

The financing of housing in Brazil

Luiz Eduardo Pinto Lima explains measures taken by the Brazilian authorities to improve the country's housing situation, against a background of endemic high inflation

UNTIL the establishment in 1964 of the Sistema Financeiro de Habitação (SFH), the Financial System for Housing, there was virtually no mechanism for financing the production of housing in Brazil. Only 120,000 dwellings had been produced and financed with budget resources from government and parastate departments such as caixas econômicas (savings banks) and the Institutos de Previdência (social security system). Approximately 50% of the population of 75 million, requiring around eight million dwellings, were not catered for.

The problem of the lack of popular housing in Brazil was fundamentally financial by nature. The system in force until 1964 had no defence mechanism against the inflation that, since 1940, has been endemic in the country. This discouraged both the accumulation of savings for housing and investment in housing.

The creation of the Financial System for Housing

With the accelerated and disordered process of urbanisation which occurred as a consequence of the industrial boom of the 1950s, it was necessary to create a specialised system that, besides catering to the growing needs of housing, infrastructure and basic sanitation, would handle the massive migration of manual workers to the urban areas.

In this context, SFH was conceived in 1964 to allow large segments of the population, especially those on low



incomes, to purchase their own homes, as well as promoting urban development in a rational form, assuring adequate standards of health, safety and welfare generally.

The basic condition for making the system viable was the institution of monetary correction, created with the objective of acting as an instrument of stabilising and minimising the social costs generated by inflation. Its introduction in Brazil was associated to the problem of the budget deficit.

Originally the housing system had a central department, the Banco Nacional de Habitação — BNH (National Housing Bank), which co-

ordinated the sub-systems shown in the chart. It carried out regulatory, guidance and inspection functions.

The BNH managed resources that derived from the collecting of compulsory savings from workers, administered by companies. The collecting was done by banks and the savings earn interest at 3% a year, plus quarterly monetary correction.

Besides the compulsory savings and profit from its operations, BNH could obtain possible budget allocations from the federal government and also resources from abroad. The BNH operated in these sub-systems as a second line bank, passing on resources by means of public and private agents who were responsible for carrying out the programmes, acting as financial agents and/or promoters.

The SBPE sub-system — Sistema Brasileiro de Poupança e Empréstimo (the Brazilian System for Savings and Loans) could act as a channel for BNH resources in the housing programme intended for the low/medium income population. It is, however, a sub-system where the action of financial conglomerates predominates. With a vast network of branches, and by means of the savings account, they made the SBPE the holder of the second largest amount of non-monetary financial assets in the country.

The organisations that make up SBPE comprise three categories: Sociedades de Crédito Imobiliário — SCI (Societies of Housing-Financing Credit), private companies organised

MONETARY CORRECTION

in the form of profit-making business corporations, and the State and Federal Savings Banks.

The SBPE's main source of funds — the savings account — gives depositors a return of 6.14% per annum, plus monetary correction, credited quarterly. Other sources of SBPE funds are housing finance notes — bonds that are totally guaranteed with a minimum maturity date of one year and interest rates of 6% per annum, as well as monetary correction — own funds, and profit.

Institutions must direct 60% of the resources obtained through savings accounts and housing financing notes to real estate investment, distributing the remaining 40% as follows:

- 20% collected by financial agents compulsorily so as to supply participants' possible cash needs;
- 20% on average maintained in liquid assets such as cash, government bonds, etc, and investments in the real estate sector, which by its characteristics of term and remuneration are more profitable, for example, financing of working capital for companies producing building materials, or commercial leasing of real estate.

In 22 years the Financial System for Housing financed approximately 4.5

Non-Monetary Financial Assets, September 1986

Category	Amount US\$ bn	Percentage of total
Savings accounts	22.6	31
Federal public bonds	25.9	36
Time deposits	16.2	23
Municipal and state bonds	4.2	6
Bills of exchange	2.8	4
Totals	71.8	100

million homes, an impressive figure compared with the 120,000 homes financed up to 1964. SIFHAP (the financial system for popular housing) accounted for 2.6 million units, and SBPE (the Brazilian system for savings and loans) accounted for the remaining 1.9 million. In May 1986 the resources of the total system amounted to US\$32.2 billion, made up of US\$9.6 billion in the Guarantee Fund for Time of Service and US\$22.6 billion in the savings and loan system.

In terms of resources, voluntary savings, represented by the savings accounts, are greater than the compulsory savings represented by the FGTS and account for 31% of the non-monetary financial assets.

The basis of the economic equilibrium of the system was the principle

of monetary correction. When the SFH was instituted it was established that the balances of the asset and liability operations should be corrected on the same date and in the same space of time. This principle guaranteed the full return of the amounts loaned, duly corrected, in such a way that there would be a possibility of re-investing and expanding the business.

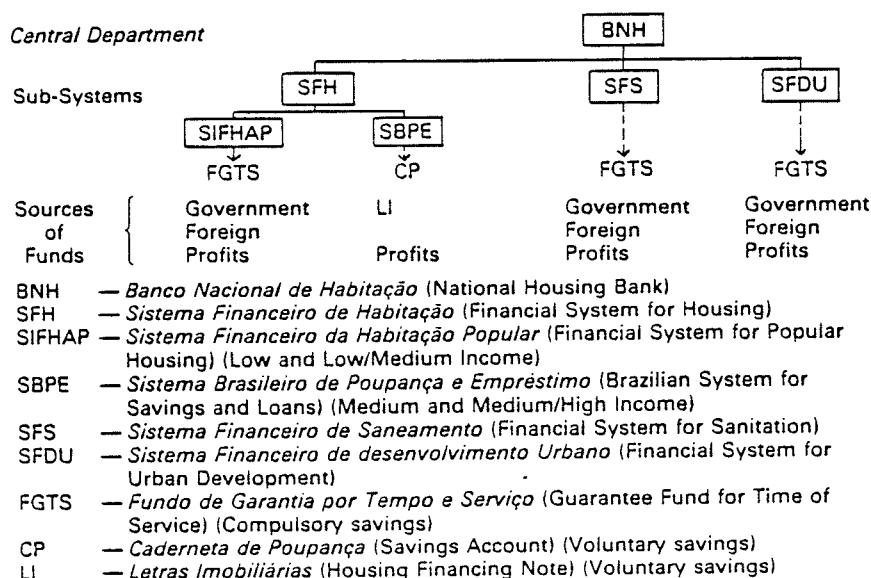
For this, the borrowers' instalments were adjusted every quarter, accompanying the adjustments of the debt which, in turn, followed the corrections of the savings deposit.

In this spirit, the Unidade Padrão de Capital — UPC (the standard unit of capital) was conceived. It became the currency of the system and corresponded to the variation in monetary correction in each calendar quarter, always calculated on the first day of the calendar quarter. It should be noted that the model adopted was based on the hypothesis that the repayment of the loan should, when re-invested, keep its value in UPCs unaltered.

As the borrowers' salary adjustment was, in general, annual, a new plan for financing was created where instalments began to be adjusted yearly in accordance with the variation of the minimum wage. The balance of the financing was still corrected each quarter by the UPC.

Because of the unequal periodicity of the different indices adopted, for the correction of the instalments and of financing balances, once the contract maturity was reached there might still be a balance to amortise,

Central Department



← 17

requiring an extension of the financing period.

In order to guarantee to the borrowers of these plans a time limit for amortising the debt, the Fundo de Compensação de Variações Salariais — FCVS (Fund for the Compensation of Salary Variation) was created, administered by the BNH, with resources originating from a contribution of those financed and of the financial agents. The FCVS guaranteed the borrower the entire amortisation of the debt, following an extension in the terms of financing of, at most, 50% of the initially contracted term.

Later, the Plano de Equivalência Salarial — PES (Plan for Salary Equivalence) was instituted where the quarterly corrections of the debt by the UPC and the instalments, yearly, by the variation of the minimum wage, were maintained, but a fixed number of instalments was guaranteed. If there was a residue of

'Real inflation higher than estimated'

the balance, this would remain under the responsibility of the FCVS.

The guarantee of a fixed term would, theoretically, be obtained by means of the use of a multiplier on the instalments. This multiplier was fixed, based on the estimates of future inflation, and was used to eliminate the effect of the monetary correction used at different periods on the instalments (annually) and on the balance (quarterly). This plan entailed a risk, should inflation be under-estimated. In this case the multiplier would be insufficient and the balance would not be paid within the term — in other words, there would be a residue to be paid by FCVS.

In 1977 the instalments again began to be corrected officially by the annual variation of the UPC.

In 1979, when the change in salary

policy established a six-monthly adjustment, the adjustment of the instalments remained annual. If the six-monthly policy for instalments had been adopted at this time the system would have recovered the equilibrium that had been compromised by the under-sized multiplier of the instalment. Real inflation was already higher than that estimated for the multiplier.

In the period 1981 to 1984 the country was plunged into a deep recession resulting from a policy of adjustment of the economy to the needs of the foreign sector. Besides seriously increasing unemployment, the adjustment led to a squeeze on salaries.

Paradoxically, inflation was not reduced with a tight monetary policy, while the government forced the maintenance of high interest rates.

The consequences for the SBPE were serious:

- a. Draining of resources from savings accounts to other assets where interest rates were flexible.
- b. A squeeze on the margins of participating financial institutions.
- c. Increase of the future commitments of the FCVS as a result of the acceleration of inflation, as the multiplier of the instalments to accelerate amortisation within the term of contract was designed for inflationary rates lower than those which occurred.
- d. Reduction in the saving capacity of the economically active population, reducing the resources for new financing.
- e. Reduction in compulsory saving by the BNH, as a result of unemployment and the reduction in real wages.
- f. Contraction of the demand for housing, engendering an accumulation of stocks and threatening the solvency of builders financed by the system.
- g. Reduction of real house prices, threatening the security of lending institutions.

h. Liquidation, merging or incorporation of several SBPE institutions, mainly those not associated with financial conglomerates, placing the credibility of the system at risk.

To deal with those serious problems, some remedial measures were adopted:

1. Transformation of the term of credit of the three-monthly yield of *Caderneta de Poupança* (savings accounts) to a monthly yield, to maintain the attractiveness of this instrument in face of the improvements in competitive investments. This measure stabilised the flow of the savings accounts, leading to a recovery in savings deposits, but it also had negative consequences:

Increase in operational and financial costs.

Increase in the instability of the liabilities as a result of the greater liquidity.

Imbalance in the periodicity of the monetary correction. The assets continued to be corrected every three months; the liabilities began to be corrected monthly.

2. In order to solve the problem of insolvency and consequent default of

'Concessions made to borrowers'

house purchasers financed by the SBPE, a series of concessions was made to borrowers which resulted in the reduction of the real value of the instalments owed. For example:

Concession of discounts on the value of the instalment for the period of one year.

Adjustment of the yearly instalment by the index corresponding to 80% of the variation in the minimum wage (valid for one year only).

Adjustment of the annual instalment by the index corresponding to about 50% of the annual variation in monetary correction,

with the condition that the following adjustments would be six-monthly, according to the variation in the salary of the professional category to which the borrower belongs.

The adoption of these measures helped deal with the more urgent problems, but left serious difficulties for the future, the principal one being the increase of the residue of the debt existing at the end of the contract, thus increasing even more the FCVS commitment for the future.

The SBPE was affected by the substantial alteration in the normal pattern of loan payments as a significant part would be received only at the end of the contracts by means of the balance of the debt, via the FCVS. The alteration was so large that many operations began to experience negative amortisations, that is, the instalment was not sufficient to cover even the monthly interest on the financing. There was also a reduction in profitability as a result of the increase in costs and a slower asset turnover.

At the beginning of 1986, in spite of the recovery of the economy begun in the second quarter of 1984, the macroeconomic scene was worrying. The good performance in 1985 had resulted from a policy that encouraged growth and an increase in employment to the detriment of inflation. The latter threatened to run wild, severely burdening the public debt and discouraging private investment essential to the continuity of economic growth.

This was aggravated by the generalised system of indexation which hampered any gradualist policy of fighting inflation. The apparent defence of real incomes rendered the structure of relative prices rigid, in a continuous process of rekindling inflation.

The Cruzado Plan

On 28 February, 1986, the government decreed the monetary reform, popularly known as the Cruzado Plan,

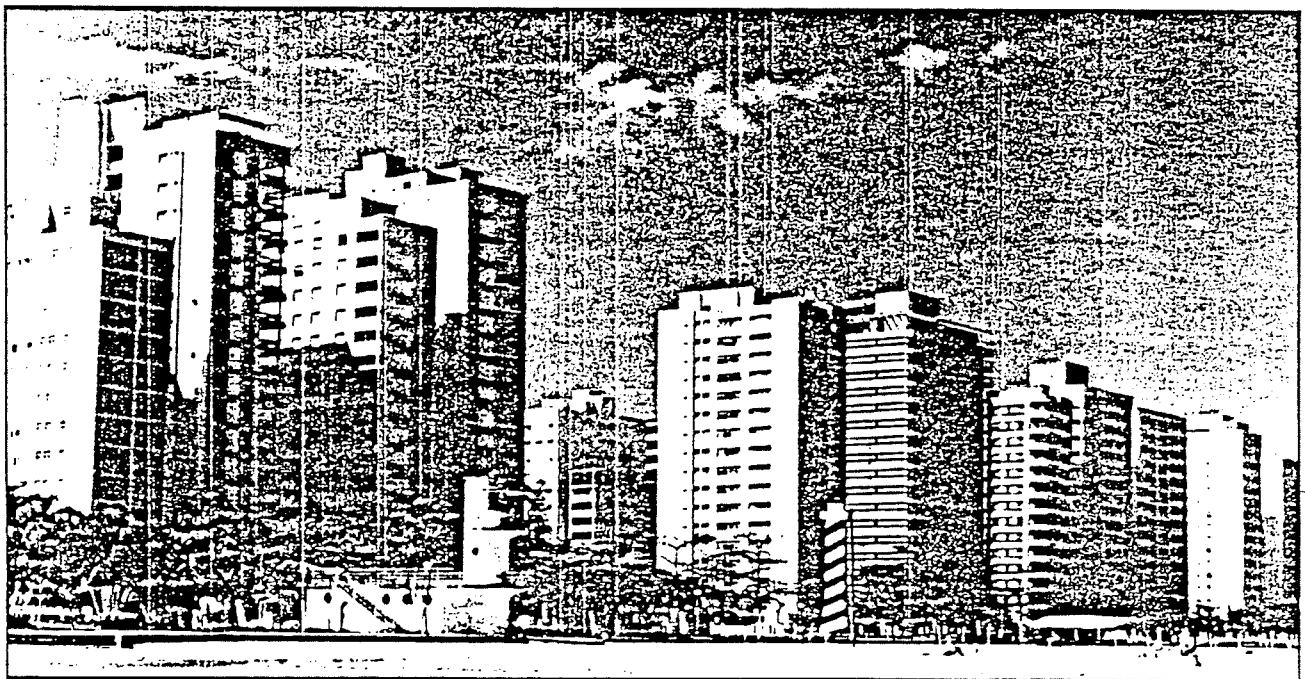
which partially did away with monetary correction, retaining it only for savings deposits, FGTS deposits and other labour funds, and also for contracts with a term over one year. Under the plan, the exchange rate was fixed and all prices, salaries and rents were frozen.

Salaries were updated by the real average of the salaries earned in the six months before March, increased by a bonus of 8%. A guarantee of a new adjustment was established, should the accumulated inflation reach 20%.

Rents were adjusted by the same criterion as the salaries, without the additional 8%, but with differentiated indices for the calculation of the real average. Residential rents were corrected below salaries, instalments in the SFH and also below commercial rents. In the field of the SFH, a number of measures were taken:

1. Freezing loan repayments for a year, after an updating similar to salaries, but excluding the addi-

→ 20



High rise housing in Rio de Janeiro.

← 19

tional 8%. Had the government included the 8% in the instalments it would have helped to rectify some of the problems which had arisen over the previous few years.

2. Interruption of the monetary correction of the debt balances for one year. During this period the correction would be applied only in the case of extra amortisation, financing transfers and anticipated discharge of the debt.

3. Change in periodicity in the credit of the yield of the savings accounts, which is once again quarterly.

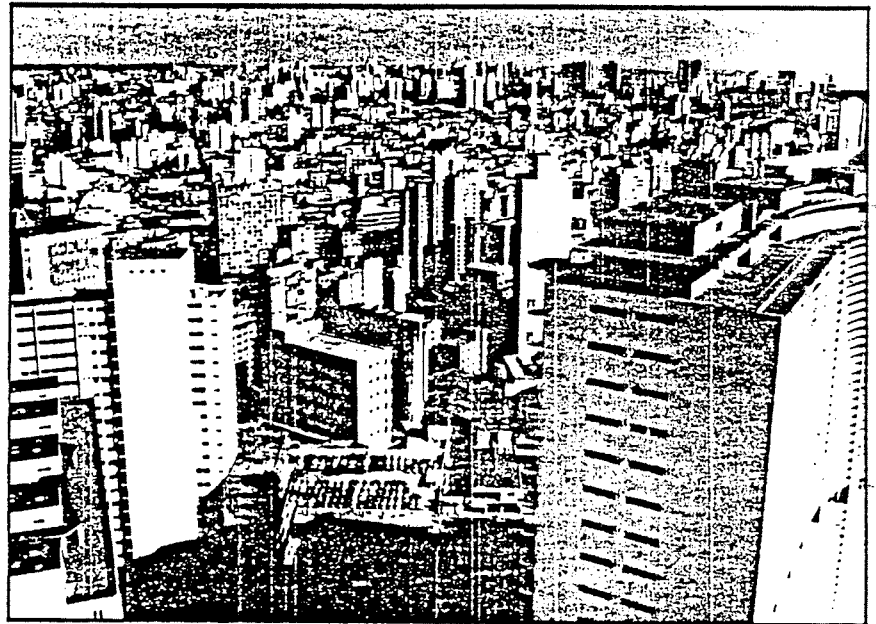
4. Maintaining the monetary correction on savings account balances.

The fact of suspending the correction of the balance of the debt for one year, and keeping it for the savings accounts, accentuated the distortion that already existed, on a lesser scale, when the savings accounts began to be remunerated monthly and the debt balances were corrected every quarter.

The monetary correction paid on the savings accounts is calculated on the average balance of the quarter. The interest is calculated on the balance of the savings account, after the correction has been added. For loans, the correction will be calculated on the balances of February 1987. During the period of the freeze the interest is being calculated on an uncorrected balance, and that is being amortised monthly. The impact of the Cruzado Plan on the SFH was intense.

In spite of the real increases in salaries and the strong growth in employment and salaries, there was a massive withdrawal of resources from the savings accounts. The savers did not immediately accept the increase in the term of redemption and the reduction of the nominal yields. They were used to high rates of monetary correction before the Cruzado Plan (the rates of the two months preceding the Plan were 16.23% and 14.36%).

High inflation afforded high



Sao Paulo, Brazil's industrial capital.

nominal yields, giving rise to the so-called phenomenon of "monetary illusion." When interest was credited, the saver withdrew not only the part referring to the interest, but also that referring to monetary correction, without perceiving that they were, in fact, reducing the invested capital.

Savers preferred to direct their resources towards consumption or to assets which greatly increased in value in the new situation, such as shares and real estate. The latter experienced an unprecedented increase in value, as the importance acquired by the safety factor, in relation to the liquidity, was a function of the prospect of stability of inflation at low levels.

In the first two months following the announcement of the Cruzado Plan, losses on savings accounts came to approximately US\$3.6 billion, corresponding to 16% of the overall balance of deposits, which in February were US\$21.9 billion. Later, with the repressed demand relatively satisfied, with the drop in stock exchanges due to the realisation of profit and with the awareness that the real yield of the saving accounts

remained unaltered, maintaining its competitiveness with other financial assets, a slow recovery of deposits began.

Even so, the year 1986 ended with a negative net increase, which had never before occurred in the history of the system.

The negative impact of the savings accounts reflected immediately on the profitability of the participating institutions. The massive withdrawals of resources affected the liquidity of the institutions, forcing the sale of short-term assets, and rendered the granting of new financing non-viable. Financing was largely confined to the construction phase. This was of no help to the great majority of the population, who saw the housing problem aggravated.

The government recently issued a series of measures to correct the distortions generated by the Cruzado Plan. The objectives were to reduce excessive demand, to encourage financial savings, to create exportable surpluses and to reduce the public debt. The path adopted was to penalise consumption via fiscal policy.

The measures included sweeping changes in the whole housing finance system:

a. The abolition of the National Housing Bank (BNH) and the transfer of its operations to the Federal Savings Bank, a department linked to the Ministry of Finance that already acted as a financial agent in the SBPE. The Federal Savings Bank has two functions. It maintains its status as an institution within the SBPE, financing housing with resources from the savings account, and it will start to give priority to catering for social housing. These latter operations will include housing finance for low income households using budgetary allocations and infrastructure and basic sanitation work with FGTS resources.

b. The guidelines for the housing policy continue to stem from the Ministry of Urban Development and the Environment.

c. SBPE regulation was transferred to the Central Bank of Brazil. The SBPE, where voluntary savings predominate, begins to cater for the middle class. Its activity will be less regulated, and its new profile will receive a more financial treatment. The new allocating structure of the resources obtained will, in principle, be in the following form:

20% — compulsory liquidity with the Central Bank.

60% — financing for housing, 50% being in operations within the traditional pattern (controlled interest rates, with ceilings and predefined term) and the remainder in freely negotiated operations with borrowers with higher financing values, at market rates of interest.

20% — other real estate operations.

d. In order to increase the competitiveness and attractiveness of the savings account, and to recover the losses suffered after the announcement of the Cruzado Plan, the period of crediting interest was changed again from quarterly to monthly.

e. The SBPE can now count on a new type of savings account known as the Peculium Account. This is the same as the traditional savings account in terms of interest rates, monetary correction periodicity and exemption from income tax on the yield. Its attraction and differentiating element is the tax benefit. The depositor may discount up to the limit of 30% of yearly income in salary, subject to taxation, US\$7,087. The deposit must be for a minimum of five years. The SBPE can also obtain savings deposits at a yield of 6.14% and monetary correction, with interest taxed at 35%.

f. Another measure that will affect not only the SBPE but the whole economy is the new criterion for calculating the monetary correction. This is no longer indexed to

'Savings should return to previous levels'

the official rate of inflation but will be measured by the remuneration of the Letra do Banco Central — LBC (Central Bank Bonds). This is a short-term federal bond that is backed by the overnight operations.

In this way, asset and liability SBPE operations begin to be corrected by the new index. The criterion for the correction of the instalments of financing for housing still has to be clarified. Today, it follows the variation in salaries which, in turn, follows inflation. Should this criterion remain, there will always be the risk of long-term operations with different indices of monetary correction. The applying of the correction to the balances of the financing for new

housing is now with the same periodicity of payments of the instalments. For old contracts, it is still effected each quarter.

The definitive profile of the new housing system depends on additional measures and on the regulation of the measures already announced. Only then will a more accurate analysis be possible of the effect of the alterations in the SBPE.

It is important to emphasise that, to solve the great housing problem in Brazil, the guidelines of a housing policy must consider housing in its broad concept. Until today, the importance of a "house of one's own" has been emphasised, but the need for housing can be catered for much more effectively if houses for rent are encouraged as a first stage in housing. In other words, the aim should be to afford a home — but not necessarily one's own.

For SBPE, the expectations are optimistic. The recent economic policy measures should normalise demand, and savings should return to their previous levels, allowing a resumption of financing.

Within the guidelines recommended by the government, not to abandon the growth of the economy and to preserve the salary gains of the lower income classes, the SBPE and its role as a channel of resources for the area of civil construction, which has a strong multiplying effect on employment and on incomes, represents an important alternative of economic growth without inflationary pressures and without an impact on the balance of payments. ■

LUIZ EDUARDO FERREIRA PINTO LIMA is director of capital for Unibanco, the Brazilian banking group. He is managing director of four housing credit company subsidiaries of Unibanco. He is vice-president of ABECIP (the Brazilian Association of Housing Credit and Savings Agencies) and president of ACRESP (the Sao Paulo Association of Housing Credit and Savings Agencies). He is also a vice-president of IUBSSA.