Housing Finance in Uruguay

by Enrique S. Pees Boz

Uruguay is a Latin American country with a territory a little over 175,000 sq. km., a population of 3 million, and a preponderantly European profile and culture. It has shown throughout its history a social and economic openness to the region and the world.

Its present indices of literacy (97%), population growth (6.4 per thousand annually), urbanization (90%) and wealth distribution (Gini: 0.42) rank it among the industrialized or developed countries, as far as human development is concerned. The country's gross domestic product is US$20 billion, and its total population is 3,164,000 inhabitants according to the 1996 census.

The country's housing sector suffers from a shortage of accommodation units among the lowest income sectors; there is also an additional qualitative deficit that is being met with the conservation and gradual restoration of a high quality housing stock rarely found in the rest of the continent. The construction and financing alternatives are likely to result in a specialization typical of advanced societies, bringing about an improvement in the primary and secondary mortgage markets.

THE HOUSING SECTOR

According to recent estimates by technical personnel of the National Mortgage Bank of Uruguay (based on data provided by the 1996 Population and Housing Census), the accumulated housing shortage amounts to 30,000 accommodation units in Montevideo—the capital city which holds 50% of the country's total population—and a similar figure in the rest of the country, the majority of which are in the "urban countryside."

Enrique S. Pees Boz is Deputy General Manager of the National Mortgage Bank of Uruguay.

The country's population has grown at a low 6.4 per thousand average annual rate in the period between the last two censuses (1985-1996). This population is distributed among 970,000 households, a notably low figure relative to the total number of existing accommodation units (1,126,000). This piece of information per se sets up a defining and determining framework for the choice of alternative solutions.

The comparison of available housing (considered inhabitable or capable of rapidly becoming inhabitable after partial reform) with that of total demand, including households with insufficient income, makes it possible to quantify the "accumulated deficit" at approximately 60,000 units. Fifty percent of these correspond to the lowest income group, usually called "Society's Clients" (in Uruguay this group comprises households with a monthly income below US$450), given their incapability of producing any kind of financial savings and therefore of resorting to the financial system.

The remaining 50% is divided between "Subsidiary Banking Customers" (households with a monthly income between US$450 and US$900) and the "Banking Customers" (households with a monthly income over US$900), these being the ones not requiring the support of "Direct Subsidies to Demand" to be able to meet mortgage repayments in market conditions.

According to National Mortgage Bank experts, the 10-year projection built from the 1996 census and covering the period 1996-2006 shows the need to construct over 200,000 accommodation units for Montevideo and the "urban countryside." This would cover the accumulated qualitative deficit, new household demand and a timely renewal of obsolete housing in the 10 years in question, with an equitable classification between new and renewed/recycled housing units.

FINANCIAL SYSTEM AND CAPITAL MARKET IN URUGUAY

Uruguay's financial system has evolved in the framework of successive governmental efforts aimed at reducing inflation rates and leading the country towards long-lasting stabilization, while upgrading conditions, enabling a sustained GDP growth and improved living standards for the population.

This was started in 1974 with the market's liberalization and a parallel trade opening to world markets in general and to the region's in particular (MERCOSUR). After the insolvency crisis that in 1982 engulfed practically the whole banking system, credits to the private resident sector experienced a significant contraction as a consequence of recession and a drop in previous activity levels. This favored the growth of non-traditional banking activities such as off-shore operations and other banking services which were to become crucial for the sector's economic balance in the following decade.

The concomitant financial reforms were encouraged beginning mid-1989 on the basis of recommendations arising from the structural adjustment agreements with the World Bank (SAL I in 1987, and, more importantly, SAL II in 1989) and the August 1991 IADB technical and financial assistance agreement.

In what concerned housing financing, and specifically the National Mortgage Bank of Uruguay (accounting for over 85% of the local mortgage market), it was suggested that generalized subsidies existing at the time should be eliminated. At the same time, its product and service offer would have to be diversified, and new financing sources more compatible with its currency, terms and rates active operations sought. This would be accompanied by a gradual mobilization of its real estate assets.

Critical Legislation

On the other hand, the development of the capital market in Uruguay was forcefully encouraged during the current decade by a series of acts, including the Insurance De-monopolization Act (1993), Social Security Reform and Pension Funds' Administration Bodies Act (1995/1996), Stock Exchange and Marketable Securities Act (1996), Pre-mortgage De-monopolization Act (1996) and Mortgage Securitization Bill (1997).

An analysis of the system's trend and development makes it possible to conclude that, despite the financial deregulation in force in Uruguay since 1974—nearly 20 years before other countries in the region—financial agents operating ever since and the financial tools used until very recently have lacked the sophistication and diversification offered by other markets in the rest of today's globalized world.

This also applies to housing finance. In addition, and in comparative terms, Uruguay's financial system may be considered small given the country's GDP (Deposits/GDP = 35%) if measured against similar indices in industrialized countries. However, and as far as Latin America is concerned, the relative size of the financial sector is above the average, and more specifically is third highest on the continent.

The Uruguayan financial system is characterized by a predominance of state banking institutions (Bank of the Republic of Uruguay and National Mortgage Bank of Uruguay) and private banks—with over 20 foreign capital entities—jointly accounting for over 80% of deposits (38% in state and 42% in private banking institutions) and 90% of domestic financial deposits (55% with the Bank of the Republic of Uruguay and National Mortgage Bank of Uruguay, and 35% with private banks).

The system has had a high regional rating and is evolving towards more sophisticated investment forms in financial markets. Local savers, risk administrators rather than speculators, invest largely (90%) in financial assets in foreign currencies.

HOUSING FINANCE IN URUGUAY

Construction of housing units is done by several national companies with little capital of their own and using traditional technology for the most part. Finance is provided by households themselves and a housing finance system in which the National Mortgage Bank of Uruguay has a predominant share (85% of the local mortgage market). The bank developed as a typical European mortgage bank but more recently has obtained deposit funding equivalent to that of a commercial multibank.

Private market mortgage loans are generally oriented to average and high-income sectors, with rates fluctuating between 16% and 20%. Government bond yields are approximately 8% to 9%, while both the state and private banking sector offer a 4% to 5% annual rate for term deposits in American dollars and a 2% to 3% rate to savings deposits in American dollars. Uruguay's current inflation rate is 8% annually, aiming at an annual 6%, and an expected devaluation of about the same figures.

Most housing loans (95% or more) granted by the National Mortgage Bank of Uruguay are signed and valued in URs (Readjustable Units). This measuring unit is adjusted monthly according to the Salary Average Index variation calculated by the General Direction of Statistics. This institution is answerable not to the National Mortgage Bank of Uruguay but to the President.

Loans' unpaid balances and monthly payments with which interest and amortization are paid are adjusted every four months (for average and upper-average quality housing) and every six months (for low and average-low housing), according to the UR's increase in value during that period. Strictly speaking, this mechanism is an implicit subsidy to the system since installments are not adjusted monthly.

Interest rates applicable to adjustable unpaid balances in URs vary between 7% and 12% per year, depending on the line of credit and on the client being a saver with the bank or not.

The "maturity loan-to-value ratio" is 65% to 80%, while the "payment-to-income ratio" may not go beyond 26%, although it occasionally reaches 35%.

Credit is made available for the following: construction and purchase, maintenance and refinancing housing loans; loans to the cooperative system; credit lines for tenants included in the Registry of Emergency Housing Candidates; loans to the State Housing Production System; loans to purchasers through the Integrated Housing Access System (IHAS); loans to be granted through the Co-financing Operative System; Savings and Loan contractual system; housing and activity promotion credit lines for young rural entrepreneurs; credit lines for suburban and rural construction; credit lines for young married couples; loans for new housing acquisition; and a Construction Promotion Plan.

A major obstacle to the expansion of private sector housing finance is the difficulty encountered by banks in recovering due credits; this is directly related to the slow and complicated judicial processes in force in the country. The Mortgage Bank of Uruguay has the exclusive right to use the "extra-judicial execution" of the property offered as a guarantee to the debt. This resource may be applied to the debtor after three unpaid installments.

The New Housing Finance System

The Ministry of Housing, Land and Environment was created in this decade to facilitate the development of the housing sector. The National Mortgage Bank of Uruguay has remained the leading actor in over 85% of local mortgage operations, and the private financial sector has begun to show an interest in investing in the local housing market.

Currently, an adverse situation in the primary mortgage markets exists in the form of a potential and actual "mismatching" of terms and currencies between savings attracted by financial institutions and the corresponding mortgage investments they fund, resulting from a lack of long-term financial mechanisms. The Inter American Development Bank is providing technical and financial support to put into practice an "Integrated Housing Access System" (IHAS) based on a combination of "Family Savings," "Direct Subsidies to Demand" and "Housing Credits" adapted to the real payment capacity of eligible families. The IHAS is depicted in Figure 1.

A significant aspect of the IAHS is the presence of new long-term institutional investors (Pension Funds Administration Bodies) that are being incorporated into the local capital markets. Their presence will make it possible to create secondary mortgage markets, with funding from the capital market, the "Mortgage Rediscount Fund" administered by the Ministry of Housing, and the "Subsidy Fund," both financed by proceeds from a

THE NATIONAL MORTGAGE BANK OF URUGUAY

The National Mortgage Bank of Uruguay is a financial institution specializing in the mortgage business, acting as a public instrument to facilitate access to housing, fostering the construction industry and offering a full range of banking services, with a special emphasis on housing finance.

It was founded on March 24, 1892, by Law 2.175 on the basis of the mortgage section of the former National Bank. Later, on June 8, 1912, the section was nationalized. Its Memorandum of Association, which set the legal basis for its performance, was passed by Law 5.343 October 22, 1915.

During its over 100 years of existence, the Bank has overcome political and economic crises, and has provided housing solutions and promoted national industrial development while substantially contributing to the creation of employment. This translates into levels of owner occupation of housing in excess of 65%, similar or even higher than those of industrialized countries.

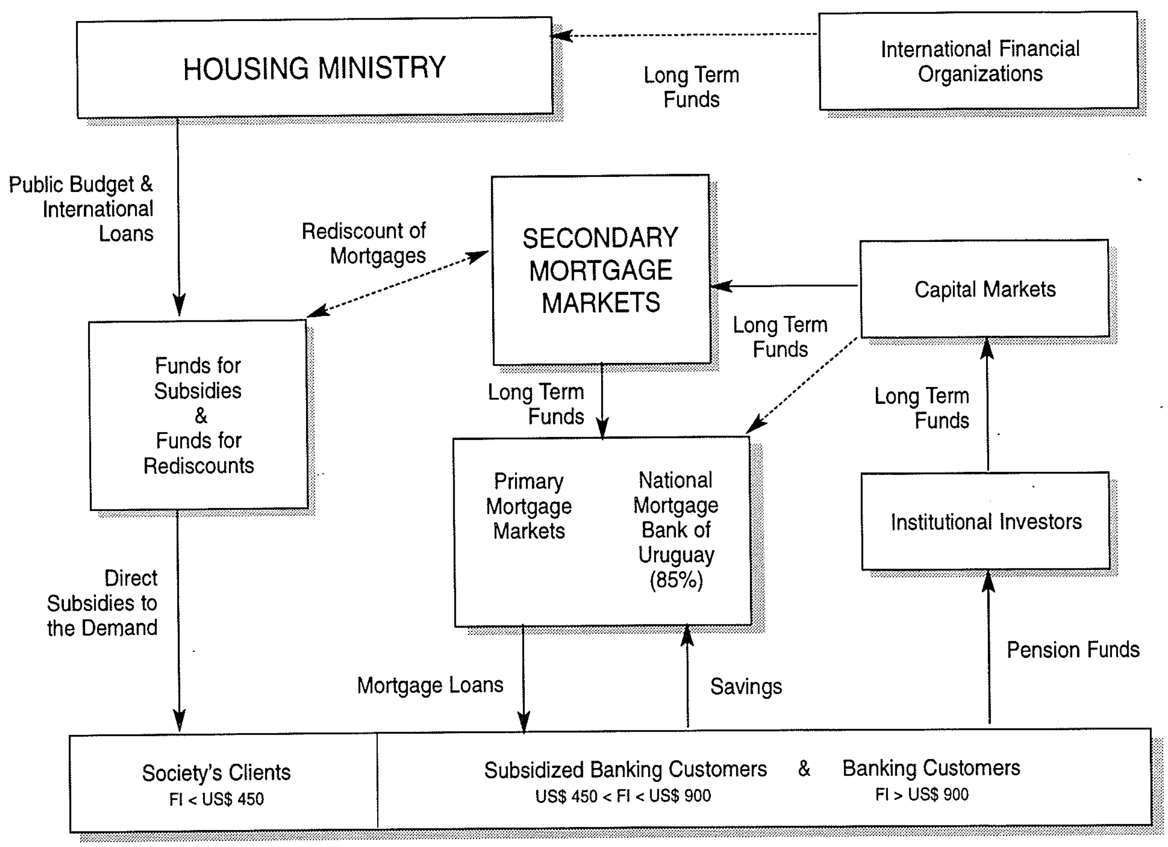
From its very beginnings and up to the end of the 1950s, the National Mortgage Bank of Uruguay acted in a fashion similar to that of a European Mortgage Bank. It concentrated all its credit activities in the Bank itself and obtained its funds by issuing bonds in national currency at a 5% annual rate (in periods characterized by price stability).

Since the 1960s, due to inflationary increases of between 60% and 100% annually, the National Mortgage Bank kept its European style in the management of credits, now valued in Adjustable Units, but it also began to finance itself by attracting sight and term deposits–for no longer than a year—with the resulting "mismatching" of terms and currencies as a consequence of the "dollarization" of Uruguay's savings market.

The bank has a current portfolio of over $2 billion in mortgages potentially "securitizable" from the moment the country approves the suitable legal framework to perform this type of operation.

The National Mortgage Bank maintains a web site where information on products and rates is provided. The Internet address is www.bhu.com.uy

Figure 1. Integrated Housing Access System



Adapted from Betrand Renaud (WB) & Michael Lea (IADB)

"Salary Tax" in force since 1968, together with resources provided by international financial bodies.

The economic agents acting in this institutional framework are the following:

- **Society's Clients**—households with a monthly income below US$450, whose demand is met by the Housing Ministry with "Demand's Direct Subsidies" consisting of "basic evolving units" or "Direct Housing Subsidy Certificates" worth approximately US$15,000.

- **Subsidiary Banking Customers**—households with a monthly income between US$ 450 and US$900, served by public (in particular by the National Mortgage Bank of Uruguay) and private financial institutions through the above mentioned supplementation mechanism between Previous Family Savings, Direct Housing Subsidy Certificates and mortgage credits.

- **Banking Customers**—households with a monthly income over US$900, who obtain mortgage credits directly from the public and private financial institutions in market conditions. Some benefits are also given to customers participating in housing loans and savings "open" systems.

The Mortgage Rediscount Fund provides for the rediscount (financing) of mortgages made by primary market lenders. It is technically and financially supported by the IADB and acts as an instrument to facilitate the participation of the public and private sectors in housing mortgage finance. It complements the demand direct subsidies granted by the Ministry of Housing, Territorial Organization and Environment (MVOTMA).

The Fund administrators—the MVOTMA and the Central Bank of Uruguay—offer those banking institutions accepted by the system the possibility of rediscounting from that fund mortgages generated by the corresponding credits at 7% to 10% annual rates.

Since 1996 and with the support of the IADB, Uruguay has started to apply its own version of the Private Pension Administration Fund. The shift from the single state pension system administered by the Bank of Pensions (BPS) to the new one is either compulsory or voluntary, depending on the age of the worker, and the choice of administrator—the ones in the market are generally related to the existing state and private financial system—is free.

At the moment, three years after its creation, these funds add up to over 519,000 members and have accumulated savings of over US$458 million. Their balance sheets and income statements must be made public in URs, the same units used by the Mortgage Bank of Uruguay; consequently, the bonds issued by this Bank in the securitization operations of which it is part will be adequate financial products for the investment of these funds' reserves.

Lastly, it should be pointed out that the system in general, and the National Mortgage Bank of Uruguay in particular, work with an indexation mechanism based on the "Adjustable Unit," whose value is fixed according to the "Salary Average Index" calculated monthly by the General Direction of Statistics and Census, including both the private and the public sector.

In spite of the dollarization of assets and liabilities in our financial market, the Adjustable Unit is the basis for all housing loans, although its use is also widespread in the real estate market in general and the renting market in particular, as well as in the Pension Funds Administration Bodies (AFAPs), all significant potential "institutional investors" for local housing financing.

SUMMARY AND PROSPECTS

An analysis of Uruguay's housing finance development and trends reveals outstanding efforts to meet the demand of low- and average- income households by means of the "Integrated Housing Access System" (IHAS). Private agents in the real and financial sectors are only gradually accepting this system.

Since 1993 this has been the most important undertaking of the Ministry of Housing, Land and Environment. It has had the technical and financial support of the IADB and a yearly contribution of $100 million from the state budget, coming in the most part from a "salary tax." The National Mortgage Bank of Uruguay has participated by contributing the complementary credits to the "Direct Housing Subsidy to Demand."

In a country where the mortgage as a legal instrument has a recognized value and credibility, the mortgage market is widespread and backed by clean, duly administered and controlled public registries. The National Mortgage Bank of Uruguay has an overwhelming position, representing over 85% of all mortgage credits—over $3 billion assets, two-thirds of which carry a mortgage guarantee.

The limited role of diversification and a very slow and gradual participation of the private financial sector in housing finance are a direct consequence of the slow, complex judicial credit recovery process typical of this country. Mortgage secondary markets—excepting the "Rediscount Fund" administered by the Ministry of Housing within the IHAS—are practically non-existent, despite the recent creation of institutional investors such as Pension Funds Administration Bodies that devote, at least initially, massive investment in government bonds denominated in foreign currency.

This in effect freezes mortgage assets to the portfolios of lenders, of which the National Mortgage Bank keeps the equivalent of $2 billion in its portfolio. The legal framework needed for their "securitization" is yet to be achieved.

In brief, the prospects for housing finance in Uruguay are good: a relatively speedy solution to the critical housing deficit in the lower income sectors of society, with the SIAV in charge of providing 20,000 to 30,000 housing units, and public and private agents offering mortgage credits to maintain, provide and develop the housing stock.

This will take place in a reorganized primary mortgage market promoted by an agile legal framework aimed at recovering delinquent credits. At the same time, the development of secondary markets favored by a desired legal regime will make mortgage securitization possible and will gradually correct currency and term mismatches. This will mobilize assets and will offer housing financing liquidity and sustainability.