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Proposed Reorganization Scheme
for the
Ecuadorian Housing Bank (BEV)
and
Housing Finance in Ecuador

A Study Commissioned by the
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Acronyms

ANME	Asociación Nacional de Mutualistas del Ecuador
BEV	Banco Ecuatoriano de la Vivienda
CRH	Corporación de Refinanciamiento Habitacional (proposed)
IEOS	Instituto Ecuatoriano de Obras Sanitarias
IESS	Instituto Ecuatoriano de Seguridad Social
JNV	Junta Nacional de la Vivienda
MIDUVI	Ministerio de Desarrollo Urbano y Vivienda
RHUDO/SA	Oficina Regional de Vivienda y Desarrollo Urbano para S.América
URH	Unidad de Refinanciamiento Habitacional del MIDUVI
USAID	Agencia de los EE.UU. para el Desarrollo Internacional

Abbreviations and Equivalencies

m	millions	
S/	Sucres	
US$	Dollars	(S/2,250 per US$)
UVC	Constant Value Unit	(S/13,600 per UVC)

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Proposed Reorganization Scheme for the Ecuadorian Housing Bank (BEV) and Housing Finance in Ecuador

Since my previous report on a "Proposed Organization Scheme for The Ministry of Urban Development and Housing and the Housing Sector in Ecuador" the Government of Ecuador (GOE) and the Ministry (MIDUVI) have implemented important measures of sectorial restructuring. Among these, the following merit highlighting.

- Enactment of a "Law for State Modernization, Privatizations and the Rendering of Public Services through Private Sector Initiatives".
- Enactment of a "General Law of Institutions in the Financial System".
- Enactment of a "Securities Market Law".
- Establishment --within the securities market law-- of a Constant Value Unit (UVC).
- Formulation by MIDUVI of a "National Policy for Urban Development, Housing and Environmental Sanitation".
- Subsumption within MIDUVI of the previously independent National Housing Agency (JNV) and the Ecuadorian Institute of Sanitation Works (IEOS).
- Consolidation within the Superintendency of Banks of supervisory functions over the Home Loan Mutual System previously entrusted to BEV and the JNV.
- Privatization of mortgage life and related lines insurance coverage on loans by the BEV.
- Establishment of a Home Refinancing Unit (URH) within BEV and the initiation of its operations to refinance mortgages written by mutuals, cooperatives and other financial intermediation institutions.
- Undertaking of studies for the establishment of a system of Direct Subsidies for Housing Demand.

At the same time and as a first step in adapting to the instituted reforms and to the new sectorial objectives, BEV has dedicated itself to improving its internal organization and its economic-financial situation. In this regard, it has already attained important achievements with measures to reduce its personnel, to refurbish and clean up its assets, and to sell certain lines and investments not directly related to the objectives of the institution. But, notwithstanding, it is evident that, considering the short time elapsed and the inherent difficulties concerned, there still remains a lot to be done for a total optimization of BEV and Ecuador's major sectorial objectives.

In this report, various available options and the more apparent solutions to complete the sought for reforms are analyzed.

Secondary Market and Mortgage Securitization

Plans to set up a Mortgage Refinancing Corporation (CRH) in collaboration with private sector financial entities are well advanced. To this effect, in discussions with the corresponding project promoters, the convenience and opportunity of adopting the following scheme were agreed to.

- Private financial entities (banks, mutuals and cooperatives) will contribute to CRH a minimum of 60% and BEV a maximum of 60% of an initial capital of US$ 5m, maintaining an equal proportion on future increases.
- BEV, with charge to its USAID HG-007 loan funds, would immediately lend to CRH the available balance of approximately US$ 5m and later the additional US$ 25m yet to be contracted for. BEV would make these loans to CRH, for a relatively long term (10 to 15 years) and at market rates in UVCs.
- CRH, with the HG-007 funds received on loan from BEV, would issue take-out commitments to buy individual mortgage loans written for the benefit of qualifying families purchasing the urbanized lots currently owned by BEV. These take-out commitments should serve to encourage the granting of necessary construction loans by commercial banks and of the corresponding mortgage loans on home sales by these same banks and other first-floor lenders.
- CRH would start by warehousing the mortgages acquired with its own funds and BEV loans for a prudent period (12 to 18 months) in order to establish a good payment record as a primary step toward securitization.
- To securitize CRH mortgages, this corporation should be enabled to set up separate portfolios for each group of mortgages being securitized, in order to preclude the losses of any one portfolio --or in CRH's own capital-- from contaminating the remaining portfolios. This should be obtainable through simple legislative reforms designed to facilitate the establishment of special securitizing corporations (the Chilean model being available as an example). Otherwise, CRH would have to find a way of securitizing its mortgages by using separate mutual investment funds as vehicles for each securitized portfolio.
- CRH's own capital, whether invested in mortgages or in marketable income securities, would serve to "over-collateralize" the CRH securities representing the securitized mortgages which, as a result, should attract the highest risk ratings in the market.
- Servicing of mortgages acquired and securitized by CRH would remain entrusted to the respective originating financial institutions.
- Profits would accrue to CRH principally from the spread between the mortgage interest rates and those of the corresponding securities.

Restructuring BEV

Currently, BEV continues to operate in a variety of roles. Principally, it acts as:
- urbanizer/developer, builder and seller of homes;
- financier of other developers and builders;
- first-floor mortgage lender;
- second-floor mortgage lender;
- savings accounts recipient;
- insurer of various risk lines; and
- manager of Assistance Centers for Social Housing.

Although concentration in a government agency of this plethora of roles typically corresponding to the private sector may be deemed not to coincide with the objectives of the previously referred to State Modernization law and with those of MIDUVI's new policy paper, its continuance is being justified as a temporary measure pending a further definition and materialization of the greater reforms planned for BEV.

But there is no doubt that such a multiplicity of functions and activities requires a diversity of specializations difficult to obtain in one institution alone and rarely controllable by a single management. What's more, in BEV's specific case, various of these functions are mutually conflictive and even exclusive. Therefore, a first fundamental decision still pending will be to redefine BEV's institutional character and the scope of its activities.

Several options can be considered to improve the operations and efficiency of BEV, while at the same time assuring fulfillment of the social housing sector's objectives.

BEV as a Housing Producer

BEV, both because of historical circumstances and as a consequence of the demands imposed upon it within the public sector, has developed as an institution primarily oriented to the production of houses. Its banking functions as savings recipient and loan granter are directly related to this productive activity. Such is so that the general public identifies BEV as the originator and provider of housing solutions more than as a financial institution. And, inevitably, BEV's own structure, administration and personnel could not remain alien to this reality. Bu were BEV to retain this role of developer and housing producer it would not only contradict the reforms propounded by the GOE but would also be limiting its preferred development as a financial institution.

MIDUVI's recent statement on a National Policy for Urban Development, Housing and Environmental Sanitation clearly describes the limitations and failings of government interventions in the direct production of housing and rejects this role for BEV. We cannot be more in agreement. But this document admits of a "transition period" during which BEV could continue to produce houses subject to certain improvements of method and substance. And this has allowed BEV to implement a new program called "Select your Home" which has undoubtedly met with success in its limited objective of building and selling homes on BEV owned land for preselected individual buyers.

Nonetheless, it must be recognized that this leaves BEV, as builder and seller, fully exposed to the subsequent claims and defaults (justified or otherwise) which normally accompany projects directly carried out by government agencies. More in tune with the new sectorial objectives would be for BEV to proceed without delay to relinquish all housing production activities, selling its holdings in this area to the private sector and leaving to it all the risks inherent in the real estate business.

In fact, BEV could sell around 909 lots immediately and another 15,455 lots within a reasonable time frame if, in the program proposed with the CRH, it were to lend to it the required funds out of: its USAID and IDB lines; its recoveries from lot sales (e.g. US$3,500 per lot); and from the buyers' down-payments (e.g. US$1,000 per house); as follows:

	Immediately	Short term	Total
HG-007	5,000,000	25,000,000	30,000,000
IDB		60,000,000	60,000,000
Lot sales	3,181,000	54,095,000	57,276,000
Down payments	909,000	15,455,000	16,364,000
Total resources US$	9,090,000	154,550,000	163,640,000
No. of Homes	909	15,455	16,364

With this, BEV would get rid of almost all its housing lots and any remainder could be easily liquidated. As to the requirement that land sold by BEV be used exclusively for social housing (with an estimated maximum price per house of US$10,000), this could be assured by making it a mandatory condition of the land sale and of the subsequent use of mortgage financing.

The preceding projection does not take into account other resources that may be generated by: (a) the proposed system of subsidies to the demand of needy families; (b) the savings accumulated as a pre-condition to such subsidies; (c) the securitization of mortgages by CRH; and (d) the example which could find an echo in other financial institutions. Any of these would accelerate and increase the financing available for mortgage lending and, consequently, would serve to reduce BEV's contribution to this lot sales program, leaving it better placed to develop an open banking activity on behalf of lower income families.

BEV as a Financial Institution

Once relieved of its role as a housing purveyor, BEV could restructure itself as the veritable financial institution that its name implies. For this, it will have to choose whether to operate as a first or a second-floor bank.

Although at one time it was thought that BEV could assume the responsibility of developing a secondary mortgage market, we believe that a role of primary financier would be more appropriate to present circumstances. On one hand, the need for a securitizing vehicle and secondary market development for the corresponding securities will be met with better prospects by the proposed CRH, now that the private sector has manifested its interest therein. On the other hand, BEV has sufficient resources and the necessary vocation to meet a national need for which the private sector is not yet prepared (at least until its profitability can be usefully demonstrated), which is the provision of mortgage loans for lower income families. BEV already has the required infrastructure to act as a first-floor bank, especially as regards its branch network which caters to the savings and loan needs of its particular client base. And, finally, with its new Home Refinancing Unit the BEV has an adequate vehicle to develop wholesale financing and refinancing activities for other private sector institutions making mortgage loans to lower income families (banks, mutuals, cooperatives and other possible demand organizers).

Summing up, BEV has the possibility of conducting a constructive role in the promotion of mortgage credit for the lower income sectors, both directly and indirectly as a support and example for other private sector institutions. And although it still suffers from limitations of an organizational nature and of definition in its objectives and goals, as well as financial and administrative, all of these are surmountable in the short term to the extent that existing reforms are deepened and remaining ones implemented.

BEV as a Privatizable Institution

Once BEV's objectives have been defined as stated above, there should be no insurmountable impediment to obtaining BEV's operational and financial recovery (assuming the freedom to act free of political and bureaucratic pressures). And once this recovery is attained it would be feasible to think of BEV's partial or total privatization.

Principal aspects conducive to BEV's recovery include:

- Conversion of its managerial staff and personnel towards a banking culture, eliminating the current focus on housing production. A future measure of BEV's success should be the attainment of its sectorial development goals and the profitability of its operations; not the (limited) number of housing units produced.

- A detailed evaluation of all offices and branches, with a view to liquidating or discontinuing those that are not fully justifiable.
- A return to the GOE of the foreign exchange risk in HG-007. This was originally the responsibility of the Finance Ministry and was transferred to BEV by private agreement between the parts. Although BEV could somewhat diminish this risk while lending in UVCs, its permanence will always represent an undesirable exposure.
- A total adaptation to market rates in its interest rate policies, both on assets and on liabilities.
- A realistic appraisal of all its assets to market values, allowing an adequate evaluation of their real returns and to ensure a fair recovery in the case of their eventual sale.
- A full recovery of its loan portfolio, which currently stands more than 50% delinquent. The discounts offered in recent months as an inducement to paying off delinquent loans should be continued until reaching a full updating of the portfolio, at the very least covering all loans over one year delinquent. Other measures to be considered are: (a) effective collection efforts and foreclosure of guarantees on all loans not taking advantage of the discounts offered for payment of remaining balances; and (b) full write-off of all unrecoverable loans (which are currently only partially provided against).
- Continue the sale of assets and business lines unnecessary to BEV's new objectives. These should include the insurance lines not yet relinquished or clearly canceled (respectively relative to mortgage risks and to deposit insurance in the Mutual System) and the unsold shares in Selva Alegre cement and other similar investments.

Other Adjustments to the Housing Finance System

Mutuals - The new Financial Institutions law greatly expands the range of activities allowed mutual savings and loan associations, empowering them to pursue innumerable financial operations not directly related to mortgage lending. It would be appropriate to link (by regulation as far as possible) the tax and other advantages currently enjoyed by these associations to their continued contribution to meeting Ecuador's social housing needs.

Subsidies - A policy of support to lower income groups to help them acquire their homes by a program of direct subsidies to the demand, such as is currently being studied by the GOE, apart from the multiple advantages described in my previous above-referenced report, will permit an important accumulation of resources by way of the prior savings required to qualify for the subsidy. If we estimate the down-payment required for the purchase of a US$10,000 home at 10%, we can anticipate that on average there will normally be in savings accounts US$500 (half the estimated down-payment) for each applicant to the subsidy, or US$ 5m for every 10,000 applicants. These savings, accumulated in the financial institutions freely chosen by applicants themselves, will make an important contribution to the availability of resources for housing finance in the country.

Pensions - Another important source for increasing the availability of long-term resources for mortgage financing (and particularly for the securitization of mortgages) is to be found in the investment requirements of a well structured pension system (as per example the AFP system implemented in Chile). To this effect, the measures which the GOE may adopt to reform the IESS system will be of paramount importance.
