

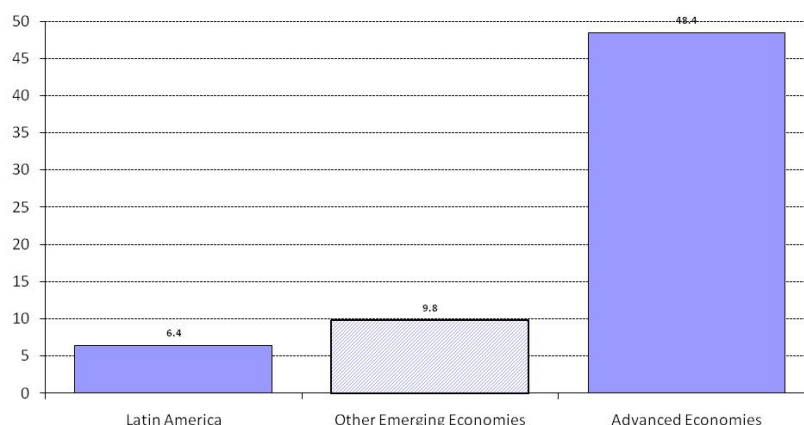
CALL FOR PROPOSALS

Housing Finance in Latin America and the Caribbean: What is holding it back?

1. Justification and Background

Access to credit has been singled out as a major challenge in achieving sustained growth and improving household welfare in Latin America and the Caribbean (LAC). While credit activity is procyclical and has shrunk in the current global financial crisis, even in normal times the region's housing financial markets are shallow compared not only to advanced economies but also to other emerging economies.

Figure 1: Mortgage Finance as a Share of GDP
Average (2000-2005)



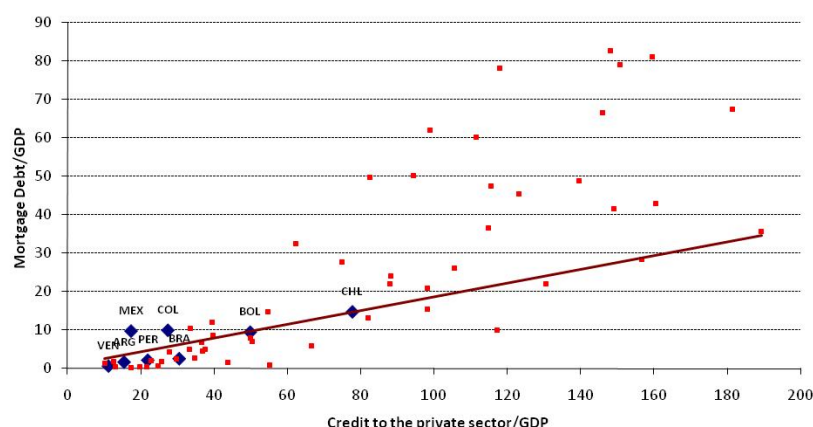
Source: Own calculations based on Warnock and Warnock (2008). Advanced Economies: Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, United Kingdom, and United States. Other Emerging Economies: Algeria, Bulgaria, China, Croatia, Czech Rep., Hungary, India, Indonesia, Israel, Korea, Malaysia, Morocco, Pakistan, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. Latin America: Argentina, Bolivia, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela.

Why LAC mortgage markets are small has been a longstanding concern. Because shelter is a basic human need and the home can be a household's most important durable purchase, homeownership can have deep welfare and development implications. A deep and well-functioning housing finance system may be necessary to realize these welfare benefits.

Recent research has examined explanations for the shallow housing finance systems in LAC and more generally in emerging economies. Galindo and Lora (2005) suggest that low incomes, legal obstacles to seizing collateral in the event of default and macroeconomic volatility are important factors. Warnock and Warnock (2008) add that poor credit information sharing may contribute to the slow mortgage market development in many emerging markets. Broner et al. (2007) propose that enforcement problems limit the development of secondary markets, which could further dampen the growth of mortgage markets.

Many factors considered by this literature are not exclusive to housing finance but could also apply more broadly to financial sector development. In fact, there is a strong correlation between the depth of mortgage markets and overall financial market development as commonly measured by the ratio of credit to the private sector to GDP (Figure 2).¹ Nonetheless, given that mortgage debt outstanding often represents a significant share of total debt outstanding in advanced economies, it is plausible that housing finance is the driver of overall financial development as opposed to being a consequence of it.² For example, from the lenders' perspective, a solid and well-functioning legal framework for housing finance offers the advantage of creating reliable collateral, which in turn may facilitate broader domestic financial development. The relationship between development of the housing finance system and broader financial sector development remains an open research question.

Figure 2: Mortgage Market Debt vs Financial Development



Source: Own calculations based on Warnock and Warnock (2008) and WDI. Countries in the sample: Algeria, Argentina, Austria, Australia, Bangladesh, Belgium, Bolivia, Brazil, Bulgaria, Canada, China, Chile, Colombia, Croatia, Czech Rep., Denmark, Estonia, Finland, France, Germany, Ghana, Greece, Hong Kong, Hungary, India, Indonesia, Iran, Ireland, Israel, Italy, Japan, Kazakhstan, Latvia, Korea, Malaysia, Mexico, Morocco, Netherland, New Zealand, Norway, Pakistan, Peru, Philippines, Poland, Portugal, Romania, Russia, Saudi Arabia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Taiwan, Thailand, Tunisia, Turkey, United Kingdom, United States, and Venezuela

Several LAC countries have recently undertaken a range of initiatives to foster housing finance. These measures include policies that aim to promote securitization, lower mortgage interest rates (through caps or subsidies); introduce inflation-indexed instruments and other public instruments that can aid in the hedging of interest rate risk, promote risk management and provide subsidies to underserved groups. Are some of these government interventions in the housing finance system more effective than others?³ What types of interventions are needed to ensure that the system remains stable in the context of macro volatility?

2. Objective

This project has three main objectives. The first is to *describe* the current state and evolution of the national system of housing finance, as well as associated current and past government policy initiatives; in essence, to

¹ Papers that have studied the rise of mortgage markets in advance and emerging economies include Dynan and Kohn (2007) and BIS (2006).

² A discussion of the macroeconomic impact of housing finance markets on the business cycle can be found in Campbell and Herkowitz (2005) and Cardarelli et al. (2008).

³ See Chiquier and Lea (2009) for a discussion on instruments and policies to promote housing finance development in emerging market economies.

describe outcomes (the state of the housing finance system) and inputs (primarily policy actions, but also other country characteristics including but not limited to market or government failures). The second objective is to *explain* the extent of development of the housing finance system by linking the outcomes reported with inputs described. The third objective is to assess the effectiveness of the housing finance system and identify where further reform and policy changes are needed.

3. Content and Methodology

To produce high-quality research on national housing finance systems, a combination of descriptive and systematic approaches is necessary. Careful and detailed descriptions of many aspects of housing and finance are essential. Systematic analysis is also necessary, in order to clearly document causal factors that drive the evolution of the national housing finance system. Throughout, the use of theoretical and/or empirical models to explain the facts and establish causality is encouraged.

Each research paper, which can be on a single country or a group of countries, will include four required sections. Because housing finance does not exist without a housing sector, in order to place the housing finance system in context the first section should provide a *brief* overview of some salient features of the housing sector. The second section, a description of the national housing finance system, focuses on outcomes. The third section focuses on inputs (drivers) such as government policies relating to housing finance and other structural factors. The fourth section provides the link between outcomes and drivers; it identifies and assesses the main drivers (both policy and non-policy) of the evolution of the housing finance system.

The *first* section will summarize relevant characteristics and components of the housing market, which is what housing finance mechanisms ultimately support. How does the housing market function? What are the main factors and trends in housing demand and production? Are there challenges in facilitating the fulfillment of households' shelter needs that have some bearing on housing finance? Is there a well-functioning rental market that reduces the need for home ownership and thus housing finance? In particular, how do the poor satisfy their housing needs? It is important to note that this first section is not the core of the project, but it is relevant background information needed to understand the context of each case study.

The *second* section will describe in detail features and components of the housing finance system in the country (or countries) under study. This section should present facts and figures that give a clear and accurate picture of what the system is, how it works and how well it functions. As such, it should include information on the size of the housing finance market; its evolution over time; relevant market segments; mortgage products, interest rates and relevant financial instruments; securitized markets (where these exist); and regulations that impact housing finance. This section should describe how different income segments of the population fulfill their housing financing needs. A narrative and a compilation of historical time series data that show how the housing finance system has evolved are important parts of the study.

Specifically, as much as possible, quantitative information should be through time (to provide a clearer picture of the evolution of housing finance) and cover the following topics:

- Size and composition of the housing finance system.
 - The size of housing lending, both in absolute terms and also appropriately scaled (by GDP or other measures).
 - Breakdowns by type of lending institution, by different categories as defined by the regulatory regime (e.g., social interest housing), by purpose of loan (purchase, refinance, improvement), and by rate type.
 - Share and evolution of floating, fixed, inflation-indexed and foreign currency housing loans in total housing lending.

- Typical or average maturity of housing finance loans.
- Non-performing housing loans as a share of total housing loans, and by different categories as defined by the regulatory regime.
- If mortgage-backed securities exist, the size of the outstanding stock of mortgage-backed bonds with respect to total mortgage lending. A description of the market for securitized assets.
- If housing finance is financed through foreign sources, the channels and the modalities through which this takes place and how it has evolved over time.
- A description of refinancing activity.
- Pricing in the housing finance system.
 - How are the different segments of the market priced?
 - What are the main indexes used for determining interest rates?
 - How are spreads determined?
- Institutions in the housing finance system.
 - Which institutions provide housing finance? Distinguish between banking and non-banking institutions, micro-credit, NGOs, and capital markets. What is the loan process, from application to closing to payment, including basic underwriting requirements?
 - What are the sources of lenders' funds?
 - Provide a picture of the industry structure by including a description of the roles of various institutions (public and private, including investors, securitizers and other secondary market institutions) in the provision of housing finance.
- Regulatory aspects of the housing finance system.
 - Is mortgage equity withdrawal allowed?
 - Is penalty-free refinancing allowed?
 - Is housing lending in foreign currency allowed? Are there special regulatory provisions for this type of lending?
 - Are there regulations influencing the loan terms and loan products? For example, is there a policy on loan-to-value ratios, maturity, or certain types of mortgage such as adjustable rate mortgages or inflation-indexed loans? How do these vary across different segments of the market?
 - What is the prudential framework for housing loans?
 - What are the procedures for default and foreclosure?
 - Are there special regulatory provisions or tax incentives for borrowers (e.g., tax deductions of mortgage interest payments) or investors (special tax treatment of mortgage backed securities)?
 - Are there ceilings on the interest rates of mortgage loans?
 - What are the typical underwriting criteria?
 - Are there other relevant administrative restrictions that affect the mortgage loans market?

The quantitative and regulatory information reported in this section should be accompanied by a narrative geared toward describing both the status of the housing finance system and its evolution.

The *third* section will describe public policy initiatives adopted for the development of the national housing finance system as well as other structural factors. Policies and strategies (targeted at specific groups or market-wide) to explore could pertain to critical aspects of housing finance, including but not limited to the following:

- Subsidies
- Tax incentives
- Creditor rights
- Credit information systems
- Titling
- Affordability of mortgages (interest rate ceilings, loan guarantees to lenders, etc.)

- Promotion of long-term lending (e.g. interest rate hedging provided by government)
- Financial vehicles
- Microlending for housing
- Housing finance for the poor
- Home loans in rural areas

The *fourth* section will focus on an overriding objective of this project, the establishment of links between outcomes and inputs (such as structural factors and policies, whether enabling or constraining) in housing finance systems. A variety of techniques could be used to establish these links. Given that factors and their availability may vary significantly from country to country, no specific methodology is prescribed. Theoretical modeling and econometric (including time series) analysis would be desirable and valued accordingly. Where such analysis is not feasible, a more narrative approach might suffice. If a narrative approach is taken, the careful descriptive analysis and discussion of facts and figures reported in the first sections must be rich enough to support clear causal statements that link key drivers to outcomes.

An analysis of a small number of countries with similar characteristics, such as countries in the Caribbean or in Central America, is highly encouraged. Such studies would obtain more funding.

4. Selection Criteria

Research institutions or teams of individual researchers may present a proposal for this project. Proposals will be evaluated based on the following criteria:

- Quality and feasibility of the proposed case (60%).
- Empirical study of determinants of housing finance (40%).
Higher points will be given to studies that will look beyond banking finance into market finance. Data quality and the statistical techniques fall under this criterion. Proposals to conduct multi-country studies will be accepted if the econometric exercise, adequately defined, involves analysis that otherwise cannot be investigated through a single country study.

To be considered for the project, the research proposal should include the following:

1. Motivation for the proposed country study (maximum 1 page per case study).
2. Data templates to be used in the study (Excel format) and a preliminary assessment of data availability. Individual country studies should refer to countries in the 26 LAC of the IDB.
3. A description of strategy for collecting relevant data, including regulatory data.
4. A detailed description of the methodologies to be used in Sections Three and Four.
5. A brief survey of previous studies conducted on the country or countries (1 page).

Final papers will be considered for dissemination as IDB working papers and may be included in a book or a special journal issue on Housing Finance in LAC. For studies with IDB funding, other forms of dissemination or publication should be explicitly approved by the coordinators until the journal issue option has been fully defined. Proposals may include suggestions for further dissemination of the final version of the paper and its policy implications.



5. Proposal Submission

- Research institutions or individual researchers interested in submitting a proposal should pre-register before **October 31, 2009** by [clicking here](#). If unable to pre-register before the due date for proposals (December 18, 2009), please send an email to red@iadb.org
- Proposals are due **Friday, December 18, 2009**.
- Proposals should be submitted using the **Web Submission Form**. Please note that there are two options within the submission form: one for institutions and another for teams of individual researchers. Please make sure to choose appropriately.

The following information will be required for submitting your proposal:

- The proposal with all the technical aspects involved in the development of the study, based on the Terms of Reference outlined in this Call for Proposals.
- A budget indicating the time and resources that will be used within the context of the research work plan. **The budget is requested as a separate file and should not be included in the proposal.** The budget proposed should disaggregate items financed by the IDB contribution and those financed by the research institution or by the team of individual researchers. The budget should distinguish among amounts assigned to professional honoraria, “overhead” and other major categories of research expenditures.
- The name and *Curricula vitae* (two pages maximum) of the technical coordinator and other researchers involved. The research team should demonstrate its ability to meet the objectives of the project, including relevant experience. Please note that for proposals submitted by institutions, subsequent substitutions for researchers originally specified in the proposal may be made with prior approval from the project coordinators, but the technical coordinator should lead the entire project until its full completion. Conditions regarding the substitution of researchers apply only to contracts with institutions and not to contracts with individual researchers.
- If an institution submits the proposal, it must provide the name and contact information of the legal representative, with authority to sign contracts with the IDB, if selected to conduct the study.
- If a team of researchers submits the proposal, the IDB will enter into a separate agreement with each individual. For this reason, a detailed budget including honoraria and expenses for each researcher is required.

Note: All proposals and research papers should be submitted in English.

6. Coordination and Schedule

The IDB project team consists of Arturo J. Galindo and Alessandro Rebusci (Research Department.) Frank Warnock and Veronica Cacdac Warnock (University of Virginia) will act as external advisors for the research project.

The tentative schedule of activities is as follows:



Call for Research Proposals

Inter-American Development Bank
Housing Finance in LAC: What is holding it back?

- **October 22, 2009:** Call for research proposals issued.
- **October 31, 2009:** Due date for **pre-registration** by [clicking here](#). If unable to pre-register before the due date for proposals, please send an email to red@iadb.org
- **December 18, 2009:** Due date for receiving proposals. Institutions should ensure that complete documentation is submitted through the **Web Submission Form**.
- **January 11, 2010:** Announcement of selected research proposals
- **February 11-12, 2010:** First Discussion **Seminar** in Washington, DC, to discuss methodologies and strategies.
- **June 4, 2010:** Due date for receiving a **first draft** of research papers.
- **July, 2010:** Second Discussion **Seminar** (specific date and location to be determined) with project leaders and advisors for the purposes of discussing the first draft of research papers.
- **August 27, 2010:** Due date for receiving a **second draft** of research papers and delivery of the datasets utilized by the study to the IDB.
- **October 29, 2010:** Deadline for **final version** of the research papers, including a summary that discusses policy lessons.

Please note that adherence to delivery dates will be strictly enforced.

6. Financial Aspects

The IDB will contribute up to **\$30,000** for each study depending on the scope of the work proposed.

The payment schedule is as follows:

- **30 percent** within 30 days of signing the formal agreement between the IDB and the respective research center.
- **20 percent** within 30 days of presenting and approving the first draft of the research paper
- **20 percent** within 30 days of presenting and approving the second draft of the research paper and upon delivery of the datasets utilized by the study to the IDB.
- **30 percent** upon approval by the Bank of the final research paper.

7. References

- Bank for International Settlements - BIS (2006) "Housing Finance in the Global Financial Market," CGFS Publication No. 26 (Basel: Committee on the Global Financial System).
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- Cardarelli, R., Monacelli, T., Rebucci, A. and L. Sala (2008) "Housing Finance, Housing Shocks and the Business Cycle: VAR Evidence from OECD countries". Mimeo.
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- Warnock, V.C. and F. Warnock (2008), "Markets and Housing Finance", Journal of Housing Economics, 17: 239-251.