVI, it has been unable to discount mortgages held by the savings and loan associations. This has in turn placed severe limits on the liquidity situation in the associations and impairs their ability to continue originating new mortgages. Due to the impact of the EHP on FINAVI, this program has practically paralyzed FINAVI's other operations.

Furthermore, the failure of FINAVI could have consequences for the future involvement of the private sector in low-income housing production and marketing in Honduras. Should this failure be interpreted as a sign of the danger to the private sector of doing business with AID and/or the GOH in the low-cost housing sector, then it could impede the implementation of the newly authorized 522-HG-008 program as well as potential future projects with the private sector. Therefore, every effort should be made by AID to insure that FINAVI does not merely survive; but that a restructuring and recuperation plan is put in place to insure that it will again become a credible player in the shelter sector in Honduras.

22. Lessons Learned

Many of the problems associated with this Project can be attributed to the haste and political nature of its development. Had the GOH developed a housing program based on sound criteria of site design and selection in accordance with principles of effective market demand, then many of the technical problems encountered in implementation would not have materialized. However, the program was designed essentially by the GOH apparently with regard only to the political impact that the rapid construction of thousands units would have on the image of the GOH in an election year to stimulate employment and provide the poor with access to low-cost housing. While these motives are not the problem per se, the failure to temper the political expediency with sounder project design criteria and feasibility analyses could have avoided the current disaster at FINAVI, as well as the potential damage to the images of the GOH, AID, and the private sector participants in the program.

A.I.D.'s involvement in the project added several important design changes and controls which have limited the losses by FINAVI. A.I.D. required: (a) developers to put up 20% of the total construction value and that they receive this payment only upon the sale of the unit by the private sector; (b) independent inspection; (c) the savings and loans to take the credit risk.

The design elements which turned out to be critical in this project and which A.I.D. has already taken into account in design of new projects are: (a) the dangers of government provided construction financing; (b) weak markets which no amount of technical assistance can fundamentally improve, and; (c) the potential of very large projects to exaggerate any project design weakness, especially when a single project dominates the entire market in a given area.

A Project was to develop a functional delivery system. Such a system should consist of appropriate distribution of both the costs and the benefits, with sufficient risk-taking to insure that all parties live up to their responsibilities under the scheme. We have learned that it is not sufficient merely to define the roles of the participating institutions, if no incentives exist to insure the smooth meshing of responsibilities and actions.

In the case of this Project, the vertical integration of the private sector supply, developer, and finance firms in conjunction with the minimal risk involved to these firms, mitigated against the efficient operation of private market forces in San Pedro Sula. The suppliers and developers originally viewed the project as a means of turning a profit on idle capacity (land and material), without regard to the marketability of the product or the site. The savings and loan associations were only to act as financial intermediaries with responsibility for sales, but none of the risks. The private sector developers, however, did have to wait before receiving 20% of the production price of each unit, payable only upon registering of the mortgage.

However, the private sector was not required to carry the financing costs of the interim loans made available as construction advances. This combined with the vertical integration of the private sector permitted the suppliers, for example, to advance construction materials to developers, owned by the same interests, without assessing their capacity to repay, as FINAVI was required to guarantee repayment. By the same token the developers were able to construct the units on their own land did not but need to worry about their marketability, since again FINAVI was required to pay the full cost of the interim financing.

Since by the time AID entered the picture the actual construction was already under way in the first three projects, it was too late to undo the damage that would ensue from the prior bad decisions by the private sector to locate projects on sites that have since proven to have low effective demand. It should also be noted that vertical integration did not lead to similar results in Tegucigalpa, and that therefore the results in San Pedro Sula are not inevitable. However, the danger posed by potential conflicts of interest in making critical decisions that affect the outcome of a project is indeed real.

Thus, while the institutional roles had been fairly well defined in this Project, the structure of the relationships did not require that the private sector assume the full risk of the construction financing and marketing of the units. If this had been incorporated into the original project design, before AID involvement, then it would have more likely resulted in the private sector taking measures to insure that the sites and unit designs would be marketable and the Project's purpose would have been realized. It is noteworthy that in the newly authorized 522-HG-008 program, the private sector will be required to provide the interim financing, build the units and market them before take-out financing will be provided. Thus, the program will put the burden on the private sector to insure that such structural problems in the operation of the private market —such as vertical integration— don't interfere with economic efficiency criteria in the implementation of the new project.

23. Recommendations and Conditions to Guaranty of Borrowing

Given the history of the program the poor rate of sales, and FINAVI's financial condition, we consider that all parties to the decision to go ahead with this borrowing should have certain guaranties that the management of the completion of the project will be more successful than in the first years of the program. Neither the Government of Honduras, FINAVI, or A.I.D. will benefit if the project is kept alive only to absorb more time and more resources. Below are expansions on the rationale for the primary conditions precedent to the borrowing of the $10 million.

Sales Strategy

All have agreed for months that prices must be lowered to promote sales. FINAVI has restructured the monthly payments and achieved an increase in the sales in all the projects, but the results must be substantially improved. In the project "Ciudad Planeta" a further decrease in the price and/or the initial interest rate will provide a basis for a more successful rate of sales. For La Mora II the decrease recommended by FINAVI's staff should be approved and should be applied in such a way so that INVA's sales terms and conditions offered to the public and FINAVI's are identical.

For the project San Jorge an auction is recommended. While this project could perhaps be sold in the normal way (and the option could be kept open if the auction offers are too low), the expenses of selling this project over many months and the special transportation which would have to be arranged will quickly eliminate any margin between the sales price which could be realized immediately at auction and a higher price realized over a period of years.

If the auction offers are judged too low, the San Jorge sales price should be set substantially below L6,000 to promote rapid sales and minimize sales expenses. Price reductions must be complemented by implementation of the sales strategies previously recommended.

Quick Decision-Making and Follow-Through

FINAVI is an institution which has been swamped by the scale and the complexity of the problems of this program. Its top managers are unable to do justice to their first responsibilities in the supervision of the savings and loan system, the proper operation of the FHA which should be the backbone of the system, and the discount of mortgages and to the management of the Emergency Housing Program. Rather FINAVI itself is now the emergency.

We recommend establishment of an Implementing Unit with the support of the administration and board of FINAVI to provide flexibility and follow-through in the administration and completion of this program. With support from one or two other professionals and a secretary, the Director should have delegation of authority from the board and President to make the following decisions:

- To reduce the monthly quota by up to 15% by reducing the financial terms and/or price.

- To commit funds up to a maximum amount of L10,000 to directly or indirectly promote sales by providing transportation, physical improvements to the projects, or advertising.

- To negotiate and approve sales contracts.

He shall report immediately on his financial commitments to FINAVI's President and shall provide a written report weekly on sales progress to the President.

A member of this unit with financial and accounting expertise shall support his activity as well as implementing the next recommendation:

Separate Accounting

Separate records exist for the Emergency Housing Program, but only estimates can be made of the damage it has done to FINAVI as a financial institution. Separate accounting must be established and should be established as well for other cost centers with priority given to FHA.

Financing

FINAVI cannot survive without additional financing. The investment in the Emergency Housing Program can be turned around through sales to provide monthly income, but only if FINAVI has the security of sufficient income to permit its daily operations to continue, including payment of sales commissions and of its own staff. The Ministry of Finance must present a financing plan which provides for FINAVI's continued operation as well as satisfaction of FINAVI's foreign debt. FINAVI's continued failure to promote sales has increased the deficits and outright losses projected by A.I.D. almost two years ago, but an even larger debt will become the Government's responsibility if an orderly completion of the program is not permitted. If this option is not attractive, A.I.D. would recommend immediate auction of the unsold inventory of houses.

The above five recommendations we regard as the minimum to permit a responsible additional A.I.D. investment of $10 million in this program. If these conditions are not acceptable to the Government of Honduras, an immediate auction could produce mortgages which could be discounted with A.I.D. in the next 180 days.