The development of housing finance in Chile, 1930-1988

THE Inter-American Housing Union has published a study: *The Private System of Housing Financing in Chile 1930-1988.* This article summarises the study which was prepared by Dr Guillermo Le Fort.

The 1930s — the Mortgage Bond

In the 1930s, mortgage bonds accounted for a significant proportion of the total volume of finance in the Chilean banking sector. In the early 1940s, a large proportion of gross internal savings was represented by this method of attracting financial resources. It is clear that the mortgage financing system in Chile at this time played an important role in financial intermediation, and housing financing was mainly carried out with resources obtained from mortgage bonds.

The 1940s and 1950s — Social Service Banks

With the high rates of inflation that developed in the 1940s the return on mortgage bonds became negative and they were no longer used as a method of financing.

Social service banks were found to be the best source of funds for housing. These were autonomous public bodies which obtained their funds from subscriptions paid by entrepreneurs and workers for retirement pensions and gratuity funds. All workers were affiliated to one of these social service institutions depending on their jobs. For example, there was a Social Service Bank for Private Employees, a National Social Service Bank for Public Employees and Journalists, the Social Service National Defence Bank, and even the Social Service Bank for Employees of the Horse-riding Club.

As these institutions had to make long-term reserves for old age pension payments, they invested a large proportion of their funds in housing loans granted to their subscribing workers with 30-year repayment terms.

However, this mechanism suffered from the problem that interest rates on housing loans were lower than the rate of inflation. The funds that each social service bank had were accordingly reduced in real terms but very few people obtained the benefits of a housing loan.

Over the years, social service banks gradually lost their housing role to the extent that by the end of the 1950s hardly any housing loans were made. This withdrawal of housing finance activity brought about a contraction in economic activity, particularly in respect of housing construction.

It was considered that it was appropriate to create a massive housing market which was accessible to the population. After extensive studies it was decided that the best solution was a scheme to attract popular savings.

The 1960s and early 1970s — the savings and loan system

The earlier experience made it essential to create a scheme whereby a person buying a home would pay the balance of the loan in real terms and a person depositing money would be able to save without losing purchasing power. The formula found was that of periodic adjustments to the value of savings accounts and loan balances. A decree dated 5 April 1960 authorised the constitution of legal, private corporations of mutual and regional nature referred to as savings and loan associations. Their main objective would be to attract public savings for housing financing. The decree also created the Central Savings and Loan Bank to control savings and loan associations, provide them with financial assistance and serve as insurer for certain operations.

In order to increase the participation in the system the opening of savings accounts were made exempt from all taxes as was interest paid.

The new mechanism soon became part of the development plan and was considered a key part of the plan due to the multiplier affect of housing construction on the economy. It was established at the time that Chile had a housing deficit of 375,000 units, with an annual population growth rate of 2.5% a year. Chile required 35,000 new homes a year in addition to 45,000 to 50,000 homes to replace losses from the stock.

There were five features of the new system—

(a) It was intended to consolidate individual and family home ownership. Therefore financing would be granted only to new home owners.

(b) At first the associations only financed the purchase of new homes. However, as the market was not capable of satisfying demand, they also began to finance older homes.

(c) The system was intended to meet the housing requirements of the middle and lower income groups.

(d) It was considered necessary for the board of an association to comprise representatives of relevant activities.

(e) Increasing resources were attracted into the system, mobilising the mortgage portfolio of the associations and the Central Bank. The associations placed the re-adjustable mortage securities in the market while the Central Bank issued re-adjustable promissory notes.

Initially, the system had contributions from the Chilean government and from USAID as well as savings from the public. The public soon perceived the system's serious, secure and profitable nature. However, the funds obtained were insufficient to give loans to those who, for example, had saved 20% of the price of their homes for six months. To overcome this difficulty foreign aid was resorted to.

The 22 associations began the active task of granting loans, projecting an image of efficient performance which helped them obtain an ever-increasing number of clients.

The associations helped to finance housing co-operatives and they increased their role such that they accounted for 80% of private sector financing for housing in 1970. The system also became a powerful instrument for the development of the housing sector and the national economy.

Four factors are given as the cause for the success of the system—

(a) The application of monetary correction to maintain the purchasing power of savings.

(b) The regional nature of the associations.

(c) State insurance of savings accounts.

(d) Government assistance and foreign aid.

Between the end of 1964 and the end of 1970 the system consolidated. Over 69,000 loans were granted and the number of clients served increased to over 320,000.

By 1965 a high rate of self-financing had been achieved and the government withdrew its contributions to the system.

After the 1970 Presidential election, the demand for savings increased and the system paid off the debt it had contracted with the Central Bank. However, the population was less willing to borrow as a result of an uncertain political situation and insecurity. There was an excess of cash in the associations which was deposited with the Central Bank. Savings captured by the system accounted for over 50% of total local savings. This stage ended with the military coup in September 1973.

In October 1973, the associations began to use their excess resources to purchase land, to build their own buildings. However, the associations were not sufficiently experienced in this and were unable to reimburse re-adjusted funds as quickly as was required. The excess cash situation quickly turned into one of lack of liquidity. The Central Bank also decided not to continue holding the excess liquidity from the system.

Accordingly, the system had a lack of liquidity and the state had to cover the difference. A 1975 law blocked withdrawals from the system; this caused a loss of confidence in the associations. This in turn led to a series of mergers and only seven institutions continued to operate. The savings and loan system gradually disappeared and now there is only one institution which does not seek to attract new resources but merely administers the mortgage portfolio obtained by the system.

From 1977, multiple banking began to develop in Chile whereby mortgage banks and commercial banks carry out various operations without there being any difference between them in this respect. Mortgage operations have been re-adjusted so that they can be protected against the effects of inflation. Commercial banks, development banks and mortgage banks, including the Chilean State Bank, grant housing loans at 15- or 20-year terms. Loan amounts are limited to 75% of the value of the home. Loan values are expressed in the development units (UF) with a peso value that changes daily according to fluctuations in the consumer price index. Loans are issued through letters of credit made out to the bearer by the lending bank. A secondary market is therefore generated. Letters of credit currently carry interest rates of between 5% and 11%. Borrowers must also pay the bank that is financing the loan an annual commission of between 1.9% and 4%. The main investors in this new instrument are pension funds and social security funds.

In 1978, when the new housing finance system first began, mortgage loans represented 1.9% of the total banking loans. The figure increased to no less than 24.6% in 1981.

Among the problems this system has had to face was a lack of correspondence between the consumer prices index and the wages and salaries index. The latter has been considerably lower than the former. This has been reflected in a higher level of arrears.

To facilitate access to housing for lower income groups there is a system of state subsidies. The subsidy is received in the form of a certificate for an amount expressed in development units. If the price of the house is lower than the subsidy plus savings the buyer will apply for a housing loan for the balance which is granted on the usual basis. ■

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