

HOUSING SECTOR SUPPORT PROGRAM

(EC-0138)

EXECUTIVE SUMMARY

BORROWER AND GUARANTOR: The Republic of Ecuador

EXECUTING AGENCY: The Ministry of Urban Development and Housing (MIDUVI)

AMOUNT AND SOURCE:

IDB:	US\$32.0 million (OC)
	US\$30.0 million (FSO)
Local counterpart funding:	US\$ 6.6 million
Total:	US\$68.6 million

FINANCIAL TERMS AND CONDITIONS:

	<u>OC</u>	<u>FSO</u>
Amortization period:	25 years	40 years
Disbursement period:	4 years	4 years
Grace period:	4 years	10 years
Commitment period:	3 years	3 years
Interest rate:	variable	1% in first 10 years, 2% thereafter
Inspection and supervision:	1%	1%
Credit fee:	0.75%	-
Currency:	US\$ Sing. Curr. Fac.	Local currency

OBJECTIVES: The main objectives of the program are to help improve housing conditions for low-income groups, make public housing expenditure more efficient and equitable, and provide incentives for commercial financial institutions and the private building industry to become involved in the housing sector.

DESCRIPTION: Ecuador has a severe housing shortage and many substandard dwellings, particularly in low-income areas. A solution to these problems will require heavier private-sector involvement, but the current legal and administrative framework offers little incentive for private businesses to work in this sector. There are constraints on financing, and low-income families have trouble paying for housing. The core components of the proposed program will focus on these three problem areas, deploying sustainable public-intervention mechanisms that can help build an efficient housing market and boost the stock of low-cost housing.

The four program components will be as follows:

1. Modernization of housing legislation and housing-sector agencies (US\$1.75 million): The aim of this component is to foster changes in the regulatory environment for the housing sector and its public institutions. It includes: (a) fostering regulatory changes to bring down the cost of formal housing solutions, namely: (i) easing national and local minimum infrastructure and building standards for property development; (ii) lowering the up-front tax cost for low-cost housing solutions; (iii) simplifying the titling and recording of properties in poor areas of cities; and (iv) providing technical assistance to municipalities to help adjust standards and titling and property recording procedures; and (b) technical assistance and institutional strengthening for MIDUVI and civil-society providers of technical support.
2. Deepening the supply of mortgage credit (US\$750,000). To assure that the proposed program will be successful, this component will finance technical assistance to help transfer know-how to intermediary financial institutions (IFIs) taking part in the program, so they can bring in credit technologies suitable for low-income housing finance. Specifically, it will: (a) help devise and implement housing finance policies in IFIs to take account of the needs of low-income borrowers; (b) train middle managers, such as heads of loan departments and branch managers; (c) train loan officers in credit management for low-income clients; and (d) help defray equipment and start-up costs of new bank branches or offices that open in areas convenient to the low-income target population. The sum of US\$600,000 has been budgeted for these activities.

Consulting support also will be provided for the Compañía de Titularización Hipotecaria [Mortgage Securitization Corporation] to devise and implement its business strategy. This will take the form of transfer of experience of similar mortgage loan securitization corporations and those offering bonds on the secondary market. The budget for these consulting services is US\$150,000.

3. Boosting the demand for housing (US\$57 million). Financing will be provided for a Housing Incentive System (SIV) that takes due regard of household income, the cost of housing, and a family's ability to come up with funds of its own, including savings and borrowings. The subsidy may be used to obtain a new dwelling or improve an existing one.

Funds allocated to the SIV for housing improvements (about 30% of the total subsidy funds) will be used to pay for improvements to existing housing in established poor neighborhoods that already have essential public utilities. The subsidy may be used to legalize lot ownership, hook up to public utilities, and improve or replace the housing unit itself. Applicants eligible for the housing-improvement subsidy will be those with under US\$240 a month in household income. SIV funds for new homes will finance about 23,000 new low-cost housing solutions worth US\$11,000 equivalent or less.

Although the SIV will be implemented, coordinated, and monitored by MIDUVI, other stakeholders also will play important parts: the municipalities, IFIs, construction companies, and civil-society organizations working in the housing sector.

4. Promotion, administration, and monitoring of the program (US\$4 million)
 - a. Promotion (US\$1 million). A special effort will be needed to properly promote the innovative program proposed herein, to make certain that it is well publicized in different quarters and to elicit the participation of the agencies envisaged. To this end, a "targeted social marketing" plan is being developed, with information programs and media campaigns directed to the target population, mainly through radio spots, press and printed notices, and direct-targeting promotion efforts.
 - b. Administration (US\$2.75 million). These funds will be used to hire staff for the Program Coordination Unit and pay for additional personnel, purchase equipment, and defray the operating costs of the regional executing agencies.

- c. Monitoring (US\$300,000). Consultants will be hired with these funds to evaluate the core elements of the program, including: (i) subsidy system targeting; (ii) private-sector participation (commercial banks, real-estate developers, NGOs); (iii) transparency of the SIV; (iv) progress made on regulatory changes; and (v) the program's environmental monitoring system.

**THE BANK'S
COUNTRY AND
SECTOR STRATEGY:**

Among the objectives pursued by the Bank in its Ecuador country strategy are to help reduce poverty and create conditions for strong, lasting growth. The program described herein is in line with that strategy, seeking as it does to improve living conditions of the poorest households and make for more efficient public spending in the housing sector. As will be indicated in the loan proposal, the program also is consonant with the objectives set out in the revised housing policy (OP-751) approved in 1995. According to that policy, the Bank's programs should help: (a) improve housing conditions for low-income populations; (b) improve public-sector efficacy in the sector, and (c) promote the development of efficient housing markets.

**ENVIRONMENTAL
AND SOCIAL IMPACT:**

The executing agency produced and published an environmental report with recommendations for the environmental management plan for the program, which was sent to the Public Information Center (PIC) on October 3, 1997. An environment and social impact report was produced and presented to the Bank's Environment and Social Impact Committee/Technical Review Group on October 31, 1997 and forwarded to the PIC on November 4, 1997. The team has built the CESI recommendations into the Operating Regulations and contract covenants for the project (see paragraphs 4.14 and 4.15)

BENEFITS:

The main benefits of this program will be as follows: (a) more efficient public spending in the housing sector, as indirect subsidies are replaced by direct, demand-based subsidies, and the private building industry and commercial financial institutions become more involved in low-cost housing; (b) more equitable public spending on housing, as a result of the design of the SIV and its targeting mechanisms; (c) higher numbers of low-income people with legally owned lots and low-cost housing solutions and, hence, with basic utilities and access to credit, through the SIV and the changes sought under the legal and institutional framework modernization component; and (d) a deeper mortgage finance market.

RISKS:

The chief risks identified are as follows:

1. Macroeconomic conditions. If high inflation rates persist and earnings continue to decline, the effective demand for housing solutions under the program could weaken. The aforesaid factors would make it more difficult for prospective program beneficiaries to save enough for a down payment, or severely erode their ability to pay.
2. Implementation capacity. Successful execution of the proposed program will hinge in part on MIDUVI's capacity to set in place the planned Housing Incentive System (SIV). Because this is a mechanism new to Ecuador, there could be some implementation delays, and differences in applying the program's rules. This risk is being countered by setting up a Program Coordination Unit and by the type of institution-strengthening activities envisaged. Furthermore, many of the main program tasks may be entrusted to private agencies and organizations, IFIs, and specialized firms subcontracted for the intake and processing of applications. MIDUVI's role as executing agency will be primarily to coordinate and oversee – both of which duties it can handle with its existing functional structure.
3. Commercial bank participation. The success of the program also will depend greatly on active involvement of commercial banks. Since the income of the prospective beneficiaries might make banks reluctant to lend to them, the program includes technical assistance to bring in appropriate lending technologies. This also will reinforce the catalytic function of the rediscount program arranged with Corporación Financiera Nacional. And, lastly, MIDUVI will approach leading financial institutions to encourage them to work as IFIs with the program.
4. Participation of the Ecuadorian Housing Bank (BEV). If commercial banks are to become actively involved in this program, it is essential that BEV lending activities not distort the market. Accordingly, there will be a requirement that BEV charge interest rates at least as high as the weighted rates of institutions taking part in the program or institutions offering similar products on the market. The repayment times of BEV loans may not be longer than the weighted amortization terms of loans made by institutions taking part in the

program or lending to the market. Nevertheless, there is a risk that BEV might not be restructured and might continue to pursue lending policies that in the past have entailed explicit or implicit interest-rate subsidies. To counter this risk, the loan contract will contain conditions regarding BEV's participation after December 1998. Also, as was noted above, there will be incentives to encourage commercial banks to become involved.

5. Availability of long-term housing finance. On the matter of long-term credit available from the Mortgage Securitization Corporation (CTH) there are two possible risks for the program. First, the CTH's anticipated impact might not make itself felt quickly. Second, there could be delays in carrying through broad finance-sector reforms, particularly the overhaul of pension funds and insurance companies. This would slow the development of a housing loan refinancing system and take away from the system's overall success.
6. Political risk. The present interim government has carefully laid the groundwork for the new SIV and for fostering commercial bank and building industry involvement in the housing sector and pushing for changes in the sector's regulatory framework. However, the proposed operation would be carried through with a new administration in office, with the concomitant risk that this same measure of political support might not be forthcoming in the near future. The progress that is expected to be made on setting the operating arrangements in place in the coming months, while the present government is in office, should allay that risk, in light of the impetus the current efforts have given for continuation of the operation and its ultimate success. Furthermore, since the MIDUVI technical team that worked with the Bank in developing the program will also be the core of the Program Coordination Unit (PCU), the transition to the implementation phase should be a smooth one.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

Conditions precedent to the first disbursement:

- a. Selection and hiring of PCU staff (paragraph 3.1).
- b. Submittal of at least three participation agreements signed with IFIs (paragraph 3.4).

- c. Development and dissemination by MIDUVI of proposed new minimum urban land-use standards (paragraph 3.11).
- d. Terms of reference and start of arrangements to hire an international consulting firm to provide technical assistance to the IFIs (paragraph 3.12).
- e. Opening of a housing finance rediscount facility in Corporación Financiera Nacional (paragraph 3.23).
- f. Entry into effect of the Operating Regulations (paragraph 3.24).
- g. Opening of accounts required for the planned financial-management arrangement (paragraphs 3.31 and 3.35).

Conditions to be satisfied in the course of the program:

- a. Terms of reference for the consulting firm engaged to promote the program (paragraph 3.13).
- b. Changes to the Operating Regulations (paragraph 3.24).
- c. Analysis of BEV's situation in December 1998 (paragraph 3.29).
- d. Annual reviews (paragraphs 3.41 and 3.42).

**POVERTY-TARGETING
AND SECTOR CLASSI-
FICATION:**

The poverty line for an Ecuadorian household in 1997 is roughly US\$240 equivalent a month. Poor families thus would comprise over half the households that would benefit from the proposed program. Specifically: (a) 30% of the SIV resources will be allocated to the program to improve housing in poor city neighborhoods, for which one eligibility criterion will be monthly household income of US\$240; (b) the 40% of SIV funds for new housing will subsidize housing solutions costing US\$7,000 or less, which families in the bottom income deciles will be able to afford; (c) the method devised to score applications and decide on beneficiary eligibility takes account of families' needs, not just their saving and borrowing efforts; this will help ensure that the lowest-income families living in the worst conditions will benefit most from the program; and (d) low-income families stand to benefit directly from the planned changes in the housing sector's

legal and administrative framework, as more of them will gain legal title to their lot and access to basic utilities and low-cost housing.

**EXCEPTIONS TO
BANK POLICY:**

None.

PROCUREMENT:

International competitive bidding will be required for the procurement of goods for the program worth more than US\$250,000. No threshold has been set for construction contracts because there are no plans for direct financing of construction work in the program.

I. BACKGROUND

A. The macroeconomic setting

- 1.1 After a successful stabilization process pursued from 1992 until 1994, Ecuador's macroeconomic performance began to fall back in 1995, in a climate of uncertainty and weakened confidence. Inflation climbed, growth slowed, and investment slipped below the level of previous years. The situation worsened in early 1997, making for an annualized rate of inflation of 31% in the first half of the year. These developments can be traced mainly to the widening fiscal deficit, lack of consistent economic policy, and uncertainty triggered by the unexpected change in government in February 1997.
- 1.2 The new administration, which has been given an 18-month mandate, has focused on political reforms to strengthen the country's future governance. On the economic side, the administration is seeking to tame inflation and narrow the budget gap, cut down on tax evasion, and achieve growth rates on the order of 3% for 1997 and 1998. 1/

B. Urban housing

- 1.3 The rapid urbanization of Ecuador's population in recent decades echoes trends elsewhere in Latin America. In 1974, 41% of Ecuadorians lived in cities; by 1990, this figure had risen to 55%. Urban concentration rates are particularly high in metropolitan Quito and Guayaquil, which are home to over 52% of all urban dwellers in the country; but mid-sized cities, notably in the Coastal area, are also growing more quickly than the national average. By the year 2000, as heavy flows from the countryside to the city continue, over 80% of new homes will be in urban areas.
- 1.4 As urban housing demand soars, mostly on the part of low-income families, municipalities are finding that they cannot keep up with the demand for public utilities, nor can the formal housing sector produce all the housing units needed. There is a serious shortage of housing solutions, and too many units in the existing housing stock are substandard. 2/ Since 1990, the formal housing sector (private and public sectors combined) has been able to supply only

1/ IDB, draft country paper, September 1997.

2/ According to the Ministry of Urban Development and Housing, there was a housing deficit of about 540,000 units in 1990, counting both the shortfall in units available (265,000) and the number of substandard dwellings (275,000). Today, the overall deficit is estimated at about 840,000 homes. Overcrowding levels in urban areas are high for the region: 5.76 people per household along the Coast, 6.36 in the East, and 5.05 in the Sierra.

41%, on average, of all homes being built, virtually all of them for middle-income and high-income groups. The gap between the number of new homes required and what the formal sector can produce has been made up by makeshift structures which, between 1990 and 1996, accounted for 59% of all dwellings built each year, most of them occupied by impoverished families in marginal urban areas.

- 1.5 Ecuador, like other Latin American countries, has seen its cities swell as squatters have moved in. It is estimated that squatter settlements account for over 70% of all land occupation. In virtually every case, the process is an organized one: typically, families pay a "fee" to the organizers to form part of the squatters' move; they then frequently pay more money to be able to hold onto their spot and gain access to basic utilities. In the next phase of the process, after squatters have resisted the authorities' efforts to evict them, they quickly erect a rudimentary housing unit made of wood, mud, cane, and other cheap and easily-worked materials, depending on the climate and what is most at hand. Two parallel processes then unfold: families start to improve their dwellings, and group efforts begin to legalize the squatter settlements and obtain public utilities and other infrastructure.
- 1.6 Defining features of these barrios are their residents' lack of legal title to land or their dwelling, little or no access to basic infrastructure and utilities, and a proliferation of substandard housing units. According to conservative estimates, in 1993 roughly 30% of Quito's population and 60% of Guayaquil residents lived in such marginal barrios - 40% and 25% of them, respectively, on land to which they did not hold legal title. These homes are overcrowded: the average is 3.1 occupants per room in barrios in Quito, Guayaquil, and mid-sized cities along the Coast, compared with the national average of 1.55 per room in urban residences (1990 census data). As for public utility services, 76% of homes in these poor neighborhoods had electricity, 35% had potable water, 24% were hooked up to sewer systems, and 30% had trash collection.

C. Government initiatives

- 1.7 In the past, the Government of Ecuador has addressed the housing needs of Ecuadorians by way of financing and direct construction of housing solutions. In recent years, the public sector has produced 48% of the new formal housing stock, primarily through programs run by the Ministry of Urban Development and Housing (MIDUVI) and the Ecuadorian Housing Bank (BEV). The country's Social Security Administration also handled a large mortgage portfolio for its members, but in 1994 it halted its lending operations because of financial problems, associated mainly with the use of subsidized interest rates and the agency's rising operating costs.
- 1.8 MIDUVI and BEV have administered barrio improvement and sites-and-services projects since 1990; one of the sites-and-services

programs was financed by the Bank. ^{3/} Between them, these two agencies have funded the construction of 10,000 homes a year, on average, in cities and rural areas. But these programs have not benefited low-income groups ^{4/} and have given rise to a number of problems, such as high-cost housing solutions that are not always of good quality, scant private-sector involvement, high administrative costs, a politicized beneficiary selection process, poor loan-repayment performance, and destabilization of the participating agencies. BEV's tenuous situation today is in part the fruit of this policy.

- 1.9 BEV virtually suspended its lending operations in August 1996 because of its serious financial problems. The agency's new management has inherited a portfolio with a 46% arrears rate and inadequate loss provisions. Accrued interest has been accounted for as interest revenue, and real-property values have not been marked to market. As a result, the balance sheet will need to be adjusted, reducing the bank's capital by some 80%. The Ecuadorian authorities are hard at work on a plan to restructure and rescue BEV, but the government has not yet decided how the rehabilitation costs should be shouldered and what shape BEV's future business policy will take.
- 1.10 **Recent measures.** In light of the outcomes of the previous housing policy, the government has been rethinking its role and embracing a new concept of the function of public institutions and development of market mechanisms. It intends to become a **process expediter**, holding on to its influence so that markets will operate well but focusing its efforts on the poorest, and handing over financial management and construction responsibilities to the private sector. To that end, the country's 1994 urban development, housing, and environmental sanitation policy calls for phasing out, in the medium term, direct government involvement in housing finance and construction. MIDUVI would then be the institution in charge of the sector and of housing policy planning, and the door would be opened to development of the private housing market. The first steps in MIDUVI's institutional shift have already been taken, but further changes are needed so it can effectively perform its new role.

^{3/} Loan 805/SF-EC for a global urban development program (discussed in paragraph 1.26).

^{4/} See the ex post evaluation of loan 805/SF-EC regarding targeting, which will be discussed later in this chapter, and T. Persaud, *Housing Delivery Systems and the Urban Poor: Comparison among Six Latin American Countries*, World Bank, 1992. One program, supported by the GTZ, that did help low-income groups was a BEV/CAVIP barrio housing improvement initiative, which made 850 loans and provided technical assistance to poor families.

- 1.11 Another provision of the above-mentioned policy is the replacement of indirect subsidies (primarily by way of BEV lending rates) with a system of direct demand-based subsidies. This would enable the government to better target its support to the neediest groups, and invigorate the demand for housing.
- 1.12 A recent development was the creation of a public-private corporation, Compañía de Titularización Hipotecaria [Mortgage Securitization Corporation] (CTH), whose market operations will be governed by the Financial Institutions Act. The mortgage bonds it will issue, which will be traded on the stock market, will be backed by the mortgage portfolios of discounting financial institutions. It is hoped that once the CTH is fully operational the financial system will be able to offer far more medium- and long-term home finance, and that the securities market will be developed and strengthened in the process.

D. Housing-production capacity of the private sector and constraints for its development

- 1.13 Between 1990 and 1996, the private sector produced 52%, on average, of the total new formal stock of housing each year. Most private developers target a medium- and high-income clientele, building homes that would require monthly incomes in excess of US\$1,200. ^{5/} This leaves out the growing number of families earning far below that figure who want housing in the city.
- 1.14 Working in parallel with private developers are a group of nongovernmental organizations (NGOs) specializing in financing, development, and marketing of low-cost housing for the poor. Such agencies as Grupo Ciudad, Fundación Mariana de Jesús, Fundación Hogar de Cristo, Asociación Solidaridad y Acción, and Fundación Ecuatoriana Populorum Progressio have successfully organized programs to improve housing and/or build new core housing of between 18 square meters and 42 square meters for low-income families. However, the scope of their work has been limited by their modest and fluctuating funding, the bulk of it coming from foreign donors.
- 1.15 In brief: the private sector is building little affordable housing for low-income groups, and can do little to answer the growing demand from this segment of the population. Standing in the way of any change in this situation are the following main obstacles: (a) national and local real-estate development laws and regulations; (b) a dearth of credit from the financial system on terms that low-income groups can manage; and (c) the meager income of those who are looking for housing solutions.

^{5/} Incomes at this level comprise roughly the top two population deciles, i.e., 130,000 of Ecuador's 1.2 million households, according to a 1991 INEC household survey.

1. The legal and administrative framework

- 1.16 Ecuador's laws and administrative provisions are an impediment to efficient development of the real estate and land market; they drive up the cost of housing and make the legalization of unregulated settlements more complicated. Inflexible municipal ordinances as to building and site servicing standards, particularly in Quito and Guayaquil, prohibit any lot from being subdivided and sold until it has been legalized and has full utility service. Accordingly, an owner of land in the urban periphery who wants to sell lots on the formal market first has to make huge outlays to bring in public utilities that are up to rigid municipal standards, and go through a protracted procedure to make the land saleable. Meanwhile, the utility companies have a single, across-the-board standard for all development projects, thereby pushing up the cost of infrastructure in projects that should be less expensive. In these circumstances, there is little incentive for developers on the formal market to start housing developments for low-income buyers: the typical developer is not going to risk taking on a low-cost housing project, and poor families see no other solution but to start and join squatter settlements.
- 1.17 Once a property has been overtaken by squatters, the issue of legal ownership of the land comes to the fore. For the most part the titling problem falls to the municipality to resolve, through a protracted process whereby the squatters' occupancy is legalized, following a central government order decreeing the occupied land to be of municipal utility. The municipality loses in this process too: as long as squatters do not hold legal title to their property, they pay no taxes on it. Likewise, residents in squatter settlements who do not have legal title have problems in accessing utilities and obtaining mortgage financing.

2. Availability of credit from the financial system

- 1.18 During Ecuador's oil boom, the country's commercial banks played a prominent role in housing finance for the middle and wealthier classes. However, in subsequent years, the supply of long-term funding available to intermediary financial institutions (IFIs) was sharply curtailed as inflation remained high and banks had difficulty, under the terms of a law in effect until 1995, in paying positive real interest rates on deposits. In September 1996, sight deposits accounted for 49.34% of all commercial bank deposits, and only 9.8% of total deposits were for over 180 days. A mere 2.6% of all mutual savings bank deposits and 0.5% of credit union deposits were on terms of longer than one year.
- 1.19 In these circumstances, IFIs (including mutual savings banks and credit unions) were obliged to lend at shorter terms and shift their attention to consumer loans and liquidity operations. The situation finally began to turn around in 1992, when long-term

lending volumes again started to increase, as the growth in commercial bank mortgage portfolios from that year on will attest. Between 1992 and 1996, the aggregate commercial bank housing finance portfolio increased seven-fold; the April 1997 total portfolio of US\$738.6 million is higher, in absolute terms, than the figure reported for 1980. In relative terms (home loans as a percentage of total lending), mortgage lending's 16.9% share is also moving toward the 1980 percentage of 24.1%.

- 1.20 In recent years, IFIs have financed the bulk of their mortgage lending from short-term deposits. This move toward maturity transformation – the increasing readiness of banks to borrow at short term and lend at long term – is a signal of increased confidence in the country's macroeconomic prospects these past years. Nevertheless, if the public's preference for short-term deposits persists, the recent growth in mortgage lending could slow, if banks decide that the risk inherent in maturity transformation is too high. In fact, there are signs of such a slowdown in the last two years: between 1993 and 1995, the share of mortgage operations in the total loan portfolio rose by 6.54 percentage points; between December 1995 and April 1997 the increase was only 1.54 percentage points.
- 1.21 Notwithstanding the reactivation of the banks' mortgage lending business, there is still a serious shortage of long-term financing for housing, particularly for low-income clients. But this shortage of long-term funds from formal lenders is not the only reason for the dearth of home finance for borrowers of few means: the IFIs themselves have done little to target that customer segment. Institutions that do make small loans have developed no special home finance products; and those that have long-term funds to lend prefer to market their product to a middle-class and high-end clientele. Thus, most home loans are for over US\$12,000, and most borrowers are salaried employees. Since formal financial institutions know little about low-income households or their ability to pay, and have nothing in their financial-technology product menus to attend to those clients' needs, poorer families have no choice but to come up with the money themselves. It thus takes them from five to fifteen years to finish building a home, a highly inefficient way of paying for housing, and one that has any number of other negative effects.

3. Household ability to pay

- 1.22 One factor that does much to explain the lack of private-sector involvement in housing production is the low income level of vast segments of the populace. As part of the preparations for the program proposed herein, an analysis was done of housing spending patterns in 224 households in various poor urban neighborhoods in

Guayaquil, Quito, and Machala. ^{6/} Some 89% of the households examined were bringing in less than US\$400 a month; total income in 29% of them was below the minimum legal wage. They were spending between 24% and 34% of this meager income on a place to live. Their outlays ranged from US\$500 to \$3,000, usually to defray the up-front cost of taking over a small piece of land, setting up makeshift housing, and later making their dwelling more habitable.

- 1.23 The fact that these families have come up with the money for the aforesaid costs shows that they can pay, and want to pay, to improve their housing conditions, but according to the analysis done, ^{7/} they simply are not in a position to build or acquire a complete housing solution costing US\$6,000 (the cheapest alternative on the market). A family would need to earn over US\$400 a month to pay for even the most rudimentary housing unit without outside financing. In the short term, then, as long as ability to pay remains a problem for vast numbers of city dwellers, there is no possibility that private industry alone will ease the housing deficit, so this segment of the population will need subsidies.

E. Rationale for the proposed program

- 1.24 In brief: Ecuador has a growing housing deficit, in terms of number of housing units and their quality, particularly among low-income groups. The problem can only be solved with heavier private-sector involvement, but a series of impediments make that prospect unattractive to the private sector at the moment - namely, the country's laws and administrative restrictions, a shortage of financing, and the low-income population's lack of means. The main components of the proposed program, as will be explained in the next chapter, target these three faces of the problem, through sustainable government interventions that will also foster the development of an efficient market and low-cost housing solutions.
- 1.25 The first component of the program will help **streamline the institutional and legal framework of the housing market**. The regulatory framework will be improved through measures involving approval and legalization processes for real-estate development, titling, and recording of property in poor urban districts, all of which will spur the private sector to offer more housing. The second component seeks to **improve financial services for low-cost housing finance**, by way of actions to strengthen the Mortgage Securitization Corporation (CTH) and thereby enable financial institutions to refinance mortgages on the secondary market and

^{6/} *Análisis de la capacidad de aporte propio movilizable de los sectores urbano-marginales para el financiamiento de inversiones en vivienda* [Analysis of ability of poor urban households to pay for housing]. Internationale Projekt Consult GmbH (IPC), August 1997.

^{7/} Ibid.

secure long-term funds. Since funding is only one of the problems standing in the way of housing finance for low-income clients, the program also includes technical assistance to encourage commercial banks to offer mortgage financing to lower-income customers. The aim of the third program component (which will account for the heaviest investment outlay) is to build demand, through a new direct, demand-driven subsidy system. Subsidies will be targeted to low-income households which cannot afford to buy adequate new housing or improve their current dwelling, and would be unable to do so even if the financial market were deepened. The program also includes funds for institutional strengthening of MIDUVI and participating NGOs, and to help monitor the program and make in-course adjustments to its design.

F. The Bank and other agencies working with the housing sector

1. Lessons learned

- 1.26 In 1987 the Bank approved a US\$57.6 million loan for an urban development program (805/SF-EC), to fund serviced lots and provide subloans with which end-borrowers would purchase materials to build core housing units themselves, on lots financed under the program. According to an evaluation done by the Bank, the program did not attain its targets; it was heavily redesigned and part of the original program was cancelled. The following problems were identified: (a) insufficient implementation capacity of the program executing agencies; (b) flawed targeting; (c) excessively complicated tendering procedures; and (d) problems in the operation of the building-materials credit component.
- 1.27 In January 1988, the World Bank approved US\$60 million in funding for the second national housing project (2898-EC), which was completed in June 1994. This program built on two previous World Bank loan operations that were intended primarily to enlarge the stock of low-income housing and strengthen BEV and the National Housing Board (now MIDUVI). Although the program achieved many of its physical targets, it was less successful on the benefit-targeting and institutional side. One of the central findings of the final evaluation of the project matches the current IDB and World Bank thinking on housing policy: direct State involvement in the financing and construction of housing solutions is neither efficient nor sustainable, and typically ends up benefiting families whose incomes are higher than the desired target population.
- 1.28 Another international agency active in this sector in Ecuador is USAID. Its local Urban Development and Housing Office has provided considerable technical support to the government in the past seven years, to help set up the CTH, devise a new housing policy, and bring the idea of direct, demand-driven subsidization to fruition. The German agency GTZ has sponsored a successful slum renewal

program, working with the Centro de Asesoramiento a la Vivienda Popular [Low-income Housing Advisory Center] (CAVIP). Experience gained in the course of those two initiatives has been drawn on extensively in designing the operation proposed herein.

2. Other operations complementing housing programs

- 1.29 The World Bank and IDB are also working with the National Program of Support for Reform of the Administration of Justice (PROJUS-TICIA), which plans a comprehensive study of the body of laws governing real property and movable property in Ecuador. The study is to recommend reforms to modernize property-related legislation and public property registry systems and make them work more effectively.
- 1.30 The World Bank, IDB, and Andean Development Corporation have provided financing for the Ecuadorian Social Investment Fund, which seeks to assist the country's poor through such initiatives as grants for small infrastructure projects. The IDB and World Bank also have helped finance public utility infrastructure throughout the country, through their support for the municipal development program carried through by Banco del Estado; a second stage of that program is now being prepared. The Inter-American Investment Corporation is considering support for the CTH in 1998.

3. Genesis of the proposed program

- 1.31 The Bank's dialogue with Ecuador on housing sector reform dates back to 1994. It has continued through two administrations, and was taken up anew with the present interim government. The program as proposed herein, the fruit of six months of collaboration between the Bank and the government, bespeaks the high priority afforded by the present administration to setting a new housing policy in place.

4. The Bank's country strategy and housing sector strategy

- 1.32 Two of the aims of the Bank's strategy for operations with Ecuador are to help reduce poverty and create conditions that are conducive to strong, stable growth. The program described here pursues those strategy objectives, through actions to improve the living conditions of low-income Ecuadorians and help make public spending on housing more efficient. For these same reasons (as will be seen in the following chapters) the program is in line with the objectives set out in the Bank's revised housing policy (OP-751) approved in 1995. According to that policy, the Bank's programs should help: (a) improve housing conditions for low-income groups; (b) make more effective use of public resources allocated to this sector, and (c) foster development of efficient housing markets.

II. THE PROGRAM

A. Objectives

- 2.1 The main objectives of the program are to help improve housing conditions for low-income groups, make public housing expenditure more efficient and equitable, and provide incentives for commercial financial institutions and the private building industry to become more active in the housing sector.

B. Description

- 2.2 In pursuit of the above objectives, the proposed program will finance actions to modernize the legal and institutional framework of the housing market, deepen the supply of mortgage finance, and boost the demand for housing. The program's four components are described below.

1. Modernization of housing legislation and housing-sector institutions (US\$1.75 million)

- 2.3 The aim of this component is to foster changes in the regulatory environment for the housing sector and its public institutions. Specific activities are as follows:

a. Fostering changes in the regulatory framework (US\$450,000)

- 2.4 Activities planned under this heading will help bring down the cost of formal housing solutions, offering new housing alternatives to people of few means and alleviating the pressure created by squatter settlements. They include: (a) easing national and local minimum building and utility-servicing standards for real-estate developments; (b) lowering up-front tax costs for low-cost housing solutions; (c) in concert with the PROJUSTICIA program mentioned in paragraph 1.29, streamlining deeding and recording procedures for properties in poor urban areas; and (d) technical assistance to individual municipalities to bring in the necessary changes in property standards, titling, and records offices, and in procedures for securing permits to develop raw land.
- 2.5 On the basis of the sector diagnosis produced during preparation of the program, an action plan has been drawn up setting out the steps to be taken to produce the changes needed in these areas, and the consulting services required to help MIDUVI in this process. The local and international consultants needed for this work would cost an estimated US\$450,000.

b. Technical assistance and support for MIDUVI and other participating agencies (US\$1.3 million)

- 2.6 To help modernize MIDUVI operations, program funds under this component will be used to: (a) implement the planned beneficiary eligibility system; (b) design and set in place modern operations planning, management control, and environmental control systems; and (c) supplement information systems already in place. Training will be provided in each of the new systems. Terms of reference for each activity and particulars of the specific outputs sought in each case are in the project technical files.
- 2.7 Another element to be financed under this heading is a support fund upon which eligible civil-society organizations working in the housing sector can draw to better equip themselves to organize the demand for housing and provide technical support to community groups, particularly in the use of subsidies to improve housing units. The sum of US\$300,000 is budgeted for this purpose. MIDUVI and the Bank will draw up guidelines for the operation of this fund, which will be part of the program's Operating Regulations.

2. Deepening of the mortgage finance market (US\$750,000)

- 2.8 Technical assistance to be funded under this heading will help transfer, to IFIs taking part in the program, know-how on lending technologies that are appropriate for low-income families who need home finance. Specific activities planned are: (a) advisory services to IFI management to help devise and implement housing finance policies geared to clients of few means; (b) training for middle managers (heads of loan departments, branch managers, etc.); (c) training for loan officers in lending and credit management for low-income clients; and (d) subsidization of equipment and start-up costs for new bank offices that open in areas convenient to the targeted low-income clientele. The budget for this work is US\$600,000. Terms of reference for the international consulting services envisaged for this purpose are in the project technical files.
- 2.9 Other consulting services planned under this component to deepen the mortgage loan market will help the CTH design and implement its business strategy. Specifically, consultants will help transfer to the CTH what similar institutions in other countries have learned about mortgage securitization and secondary market bond offerings. The budget for this assistance is US\$150,000.
- 2.10 In parallel with the above technical assistance, funds will be available under Corporación Nacional Financiera's existing home finance rediscount facility, to give an initial impetus to long-term lending until the IFIs (through the CTH) can come up with long-term funds via the secondary market.

3. Boosting the demand for housing (US\$57 million)

- 2.11 The program will fund a Housing Incentive System (SIV) to help low-income families afford new housing solutions or improve their current dwelling. To ensure that efficient use is made of public monies expended for housing-sector development, the program will draw as much as possible on the ability of low-income city dwellers to come up with funds of their own to pay for housing. The size of the subsidy envisaged thus has been determined by reference to the saving and borrowing capacity of households that stand to benefit from the subsidy, which was gauged in a study conducted during preparation of the proposed program. 8/
- 2.12 The design of the SIV strikes a balance between the two core objectives sought in devising subsidy ranges: promotion of economic equity, and development of the housing market. On the **equity** side, since it is harder for low-income households to acquire a home of their own, the SIV specifically seeks to build demand for housing in this segment of the population. The bulk of the subsidy thus will go to households that bring in US\$400 a month or less; and at least 30% of SIV funding is to be dispensed as subsidies to households with monthly incomes of under US\$240.
- 2.13 On the other hand, if **development of the housing market** is to be fostered, demand incentives ought not to be limited to the most rudimentary housing options. In order to invigorate the market, make for dynamic growth of the housing stock, and spur a strong demand for housing solutions and financing therefor, a small share of SIV funds in the proposed program is being earmarked for measures to tap the demand for housing costing up to US\$11,000, which would be affordable for families earning US\$400 to US\$600 monthly. Including this small provision in the SIV for households falling into that income bracket is also a way of countering the risk that benefits intended for poorer families might find their way to higher-income segments of the population.
- 2.14 An eligibility system has been devised to make certain that the subsidy is targeted as planned. The selection criteria will be (a) **socioeconomic situation**, looking at income, access to basic services, social circumstances and environmental condition of the current dwelling, family makeup, and urban surroundings, and (b) **prospective beneficiary contribution**, in the form of demonstrated savings and/or borrowing; for this criterion, applicants will be scored higher if their financial package offers both savings and credit, and even higher if the package was obtained from a commercial bank.

8/ IPC study, 1997.

2.15 To allay the risk that benefits might filter upward to higher-income recipients, there will be a cross-checking mechanism in the program: since obtaining credit will be an integral part of a beneficiary's acceptance into the program, financial institutions will have to do comprehensive checks of the applicant's financial situation. These same analyses will serve as an implicit check of the information furnished by a person applying for a subsidy. This system gives applicants much less of an incentive to embellish their financial condition: typically, a person applying for a subsidy might be tempted to undervalue earnings, but for the proposed program this would be counterproductive, since the applicant will also need to qualify for a loan. This possibility of cross-checking subsidy application data against the bank's credit analysis findings will lessen the risk of mistargeting and help ensure efficient use of the subsidies.

a. Housing improvement in poor city neighborhoods
(US\$17 million)

2.16 The funding for this subcomponent (about 30% of the total subsidy budgeted) will pay for improvements to existing housing in established barrios that have the most basic public utility service. Those receiving the subsidy may use it to legalize the lot on which they live (including its purchase, if needed), utility hookups, and improvement or replacement of the housing structure itself. SIV funding for housing improvements will be restricted to households earning less than US\$240 a month.

2.17 There will be two scales of subsidies. The first, for replacement of makeshift structures, will have a ceiling of US\$1,500 - i.e., 75% of the amount eligible for subsidization in this component - and would correspond to an improvement of 18 square meters. The second scale is for spot improvements, with a subsidy of up to US\$800 (for US\$1,000 in improvements). The difference in each case (total cost of improvement minus subsidy) will be paid by the family (see Table II-1).

<p align="center">Table II-1 OPTIONS: HOUSING IMPROVEMENT OR REPLACEMENT (amounts in US\$)</p>				
OPTION	MAXIMUM COST	BENEFICIARY SHARE	GOVERNMENT SHARE	
			AMOUNT	% OF COST OF SOLUTION
Improvement	1,000	200	800	80%
Replacement	2,000	500	1,500	75%

b. New dwellings (US\$40 million)

- 2.18 About 23,000 new housing solutions will be funded under this subcomponent. They will be single-family, inexpensive dwellings, costing the equivalent of US\$11,000 or less (see Table II-2). Subsidies will be awarded to individual applicants, but recipients may pool them. The competition and selection process is described in chapter III.
- 2.19 The subsidy arrangement and ceilings were devised through an analysis of prospective beneficiaries' ability to pay, comparing this information with market prices for core housing solutions. Historical spending data were used to gauge the amount that low-income families could come up with themselves, and this was translated into a financing package of savings plus a loan. Calculations of borrowing needs were done using a comparable U.S. dollar market rate and 7.5-year repayment term, plus two years of prior savings. A second set of calculations was done using a five-year repayment term and three years of previous savings. The result was an average beneficiary contribution of roughly US\$4,600 for households earning US\$200 to US\$250 a month, US\$6,200 for those earning US\$250 to US\$350, US\$8,500 for those bringing in US\$350 to US\$500, and over US\$10,000 for those with monthly incomes between US\$500 and US\$600.
- 2.20 The gap between the money that beneficiaries could come up with personally and the cost of the different ranges of housing solutions was calculated assuming self-targeting, i.e., on the reasonable assumption that applicants from the lowest income brackets will opt for the US\$7,000 basic housing solution and those with higher incomes will choose the more expensive options. According to the calculations, a US\$7,000 solution would require a maximum subsidy of US\$2,400, so that families earning US\$200 to US\$250 monthly could afford core housing. With the subsidies envisaged, households with monthly incomes of US\$250 to US\$350 could afford a US\$8,000 dwelling and those earning US\$350 to US\$500 could acquire the US\$9,500 option. There also will be incentives for families earning between US\$500 and US\$600 to elect the US\$11,000 housing option. The subsidy thus ranges from 4.5% (for households earning the most and opting for the most expensive housing solution) to 34% (households earnings the least, and cheapest housing option).

Table II-2 CLASSES OF NEW HOUSING (amounts in US\$)					
ELIGIBLE HOUSING OPTION		FAMILY SHARE	GOVERNMENT SHARE		% OF TOTAL FOR SUBSIDIES
ESTIMATED SIZE (m²)	COST		PER FAMILY	AS % OF COST OF UNIT	
36	up to 7,000	4,600	2,400	34.3	40.0
40	up to 8,000	6,200	1,800	22.5	20.0
45	up to 9,500	8,500	1,000	10.5	7.5
55	up to 11,000	10,500	500	4.5	2.5

2.21 Equity considerations have been addressed by setting ceilings for housing units that would qualify for the subsidy, on a scale that affords the heaviest support to those earning the least. In addition, of the 70% of funds intended to subsidize new housing solutions, 40% will be for units worth up to US\$7,000 (affordable by families earning less than US\$240 a month); of the 30% balance, 20% will go to subsidize solutions costing up to US\$ 8,000, 7.5% for solutions up to US\$ 9,500, and 2.5% for housing solutions costing up to US\$ 11,000.

2.22 The Bank also is funding a program to restore Quito's historic quarter, which UNESCO has placed on the list of World Cultural Heritage Sites, but no specific housing-rehabilitation actions were built into that operation. The Municipality of Quito and MIDUVI are studying a joint initiative under which they, with support from other international agencies such as UNESCO, could help make for sustainable social conditions in the historic quarter. The program proposed herein includes some modest support in this respect, through subsidies directed at rehabilitating housing in that part of the city. MIDUVI and the Bank are to reach agreement as to procedures for this support, eligibility criteria, amounts, and other particulars, before any such subsidy is awarded.

4. Promotion, administration, and monitoring of the program
(US\$4.1 million)

a. Promotion (US\$1 million)

2.23 Given the innovative nature of the proposed program, special efforts will be needed to make sure it is well publicized in various quarters and to encourage institutions to take part. To this end, a "targeted social marketing" plan is being drawn up, which will call for: (a) development of publicity programs and arranging for their broadcast via media to which prospective beneficiaries have access, such as radio spots and direct targeting campaigns; (b) design of printed matter; and (c) hiring of

technical support services for the development and organization of participating NGOs.

b. Administration (US\$2.75 million)

- 2.24 Funds budgeted for this item will pay for staff hired for the Program Coordination Unit and additional personnel, equipment, and operating costs of the regional executing agencies. An itemized budget is in the project technical files.

c. Monitoring (US\$300,000)

- 2.25 These funds will be used to engage consultants to evaluate the core elements of the program, among them: (a) targeting of the subsidy system; (b) private-sector involvement in the program (commercial banks, construction companies, NGOs); (c) transparency of the SIV; (d) status of changes in the regulatory framework; and (e) the program's environmental monitoring system.

D. Cost and financing

- 2.26 The total estimated cost of the program, not counting beneficiaries' contributions, is the equivalent of US\$68.6 million, of which the Bank would furnish US\$32 million as an ordinary-capital loan and US\$30 million as a loan from the Fund for Special Operations. The Ecuadorian government would contribute the balance of US\$6.6 million. Table II-3 presents a breakdown of the cost and funding sources.
- 2.27 The borrower's contribution will be spread over the four years of the program, peaking at US\$2 million in year 3. Since program outlays each year will be manageable, relative to overall national annual expenditure, the borrower is expected to be able to furnish its share of the funding as planned.

Table II-3 PROGRAM COSTS (US\$000 equivalent)					
ITEM OF EXPENDITURE	IDB OC	IDB FSO	LOCAL	TOTAL	% OF TOTAL
1. MODERNIZATION OF HOUSING MARKET LEGISLATION AND INSTITUTIONS	1,550	-	201	1,751	2.6
1.1 Promotion of regulatory changes	260	-	190	450	0.7
1.2 Technical assistance and support to MIDUVI and other participating agencies	1,290	-	11	1,301	1.9
2. DEEPENING OF THE MORTGAGE CREDIT MARKET	590	-	160	750	1.1
3. BOOSTING OF DEMAND FOR HOUSING	25,300	29,700	2,000	57,000	83.1
3.1 Housing improvements	4,000	11,000	2,000	17,000	24.8
3.2 New housing	21,300	18,700	-	40,000	58.3
4. PROMOTION, ADMINISTRATION, AND MONITORING	3,847	-	203	4,050	5.9
4.1 Promotion	1,000	-	-	1,000	1.5
4.2 Administration	2,547	-	203	2,750	4.0
4.3 Monitoring	300	-	-	300	0.4
SUBTOTAL	31,287	29,700	2,564	63,551	93.0
5. CONTINGENCIES	393	-	207	600	0.9
6. FINANCIAL COSTS	320	300	3,829	4,449	6.0
6.1 Interest	-	-	3,237	3,237	4.7
6.2 Credit fee	-	-	592	592	0.9
6.3 Inspection and supervision	320	300	-	620	0.9
TOTAL	32,000	30,000	6,600	68,600	100.0
Percentage by source of funding	46	44	10	100	

E. Scale of the program

- 2.28 The program was scaled by reference to the following: (a) operational capacity of institutions comprising the implementation arrangement adopted for the program; (b) an estimate of nationwide prospects for the production of new housing stock; (c) effective demand for the direct subsidies, taking into consideration the target households' ability to save and to borrow, and the cost of eligible housing solutions. The program's scale also is considered appropriate for the type of new initiative it represents, in which a novel housing-subsidy approach will be essayed.

III. INSTITUTIONAL FRAMEWORK AND PROGRAM IMPLEMENTATION

A. Institutional framework

1. Borrower and executing agency

- 3.1 The borrower will be the Republic of Ecuador, and the executing agency the Ministry of Urban Development and Housing (MIDUVI). Activities for this nationwide program will be carried through and supervised by MIDUVI through its regional units. A Program Coordination Unit (PCU) will be set up at MIDUVI headquarters to support the regional units and keep program records and reports. As a condition precedent to disbursement of the financing, the PCU staff must have been selected and hired (in consultation with the Bank) and the PCU must be equipped for operation.

2. Other participating agencies

- 3.2 The parties most involved in the program's execution will be: (a) intermediary financial institutions (IFIs), including the Ecuadorian Housing Bank (BEV); the latter institution will take part in the initial stage of the program, with a maximum 20% share of total lending; the IFIs will take receipt of beneficiary savings and lend to beneficiaries to supplement their savings and the subsidy; (b) private real-estate developers and builders, who for the most part will build new housing units, but will occasionally do improvements; (c) civil society organizations, whether established NGOs or groups of individual consultants, who will provide technical assistance to beneficiaries and help organize the demand; (d) municipalities, which will expedite low-income housing developments by changing municipal ordinances and procedures; and (e) individual beneficiaries or groups of families eligible for direct subsidies.

B. Functions of the participating agencies

- 3.3 MIDUVI, with support from the PCU, will set basic conditions for the program, adjust them as needed, and ensure that program activities adhere to the conditions and dovetail properly. MIDUVI's principal functions will be: (a) administration and financial controls, including monthly adjustment of the program's quantitative variables to maintain real values, applying price indexes as necessary; (b) information and promotion; (c) eligibility rating and selection of beneficiaries; and (d) eligibility rating of IFIs that are prepared to participate in the program.
- 3.4 The IFIs, which may be commercial banks, mutual banks, or credit unions, will have the following functions: (a) take receipt of deposit monies from prospective beneficiaries, such savings being a

prerequisite for them to apply for a subsidy; and (b) make mortgage loans (it is hoped) which, when added to beneficiaries' own savings and the subsidy, will enable them to obtain housing. In order to take part, an IFI must satisfy the program eligibility requirements and sign an agreement with MIDUVI. As a **condition precedent to the first disbursement from the financing**, at least three participation agreements with IFIs must be presented.

- 3.5 Because it will take some time for private-sector institutions to build the required expertise, the plan is to involve BEV in the early stages of the program. But, since that bank is in the midst of change and restructuring, specific guidelines for its initial participation (until December 1998) have been drawn up, together with strict criteria that would apply should it continue to be involved after that date, which will depend on a review of its financial condition and management capacity at that time (see paragraph 3.29).
- 3.6 The **municipalities** will ease standards for low-income housing developments, streamline the permit process, and make other changes to improve the operation of the land market.
- 3.7 **Private real-estate developers and/or building firms** will build the housing solutions. Improvements are expected to be done by construction microenterprises.
- 3.8 **NGOs, other civil society organizations, and individual consultants** will provide technical support to beneficiaries on housing matters, help organize prospective SIV users and, in some cases, act as contractors and/or build housing. Some of the NGOs identified as major participants in the program are Fundación Hogar de Cristo, Grupo Ciudad, Fundación Mariana de Jesús, Fundación Habitiera, and Centro Andino de Acción Popular. The specific functions of the parties and the scope of their work will be set out in the Operating Regulations.

C. Program implementation

- 3.9 Within MIDUVI, responsibility for the program's implementation will rest with the Housing Branch, with support from the PCU and the ministry's other line units. Program activities will be carried out by nine regional offices across the country.

1. Institution-strengthening and technical assistance components

- 3.10 The program components not directly related to the subsidy plan will be carried out by MIDUVI itself, through the PCU. The PCU will hire consultants needed to monitor these components.
- 3.11 For the planned modernization of legislation and the institutional configuration, MIDUVI will head up the changes set out in the

action plan for that component. As a first step, which will be a **condition precedent to the first disbursement**, MIDUVI will finish devising and then publicize proposed new minimum standards for low-cost housing units and developments.

- 3.12 To spur commercial IFIs to join the program, MIDUVI will hire an international consulting firm, using selection criteria and terms of reference agreed on with the Bank. As a **condition precedent to the first disbursement**, MIDUVI is to present the required terms of reference, agreed upon with the Bank, and demonstrate that it has started the process of engaging the firm. The consultants will be assisted by specialized staff in the PCU.
- 3.13 A specialized firm will be hired to promote the program. It is to produce a plan for year 1 to publicize the program on two fronts. First, to prepare the way for the first subsidy competition, it will publicize the general features of the program; and as each competition is arranged, it will publicize its specific terms and conditions. Second, it will organize a targeted, ongoing publicity campaign to make the public aware of the program's social benefits, with the particular aim of encouraging the most vulnerable groups to apply. At the same time it will encourage beneficiaries to pool efforts, as a better way of tackling housing improvements. The promotional program will be reviewed each year and adjusted as necessary. Before engaging this specialized firm MIDUVI is to provide the Bank with the terms of reference for its work.

2. Investment component

- 3.14 The subsidy allocation mechanism will require transparent competition for subsidy funds, so the investment component of the proposed program is built around such competitions. Applications received in each competition will be screened, scored, and ranked for subsidy eligibility. The main elements of the project cycle envisaged in this component are described in the following paragraphs.
- 3.15 **Up-front requirement and application for subsidy.** A family wishing to join the program must open a savings account in an IFI, which will explain the details of the subsidy system. (In the course of the general information campaign the public will have learned the basic requirements and procedures for the subsidy system.) The prospective beneficiary will sign a standard contract with the IFI stating the type of housing solution desired. The contract will also state the minimum savings the applicant, if successful, will have to produce in order to receive the subsidy.
- 3.16 **Call for applications.** From time to time MIDUVI will organize separate competitions under each of which a specified number of subsidies will be awarded. Since the features of the individual competitions will vary, the program will organize a separate

publicity campaign each time, furnishing specific details in each case. This stage in the process is expected to take about 20 working days. The plan is to hold these competitions by region, to expedite the process and focus efforts. In year 1, however, a national competition will be arranged, to launch the program.

- 3.17 **Intake of applications.** Persons wishing to apply for a subsidy will complete and file an application, providing all information indicated. The agencies receiving applications will simply check them for completeness at this stage. That work may be contracted out, since it is a self-contained, temporary function for which people can be quickly trained. The main information an applicant will have to supply is as follows: (a) certificate of savings account; (b) information on the applicant's socioeconomic situation, including a copy of an income tax return or other evidence of income; and (c) attestation that the applicant owns no real property. Applicants who wish to do so may submit an attestation by an IFI that they qualify for a mortgage; this will raise their score. This part of the process is expected to take 42 working days; it will run parallel to the call for applications, since in theory applications will begin to arrive immediately after the first subsidy competition is announced.
- 3.18 **Processing of applications.** Applications received will be electronically processed and scored using a point system devised for the purpose, to produce a preliminary list of successful subsidy applicants. Though this work might be performed by MIDUVI staff, the idea is that it be contracted out, at the start of the program, to one or more electronic data-processing firms, which would operate under MIDUVI's direction and supervision. It has been decided that applications received under the first competition could be processed at head office, to check transparency of the process and make sure the scoring system is working. Subsequent calls for applications could be processed in the regions. This first stage will yield a **provisional list of subsidy recipients**, which will be published in the mass media. This stage will take about 65 working days.
- 3.19 **Appeal period.** Any complaints filed after the provisional list has been published will be processed and ruled upon, and the **final list of subsidy recipients** will be drawn up, containing the names of the applicants who meet all the requirements.
- 3.20 **Issuance and delivery of subsidy award certificates.** One month after publication of the final list of subsidy recipients, MIDUVI's Finance Department will issue certificates to the successful applicants, following the procedure set out in the Operating Regulations.
- 3.21 **Redemption of subsidy certificates.** Persons who are awarded subsidies will have to arrange, on the market, the housing solution

for which they are eligible, or locate a contractor if their plan is to improve an existing dwelling. Once the process is complete (location of housing solution or builder; loan arranged; housing purchased or improvements completed), the beneficiary will endorse the subsidy certificate over to the seller or to the construction company if an existing dwelling was improved. The seller or construction firm will surrender the certificate to MIDUVI. After checking that the prescribed procedures were followed, MIDUVI will approve payment of the certificate, and the seller or builder then can redeem it at any IFI. Subsidies will in no event be paid directly to a beneficiary.

- 3.22 Information on project cycle details, expected timetable for each call for applications, and the general subsidy-allocation arrangement are in the project technical files.

3. Corporación Financiera Nacional rediscount facility

- 3.23 To adapt the housing-finance rediscount line now operating in Corporación Financiera Nacional (CFN) to the proposed program (see paragraph 2.10), CFN will open a window within this credit line, whereby it will discount loans awarded under the program. The terms of operations through this window will be: (a) loan amount not to exceed US\$7,000; (b) repayment term not to exceed 10 years; and (c) no cap on IFI lending rates for these loans. **The opening of this window in CFN will be a condition precedent to the first disbursement under the proposed program.** To ensure reasonable interest rates for borrowers, measures have been built into the program to spur competition among lenders; one of these will be the regular publication, by MIDUVI, of a table comparing effective lending rates charged by the different institutions taking part in the program.

4. Operating Regulations

- 3.24 A draft of the program's Operations Regulations has been agreed on with MIDUVI. The entry into force of the final text is a **condition precedent to disbursement of the financing**. Among the elements to be addressed in the regulations are operating arrangements for the program and eligibility and/or application-scoring systems for choosing program participants. The following documents dealing with various facets of program operations will be an integral part of the regulations: (a) an organization and procedures manual for PCU operations; (b) system for determining eligibility of households applying for the program benefits; (c) subsidy regulations; (d) eligibility and scoring criteria for financial institutions wishing to take part; (e) guidelines and criteria for the participation of NGOs and other technical-support providers; and (f) the form of contract for IFI participation. Any change to the Operating Regulations in the course of the program will need to be agreed upon in advance with the Bank.

- 3.25 **IFI eligibility criteria.** To be eligible to take part in the program, an IFI must be under the oversight of the Banking Superintendency and satisfy the following conditions: (a) it must be in full compliance with all prudential standards under the Financial Institutions Act and regulations thereunder, and with all rules and directives made by the Banking Superintendency and other pertinent control and oversight bodies; (b) it must demonstrate positive performance in the fiscal year immediately preceding the year of the call for applications; and (c) its 90-day arrears rate on loans under the program may not exceed 10%.
- 3.26 The PCU, in concert with the Superintendency and CFN, will review the performance of participating IFIs twice a year to check that they continue to meet the eligibility requirements. If not, disbursements and technical support to the noncomplying IFI will be halted. If the IFI is not in compliance within 30 days, it will be removed from the program.
- 3.27 **Guidelines and conditions for BEV's participation.** The general thrust of the program is to encourage commercial financial institutions to step up mortgage lending to low-income groups. Since bringing private-sector institutions into this particular market segment will entail a gradual learning process, it is likely that their response will be weak in the first year of the program.
- 3.28 So as not to jeopardize this crucial stage in the launching of the program, it is being proposed that BEV take part during this initial interval, even though its situation is somewhat unsteady in this stage of transition, after weak management in recent years.
- 3.29 Because of BEV's current circumstances, guidelines have been drawn up for its participation in the first stage of the program, through December 1998, along with conditions for its continuing involvement after that time, which would be subject to a review of its financial condition and management.
- a. **Guidelines for BEV participation through December 1998:** (i) as a means of ensuring that the terms and conditions for program loans are such as to elicit commercial-bank interest, two requirements would apply: BEV lending rates may not be lower than the weighted rate of the two institutions offering the lowest rates for loans under the program or the weighted rate of the institutions that offer similar products for this market segment; and BEV repayment terms may not exceed the weighted terms offered by institutions participating in the program or the weighted amortization terms offered for similar products available to these market segments; and (ii) BEV's share of the total program loan portfolio may not exceed 50%.
- b. **Guidelines for BEV participation after December 1998:** (i) After December 1998, BEV must be in strict compliance with

the same conditions required of commercial IFIs taking part in the program. Its adherence to these conditions will be checked through an external audit to be conducted according to terms of reference to be worked out with the Bank, and which satisfy the Bank's requirements. In November 1998 the Bank will evaluate BEV's situation and its adherence to the agreed conditions. (ii) BEV's share in the aggregate program loan portfolio in any year may not exceed 20%.

D. Movement of funds and financial management

- 3.30 The proceeds of the loans and the local counterpart will be transferred to the program in accordance with its implementation timetable. The following arrangement will be in place for movement of funds: MIDUVI's Finance Department will operate two bank accounts for the program, one in U.S. dollars, in the Central Bank of Ecuador, and the other in sucres, in a trust arrangement to be set up, for deposit of the counterpart funds and of periodic disbursements of loan proceeds if brought in sucres. The loan proceeds will be kept in dollars in the Central Bank account, the aim being to mitigate any inflationary effect on a portion of the program funds.
- 3.31 The bank accounts and trust arrangement will be managed pursuant to a financial management manual to be agreed upon with the Bank, which will form part of the Operating Regulations. Establishment of the set of accounts for the above-described arrangement will be a **condition precedent to the first disbursement of the financing** (see paragraph 3.35).

E. Contracting of construction work and consultants

- 3.32 Since the program does not call for direct financing of construction work, no threshold for construction contracts applies. Goods will be procured following the procedures set out in Annex B to the loan contract. International competitive bidding will be mandatory for procurements of over US\$250,000. This threshold is warranted inasmuch as similar projects in Ecuador have been found to elicit international interest when contracts were above that amount. Purchases worth less than US\$250,000 will be governed by Ecuadorian law, under the terms of which at least three quotations must be sought for contracts under US\$100,000 and public tendering is required for those over US\$100,000. ^{9/} These rules are consonant with Bank procedures (see Annex III-1).
- 3.33 Consultants will be hired in accordance with the Bank's procedures, as set out in Annex C to the loan contract.

^{9/} The Bank and the Ecuadorian authorities have worked out special procedures for local competitive bidding.

F. Disbursement timetable

- 3.34 The tentative timetable of disbursements of the loan resources and local counterpart is as follows, in keeping with the program's implementation schedule:

Table III-1 TENTATIVE DISBURSEMENT TIMETABLE (US\$000 equivalent)						
SOURCE	YEAR 1	YEAR 2	YEAR 3	YEAR 4	TOTAL	%
IDB/OC	3,039	1,858	13,776	13,327	32,000	46
IDB/FSO	4,575	19,075	6,275	75	30,000	44
Local	1,033	1,605	2,003	1,959	6,600	10
TOTAL	8,647	22,538	22,054	15,361	68,600	100
Percentage of total each year	13	33	32	22	100	

- 3.35 The borrower must demonstrate to the Bank's satisfaction that the local counterpart for the first year has been allocated and that an arrangement has been devised for transferring proceeds of the financing to the executing agency, for deposit in a special U.S. dollar account opened in the name of the program in the Central Bank of Ecuador.

G. Recognition of expenditures and advance of funds

- 3.36 The borrower has requested that the Bank allow recognition of expenditures expected to be incurred to prepare for the program's operation (no outlays for housing) up to the date of the Board of Executive Directors resolution approving the financing. The project team has reviewed the request and the regulations and procedures followed in expending the funds. Based on its review, and with the aim of ensuring that the program is launched on a solid footing, the project team calculates the amount that the Bank could recognize retroactively against the local counterpart and the financing at US\$1.1 million. The outlays funded would be for consulting contracts and equipment purchases.
- 3.37 Given the type of activities planned and the expected pace of the program, it is recommended that up to the equivalent of 5% of the financing (US\$3.1 million) be made available as an advance.

H. Monitoring of the program by the Bank

- 3.38 The aim of the monitoring and evaluation processes devised is to identify problems arising in the course of the program, so that any

necessary changes can be made in the program and its targets. The Bank's Country Office will monitor general progress on the program. To assist in this process, the budget includes funds for MIDUVI to hire a consulting firm, with clearance from the Bank, during the first six months of the program. The monitoring and evaluation methodology will be based on program benchmarks (Annex III-2), using information to be compiled by the parties and methods to be agreed on with the Bank. In principle, the monitoring and evaluation arrangement would be as described in the following paragraphs.

- 3.39 **Launching meeting.** Within three months after the signature of the loan contract, the borrower, with assistance from the Bank, will hold a seminar/workshop to launch the program. MIDUVI officers in charge of program activities, including staff of the PCU and the regional units, will take part in this event.
- 3.40 **Reports and annual review meetings.** The executing agency will present semiannual reports describing the progress on each component and the status of compliance with each of the annual targets set out in the benchmark matrix for the program, on the basis of which annual work plans will be drawn up. The idea is to hold meetings each year within two months after delivery of the second six-month report, with representatives of the Bank, MIDUVI authorities, PCU executive and technical staff, and directors of the regional units in attendance.
- 3.41 The minimum elements of every **annual review meeting** will be as follows: (a) a review of program operations the previous year, including accomplishments and disbursements; (b) a review of IFI participation in the program and, specifically, of BEV's involvement in the program and in the sector; (c) a comparison of the program's specific achievements against the benchmark goals and targets; (d) an evaluation of implementation arrangements; and (e) agreement on an action plan for the program the following year, including any corrective measures needed, changes, if any, to be made in the regulations, apportionment of funds among expenditure categories, and new targets, if so decided in the review.
- 3.42 The annual meeting in the second year will assess progress made on consulting work funded by the program for the legal and institutional framework modernization component and the consultants' recommendations and achievements as to changes in housing sector policy and the legal framework. Subsequently, MIDUVI will organize a seminar, with sector and Bank officials in attendance, to discuss an action plan for policy changes, in preparation for the possible expansion of the direct subsidy program and to supplement such an initiative.

I. External audit

- 3.43 Each year of the program the executing agency will present the program's financial statements, which must have been duly audited by a firm of independent auditors acceptable to the Bank.

IV. BENEFITS AND RISKS

- 4.1 The proposed operation is expected to boost housing-sector investment by way of three main types of activities. First, the component to modernize the legal and institutional framework, with the planned changes in laws and administrative requirements and with institutional support, will create an enabling environment in which private industry will have incentives to add to the country's stock of core housing. Second, the planned Housing Incentive System (SIV) is an equitable means of spurring effective demand for such core housing, through subsidies offered to people of few means. And third, initiatives targeted to the financial sector are intended to step up the supply of mortgage finance, so that money available can be mobilized into an effective demand for housing outlays. This chapter summarizes the benefits expected from the program and potential risks, and discusses the sustainability of such housing policy reform measures in Ecuador.

A. Benefits

1. Economic impact

- 4.2 **The housing market.** By way of the components described above, the program is expected to boost expenditure on housing by people in the lowest income brackets, which will mean a minimum of 33,000 core housing units provided for families in these circumstances. This increase in the stock of commercially supplied basic housing, including solutions worth up to US\$11,000, and competition for such units, will do much to spur technological innovation, and thereby lower market costs of basic housing.
- 4.3 **The land market.** Three elements of the program will help make land more readily available for low-cost housing developments: (a) land will be included in the complete basic housing package for families opting for new housing; (b) there is an incentive in the component for rehabilitation of existing dwellings for occupants to legalize ownership of their land; the foregoing two elements will help increase the numbers of those holding legal title to small lots; and (c) the planned changes to municipal ordinances and standards will make it easier to buy and sell these lots. The overall effect of these three elements will be to increase the supply of small lots and thereby invigorate the land market.
- 4.4 **The financial market.** The program component that seeks to deepen the mortgage finance market will add to the supply of small loans and microlending by private-sector IFIs, and help develop a secondary mortgage finance market. The first of these activities - fostering the small-loan business and microlending - will make housing finance a possibility for people who have never had access to the formal financial system. This should improve loan terms for

these borrowers, enabling them to invest for the first time in new dwellings or improvements. Furthermore, one element of the proposed subsidy arrangement is the requirement that beneficiaries put in savings of their own, so the program will help mobilize a considerable volume of savings and move it into the financial system, thereby deepening the system and making for more efficient lending. The second set of activities under this component — strengthening the CTH as a catalyst for the secondary mortgage market — will help make certain that long-term funds will be available now and in future, thereby fostering development of the financial market and the growth of long-term investment generally.

2. The program's impact on efficiency of the housing sector

- 4.5 **Efficiency of the housing supply.** In a reasonably competitive housing market, the supply of housing is more efficient and basic housing thus becomes more affordable. When there is competition in the market, buyers will have all the information they need, and conditions must be in place to avoid collusion between construction companies or suppliers of building materials. The proposed program seeks to create such a competitive environment by way of three actions: (a) promoting the program to many real-estate developers and builders in Ecuadorian cities; (b) financing the compilation and circulation of information on costs and features of housing solutions; and (c) building a demand for housing to step up pressure on the supply side.
- 4.6 **Efficiency of the supply of mortgage finance.** To make for an efficient supply of mortgage finance, the program provides for intensive technical assistance to IFIs. This support will be confined to three or four IFIs that stand out for their operations with this market segment; in similar programs in the past, this number proved to be sufficient to create competition pressure and promote efficiency. This component will enhance the internal efficiency of financial institutions, improving lending technologies and lowering administrative costs. Furthermore, one feature of the technical assistance will be mechanisms to foster a transparent credit market, such as bank reporting of effective interest rates.
- 4.7 **Efficiency of public spending on housing.** Low-income families cannot save and borrow enough to pay the full cost of basic housing solutions, so the proposed program contains a subsidy component. Since the indirect subsidy schemes essayed in the past — among them the use of subsidized interest rates — have proved to be inefficient, the subsidies here would be direct, demand-drive ones. So that scarce public funds can be put to the most efficient use possible, the subsidy will be tied to beneficiaries' ability to put in money of their own; this also will keep subsidy amounts down. In addition, under the institutional design being proposed for the subsidy arrangement, credit information obtained by the IFIs can be

checked against information on the subsidy application, to ensure that the selection process for subsidy recipients is sound.

3. Social impact

- 4.8 **Targeting.** The poverty line for Ecuador is a household income of less than about US\$240 equivalent a month. Only families with monthly earnings at or below that figure will be eligible for the housing improvement component. For the new housing component, families may be earning up to US\$600 a month. However, it is expected that over half the program beneficiaries will be families living below the poverty line, because: (a) 30% of the SIV funds are for the housing improvement component; (b) 40% of the SIV funds are for subsidies for basic housing solutions worth US\$7,000 or less, which would be within the means of low-income families; and (c) the application-scoring method gives points both for need and for effort, making it much more likely that families benefiting from the program will be those earning the least.
- 4.9 MIDUVI's technical team, with support from outside consultants, is developing an eligibility system similar to those used in housing programs in Colombia and Chile and in a Bank-funded pilot program in Venezuela. It also has devised minimum eligibility requirements having to do with income and current housing circumstances (urban, in an eligible municipality, and for new-housing applications; not already a home owner). Persons who receive one housing subsidy under the program may not apply for another. In the scoring system devised, applicants can compete on the strength of income, access to basic services, social circumstances and environmental condition of their current dwelling, family makeup, urban surroundings, savings, and credit obtained. A test run will be done of the eligibility system in the coming months, and it will be adjusted as needed during the first year of the program. The program also will pay for institution-strengthening, to refine this instrument and train those who will be using it.
- 4.10 The changes in the land market that should come about when the administrative and legal framework is adjusted will benefit low-income families in the medium and long term, as more of them are able to acquire land and low-cost housing solutions.
- 4.11 **Women as program participants and beneficiaries.** There is no formal impediment in Ecuador's laws or institutional policies to a female head of household being awarded a direct subsidy, having a savings account in a financial institution or borrowing from one, or holding title to property. However, because of a number of factors those entitlements are not being fully exercised in practice. One subject to be addressed in the technical assistance planned for financial institutions under this program will be the question of lending to women, with the aim of ensuring that lending operations are gender-neutral. Secondly, the content and

methodology for the promotion and publicity activities will advocate equal access for men and women to information on the program and its benefits. Lastly, by virtue of indicators to be included in the reporting system, the program's benefits will be able to be measured for men and women separately.

- 4.12 The program also takes into account the special vulnerability of single-parent families, whether the household is headed by a man or a woman, so such households will be given additional points when applications are scored. The housing improvement subsidies are expected to particularly benefit single mothers who are living with relatives, making it possible to add a room to the home, and women engaged in production activities in their homes.
- 4.13 To equip MIDUVI to build gender considerations into the proposed operation, the ministry will be strengthened under the Training and Awareness Program and the Women's Studies Program of the National Council on Women (CONAMU), funded under the IDB preinvestment program. CONAMU plans to develop gender equity criteria for the housing sector, working to that end with government agencies and NGOs; to train MIDUVI staff in gender issues, and to document lessons learned from the CAVIP urban renewal model.

4. Environmental impact

- 4.14 The environment and social impact report for the proposed program was presented to the Bank's Committee on Environment and Social Impact/Technical Review Group on October 31, 1997, and sent to the Public Information Center (PIC) on November 4, 1997. An environmental impact report produced and published by the executing agency on September 15, 1997, containing recommendations for the program's environmental management plan, was forwarded to the PIC on October 3, 1997.
- 4.15 The components of the proposed environmental monitoring system are as follows: (a) promotion of the program, with notice of its environmental guidelines, to builders, housing developers, NGOs, financial institutions, and municipalities; (b) technical assistance for beneficiaries, through a Technical Assistance and Monitoring Unit (UATS) in the PCU, which will operate through NGOs and other PCU-accredited agencies; (c) strengthening of technical capacity in the UATS so it uses program funds and works efficiently; (d) operating procedures as to the use of incentives for acquiring new housing units or rehabilitating existing ones; and (e) environmental guidelines for the program, including basic environmental standards for selecting lots, improving existing housing and building new dwellings, and for environmental sanitation systems. These guidelines will be part of the Operating Regulations and also part of the Minimum Urban Land-use Standards to be adopted by municipalities, as part of the program's legal and institutional modernization component.

B. Sustainability

- 4.16 The program will help in two ways to make housing-sector improvements sustainable. First, it will create incentives to persuade private businesses to operate in new segments of the financial and real-estate markets, as one of the keys to alleviating the country's housing deficit. Second, it will support the government's efforts to reshape its housing policy and devise lasting solutions to the housing problem.
- 4.17 In its housing reforms the government has given high priority to design of the SIV, as the centerpiece of efforts to build strong demand for housing. Since the implementation and institutional launching of this subsidy system will be one determinant of the program's success and sustainability, there is provision in the program for administrative support and technical assistance to set up the Program Coordination Unit (which would operate the SIV) within MIDUVI.
- 4.18 The other cornerstone of the government's new policy is its intention to foster changes in housing regulations. Consultants hired with program funds will help design sound regulations and see them set in place. The changes sought in the legal and administrative framework are those that are essential for sustainable improvements in housing conditions of the low-income population.
- 4.19 The program's financial component is designed to involve private-sector IFIs more actively in this segment of housing finance and ensure that the improvements achieved will be lasting. IFIs taking part in the program will have two tasks: they will manage savings accounts and make loans, and, with the findings of their credit analyses of loan applicants, they will afford an efficient means of cross-checking financial information furnished in subsidy applications. During the program preparation missions, financial institutions expressed interest in operations of this type. The temporary technical assistance which the IFIs could tap (see paragraph 2.8) is a way to build on this interest, helping the institutions to bring in new financial products.
- 4.20 Real-estate developers and builders which operate nationwide or regionally were consulted during preparations for the program on key features and procedures of its operation. They indicated strong interest in the program, particularly the small and mid-sized regional construction firms.
- 4.21 The civil society organizations that would deliver the technical assistance will be pivotal in building effective demand for housing and matching it with the supply. Ecuador has a number of organizations with the desired characteristics, and there are funds in the program to encourage them to take part, including support for organization and training.

- 4.22 **Financial viability.** The government has offered a substantial amount of funding under its Project Preparation Facility line of credit (1018/OC-EC) to prepare the program described herein and defray costs until the first disbursement is released. The 1998 Budget Act includes an appropriation for the counterpart funds required for year 1 of the program. The operation will entail an aggregate government commitment of US\$6.6 million over four years, not exceeding US\$2 million in any one year. Relative to MIDUVI's 1998 budget of about US\$35 million equivalent, these sums should be manageable.

C. Risks

- 4.23 **Macroeconomic conditions.** If high inflation rates persist and earnings continue to decline, the effective demand for housing solutions under the program could weaken. The aforesaid factors would make it much more difficult for prospective program beneficiaries to save enough for a downpayment, or severely erode their ability to pay. This would cut down on the number of housing solutions the program could fund.
- 4.24 **Implementation capacity.** Successful execution of the proposed program will hinge in part on MIDUVI's capacity to set in place the planned Housing Incentive System (SIV). Because this is a mechanism new to Ecuador, there could be some implementation delays, and differences in applying the program's rules. This risk is being countered by setting up a Program Coordination Unit and by the type of institution-strengthening activities envisaged. Furthermore, many of the main program tasks can be entrusted to private agencies and organizations, IFIs, and specialized firms subcontracted for the intake and processing of applications. MIDUVI's role as executing agency will be primarily to coordinate and oversee - both of which duties it can handle with its existing functional structure.
- 4.25 **Commercial bank participation.** The success of the program also will depend greatly on active involvement of commercial banks. Since the income of the prospective beneficiaries might make banks reluctant to lend to them, the program includes essential technical assistance to bring in appropriate lending technologies. This also will help boost the catalytic function of the rediscount program arranged with Corporación Financiera Nacional. And, lastly, MIDUVI will conduct a promotional campaign to encourage leading financial institutions - those which could do much to ensure the program's success - to join in. There is provision in the program to fund these efforts.
- 4.26 **Participation of the Ecuadorian Housing Bank (BEV).** If commercial banks are to become actively involved in this program, it is essential that BEV lending activity not distort the market. Accordingly, one condition of the program will be that BEV lending

rates not be lower than the weighted rates of institutions taking part in the program or of institutions offering similar products on the market. The repayment times of BEV loans may not be longer than the weighted amortization terms of loans made by institutions taking part in the program or lending to the market. Nevertheless, there is a risk that BEV might not be restructured and that it might continue to pursue lending policies that in the past have entailed explicit or implicit interest-rate subsidies. To counter this risk, the loan contract will contain conditions regarding BEV's participation after December 1998. Also, as was noted above, there will be incentives to encourage commercial banks to become involved.

4.27 **Availability of long-term housing finance.** On the matter of long-term credit available through the Mortgage Securitization Corporation (CTH) there are two possible risks for the program. First, the CTH's anticipated impact might not make itself felt quickly. Second, there could be delays in carrying through the broader finance-sector reforms, particularly the overhaul of pension funds and insurance companies. This would impede the development of a housing loan refinancing system and therefore jeopardize the system's overall success.

4.28 **Political risk.** The present interim government has carefully laid the groundwork for the new SIV by fostering commercial bank investment, spurring building industry involvement in the sector, and advocating changes in housing regulations. However, the proposed operation would be carried through under a new administration, with the concomitant risk that this same political support might not be forthcoming in the near future. The progress that is expected to be made on setting the operating arrangements in place in the coming months, while the present government is still in office, should allay that risk, in light of the impetus the current efforts have given for continuity of the operation and its ultimate success. Furthermore, since the MIDUVI technical team that worked with the Bank in developing the program will also be the core of the Program Coordination Unit, the transition to the implementation phase should be a smooth one.

TENTATIVE PROCUREMENT PLAN				
MAIN PROCUREMENT ITEMS FOR THE PROGRAM	SOURCE OF FUNDS	METHOD	PREQUALIFICATION	DATE
Goods totaling US\$176,000 Office equipment Furnishings Printed matter (one lot per year) Information processing equipment (two lots)	IDB 100%	LP	No	1/98
	IDB 100%	LP	No	1/98
	IDB 100%	LP	No	1/00
	IDB 100%	LCB	No	1/98
Consulting and other services, totaling approximately US\$2.56 million	IDB 100%	LCB	No	1/98 1/00 1/01

LP = Local purchase
LCB = Local competitive bidding
Date: 1 = in the first half of the year shown

**HOUSING SECTOR SUPPORT PROGRAM (EC-0138)
LOGICAL FRAMEWORK**

OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
improve housing conditions for the low-income population and make public housing in the housing sector more equitable	Improvement in housing conditions (number of low-cost housing units built or improved)	Construction industry statistics	Demand-based subsidies are more effective than other instruments in spurring demand/supply
Establish a system of direct, demand-based subsidies to make new housing more affordable for low-income families or enable them to improve existing dwellings, and encourage commercial financial institutions to produce housing units that low-income buyers can afford	<ol style="list-style-type: none"> Public and private money being spent on housing solutions for low-income households Increase in number of housing units built by the private sector for different segments of the population Increase in mortgage lending to different segments of the population 	<ol style="list-style-type: none"> Official reports produced by housing sector agencies Annual reports of construction and related trade associations Reports of participating financial institutions and the Banking Superintendency 	<ol style="list-style-type: none"> Volume of subsidies awarded acts as a catalyst for beneficiaries to contribute their own money for housing; financial institutions to offer mortgage finance for this clientele Availability of subsidies for low-income buyers prompts construction firms to build housing Prospective beneficiaries wish to be able to take out mortgages; lenders stand to gain from taking part in the program
OUTCOMES <p>1. Policies to national and municipal level; legal frameworks are devised and implemented</p> <p>2. MIDUVI has completed its restructuring and is now the modern, responsive institution required to head up and coordinate the sector</p> <p>3. IFIs have been given technical assistance on housing finance policies geared to low-income buyers</p> <p>4. Demand-based subsidy system has been set up, is operating efficiently, and has stimulated the demand for housing</p>	<ol style="list-style-type: none"> Legislation in force. Agreement between MIDUVI and municipalities. Number of municipalities that have rewritten their ordinances The new MIDUVI structure is operational; necessary decrees have been issued; procedures and information and control systems are operational IFI staff have been trained; new equipment and systems are in operation Number of subsidy certificates issued and redeemed 	<ol style="list-style-type: none"> Government documents, including decrees and regulations issued; interviews with construction associations and individual private contractors Program records, visits to MIDUVI premises, official MIDUVI documents Program records, consultants' reports, visits to IFIs Program records, IFI records, surveys of beneficiaries and other program participants 	<ol style="list-style-type: none"> Municipalities are interested in proposed changes, understand the benefits that will ensue, and will amend existing standards and regulations MIDUVI's informal power structure leads people to believe in the need for change and not resist it The IFIs understand what they can gain from the technical assistance offered, and become actively involved The prospective beneficiary population and other system stakeholders understand and expedite implementation of rules and procedures for the new system, including the new target housing system

MONITORING BENCHMARKS				
ACTIVITIES	YEAR 1	YEAR 2	YEAR 3	YEAR 4
REGULATION OF THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE HOUSING MARKET				
<ul style="list-style-type: none"> - Review of changes in national municipal regulatory systems - Review of irregular legal provisions - Review of minimum stable urban land-use and zoning standards - Streamlining of the low-cost housing development process - Review of municipal tax law and landlord-tenant regulations 	<ul style="list-style-type: none"> - Laws in force are being applied by municipalities - At least 1,000 titles granted - MIDUVI standards established - At least 25% of municipalities have adopted the minimum standards 	<ul style="list-style-type: none"> - 2,000 titles granted - At least 50% of municipalities have adopted the standards - Bills drafted 	<ul style="list-style-type: none"> - 3,000 titles granted - At least 75% of municipalities have adopted the standards 	<ul style="list-style-type: none"> - 4,000 titles granted - All municipalities have adopted the standards - Congressional approval of amendments
<ul style="list-style-type: none"> - Strengthening of IFI management strategy 	<ul style="list-style-type: none"> - Consolidation of the Program Coordination Unit (PCU), with support units created therein for (a) the Housing Incentive System (SIV) and (b) changes to legislation and environmental issues - MIDUVI planning unit strengthened (housing-policy development) 			
<ul style="list-style-type: none"> - Support for the long-range strategy 	<ul style="list-style-type: none"> - Support for monitoring and promotion of IFI participation in the SIV - Specialized consulting support for the administration and personnel system 			
<ul style="list-style-type: none"> - Support for SIV processing services 	<ul style="list-style-type: none"> - Hiring of processing services. Calls for applications 	<ul style="list-style-type: none"> - Hiring of processing services. Calls for applications. 	<ul style="list-style-type: none"> - Hiring of processing services. Calls for applications 	
<ul style="list-style-type: none"> - Support for participating agencies 	<ul style="list-style-type: none"> - Development of guidelines for use of monies from the NGO-strengthening fund 	<ul style="list-style-type: none"> - 10 NGOs and other technical support agencies working in the program 	<ul style="list-style-type: none"> - 20 NGOs working in the program at the municipal level 	<ul style="list-style-type: none"> - 25 NGOs working in the program at the municipal level

ACTIVITIES	YEAR 1	YEAR 2	YEAR 3	YEAR 4
IMPROVING THE MORTGAGE LENDING MARKET				
<ul style="list-style-type: none"> - Inception of the Mortgage Corporation (CTH) - Technical assistance to IFIs 	<ul style="list-style-type: none"> - Fannie Mae hired - CTH's Board adopts its business plan - Contract signed with international consulting firm - Three or four IFIs chosen for intensive technical assistance are taking part in the program - 40 loan officers trained - 5,000 active loans by the end of the year - Review to verify BEV eligibility 	<ul style="list-style-type: none"> - CTH starts full operation - 25% of eligible IFIs are taking part in the program - BEV participating if it is in compliance with agreed conditions - 20 loan officers trained - 10,000 active loans 	<ul style="list-style-type: none"> - In-progress review of securitization operations - 30% of eligible IFIs are taking part in the program - BEV participating if it is in compliance with agreed conditions - 20,000 active loans 	<ul style="list-style-type: none"> - In-progress review of securitization operations - 35% of eligible IFIs are taking part in the program - BEV participating if it is in compliance with agreed conditions - 30,000 active loans
IMPROVING THE DEMAND FOR HOUSING				
<ul style="list-style-type: none"> - Distribution of subsidies - Housing improvements - Housing - Marketing 	<ul style="list-style-type: none"> - 4,000 subsidy certificates awarded - 1,000 certificates redeemed - 6,000 subsidy certificates awarded - 1,500 certificates redeemed - Review of effectiveness of beneficiary eligibility system (SEB) - SEB adjusted as necessary 	<ul style="list-style-type: none"> - 4,000 subsidy certificates awarded - 4,000 certificates redeemed - 6,000 subsidy certificates awarded - 6,000 certificates redeemed - Adjustments, checking and review - 80% of beneficiaries satisfy eligibility requirements 	<ul style="list-style-type: none"> - 4,000 subsidy certificates awarded - 4,000 certificates redeemed - 6,000 subsidy certificates awarded - 6,000 certificates redeemed - Adjustments, checking and review - 80% of beneficiaries satisfy eligibility requirements 	<ul style="list-style-type: none"> - 3,000 certificates redeemed - 4,500 certificates redeemed - Adjustments, checking and review - SEB refined and operational
OPERATION, ADMINISTRATION, AND MONITORING				
<ul style="list-style-type: none"> - Evaluation 	<ul style="list-style-type: none"> - Consultants hired for promotional activities - Social promotion plan executed - Materials (videos, printed matter) available - Consulting firm hired for monitoring - Program administration budget planned and executed 	<ul style="list-style-type: none"> - Promotional efforts continue, with adjustments as needed - Promotional materials adapted as their effectiveness is gauged - Annual meetings with the Bank to review information obtained - PCU budget 	<ul style="list-style-type: none"> - PCU budget 	

PROPOSED RESOLUTION

ECUADOR. LOAN ____/OC-EC TO THE REPUBLIC OF ECUADOR

(Housing Sector Support Program)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of Ecuador, as Borrower, for the purpose of granting it a loan to cooperate in the execution of a Program for Support of the Housing Sector. Such loan will be for the amount of up to thrity-two million United States of America dollars (US\$32,000,000), from the Single Currency Facility of the ordinary capital resources of the Bank, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" set forth in the Executive Summary of the Loan Proposal.

PROPOSED RESOLUTION

ECUADOR. LOAN ____/SF-EC TO THE REPUBLIC OF ECUADOR
(Housing Sector Support Program)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf the Bank, to enter into such contract or contracts as may be necessary with the Republic of Ecuador, as Borrower, for the purpose of granting the former a loan to cooperate in the execution of a Program for Support of the Housing Sector. Such financing will be up to the equivalent of US\$30,000,000, in sucres, which are part of the resources of the Fund for Special Operations, and it will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.