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Summary Note: Ecuador Urban and Housing NLTA

1. This note provides an overview of all the activities undertaken under the NLTA during FY12-14 and discusses main results and findings. The NLTA started in FY2012 at the request from the Government of Ecuador. The request was made from the Housing Bank (Banco Ecuatoriano de la Vivienda, BEV, which was later absorbed by Banco de Estado, BEDE) and the Ministry of Urban Development and Housing (MIDUVI) to provide recommendations and advice on housing finance for low income population. This was when the Bank still had limited engagement with the country after the break in the dialogue¹. As an entry point, the Bank together with BEDE/MIDUVI organized an international seminar on low income housing finance together with the MIDUVI and the BEV by bringing lessons learnt and international experiences on the subject from more than 12 countries. Following the successful seminar, BEV and the Ministry of Economic Policy Coordination (MEPC) requested the Bank's technical assistance in low income housing policy and finance. The NLTA started on a gradual re-engagement with key decision makers for the housing sector and paved a way to rebuild the dialogue with them.

2. The NLTA had development objectives of assisting the Government of Ecuador (GoE) in strengthening policy formulation for integrated urban land and low income housing through the provision of analytical products and services. More specifically, the proposed TA aimed to enhance the knowledge base of the GoE and provide an input to the policy formulation in the areas of: (i) the analytical assessment of housing demand and supply; (ii) the review and evaluation of housing subsidy program; (iii) the development of sustainable low income housing policy; (iv) the understanding of Ecuador's urban portfolio and guidance; and (v) re-engagement in urban policy dialogue in the country. The umbrella NLTA was meant to support the re-engagement of urban sector dialogue with key ministries and sub-national governments and it was designed to be flexible and responsive to the client's demand. The NLTA certainly contributed to opening a sector dialogue and establishing client relationship and also to channeling sector knowledge and international experiences to the clients.

3. Since the Concept Note for the NLTA was prepared and reviewed, three additional TFs were mobilized to complement and leverage the sector dialogue: FIRST TF for low income housing policy (US\$160,000, closing end FY14); Multi-Donor TF for land policy and housing affordability (US\$75,000, closing end FY14), and Korea Green Growth TF, US\$250,000). The NLTA integrated activities supported under these three TFs (with an exception of Korea GGTF). The overall objective of FIRST TF was to provide recommendations for demand side subsidies to target better lower income groups and to create incentives for private lenders and the capital market development. The MDTF was supported TA to look at the supply side of housing policy and evaluate the performance of low-income housing market in Quito as a case study, using a variation of the Land Market Assessment (LMA) method, developed by the World Bank. The Korea Green Growth TF was to support sustainable urban growth of the metropolitan cities of Ecuador by: i) providing analytical framework and practical guidelines for effective urban growth management and ii) providing practical instruments for more compact and sustainable land development. During FY14, the team has completed all the activities related to FIRST TF and MDTF together with NLTA.

¹ Interim Strategy Note for FY14 and FY15 was approved in March 2013, building upon gradual engagement in analytical and advisory services.

4. **Background Context:** Similar to most countries in the region, a rapid urbanization process has taken place in Ecuador in the last four decades, quadrupling the urban population from 2.4 million in 1970 to 9.2 million in 2010. About two thirds of the population live in urban areas (9.2 million out of a total of 14.2 million habitants), and it is estimated that more than 70% will be living in urban centers by 2030². The annual rate of urbanization between 2000 and 2010 was 2.43%. Rapid urbanization has increased the number of poor people living in urban areas from 1.1 million to 3.5 million. Ecuador is one of the least urbanized countries in the region and is still urbanizing, albeit at a slower rate than before. For instance, in 2010, about 65% of the total population in Ecuador lived in cities, compared with 80% in Latin America.

5. Ecuador faces a problem of both quantitative and qualitative housing deficits, especially for the most vulnerable segment of the population. The current housing deficit is estimated to reach two million housing units, about 51% of the current housing stock in Ecuador. According to the housing diagnosis that the Bank carried out in 2012, about 51% of the housing stock in Ecuador need to either be improved (34%) or replaced (17%), based on the quality of its floor, ceiling and wall materials. The poorest 30% account for about 65% of the total quantitative housing deficit. Nearly 40% of poor households live in dwellings that need repairs. According to a Bank's recent study, nearly half of urban households live in overcrowded or structurally unsafe dwellings, increasingly in informal settlements and in areas vulnerable to natural disasters. Based upon current trends, 250,000 units of additional housing will be needed in Ecuador by 2020. Informal housing is typically developed incrementally, at a premium to users, with municipalities retrofitting services post-facto, and density remaining low³. There is an urgent need to think about the provision of low income housing in coordination with the provision of basic services in the growing peri-urban areas.

6. **Housing Policy Dialogue:** Housing policy and finance dialogue was carried out by a number of technical presentations, policy dialogue, and stakeholder discussion. Technical notes were also provided to the GoE together with presentations. In particular, the Bank played an important role to convene policy dialogue and bring key stakeholders in housing policy finance including MIDUVI, the Ministry of Economic Policy Coordination, the Ministry of Finance, the State Bank (Banco del Estado), Banco del Instituto Ecuatoriano de Seguridad Social (BIESS, Ecuador's Provident Fund), the Corporación Nacional de Finanzas Populares (CONAFIPS); the Corporación de Desarrollo del Mercado Secundario de Hipotecas (CTH). The Bank also carried out high-level ministerial meetings to present the Bank's recommendations, as well as several workshop/stakeholder consultations. Overall, the Bank's analysis on affordability, distribution channel, and impact of interest rate subsidy on long term cost of financing, as well as methodology to analyze housing demand prove to be highly useful and important contributions to MIDUVI. The analytics that the Bank team provided often became basis for their policy documents. In addition, the Bank's recommendations provided an important input to the housing subsidy program and also generated lively debate and discussion among the policy makers related to housing finance.

7. The Bank's main recommendations for housing policy and finance are summarized as follows (see the technical note for more details):

- a. For institutional framework: Reconsider the role of BIESS in mortgage market by revisiting the existing implicit interest rate subsidy which will help private sector to participate in and compete in mortgage market; establish a level playing field for all the agencies/institutions involved in housing policy so that it does not generate arbitrage or regulatory distortion; strengthen a coordination mechanism among different

² Statistical Yearbook for Latin America and the Caribbean, CEPAL/ECLAC 2010.

³ Quito's current density is 3,400 inhabitants / km², which stands at less than a third of that in Lima, with 12,000 inhabitants /km², and less than a fifth of the density in Bogota, which has 18,100 inhabitants /km².

actors/stakeholders that oversees overall housing policy; strengthen monitoring and evaluation of the subsidy program; and reconsider the role of Banco de Estado as second-tier financing intermediaries rather than first tier channeling directly subsidy monies to developers.

- b. For subsidy instruments: a) Establish differentiated instruments for different income segments that the policy aims to attend to. The existing subsidy program for housing acquisition reaches middle to lower income population for home purchase leaving the poorest population unattended. The population in the poorest segments should be supported by different products such as housing improvement or rental housing; b) Revisit interest rate subsidy scheme, if not reducing its role, at least revise the current structure (for instance, so interest rate subsidy can be applied only in the first years, or for specific income segment, or with progress interest rate, etc). International experiences point to the fact that interest rate subsidy tends to be regressive, expensive and ineffective; and c) incorporate other subsidy instruments that are not yet contemplated such as partial guarantee, mortgage insurance, and programs for non-affiliated, so as to provide market incentives for banks and developers; consider establishing a window of long-term funding such as mortgage liquidity facility.
8. Key recommendations such as strengthening institutional roles and responsibilities, investing M&E framework, and developing differentiated housing programs were reflected and adopted in the GoE's policy. In addition, operational aspects of subsidy implementation to streamline and simplify procedures and permits were well received and taken into account in their revised subsidy program. Finally, the Bank's dialogue resulted in enhanced understanding of the effects of the interest rate subsidy as well as the role of provident fund BIESS in mortgage market. While there was a clear consensus among policy makers that interest rate subsidy has worked sub-optimally and it is regressive and expensive, it is unclear at the moment if and when alternative instruments would be adopted any time in the near future. In addition, the role of Banco de Estado was extensively discussed to restructure it as a second tier financial institution moving away from existing direct involvement with developers and municipalities for housing and municipal infrastructure provision. This dialogue is expected to continue in the future in the broader discussion being initiated by the GoE of the roles and responsibilities of public banks.
9. On the supply side constraint, the study carried under the MDTF analyzed the extent to which constrained land supply and high price are becoming the main impediments to the provision of affordable housing. The study was carried out in Quito as a case study (since Quito municipality expressed an interest in the study and there was an opening in the dialogue). The report explores how land supply, housing demand, property titling, land use, zoning and infrastructure availability shape land and housing prices. Quito's unique topography, which limits development to its north-south valley, impedes urban expansion. The lack of developable land forces developers to build at high densities in the valley—making housing construction expensive. The lack of developable land and limited opportunities for low cost construction makes housing expensive and unaffordable for low and middle-income households. It further identify key constraints to the production of affordable housing in the Quito metropolitan area and a series of recommendations on how the metropolitan government of Quito can increase housing supply and enhance housing affordability. The recommendations included, among others: rental housing vouchers, restructuring and alignment of land use planning to accommodate future growth, expanding transit connectivity in the north eastern, and southern valleys, redevelopment of airport land into high-density residential development and other under-developed sites in the city, streamline land use and zoning regulations to foster more efficient and speedy development, and introduction of inclusionary zoning to promote the development of affordable housing units.
10. In addition, the GoE was considering setting up a land bank within MIDUVI in order to address

supply side constraints for low income housing and asked for the just-in-time policy note on the international experiences on land banks. The note included a review of international cases (mostly North American cases as well as Colombia, India and China) where land banks typically were used to address urban blight, to developing affordable housing and to revitalize neighborhoods in the context of economic decline of an area. Lessons learned from these cases and a discussion of the necessary conditions needed to set up and successfully manage land with a land bank. The note highlighted that land banks operate best at the municipal level and they rely upon clear national or state legislation to define their legal authority and policy mandate. In most cases, land banks work better when outsourcing the construction and management of affordable housing to public, non-profit or private sector partners. It also stressed that land banks should not undermine the private sector in developing real estate, including affordable housing. Finally, land should be distributed or sold through unambiguous, transparent processes as to avoid the risk of corruption. While public tender processes are not always possible, there should be clearly established processes and where appropriate, defined prices for different land products sold by land banks.

11. Urban Engagement at National and Sub-National Levels: the NLTA also initiated a broader urban sector dialogue as part of re-engagement efforts. In the very early stage of NLTA, the team provided the rapid analysis of the system of cities, looking at the demographic characteristics of cities in Ecuador, urbanization trends, the distribution of cities by size, and overview of demographic changes in the cities. It also looked at economic structures and specialization of cities across city classification, and examined access to basic service such as water, sanitation and electricity. The analysis used the methodology of the Urbanization Review and the results were shared and disseminated with the MIDUVI, MCPE and Secretaria Nacional de Planificación y Desarrollo (SENPLADES).

12. In addition, at the request from MIDUVI, the Bank provided a three-day workshop and training for national cadastral system in June 2012. The Bank facilitated a south-south exchange by bringing experts from Colombia who led the successful cadastral updates in Bogota and also invited representatives from Quito, Cuenca, Ibarra and Ona municipalities to the discussion. MIDUVI has a responsibility in developing national cadastral system, as well as in designing and implementing the national cadastral law. MIDUVI was in the process of analyzing cadastral management in Ecuador's municipalities and was about to initiate a pilot project to generate standardized and integrated cadastral system. To this end, the Bank team facilitated the presentation of Colombia's experience in cadastral updates and the experts also provided diagnosis and recommendations in the four key areas of institutional aspects, methodology and process, human resource needs and technology. The workshop was well received both by MIDUVI as well as by participating municipalities and the working session with municipalities and the experts resulted in tangle recommendation/diagnosis that was presented to MIDUVI and other key stakeholders.

13. The NLTA also supported a number of workshops and international seminars related to urban upgrading and financing. First, the NLTA supported organizing and participating in a workshop in Cuenca in June 2012. The "Towards Safer, Sustainable, and Inclusive Cities" was represented by multi-sectoral teams working in transport, DRM, environment and urban/housing. This marked as the first sub-national engagement in Ecuador (later the Bank team had a separate visit to Cuenca together with SD director to explore areas for possible lending engagement in March 2013). In addition, the NLTA also supported an international workshop on innovative urban financing and urban upgrading experiences in Quito, June 2013, following the visit of the mayor of Quito to Washington, DC. The workshop provided an overview of different financing instruments for local economic development, drawing upon mainly the US and Brazil experiences and discussed necessary legal and institutional environment for each instrument to work, and brainstormed quickly how some of these instruments can be adopted in the context of Quito urban development. The workshop also served as a venue for the municipality to present the financing of key urban development initiatives in Quito. In parallel, the workshop also discussed

lessons learnt for urban upgrading and service provision, in particular, based on integrated approach for social, spatial, and economic inclusion. The workshop drew upon experiences in Bolivia, Brazil, and other Latin American countries. The workshop provided an opening to engage and continue a dialogue with Quito municipality for technical collaboration.