HOUSING POLICY IN HONDURAS: DIAGNOSIS AND GUIDELINES FOR ACTION

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EXECUTIVE SUMMARY

Introduction: President Ricardo Maduro, who came into power in January 2002, promised to make housing a key component of the Government's Poverty Reduction Strategy and a key instrument for spurring economic growth. He has since committed himself to transforming this promise into an effective, equitable and sustainable national housing policy, embedded in a solid institutional structure that should outlive his own tenure. The four objectives of this report are: (1) To examine the context of the Honduran housing sector (Part I); (2) To assess the current conditions in the sector (Part II); (3) To examine the status of housing policy (Part III); and (4) To propose a preliminary set of guidelines for Government action on housing at the present time (Part IV).

Part I—The Context of the Honduran Housing Sector

Conditions in the housing sector in Honduras are largely the reflection of its context. Seven contextual factors have particularly strong effects on the sector: (1) Environmental hazards and natural disasters; (2) Population growth, urbanization, and household formation; (3) Poverty, the level of economic development, and economic growth; (4) The distribution of income; (5) Inflation and government fiscal policy; (6) Conditions in the financial sector; and (7) Conditions in the construction sector.

Environmental Hazards and Natural Disasters: In October–November of 1998, Hurricane Mitch left 6,000 dead and more than 8,000 missing, causing widespread material damage estimated at some $3.8 billion. From the perspective of housing policy, the continued vulnerability of Honduras to severe tropical storms requires (1) an effective enforcement program for preventing residential construction on steep unstable slopes and in river beds subject to flooding; (2) an infrastructure upgrading program in existing settlements to improve storm drainage and resist mudslides; (3) a resettlement program for families

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living in environmentally vulnerable communities that cannot or should not be improved.

Population growth, urbanization, and household formation: Honduras had a population of 6.3 million in 2001 and its population is now growing at 2.6% per annum. It is still one of the least urbanized countries in Latin America and the Caribbean, with only 47% of its population residing in urban areas in 2001. It now has the highest urban growth rate in the region—4.0% per annum. Assuming that their population growth rates during 1988–2001 continue—a conservative projection— Tegucigalpa and San Pedro Sula will double their populations in 15 and 13 years respectively. The net additions to the overall number of households in Honduras in 2001 were of the order of 42,000 of which 30,000 were in urban areas—9,000 in Tegucigalpa, 7,000 in San Pedro Sula, and 14,000 in other cities.

Poverty, the Level of Economic Development, and Economic Growth: Per capita Gross Domestic Product (GDP) in 2000 was 15,150 Lempiras ($924). Levels of poverty and extreme poverty in Honduras are high, especially in rural areas where in mid–2001 54% of the people lived on less than $1 a day and 82% on less than $2 a day. Levels of poverty are lower in urban areas. During the same period, 7% of the urban population lived on less than $1 a day, and 14% on less than $2 a day. From 1970 to 1997, the average growth rate of real per capita GDP was 0.4%, in other words close to zero. Given low levels of per capita income and stagnant economic growth, we cannot expect the quality of housing in Honduras to be comparable to that of more–developed countries. **Overcrowding—a key indicator of housing–related poverty—has been identified as the most prevalent Unsatisfied Basic Need (UBN) in the country.**

The distribution of income: The distribution of income in Honduras is highly skewed. Incomes are much higher in urban areas, and the income distribution in urban areas is less skewed than in rural areas. In 2001, according to the latest household survey, the median annual household income was L.81,712 (US$5,309) in Tegucigalpa and L.87,824 (US$5,707) in San Pedro Sula. The median annual household income was L.73,005 (US$4,744) in urban areas, more than twice the median income— L.28,547 (US$1,855)—in rural areas.

Inflation and Government Fiscal Policy: The consumer price index averaged 28.7% in 1990–91, declined to 9.8% in 1992–3, increased again to an average of 20.2% in 1994–97, and was maintained at 11.5% during 1997–2001 despite the fiscal pressure exerted by Hurricane Mitch in late 1998. In 2001, the inflation rate was 9.7%. Central government deficit as a percent of GDP rose from 4.5% in 2000 to 6.1% in 2001, and is expected to remain at that level in 2002–3. Honduras pre–qualified for debt relief under as a Heavily–Indebted Poor Country (HIPC). The new government hopes to come to a decision point with the International Monetary Fund (IMF) under the Poverty Reduction and Growth Facility (PRGF) program by December 2002.

Conditions in the Financial Sector: The financial system in Honduras is presently in an unsteady state, having endured the forced liquidation of one bank in 1999 and another bank in 2001. The system now consists of 21 commercial banks, 4 savings and Loan Associations, and 10 financial companies. In November of 2001 the total active portfolio of the banking system amounted to L.64.6 billion (US$4.3 billion). There is a near absence of deposits in excess of 90 days. The *real* lending rate was of the order of 14.5% in 2000 and 2001, largely because of very high levels of intermediation. The 23.2% average lending rate in 2001 was 11.4% above the average deposit rate.

Conditions in the Construction Sector: The average volume of construction as a percentage of GDP between 1991 and 2001 was 4.8%. The volume of construction as a share of overall investment declined through most of the decade, from a high 25.2% in 1992 to a low 15.3% in 1998, and increased to 18.0% by 2001. Employment in the construction sector constituted 5.5% of total employment in 2001 and, because of the current recession in the sector, unemployment reached 10.2%, more than double the 4.2% overall rate of unemployment. Half of all construction employees are either self–employed or work with one additional person. In general, construction prices appear to have moved in parallel with the overall inflation rate in recent years.

Part II–Conditions in the Housing Sector

Other than the contextual factors discussed in Part I, there are three principal conditions within the housing sector itself that affect housing supply and demand in Honduras: (1) The availability of land; (2) The volume, structure and costs of housing production; and (3) The availability of mortgage finance. The actual performance of the housing sector can be summarized by examining four of its key dimensions: (4) House prices, rents, and affordability; (5) Dwelling units and living space; (6) The quality of housing; and (7) Tenure.

The availability of land: The population of Metropolitan Tegucigalpa was 990,982 in the year 2000, and it occupied a built–up area of 96.7 square kilometers. Its gross population density was therefore 10,250/km^2, one of the highest densities to be found in the region. At this density every additional person that comes to live in the city consumes, on average, 100m^2 of new urban land. The average *cost* of serviced land on the urban fringe is of the order of L. 180 ($11.25)/m^2. There are still organized invasions in Tegucigalpa, and it was still possible in early May of 2002 to buy 15–meter–by–8–meter plots in a new invasion for L.3,100 ($190).

The Volume, Structure and Costs of Housing Production: On average, 34,000 housing units are now produced in urban areas every year—9,000 in Tegucigalpa, 10,000 in San Pedro Sula, and 15,000 in other cities. The rate of housing production in 2001 in Tegucigalpa, for example, was relatively high—9.3 dwelling units per 1,000 people. Some 65–75% of annual housing production now takes place *outside* the formal sector. The *direct* construction cost of a median–priced formal house in Tegucigalpa is currently of the order of L.1,800 ($110) per m^2. Construction costs in the informal sector appear to be similar, but a basic 36m^2 starter house in a new invasion costs only L.10,000, or L.275 ($17) per m^2.

The availability of mortgage finance: Lending interest rates in the banking system are still 23–28%, even though inflation has been reduced to single digits. By the end of 2001, the total mortgage portfolio in Honduras was of the order of L.12 billion ($747 million). The total number of new housing loans in 2001 was estimated at 17,000, and the number of loans for new formal–sector housing in 2001 was estimated to be of the order of 7–8,000. There are no ready sources of long–term funds except for pocketbook savings. Government bond yields remain high—15.3% in 2001—reducing the incentive to lend.

House Prices, Rents and Affordability: House prices and rents in Honduras have generally appreciated at the same rate as the overall rate of inflation. Hondurans appear to invest heavily in their housing. The *median* value of a house in Tegucigalpa at the present time is approximately L.275,000 ($17,000). Yet a median–income family in the city could only afford a house worth slightly more than one–third of this value if it wanted to finance it with a mortgage loan under the present terms. The house price–to–income ratio in Tegucigalpa is of the order of 3.2. The private sector has gone down market: The cheapest land–and–house package offered by the private sector in Tegucigalpa at present is priced at L.110,000 ($6,700), amounting to 1.3 median incomes.

Dwelling Units and Living Space: **[out: There are 16% more dwelling units than households in the country, and 3% more in Tegucigalpa.] While the population in the country has grown at an average rate of 2.4% between 1988 and 2001, the housing stock has grown at the rate of 3.7%, some 50% faster than the growth of the population. This has made it possible to accommodate the reduction in household size from 5.5 to 5.0 during this period. However, the estimated** number of households **still** exceeded the number of *occupied* dwelling units in 2001, by 2.0% in the country as a whole and by 4.0% in Tegucigalpa. The overall *quantitative* **[italics]** housing deficit **could still** be of the order of 50–**100,000** units in the country **[out: as a whole, and 12–25,000 in Tegucigalpa] depending largely on the method for estimating the number of units in high–risk areas that require total replacement through resettlement.** The median floor area per person in Tegucigalpa is estimated to be 10.4m², the median house size to be 51m², and the median number of persons per bedroom to be 2.1. **Still, there is considerable overcrowding. In** 10 percent of the households in the country, 6 or more persons share a single bedroom. In Tegucigalpa, in 10 percent of the households 4.6 or more persons share a bedroom.

The Quality of Housing: In Tegucigalpa in 2000, only 2 percent of exterior walls were made of non–permanent materials. 96 percent of the houses in the city were connected to the water–supply network, but piped water supply was intermittent; 75 percent had indoor toilets and 98 percent had electrical connections; 35 percent were located on streets with no direct vehicular access; and 41 percent were located on non–asphalted roads. The quality of houses and residential infrastructure in Honduras is improving: In recent years, the percentage of houses with masonry walls increased substantially everywhere the percentage of outdoor latrines in urban areas declined from 28 percent to 14 percent; and the percentage of rural houses connected to the electrical grid increased from 34 to 49 percent.

Tenure: The share of owner–occupied housing in Tegucigalpa—79 percent in 1998—in high in comparative terms. Between 1988 and 1998, the share of owner–occupied housing increased from 82 to 86 percent in the country as a whole; from 90 to 96 percent in rural areas; and from 71 to 75 percent in urban areas. It remains relatively low, at 66 percent, in San Pedro Sula. Invasions appear to continue unabated. According to a recent study, some 46 percent of all residential properties in Tegucigalpa were obtained through illegal land invasion. Yet another 13 percent have unclear or restricted land titles. Only 40 percent of the residential properties in the city have proper legal titles and authorized construction.

Part III—The Status of Housing Policy

To better understand whether the present housing policy framework can adequately address the key housing policy issues now facing the country, we must focus on the status of housing policy along its six critical dimensions: (1) the property rights regime; (2) the housing finance regime; (3) housing subsidies; (4) residential infrastructure; (5) the legal and regulatory regime governing the housing sector; and (6) the institutional framework for government intervention in the sector.

The Evolution of Housing Policy in Honduras: Honduras created an independent housing agency in 1957—the *Instituto Nacional de la Vivienda* (the National Housing Institute, or INVA)—with a mandate to finance, construct, and manage social housing. The *Fondo Social para la Vivienda* (FOSOVI, or the Social Fund for Housing) was created in 1992 to replace INVA, and to redefine the role of the state in the housing sector as a *facilitator*. Responsibility for the formulation and execution of housing policy was officially transferred to the Ministry of Transport, Public Works and Housing (SOPTRAVI), created in 1996 as part of the Modernization of the State.

The Property Rights Regime: Honduras has responded positively to tenure legalization. The 1990 Law of Municipalities authorized municipal corporations to take over *ejido* lands within their boundaries, and to sell occupied plots of land to their inhabitants at a price no less than 10 percent of the latest assessed value of the land. The Department of Tenure, Administration and Legalization of Lands at the Municipality of Tegucigalpa now regularly engages in legalization on its own lands, on *ejido* lands, and on private lands were invaders and landowners have reached sale agreements. The legalization cost for a plot on municipal and *ejido* lands was estimated at L.6,400 ($460), and for a plot on private lands at L.16,700 ($1,210).

The Housing Finance Regime: There are two second–tier institutions that lend mortgage funds at below–market rates, FONAPROVI (*Fondo Nacional para la Producción y la Vivienda*) and RAP (*Regimen de Aportaciones Privados*). By the end of December 2001, FONAPROVI had a portfolio of L.1,587 billion ($99 million) in housing loans and its lending rate to banks was 15.1%. RAP had a housing loan portfolio of L.1.1 billion ($68 **million**). It collected mandatory contributions from employees and their employers and kept them in saving accounts at 3%, while its lending rate to banks averaged 15%. Loans for the purchase and construction of housing averaged L.330,000 ($20,800) and L.250,000 ($15,200) in FONAPROVI and RAP respectively. A third institution that makes smaller loans in combination with a subsidy for housing is FUNDEVI *(Fundación para el Deasarrollo de la Vivienda Urbana y Rural)*, which had a portfolio of L.536 million ($33 million) in December 2001. Its lending rate to borrowers was 21%.

Housing subsidies: During the past two years, the Government has been allocating L.100 million ($6 million) for housing. Housing subsidies can provide three efficient and well–targeted tools for poverty reduction: (1) increasing **the value of** the *assets* of the poor through tenure regularization; (2) reducing *overcrowding* through adding living space to houses; and (3) providing for *basic needs*—especially for water, sanitation and storm drainage— through upgrading residential infrastructure. It is therefore **recommended [out: essential]** that the Government of Honduras resolve to allocate more resources for housing subsidies in the years to come. A recent proposal for a national housing program for 2002–2005 advocates a massive expansion of housing subsidies, to an average of L.890 million ($54 million) per year.

Residential infrastructure: There are still critical infrastructure shortages in both rural and urban areas. The most visible infrastructure needs in existing urban communities are a regular, reliable and affordable water supply and a piped sewerage system, combined with a storm drainage system. While most roads in informal settlements are still unpaved, street pavement does not appear to be a high priority at the present time. The extension of residential infrastructure to new settlement areas has a critical influence on the housing sector. The rapidly growing cities in Honduras must be allowed to expand at their natural rate of growth and not be subject to infrastructure bottlenecks—particularly those associated with roads and water supply.

The Legal and Regulatory Regime Governing the Housing Sector: The housing sector in Honduras still lacks the legal and regulatory framework that is necessary for the well–functioning of the sector. Ten legal and regulatory initiatives were identified: (1) creation of a legal framework for the legalization of tenure and the issuance of titles; (2) The unification and reform of the Property Register and the Cadastre; (3) creation of a legal framework for the management of urban growth; (4) reform of land subdivision regulations; (5) reform of the permit–granting system; (6) reform of costs associated with the sale or transfer of housing property; (7) creation of a legal framework for the securitization of mortgages; (8) creation of legal framework for transforming the housing arm of FONAPROVI into a second–tier housing finance institution; (9) passage of a decree that will facilitate the rescue of the FOSOVI portfolio; and (10) The passage of a new Housing Sector Law.

The Institutional Framework For Government Intervention In The Housing Sector: For better or for worse, government intervention in the housing sector in Honduras in recent years has been minimal. At present, there are three critical institutional needs: (1) to place the key housing functions of Government under *one roof*, so as to focus the limited human resources available on the rapid implementation of the Government's housing agenda; (2) to ensure that *all* the key stakeholders in the sector are empowered to participate in the formulation and oversight of housing policy; and (3) to strengthen the professional and technical capacity of the Executive Branch by creating a cadre of full–time, committed and well–informed officials that can operate and execute housing policy through intermediaries in the private and civic sector.

Part IV—Guidelines for Action

A Two–Pronged Housing Strategy: The Government of Honduras should assume a proactive approach to housing in a two–pronged strategy: (a) using housing programs targeted at the poor as a central tool in its Poverty Reduction program; and (b) acting to reduce mortgage lending rates as a means of increasing housing demand, stimulating residential construction and employment, and spurring economic growth.

A Single Government Housing Agency: There should be one government agency charged with the conduct of housing policy and the execution of the Government's Poverty Reduction housing program. This agency should be part of the Executive Branch of government at the level of a secretariat or a Vice ministry—possibly within the Ministry of Transport, Public Work and Housing (SOPTRAVI) as specified by the Law on the Modernization of the State—and have a regular budget.

The Key Functions of the Housing Agency: The key functions of the housing agency would be (a) to formulate housing policy and oversee the housing sector; (b) to allocate housing subsidies for various programs through intermediaries; (c) to collect data for monitoring the sector as a whole and for supervising the subsidy programs; (d) to promote and pass the legal and regulatory agenda necessary for the smooth functioning of the sector; (e) to ensure that high–risk lands remain undeveloped and that sufficient lands are approved for urban expansion; (f) to involve municipalities in the conduct of housing policy; and (g) to build professional capacity for the conduct of housing programs.

An Independent Status For a Second–Tier Housing Finance Agency: The housing arm of FONAPROVI should be transformed into a second–tier housing finance agency, charged with supplying long–term loan funds to financial intermediaries in the private sector and in the civic sector. Being part of the banking system, it should be subject to regulation by banking authorities. It need not be under the housing agency's umbrella, but may be required to have the head of the housing agency on its Board of Directors.

The Two Guiding Principles in the Conduct Of Housing Policy: First, the Government should continue to adopt a *facilitator* role in the housing sector, relying on private–sector and civic–sector intermediaries to implement all its housing programs and refraining from constructing, financing, or administering housing programs by itself. Second, it should focus its interventions on the *housing sector as a whole*, with a special but not an exclusive emphasis on the housing problems of the poor.

The Reduction of Overcrowding: The previous analysis has shown that there is no significant *quantitative* housing deficit in the country, and therefore no immediate need for large–scale new housing construction. Overall, housing *quality* was also found to be good. There is, however, a serious need to reduce overcrowding by adding rooms or small dwelling units on owned lots and by adding new serviced lots in both urban and rural areas.

The Legalization of Titles in Informal Settlements: Low–income Hondurans are investing ample funds and efforts in their houses and have now accumulated considerable wealth in housing assets. This wealth protects them by providing them with a level of economic security. But to make it fungible it needs to have proper documentation. Secure titles can transform the houses of the poor into valuable assets.

The Reduction of Mortgage Interest Rates: There is a serious shortage of affordable mortgage credit and a critical need to reduce mortgage interest rates in commercial banks and S&Ls to affordable levels—not more than 7–8 points above the inflation rate. The reduction of interest rates is they key instrument for energizing the sector. It will help the middle class—which at present rates cannot afford the lowest–priced housing units built by the formal sector—enter the market in large numbers. Unfortunately, it was not possible to determine whether this was a realistic option at the present time.

The Role of Housing in Poverty Reduction: Housing assistance as a tool in the Government's Poverty Reduction program should focus on two complementary strategies: (a) The Overcrowding Reduction Strategy—the construction of additional rooms and small housing units on owned lots and the supply of minimally–serviced lots; and (b) The Titling Strategy—the transfer of legal titles to low–income families aimed at transforming their housing wealth into a form of economic security. It is proposed that a third housing strategy aimed at poverty reduction—the Water+ Sanitation+Drainage Strategy aimed at upgrading informal communities—should be introduced at a later date, once these two strategies are put into operation.

The Housing Subsidy System: All housing assistance programs will employ one single mechanism, the ABC subsidy system (*Ahorro+Bono+Credito*). All beneficiaries will be expected to accumulate savings as a condition for participating in the programs, and their savings will be combined with a one–time up–front subsidy, as well as with some credit. Credit may be in the form of mortgage credit or shorter–term micro–credit, and extending it to low–income families may involve higher administrative costs rates and a higher risk of arrears.

The Available Volume of Housing Subsidies: Subsidy funds for the operation of the housing assistance program could not be estimated. They could be as high as L.900 million ($55 million) per year if the Government agreed to budget 1.5% of current government expenditures (L.250 million or $15 million per year) and to add L.500 million or $30 million per year from Poverty Reduction funds. External funding by bi–lateral and multi–lateral agencies could be of the order of L.250 million or $15 million per year, and could be used to fund subsidy programs (L.150 million or $10 million) as well as non–subsidy initiatives (L.100 million or $5 million).

The Average Size of a Housing Subsidy: The average subsidy level per beneficiary household was also impossible to estimate, but could be of the order of L.25,000 ($1,500). This level of subsidy, coupled with savings and micro–credit, should be sufficient on average to finance room additions, serviced lots, legalization of titles and house construction on owned lots, enabling many as 36,000 households to benefit from the housing program every year. But operating at this level would require expanding the program very rapidly and administering it very efficiently.

Proposed Housing Programs and Initiatives: During the coming four years the housing agency could start as many as six new programs and as many as **nine** new initiatives. The six proposed programs are: (a) The Titling Program; (b) The House Extension on Owned Lot program; (c) The House Construction on owned lot program; (d) The Serviced Lot program; (e) The Monitoring program; and (f) The Capacity Building program. Possible initiatives are: (a) the Housing Law initiative; (b) The Growth Management Commissions Initiative; (c) The Construction Cost Reduction initiative; (d) The Permit Streamlining initiative; (e) The Transfer Cost Reduction initiative; (f) The Subdivision Regulatory Reform initiative; (g) The Building Code Reform initiative; and (h) The FOSOVI Portfolio Rescue initiative.

The Titling Program: There are already several procedures in operation by municipalities for the regularization of land tenure. There is a need to streamline these procedures; to back them up with a special court that can quickly resolve land disputes; and to facilitate the involvement of private sector and civic–sector intermediaries in the process through official accreditation. The aim of the program would be to collaborate with municipalities in the issuance of an average of 8–10,000 land titles annually during the next four years. The average cost of titling is of the order of L.5–8,000 ($300–500) on municipal and *ejido* lands, and L.13–20,000 ($800–1,200) on private lands.

The House Extension on owned lot program: This program would be operated at the regional or municipal level, receiving applications from needy families that can demonstrate a condition of overcrowding and that can save for housing. The families would be provided with technical assistance to plan the extension of their homes. They would then be provided with a credit and a one–time subsidy, following the model now in practice by FUNDEVI. The aim of the program would be to assist an average of 12–14,000 households per year in extending their houses during the coming four years.

The House Construction on owned lot program: House construction on owned lots will also follow the model created by FUNDEVI and more specifically by its urban program, PRIMHUR. It will combine savings with an upfront subsidy and a mortgage credit. To accelerate the program and to reduce construction costs, alternative means of house construction will be tried, including the house kits now in operation in Panamá. The aim of the program would be to build an average of 6–8,000 housing units per year during the coming four years.

The Serviced Lot program: This program should assist families in the purchase of a minimally–serviced lot on the urban fringe provided by private sector or civic sector intermediaries. The program will be targeted at overcrowded households with more than one family sharing the house. It will also be targeted at families in high–risk areas that require resettlement. Its aim would be to generate 6–8,000 serviced lots per year.

The Monitoring program: There is already an embryonic monitoring program at the UPPV that focuses on housing markets. It is proposed that the housing agency will set up a well–funded and well–staffed monitoring program with a set of established procedures and a set of agreed–upon indicators. The monitoring program will oversee the housing sector as a whole as well as the programs and initiatives undertaken by the agency. It will publish annual reports on conditions in the housing sector, based on household surveys, auditors' reports, satellite imagery, and consultancy reports as well as regular information on program performance.

The Capacity Building program: It is proposed that the housing agency design and implement a broad capacity–building program aimed at developing the human resources needed for the rapid implementation of the housing agency's agenda. The program will make use of educational institutions and outside consultants, both at the design and the implementation stages of the program. It will produce teaching materials as well as organize courses and workshops throughout the country.

The Housing Law initiative: At present, there are already several drafts of the Housing Sector Law in circulation. This initiative proposes to expand the draft Law so as to establish the necessary legal framework for key interventions in the sector—the legalization of property rights to housing in informal settlements; the regular allocation of a housing budget in a system of subsidies; the delineation of lands unsuitable for residential development; the preparation of adequate lands for urban expansion; and the development of a regulatory framework for land subdivision and house construction.

The Growth Management Commission Initiative: Municipalities should be supported with funds and technical assistance from the housing agency and encouraged to create and administer plans for urban growth that allocate sufficient land for the rapid expansion of cities and their doubling in size in the next 15 years. This initiative proposes to support the creation of Growth Management Commissions in one or more municipalities and to assist them in their operations, with the double aim of preventing settlement in high–risk areas and approving adequate land reserves for future urban development within an agreed–upon timeframe. A second aim of this initiative would be to create appropriate uniform legislation that could then be adopted by other municipalities.

The Construction Cost Reduction initiative: The construction cost for a basic house is still high by regional standards. This initiative seeks to explore means of reducing the construction cost of a basic house by creating a pilot project and inviting local and international firms and NGOs to build habitable yet low–cost demonstration houses that meet cost targets. Successful builders could then participate in the House Construction on Owned Lot program. It is proposed that the pilot project contain some 60 houses and aim to reduce construction costs to L.700–900 ($43–55) per m^2.

The Permit Streamlining initiative: At present, the issuance of permits by most municipalities is still cumbersome and costly. This initiative proposes to unify the entire permit–granting functions in a single window in one or more municipalities. It could also experiment with including in the single window all the central government agencies involved in giving permits for residential land development (e.g. the *Secretaria de Recursos Naturales y Ambiente,* The Ministry of Natural Resources and the Environment or SERNA). The possibility of privatizing the permit–granting system or opening it up to an international bid will also be examined.

The Transfer Cost Reduction initiative: It has been estimated that stamp fees, registration fees, lawyers' and notaries' fees, transfer taxes, appraisal fees, and bank application fees associated with the transfer of housing property now total more than 10% of the value of the property. This initiative seeks to find ways and propose means of systematically reducing these expenditures, going beyond the cost reduction that is expected to result from reforming the Property Register.

The Subdivision Regulation Reform initiative: This initiative seeks to reform land subdivision regulations in one or more municipalities, so that regulations allow for a minimum initial level of urban services and for their progressive development over time. The absence of such regulations encourages developers to continue to operate outside the system altogether, and to develop land as an invasion that is then not subject to any form of planning control. In parallel, the initiative seeks to establish procedures for subdividing lands already occupied in preparation for title registration.

The Building Code Reform initiative: In collaboration with one or more municipalities, this initiative seeks to create and disseminate a user–friendly building code for low–cost and self–built housing that is normally constructed without a building permit. Instead of making the code more technical, it would focus on essential methods and simple techniques for protecting low–cost houses against natural disasters. The initiative could include testing the proposed code with potential users, its approval by the authorities, and its publication and dissemination.

***The Rent Control Reform Initiative:* This initiative seeks to examine the effect of rent control legislation on the operation of the shrinking rental market for low–income families in Honduras, with particular emphasis on the prevalence of illegal practices in the market and on the artificial shortages created by discouraging new construction of rental housing. It seeks to propose new legislation that would energize the construction of new rental housing by removing the price fixing imposed by the present legislation, and by encouraging the development of enforceable contractual agreements in the existing rental market.**

The FOSOVI Portfolio Rescue initiative: This initiative seeks to accelerate the rescue of the FOSOVI portfolio through legislative, legal and political means. A precise inventory of this portfolio does not exist and its quality is unknown, but it has been claimed to have a value as high as L.3 billion ($180 million). These assets are presently frozen in a complicated court dispute, and the prospects of resolving it in the near future remain unclear. Their rescue, clean–up and transfer to the housing agency would allow it to generate income for its Poverty Reduction housing programs.

Proposed Housing Finance Programs and Initiatives: It is proposed that in the coming four years the housing arm of FONAPROVI begin one new program and as many as four new initiatives. The new program is the Credit for the *Ahorro+Bono+Credito* program. Possible initiatives are: (a) The Second–Tier Mortgage Institution initiative; (c) The Pension Fund Reform initiative; (d) The Intermediation Rate Reduction initiative; and (e) The Remittances for Mortgages initiative.

The Credit for the Ahorro+Bono+Credito program: The *Ahorro+Bono+Credito* program operated by the housing agency will also require both mortgage credit and micro–credit for its operation. The amount was difficult to estimate, but could possibly be of the order of L.500 million ($30 million) per year. Since this credit is to be given to low–income people, it will carry a higher degree of risk. FONAPROVI should take part in issuing credit through intermediaries to these low–income groups, and such loans may need to be insured.

The Intermediation Rate Reduction initiative: Intermediation rates in both RAP and FONAPROVI and in the commercial banks and S&Ls that lend for housing are high in comparative terms. The average lending–to–deposit spread in the banking system as a whole in 2001, for example, was 11.4%, down from 17.9% in 1996. These high intermediation rates have been attributed to the expectations of the return of double–digit inflation and to the shaky financial environment. This initiative seeks to explore ways of bringing down levels of intermediation on mortgage loans to 4–5% from their present levels that are considerably higher.

The Second–Tier Mortgage Institution initiative: The housing arm of FONAPROVI should be separated from the production arm and transformed into a second–tier mortgage institution. This initiative will seek to separate it and then transform it into a true second–tier institution by streamlining its Board of Directors, by removing the requirement that each mortgage be examined independently, by standardizing mortgages, and by reducing intermediation costs. These proposed reforms should also go hand in hand with advances toward securitization, both of local currency and dollar–denominated mortgage loans.

The Pension Fund Reform initiative: The two pension funds, INJUPEMP and IMPREMA, have a considerable housing mortgage portfolio, but maintain all their liquid assets in short–term financial instruments. They hold no long–term funds at all as their regulations mandate them to seek the greatest return on their investments. This initiative will seek to change their mandate so as to make it possible for them to invest in long–term instruments. This will in turn create a ready market for the securitization of mortgages and the sale of mortgaged–backed securities to these institutions.

The Remittances for Mortgages initiative: It was estimated that Hondurans in the U.S. sent $600 million to Honduras in 2001. If 25% of this amount could **eventually** be directed to mortgage payments on dollar–denominated loans it would result in tripling the total mortgage portfolio in the country at the present time, and would make it possible for median–income families to afford median–valued houses. This initiative seeks to study the use of remittances for housing in Honduras **and in neighboring countries**, **to** investigate possible ways for using remittances to make regular housing payments, and **to** examine possible avenues for securitizing dollar–denominated mortgages.

INTRODUCTION

This report is a preliminary assessment of the housing sector and the status of housing policy in Honduras at the present time. Its practical and immediate goal is to inform and facilitate the current discussions between the new Government of President Ricardo Maduro and the Inter–American Development Bank (IDB) on a national housing policy for Honduras. President Maduro, who came into power in January 2002, promised to make housing a key component of the Government's Poverty Reduction Strategy and a key instrument for spurring economic growth. He has since committed himself transforming this promise into an effective, equitable and sustainable national housing policy, embedded in a solid institutional structure that should outlive his own tenure. A viable policy framework would provide a firm foundation for IDB support for the housing sector in the near future.

The four specific objectives of this report are:

1. To examine the context of the Honduran housing sector (Part I);
2. To assess the current conditions in the sector (Part II);
3. To examine the status of housing policy (Part III); and
1. To propose a preliminary set of guidelines for action (Part IV).

I THE CONTEXT OF THE HONDURAN HOUSING SECTOR

Conditions in the housing sector in Honduras are largely the reflection of its context—the environmental, demographic, economic, social, cultural, and political factors that are largely external to the sector. The effects of these factors must be clearly understood, because—although they are traditionally outside the scope of *housing* policy—they influence housing sector performance in important ways. Seven of these factors have particularly strong effects on the sector:

1. Environmental hazards and natural disasters;
2. Population growth, urbanization and household formation;
3. Poverty, the level of economic development, and economic growth;
4. The distribution of income;
5. Inflation and government fiscal policy;
6. Conditions in the financial sector; and
7. Conditions in the construction sector.

Table 1 below presents the basic economic, social, and demographic indicators that summarize these contextual factors in Honduras. It also compares them to parallel indicators in other countries in the region, to conditions in Latin American and the Caribbean as a whole, to conditions in other lower–middle–income countries with per capita Gross National Product (GNP) similar to that of Honduras, and to conditions in the world at large. In the following paragraphs, the seven contextual factors listed above are discussed in greater detail, bringing into focus their effects on the housing sector and their implications for housing policy.

1. Environmental Hazards and Natural Disasters:

Honduras is situated in the path of severe tropical storms. In October–November of 1998, Hurricane Mitch left 6,000 dead and more than 8,000 missing, causing widespread material damage estimated at some $3.8 billion [IMF, 2001, 20]. It is estimated that Mitch destroyed 32,000 houses and damaged 46,000 structures [IDB, 1999, 1]. The total damage to the housing sector was estimated at $334 million, and the cost of reconstruction and rehabilitation at $485 million [IMF, 2001,18]. Essential urban and rural infrastructure works critical to the housing sector (roads, bridges, water, sewerage, drainage and electrical systems) were destroyed or severely damaged. Most of the physical damage was attributed to floods and mudslides. In Tegucigalpa, for example, several thousand houses along the Choluteca River were destroyed or damaged by severe flooding. In parallel, mudslides destroyed houses in informal settlements located on steep slopes with inadequate storm drainage systems and retaining walls.

From the perspective of housing policy, the continued vulnerability of Honduras to severe tropical storms requires: (a) a robust institutional framework for managing the housing sector that can facilitate post–disaster housing activities at short notice, as an integral part of national housing policy; (b) a program of retrofitting existing houses to better withstand storms; (c) a campaign to spread information and to enforce storm–resistant house–building methods; (d) an infrastructure upgrading program in existing settlements to improve storm drainage and resist mudslides; (e) an effective enforcement program for preventing residential construction on steep unstable slopes and in river beds subject to flooding; and (f) an adequately–financed and politically–acceptable resettlement program for families living in environmentally vulnerable communities that cannot or should not be improved.

Table 1: Basic Economic, Social and Demographic Indicators, 1990–2001

Indicator	Honduras	Dominican Republic	Panama	Trinidad & Tobago	Guatemala	Ecuador	Argentina	Latin America & the Caribbean	Lower-Middle Income Countries	The World
Country Population (millions), 1997	6.3[8]	8.1	2.8[4]	1.3	11.1	12.0	37.0[4]	494	2,283	5,820
Annual Population Growth Rate, 1997-2015 (%)	2.7	1.7	1.3	0.9	2.7	1.5	1.2[4]	1.3	0.9	1.1
Urban Population (%), 1997	46.6[8]	66.2	56.4	71.2	39.7	60	89.6[4]	74	42	46
Labor Force in Agriculture, 1990 (%)	31.8[8]	18.2[5]	21	9[1]	52	33	10.4[4]	25	58	49
Household Size, 1990	5.1[8]	4.25[5]	4.2	4.1	4.8[1]	4.7	3.6[2]	4.3	4.6	4.1
Annual Urban Population Growth (%), 1990-2010	3.5	2.8	2.48	1.13	3.8	3.13	1.40[4]	2.15	-	2.55
Country GNP ($ billions), 1997	6.0[8]	13.5	8.4	5.5	18.8	18.4	278.3[4]	1,196.8	2,817.9	29,925
GNP per Capita ($), 1997	952[8]	1,862	3,080	4,230	1,691	1,570	7,516[4]	3,940	1,230	5,180
Annual GDP per Capita Growth (%), 1990-98	1.6	4.7[6]	2.9	1.6	1.5	1.0	3.0	1.8	-	-
Income Distribution Gini Index (1985-95)	49[8]	51.5[7]	57.0	50.0[2]	59.6	46.6	49.1[4]	51.6	-	39.1
Annual Inflation (%), 1990-97	11.5[9]	6.9[6]	1.4	6.7	17.0	37.7	1.6[7]	106.2	-	14.4
Under-5 Mortality Rate per '000, 1996	50	47	25	15	55	40	22[7]	41	44	73
Female Life Expectancy (years), 1996	65	73	76	75	69	73	77[7]	73	71	69
Female Adult Illiteracy (%), 1995	27	18	10	3	51	12	3.4[7]	15	27	38
Access to Safe Water (%), 1995	90[8]	71	83	82	68	70	86.7[2]	73	-	78
Access to Sanitation in Urban Areas (%), 1995	76[8]	76	87	97	78	60	60.3[2]	80	75	-
Government Revenues as % of GDP, 1996	18.3[4]	14.2	27.9	27.7	11.0	15.7	19.7[3]	21.6	24.1	26.6
Government Budget Deficit as % of GDP, 1996	–2.1[9]	0.5	-3.0	–3.1[3]	–2.8	0.0	–1.7[3]	-3.3	-3.4	-3.1
Debt as percent of GDP (%), 1997	71.3[4]	23.3	88.1	36.9	22.4	75.0	48.3[7]	33.6	-	-
Gross Domestic Investment as % of GDP, 1997	24.7[7]	22.0	31.1	21.0[3]	17.0	20.2	19.1[3]	24.4	27	22
Value Added by Construction as % of GDP, 1997	4.7[4]	10.9	3.8	10.8	2.5	3.2	5.8[3]	5.3	-	-
Gross Domestic Savings as % of GDP, 1997	23.4[7]	15.0	24.1	29.0	9.4	19.2	17.4[3]	20	27	22
Banking Sector Credit as % of GDP, 1997	78.5[4]	34.1	92.1	59.2	15.8	29.0	27.3	35.7	65.6	139.1
Institutional Investor Credit Rating, 2000	19.3	31.9	42.7	47.2	31.0	19.1	43.0	33.5[5]	33.6[5]	35.8[5]
Corruption Perceptions Ranking (lowest=91), 2001	71	63	51	31	65	79	57	50	-	46

Sources: The World Bank, *World Development Report – 1998/9*; IMF, "Honduras: Poverty Reduction Strategy Paper," 2001; Inter-American Development Bank, IDB Statistics and Quantitative Analysis Unit, www.iadb.org; Transparency International, *The Corruption Perceptions Index-2001*; Banco Central de Honduras, *Boletin Estadistico*, September 2001; Shlomo Angel, various housing sector assessments (see references); [1] Data for 1995. [2] Data for 1997 . [3] Data for 1999. [4] Data for 2000. [5] Data for 1998. [6] Data for 1992–1999. [7] Data for 1998. [8] Data for 2001. [9] Data for 1997–2001.

2. Population growth, urbanization, household formation:

The high overall quantitative demand for new urban housing is, in large part, a function of new household formation, which, in Honduras, is a function of three inter–related factors—its high population growth rate, its rapid rate of urbanization, and the gradual reduction in household size concomitant with the increased urbanity of its population.

Honduras had a population of 6.3 million in 2001, and its population is now growing at 2.6% per annum, one of the highest population growth rates in Latin America and the Caribbean, equal to that of Guatemala and Paraguay and surpassed only by Nicaragua (2.8%) and Belize (3.4%). By comparison, the population growth rate now averages only 1.5% per annum in the region, 1.3% in the world at large, 1.4%in low– and middle–income countries, and 1.9% in low–income countries.

Honduras is still one of the least urbanized countries in Latin America and the Caribbean, with only 47% of its population residing in urban areas in 2001. Only two countries in the region are less urbanized, Haiti and Guatemala (35% and 40% respectively in 2000). By contrast, the average level of urbanization in the region was 75% in 2000. It was 47% in the world as a whole in 2000, 41% in low– and middle–income countries, and 32% in low–income countries.

In parallel with being one of the least urbanized countries in Latin America and the Caribbean, Honduras now has the highest urban growth rate in the region—4.0% per annum between 1996 and 2000—followed by Paraguay (4.0%), Haiti (3.9%), Bolivia (3.8%) and Nicaragua (3.6%). The annual urban growth rate in the region as a whole is now only 2.1%. It is 2.1% in the world at large as well, 2.6% in low– and middle–income countries, and 3.5% for low–income countries [World Bank, 2001b]. The high rate of urban growth in Honduras implies that the housing problem will become more and more of an urban—rather than a rural—problem.

Table 2 below displays the growth of population and of the number of households in the country as a whole, in urban areas, in the Tegucigalpa Central District, and in San Pedro Sula between 1988 and 2001. Because of rural–urban migration, the annual population growth rate in urban areas—3.9% between 1996 and 2001—was higher than the population growth for the country as a whole. The urban household formation rate—4.8% during that period—was even higher, because of the gradual reduction of household size from 5.0 in 1988 to 4.7 in 2001. Both population growth and household formation rates were higher still in Tegucigalpa (4.1% and 4.5% respectively) and in San Pedro Sula (5.4% and 5.9% respectively), implying that the two largest cities in the country face higher rates of growth of housing demand that other, smaller cities. Assuming that their population growth rates during 1988–2001 continue—a conservative projection— Tegucigalpa and San Pedro Sula, two of the fastest growing cities in the region, will double their populations in 15 and 13 years respectively.

As table 2 shows, the net additions to the overall number of households in Honduras in 2001 were of the order of 42,000 of which 30,000 were in urban areas—9,000 in Tegucigalpa, 7,000 in San Pedro Sula, and 26,000 in other cities. These numbers provide rough estimates of the quantitative annual demand for housing in the country. The relationships between the number of households, the number of dwelling units and the number of occupied dwelling units shown in table 2 will be discussed in greater detail in

Part II.

Table 2: Population, Household, and Dwelling Unit Growth in Honduras, 1988–2001

Geographical Unit	1988	1996	2001	**Annual** Percent Change 1996-2001	Annual Addition in 2001
Country as a Whole					
Total Population	4,443,721	5,569,321	6,340,009	2.6%	162,230
Number of Households	*804,787**	1,067,097	1,258,299	3.4%	40,802
Number of Dwelling Units	906,697	*1,223,885*	1,459,377	3.6%	50,471
Number of Occupied Dwelling Units	796,836	*1,050,359*	1,234,017	3.3%	39,137
Household Size	*5.5*	5.2	5.0	-0.7%	
Urban Areas					
Total Population	*1,826,515*	2,436,967	2,957,406	3.9%	112,298
Number of Households	*364,441*	497,976	630,735	4.8%	29,119
Number of Dwelling Units	*383,568*	*550,000*	*688,951*	4.6%	30,349
Number of Occupied Dwelling Units	*347,889*	*493,617*	614,269	4.5%	26,286
Household Size	*5.0*	4.9	4.7	-0.9%	
Tegucigalpa Central District					
Total Population	539,590	805,013	982,737	4.1%	38,436
Number of Households	*105,237*	162,096	201,870	4.5%	8,668
Number of Dwelling Units	114,564	*170,624*	208,070	4.0%	8,095
Number of Occupied Dwelling Units	102,573	*156,688*	194,127	4.4%	8,143
Household Size	*5.1*	5.0	4.9	-0.4%	
San Pedro Sula					
Total Population	270,804	408,766	531,780	5.4%	27,257
Number of Households	*56,081*	87,690	116,621	5.9%	6,464
Number of Dwelling Units	59,912	*101,212*	141,270	6.9%	9,114
Number of Occupied Dwelling Units	54,535	*85,776*	114,496	5.9%	6,426
Household Size	*4.8*	4.7	4.6	-0.4%	

Sources: Dirección Nacional de Estadistica y Censos, 1990. *Censo Nacional de Vivienda – 1988;* Dirección Nacional de Estadistica y Censos, 1997, Decimosexta Encuesta Permanente de Hogares; Instituto Nacional de Estadistica, 2001. Vigésimo Tercera Encuesta Permanente de Hogares; and Comisión Precidential de Modernización del Estado, XVI Censo de Población y Vivienda 2001—Resultados Preliminares.
Note: Figures shown in italics are the author's own estimates, based on the available data.

3. *Poverty, the Level of Economic Development, and Economic Growth:*

There is no doubt that housing conditions are, first and foremost, a function of the level of economic development. Measured across the globe, the size of houses, their monetary value, and their quality are all highly correlated with the level of economic development [Angel, 2000]. When looking at housing conditions in Honduras, therefore, it is important to remember that Honduras is a poor country. Its per capita Gross Domestic Product (GDP) in 2000, for example—a gross measure of the level of economic development—was 15,150 Lempiras ($924)[1], the third lowest in Latin America and the Caribbean, after Nicaragua ($422) and Haiti ($403). In comparison, the average per capita GDP was $3,880 in Latin America and the Caribbean as a whole, $5,120 in the world at large, $1,270 in low– and middle–income countries, and $425 in low–income countries [World Bank, 2001b].

Measured in Purchasing Power Parities (PPP), per capita GDP in Honduras—$2,340 in 1999—was also the third lowest in Latin America and the Caribbean, after Nicaragua ($2,279) and Haiti ($1,464). Its Human Development Index—a more comprehensive measure of development—was also the third lowest in the region, after Guatemala and Haiti [UNDP, 2001, 143]. It reflected the relatively high child mortality rates in the country, 50 per 1,000 in 1996, the relatively low life expectancy (65 years for females in 1996), and the relatively low level of education in the country—27% of adult females were found to be illiterate in 1996. Levels of poverty and extreme poverty in Honduras are high, especially in rural areas where in mid–2001 54% of the people lived on less than $1 a day and 82% on less than $2 a day. Levels of poverty are lower in urban areas. During the same period, 7% of the urban population lived on less than $1 a day, and 14% on less than $2 a day. **Overcrowding—a key indicator of housing–related poverty—has been identified as the most prevalent Unsatisfied Basic Need (UBN) in the country [UNDP, 2000, table 2.8, 35].**

Unfortunately, poverty in Honduras —particularly the poverty associated with insufficient income—has persisted, at least partly, as a result of the absence of real economic growth. From 1970 to 1997, the average growth rate of real per capita GDP was 0.4%, in other words close to zero [IMF, 1998, 6]. During the 1990s, "per capita GDP growth has been slow and erratic; the high was 3.3% in 1993 and 1999 per capita GDP fell by 4.0% and 4.3% respectively. During this period the average rate of per capita GDP growth was 0.5%, the result of an annual Growth Domestic Product growth rate of 3.2%, only slightly above the average population growth rate of 2.7%" [IMF, 2001b, 21]. Economic growth accelerated in 2000, when GDP grew at 4.9%, but decelerated again in 2001 when GDP growth fell to 2.4%—a slower rate of growth than that of the population.

Given low levels of per capita income and stagnant economic growth, we cannot expect the quality of housing in Honduras to be comparable to that of more–developed countries or to that of countries experiencing faster rates of economic growth. This implies that expected housing, building and land subdivision standards must be tailored to what the Honduran population can afford. More importantly, the definition of what constitutes 'adequate' housing and what types of housing constitute part of the quantitative or qualitative housing 'deficit' in the country must be tailored to what is attainable given the limited resources available for housing at the present time.

4. *The distribution of income*:

Household income typically determines how much can be spent on housing, and, in turn, what quantity and quality of housing can be purchased. While overall housing conditions in Honduras are clearly a function of its level of development as a whole, the specific housing conditions of different households cannot be understood without reference to the distribution of income. The distribution of income in Honduras has three important characteristics: first, it is highly skewed, as in most countries in Latin America[2]; second, as in most countries, incomes are much higher in urban areas; and third, the income distribution in Honduras is less skewed in urban areas than in rural areas[3], suggesting that new migrants improve their economic well–being as they move into the city and that the city functions as an equalizer of incomes.

The household income distribution for the Tegucigalpa Central District and for San Pedro Sula is given in table 3 below. In 2001, according to the latest household survey, the median annual household income was L.81,712 (US$5,309) in Tegucigalpa, and L.87,824 (US$5,707) in San Pedro Sula.

Table 3: Annual Household Income Distribution in Tegucigalpa and San Pedro Sula, May 2001

	Tegucigalpa				San Pedro Sula			
Income	Lempiras		US Dollars		Lempiras		US Dollars	
Decile	From	To	From	To	From	To	From	To
1st	0	27,237	0	1,770	0	29,275	0	1,902
2nd	27,237	46,304	1,770	3,009	29,275	49,767	1,902	3,234
3rd	46,304	54,475	3,009	3,540	49,767	58,549	3,234	3,804
4th	54,475	68,093	3,540	4,425	58,549	73,186	3,804	4,755
5th	68,093	81,712	4,425	5,309	73,186	87,824	4,755	5,707
6th	81,712	98,055	5,309	6,371	87,824	105,388	5,707	6,848
7th	98,055	125,292	6,371	8,141	105,388	134,663	6,848	8,750
8th	125,292	157,977	8,141	10,265	134,663	169,792	8,750	11,033
9th	157,977	256,032	10,265	16,636	169,792	275,181	11,033	17,880
10th	256,032+		16,636+		275,181+		17,880+	

Source: Estimated from INE, 2001, *Vigésimo Tercera Encuesta Permanente de Hogares*, pp. 14–6, 55 and 61.

The household income distribution for the urban areas and the rural areas in Honduras is given in table 4 below. In 2001, the median annual household income was L.73,005 (US$4,744) in urban areas, more than twice the median income— L.28,547 (US$1,855)—in rural areas. In urban areas, the total income earned by the 20% highest–income households was 9 times the total income earned by the 20% lowest–income households. The corresponding multiple was 18 in rural areas. On the whole, median income in Tegucigalpa was 12% higher than that of the urban areas as a whole, and San Pedro Sula's was 20% higher. Median income in the rural areas was 60% lower than that of the urban areas.

Combining income distribution data with house price data and mortgage data allows us to estimate levels of housing affordability in Honduras, as well as levels of access to housing finance both of which will be discussed in Part II.

Table 4: Annual Household Income Distribution in Urban and Rural Areas, May 2001

	Urban Areas				Rural Areas			
Income	Lempiras		US Dollars		Lempiras		US Dollars	
Decile	From	To	From	To	From	To	From	To
1st	0	24,335	0	1,581	0	6,588	0	428
2nd	24,335	41,370	1,581	2,688	6,588	13,834	428	899
3rd	41,370	48,670	2,688	3,162	13,834	15,371	899	999
4th	48,670	60,838	3,162	3,953	15,371	19,763	999	1,284
5th	60,838	73,005	3,953	4,744	19,763	28,547	1,284	1,855
6th	73,005	87,606	4,744	5,692	28,547	37,330	1,855	2,426
7th	87,606	111,941	5,692	7,274	37,330	50,506	2,426	3,282
8th	111,941	141,143	7,274	9,171	50,506	65,877	3,282	4,281
9th	141,143	228,749	9,171	14,863	65,877	118,579	4,281	7,705
10th	228,749+		14,863+		118,579+		7,705+	

Source: Estimated from INE, 2001, *Vigésimo Tercera Encuesta Permanente de Hogares*, pp. 14–16, 55 and 61–62.

5. *Inflation and Government Fiscal Policy:*

Unlike many other countries in Latin America, Honduras was not subject to hyper–inflation, although it was subject to some considerable price fluctuations. The consumer price index increased by an average of 6.2% between 1980 and 1989. It rose to an average of 28.7% in 1990–91 [Banco Central, 1998, 56], declined to 9.8% in 1992–3, increased again to an average of 20.2% in 1994–97, and was maintained at 11.5% during 1997–2001 despite the fiscal pressure exerted by Hurricane Mitch in late 1998. In 2001, the inflation rate was 9.7% [Banco Central, 2002].

Since the early 1990s, the Government has adopted a policy of price stabilization and has generally succeeded in recent years in bringing inflationary pressures under control. The average fiscal deficit between 1997 and 2000 was 2.1%[IMF, 2001a, 545]. During the same period, the Government, with the support of loans, grants and debt relief, has managed to increase social spending (on education, health and sanitation, social safety nets, and rural sector support) from 7.2% of GDP and 35.5% of government expenditures in 1997 to 11.5% of GDP and 44.5% of Government expenditures in 2000 [IMF, 2001b, Annex D.8]. This has been achieved without increased Government indebtedness during this period. In fact, although Honduras is still a highly–indebted country, total debt as a percent of GDP decreased from 76.1% to 66.6%. Unfortunately, it rose again in 2001 and is expected to rise in 2002, as government continues deficit spending. The central government deficit as a percent of GDP rose from 4.5% in 2000 to 6.1% in 2001, and is expected to remain at that level in 2002–3 [The Economist, 2002].

Honduras pre–qualified for debt relief under as a Heavily–Indebted Poor Country (HIPC) and its poverty reduction strategy was approved by the World Bank, the IMF and the IDB in October 2001. The new government hopes to come to a decision point with the International Monetary Fund (IMF) under the Poverty Reduction and Growth Facility (PRGF) program by December 2002. Qualifying for the program will require a tight fiscal and monetary policy, an increase in government revenue, social security reform, the introduction of an anti–corruption strategy, improved financial sector supervision, and increased social spending. It is not yet clear whether the housing sector will be allocated additional resources as part of the poverty reduction strategy.

Price stabilization and the maintenance of inflation in single digits are essential to the growth of the mortgage market, which is, in turn, the key to the growth of housing supply. Mortgage markets rely on the availability of long–term funds and on low interest rates, both of which are still largely absent in Honduras, as we shall see in the following section.

6. Conditions in the Financial Sector:

A strong and efficient financial sector is a precondition for the development of long–term mortgage finance, and for the support of housing projects with construction loans. Unfortunately, the financial system in Honduras is presently in an unsteady state, having endured the forced liquidation of one bank (Banco Corporative) in 1999 and another bank (Banco Hondureño de Créditos y Servicios) in 2001. In May of 2002, yet another bank (Banco Capital) faced bankruptcy. The Honduran financial system is still in a precarious state, and it is quite possible that more financial institutions will collapse in the near future.

The system now consists of 21 commercial banks, 4 savings and Loan Associations, and 10 financial companies. In November of 2001, as table 5 below shows, the total active portfolio of the banking system amounted to L.64.6 billion (US$4.3 billion), of which 91% was in commercial banks and 7% in Savings and Loan Associations. The size of the portfolio relative to GDP—73.3% in 2001—was large in comparison to other countries in the region. It was not a very productive portfolio, however, as loans formed only 59.2% of the portfolio. There was also a high percentage of loans in default, 14.1% in commercial banks, 9.8% in savings and loan associations, and 28.3% in financial companies [CNBS, 2001,34].

Two characteristics of the Honduran financial system are particularly damaging to the development of the housing sector: the near absence of deposits in excess of 90 days, and the high level of interest on loans. The first is largely due to the precariousness of the financial system and to the absence of confidence in the continued ability of the Government to harness inflation. It places both lenders and borrowers of long–term mortgages at a high degree of risk. Banks are forced to use short–term deposits to finance long–term loans and are at risk that depositors will withdraw their funds at short notice. Borrowers are saddled with adjustable (and unpredictable) mortgage interest rates, and are at risk that they will not be able to sustain future payments if interest rates climb precipitously.

Table 5: The Parameters of the Private Banking System in Honduras (in millions of Lempiras and US Dollars), 1998–2001

Banking System Parameters	Dec 1998 Lemps.	Dec 1998 US$	Dec 2000 Lemps.	Dec 2000 US$	Nov 2001 Lemps.	Nov 2001 US$
Total Active Portfolio	42,550	3,081	60,491	3,995	64,552	4,264
Active Portfolio as % of GDP	60.4%		78.5%		73.3%	
Total Loan Portfolio	25,196	1,824	38,088	2,516	38,209	2,524
Loans as % of GDP	35.8%		49.4%		43.4%	
Loans as % of Active Portfolio	59.2%		63.0%		59.2%	
Real Estate Loan Portfolio	4,882	354	7,606	502	8,634	570
Real Estate Loans as % of GDP	6.9%		9.9%		9.8%	
Real Estate Loans as % of Active Portfolio	11.5%		12.6%		13.4%	
Real Estate Loans as % of Loans	19.4%		20.0%		22.6%	
Housing Loan Portfolio*	-		-		6,046	399
Housing Loans as % of GDP	-		-		6.9%	
Housing Loans as % of Active Portfolio	-		-		9.4%	
Housing Loans as % of Loans	-		-		15.8%	
Housing Loans as % of Real Estate Loans	-		-		70.0%	

Sources: CNBS, 1998, 2000 and 2001.

* Estimated by Marco Antonio Aguirre of RAP, 2002. The housing loan portfolio does not include public–sector loans and loans by public pension funds, which together amounted to some **6 billion** Lempiras (US$312 million) in 2001.

The prevailing interest rates in the financial system remain high in comparative terms due to three factors: the relatively high level of inflation, the real interest rates paid to depositors, and the wide margins of intermediation charged by banks. Table 6 displays the changes in deposit and lending rates in Honduras from 1992 to 2001. While inflation rates have gone down systematically from 1994 onwards, losing more than 20 percentage points, nominal lending rates have barely followed the downward trend. The *real* lending rate was of the order of 14.5% in 2000 and 2001, largely because of very high levels of intermediation: the 23.2% average lending rate in 2001 was 11.4% above average deposit rate. It is quite clear that until the costs of intermediation come down, mortgage loans will remain largely unaffordable to the great majority of the Honduran population.

7. Conditions in the Construction Sector:

Residential construction activity is influenced to a significant extent by conditions in the construction sector. First, the volume of residential construction is usually affected by the cyclical ups and downs in the construction sector, which are themselves affected by the overall economic and investment climate. Second, the character of residential construction is affected by the organization and the division of labor in the sector as a whole, by its level of sophistication and competitiveness, and by its business practices. Third, residential construction costs are affected by the costs of construction labor and materials in the sector as a whole. The *residential* construction sector will be discussed in greater detail in the following section. The discussion here is limited to conditions in the construction sector as a whole.

Table 6: Average Deposit and Lending Interest Rates in Honduras, 1992–2001

Year (December)	Annual Cost of Living Increase (%)	Average Nominal Deposit Rate (%)	Average Real Deposit Rate (%)	Average Nominal Lending Rate (%)	Average Real Lending Rate (%)	Average Lending-to-Deposit Difference (%)
1992	6.5	11.1	4.6	20.7	14.2	9.6
1993	13.0	10.8	-2.2	23.4	10.4	12.6
1994	28.9	10.8	-18.1	26.1	-2.8	15.3
1995	26.8	11.5	-15.3	28.4	1.6	16.9
1996	25.3	11.7	-13.7	29.5	4.2	17.9
1997	12.8	15.5	2.6	32.1	19.3	16.7
1998	15.7	16.0	0.3	30.6	14.9	14.6
1999	10.9	15.0	4.1	29.5	18.6	14.4
2000	10.1	12.2	2.1	24.6	14.5	12.3
2001	8.8	11.8	3.0	23.2	14.4	11.4

Source: Banco Central de Honduras, 2002.

Table 7 below provides an overview of the volume of construction in Honduras during the last decade. The average volume of construction as a percentage of GDP between 1991 and 2001 was 4.8%, slightly lower than the regional average of 5.3. Investment in construction has been typically cyclical, with a peak reached in 1993, followed by a trough in 1996, another peak in 2000, and a decline in construction activity in 2001. The volume of construction as a share of overall investment declined through most of the decade, from a high 25.2% in 1992 to a low 15.3% in 1998, and increased to 18.0% by 2001. With the increase in investments in the *maquila* industry in recent years, it has also become a smaller share—less than one quarter—of total private investment.

Employment in the construction sector constituted 5.5% of total employment in 2001 and, because of the current recession in the sector, unemployment reached 10.2%, more than double the 4.2% overall rate of unemployment [INE, 2001,17]. Construction firms in Honduras are typically small and there are no construction monopolies. Half of all construction employees are either self–employed or work with one additional person. 30 percent of all employees work in firms with 3–to–9 employees, and 20% work in firms with 10 or more employees [Dirección General de Estadística y Censos, 1998, 30].

The construction sector in Honduras appears to suffer from the lack of trained manpower and from monopolistic practices in the production and import of key building materials such as cement, steel, and bathroom fixtures. Cement prices, however—now at L.1,350 ($82) per metric ton—do not appear to be higher than in other countries in the region, and there are also no regulatory barriers to the importation of building materials. It was not possible to ascertain, in the absence of better data, whether overall construction prices for similar–quality construction were higher in Honduras than elsewhere in the region. In general, construction prices appear to have moved in parallel with the overall inflation rate in recent years. Residential construction prices will be reviewed in greater detail in Part II of this report, which focuses on conditions in the housing sector.

Table 7: The Volume of Construction in Honduras, 1991–2001

Year	Volume of Construction		Volume of construction as a Percentage of		
	Lempiras (millions)	US% (millions)	Gross Domestic Product (GDP)	Gross Fixed Capital Formation	Private Gross Fixed Capital Formation
1991	745	138	4.6%	24.1%	38.8%
1992	1,061	182	5.6%	25.2%	47.2%
1993	1,457	201	6.4%	22.3%	39.3%
1994	1,465	156	5.1%	18.1%	29.9%
1995	1,791	173	4.8%	19.9%	34.2%
1996	1,900	148	4.0%	16.6%	26.1%
1997	2,464	188	4.0%	15.7%	21.3%
1998	3,043	220	4.3%	15.3%	18.9%
1999	3,863	266	5.0%	16.8%	21.3%
2000	4,157	275	4.7%	18.0%	23.1%
2001	4,261	266	4.3%	18.0%	23.5%

Sources: Banco Central, 1998, 2001 and 2002.

II CONDITIONS IN THE HOUSING SECTOR

This section presents a broad perspective of the housing sector in Honduras, concentrating on housing conditions in Tegucigalpa, where one–sixth of the population of the country and one–third its urban population now reside, and to a more limited extent on San Pedro Sula, where 8% the country's population and 18% of its urban population now reside. It is important to focus on the two metropolitan regions of Honduras because this is where, along numerous dimensions, housing problems are and will be most severe. This does not mean, however, that the housing problems of other cities and of villages in the rural areas can be ignored. Surely, they need to be addressed, and will be addressed to the extent possible in this preliminary analysis.

Other than the contextual factors discussed in Part I, there are three principal conditions within the housing sector itself that affect housing supply and demand in Honduras:

1. The availability of land;
2. The volume, structure and costs of housing production; and
3. The availability of mortgage finance.

The actual performance of the housing sector can be summarized by examining four of its key dimensions:

4. House prices, rents, and affordability;
5. Dwelling units and living space;
6. The quality of housing; and

7. Tenure.

These seven aspects of the housing sector in Honduras in general, and in metropolitan Tegucigalpa in particular, will be discussed in greater detail below. Table 8 below presents basic indicators that summarize these aspects and compares them with conditions in other cities in Latin American and the Caribbean, with housing conditions in countries with similar per capita incomes to that of Honduras, and with housing conditions in the world at large.

1. The availability of land:

As noted earlier, Honduras is undergoing a rapid process of urbanization. The urban population is growing at 3.9% per year. In Tegucigalpa and San Pedro Sula—two of the fastest growing cities in Latin America—it is growing at more rapid rates, 4.1% and 5.4% per year respectively. At these rates, as we noted earlier, they will double their populations in 15 and 13 years respectively. The recently completed Territorial Plan for Tegucigalpa [Enginyeria I Gestió d'Infraestructures, 2002] expects it to grow even faster. At a medium projection of population growth, estimated at 4.5% per annum, Tegucigalpa will reach a population of 1.8 million by 2015 and a population of 2.7 million by 2025.

According to the Territorial Plan, the population of Metropolitan Tegucigalpa was 990,982 in the year 2000, and it occupied a built–up area of 96.7 square kilometers. Its gross population density was therefore 10,250/km^2, one of the highest densities to be found in the region. As table 9 below shows, at this density every additional person that comes to live in the city consumes, on average, 100m^2 of new urban land. At the projected 4.5% rate of population growth, Tegucigalpa must prepare to expand it built–up area at the average rate of 530 hectares per year for the remainder of this decade, and 830 hectares per year during the next decade. In other words, it must be prepared to double its built–up area to 194 km^2 by the year 2015. This, no doubt, is the central challenge for the municipal authorities and for central government authorities with responsibilities for expanding urban infrastructure, particularly roads, water and sewerage.

The inevitable rapid expansion of metropolitan Tegucigalpa presents serious problems: The difficult mountainous topography limits the amount of flat or gently–sloping land that is suitable for urban growth. Land along the riverbeds is subject to flooding and is therefore also unsuitable for development. Much of the newly–settled land, especially to the south of the city, is at elevations that are higher than the water level in the reservoirs that serve the city and will require water to be pumped to these

Table 8: Basic Housing Indicators for Tegucigalpa Compared with Other Cities, Countries and Country Groups, 1990–2001

Indicator	Tegucigalpa, Honduras	Santo Domingo, Dominican Republic	Panama City, Panama	Guatemala City, Guatemala	Quito, Ecuador	Caracas, Venezuela	Buenos Aires, Argentina	Latin America & Caribbean Cities,1990	Lower–Middle Income Countries	Upper–Middle Income Countries	The World 1990
Dwelling Units per 1,000 People	212	242	250	214	239	236	283	221	195	225	229
Median House Size (m^2)	51	54	67	38	33.6	78	48	67	47	67	62
Floor Area per Person (m^2)	10.4	14	16	8	8.6	16	13.7	15.6	9.4	15.9	15.3
Urban Density (persons per km^2)	10,250	9,500	5,835	6,400	9,200	6,000	4,814	5,700	6,300	6,600	6,600
Land Registration (%)	40[1]	60	80	50	55	35	90	70	78	100	100
Permanent Structures (%)	90+	89	90	87	71.3	89	93.4	90	94	97	97
Water Connection (%)	98	96.5	90	88	94.1	90	82.6	91	87	98	95
Journey to Work (minutes)	33	30	60	45	56	49	55	56	40	40	37
Infrastructure Expenditure–to–income Ratio (%)	–	2.3	7.2	8.9	9.1	–	–	4.1	7.9	4.9	5.9
Public Housing (%)	0	0	0	0	0	38	6.1	10	12	22	12
Unauthorized Housing (%)	47	60	15	44	30.0	–	15.8	26.4	27.1	9	15
Squatter Housing (%)	46	40	12.2	29	7.5	40	4.9	25	16	4	4
Homelessness per 1,000 people	<1	<1	<1	3.9	0.6	5.0	<1	2.1	0.2	1.1	0.9
Owner Occupancy (%)	79	60	77	61	79	67.6	83.8	65	59	57	55
The Median House Price ($)	17,070	9,100	27,000	7,742	6,767	29,000	44,700	11,818	16,205	23,646	20,315
The House Price–to–Income Ratio	3.2	1.1	1.4	1.6	2.4	5.7	3.6	2.4	4.5	4.4	5.0
The Rent–to–Income Ratio (%)	16.5	21.1	25.0	22.0	12.5	15.0	32.0	19.8	16.2	14.6	16.2
Lowest–Priced Private–Sector House ($)	7,300	15,150	14,000	–	6,040	3,800	40,000	33,000	14,400	17,600	14,100
Down–Market Penetration	1.3	2.0	0.8	1.2	2.1	6.7	2.7	3.9	3.6	3.4	3.4
Price of Serviced Land on Urban Fringe ($ per m^2)	17	26	25	21	35	30	40	–	14	41	69
Serviced Land Price–to–Income Ratio	0.3	0.3	0.1	0.3	0.7	1.1	0.4	–	0.5	0.8	0.9
Construction Cost per Square Meter ($)	165	156	140	180	155	225	510	171	156	203	171
The Housing Credit Portfolio (%)	16.4	13.4	22.8	7	20.1	<10	9.4	20	8	18	14
The Mortgage–to–Prime Difference (%)	0	–2.0	2.0	3.0	–20	14	6.0	3.2	0.5	–0.4	0.2
The Mortgage Arrears Rate (%)	2.5	2.4	<1	5	3	5.8	1–4	6	10	5	5
New Household Formation (%)	4.5	3.5	2.55	3.0	4.2	1.56	1.2	3.1	3.9	2.7	3.1
Housing Production per 1,000 people	9.3	7.9	9.4	6.2	9.3	5.8	6.3	6.0	7.7	6.1	6.5
Residential Mobility (%)	–	–	–	1.5	3.4	5.6	–	3.4	5.0	4.4	7.1
The Vacancy Rate (%)	6.7	7.7	11.4	–	1.6	8.3	15.0	4.2	2.8	3.8	3.5

Sources: Banco Central de Honduras, *Boletin Estadistico*, Vol. LI, No. 9, 2001; Enginyeria I Gestió d'Infraestructures, *Avance Plan Territorial Tegucigalpa/ Honduras*, 2002; Instituto Nacional de Estadistica (INE), *Programa de Encuesta de Hogares: Vigésimo Tercera Encuesta Permanente de Hogares,* 2001; International monetary Fund (IMF), "Honduras: Statistical Annex," 2000; Listado Carrusel, "Venta Casas en Tegucigalpa,", April 2002; Instituto Libertad y Democracia (ILD), 2001, *Activos Perdiales y Empresariales Extralegales en Honduras*; Shlomo Angel, *Housing Policy Matters: A Global Analysis*, 2000; Shlomo Angel, various housing sector assessments (see References); Shlomo Angel, field visits in Tegucigalpa, April 2002; Superintendencia de Bancos, Seguros e Instituciones Financieras, *Boletin Mensual de Estadistica del Sistema Financiero y de Seguros*, November 2001; [1] Restricted to residential property only.

locations at higher costs. And, also because of the topography, transportation routes are circuitous, limited to a few channels, and journey–to–work times are already high (they averaged 33 minutes in 2000[4]).

Table 9: Land Use, Densities, and Land Consumption in Tegucigalpa, 2001

Land Use	Land (hectares)	% of Total	Population Number	% of Total	Net Density (persons/ hectare)	Gross density (persons/ hectare)	Net Land Consumption (m^2/person)	Gross Land Consumption (m^2/person)
Residential	6,386	66.1%	990,872	100.0%	155	103	64	98
High-Quality	1,160	12.0%	35,633	3.6%	31	20	326	493
Medium-Quality	3,082	31.9%	509,780	51.4%	165	109	60	92
Low-Quality	2,032	21.0%	426,651	43.1%	210	139	48	72
Historical District	66	0.7%	9,606	1.0%	146	96	69	104
Multi-Family	46	0.5%	9,202	0.9%	200	132	50	76
Other Land Uses	3,280	33.9%						
Total	9,666	100.0%						

Source: Enginyeria I Gestió d'Infraestructures, 2002, *Avance Plan Territorial Tegucigalpa/Honduras*, Suelo Residencial, Situación Año 2000.

There is therefore an urgent need for minimal planning for the expansion of the city, preparing to make the minimal investments in infrastructure, public facilities, open spaces and environmental protection. Such minimal planning is essential at this time, to ensure the regular supply of land in the coming years at prices that will be affordable to the new inhabitants of the city. The absence of a proactive approach to the rapid expansion of the city will have two negative effects on the housing sector: first, land supply bottlenecks will increase land prices and therefore house prices; and second, unplanned growth (without reserving adequate land for public uses and protecting sensitive lands) will make the provision of public services and disaster relief more costly in the future. Similar preparations will also need to be made in San Pedro Sula and in other cities, but they are likely to be easier to implement than in Tegucigalpa.

Is new residential land in Tegucigalpa affordable? Unfortunately, no systematic information on land prices is currently available but the provisional answer is 'yes.' Formal developers interviewed estimate the cost of raw land on the urban fringe to be of the order of L.20–60 per gross square vara ($1.75–5.20/m^2$)[5] at the present time. They estimate the cost of providing basic infrastructure services (unpaved roads, water, sewerage, drainage and electricity) to be of the order of L.40–120 per net square vara ($3.45–10.40/m^2$) depending on the level of services. A serviced plot in a land subdivision with basic services would thus cost L.65–195 per salable square vara ($5.65–16.90/m^2$). The average *cost* of serviced land on the urban fringe would be of the order of $11.25/m^2$. The average price could be much higher, possibly $16/m^2$. The median income in Tegucigalpa in 2001 was $5,309. The serviced land price–to–income ratio would thus be 16/5309 = 0.3%. As can be seen from table 8, this price is by no means excessive in comparison to other metropolitan areas in the region.

Do low–income families have ready access to land? The provisional answer is again 'yes.' There are still organized invasions in Tegucigalpa, and the organizers can often arrive at a negotiated price with the original owners of the land and have the land transferred formally to the community. *Alto de la Laguna*, situated on a high plateau on the southern edge of the city, is one such community. It invaded the land in 1999 and then bought it from the original owners at L.18 per gross square vara ($1.60/m^2$). The land was subdivided into 4,000 plots and roads were bulldozed, but no other services were provided. Electricity poles are presently being erected and water is being brought by trucks. It was still possible in early May of 2002 to buy 15–meter–by–8–meter plots there for L.3,100 ($190) to be paid in three monthly payments, at L.37 per net square vara ($1.60/m^2$).[6] Such plots would certainly be affordable by families in the lowest–income decile in Tegucigalpa. Title documents for the plots could be obtained in the municipality for an additional L.340 ($21).

To conclude, residential land on the fringe of Tegucigalpa (and San Pedro Sula) is still available and largely affordable. Given the intense demand for land in the coming years, it is important to ensure that sufficient land keeps coming into the market at affordable prices. This needs to be done in the face of increasing concerns about the environmental degradation of urban fringe lands, about the continuing practice of land invasion, about the continued defiance of land subdivision and zoning regulations, and about the high costs of delivering water to high–altitude areas. Still, the present land production mechanism continues to supply ample affordable land for housing and needs to be protected until better alternatives are found.

2. *The Volume, Structure and Costs of Housing Production:*

How many houses are built in Honduran cities every year? As we observed in table 2 above, the *net* annual increase in the housing stock in the *urban* areas of Honduras alone is currently of the order of 30,000, of which 8,000 is in Tegucigalpa, 9,000 is in San Pedro Sula, and 11,000 is in other cities.[7] If we assume, conservatively, that 0.5% of the stock is destroyed and replaced every year, then we can arrive at an overall estimate of annual housing production: On average, 34,000 housing units are now produced in urban areas every year—9,000 in Tegucigalpa, 10,000 in San Pedro Sula, and 15,000 in other cities. The rate of housing production in 2001 in Tegucigalpa, for example, was 9.3 dwelling units per 1,000 people. In comparative terms (see table 8) this is a high production rate, higher than the regional average and the average for countries with similar per capita incomes. There is no question that Honduras has an aggressive urban housing production system, a system that ensures that everyone has access to shelter and that virtually no one remains homeless.

What is the share of the *formal* private sector in total housing production in a typical year? There are no published figures to consult on this matter. A recent World Bank study estimated that in Tegucigalpa, for example, 3,000 formal housing units are built in a typical year [World Bank, 2001, vol. 2, 45]. An informed developer in San Pedro Sula estimated that 3,000 units are built there in a typical year too.[8] Those estimates would amount to 33% and 30% of total housing production in each city respectively. McDonald [2000, 20] estimated the level of formal annual housing production in the country as a whole to be of the order of 7,500. These rough estimates suggest that some 65–75% of annual housing production now takes place *outside* the formal sector, a relatively high figure in comparative terms.

Has housing production kept up with population growth or is it lagging behind, creating a larger and larger *quantitative* housing deficit? A comparison of census data between 1988 and 2001 shows clearly that the housing stock has grown more rapidly than the population in all the departments in the country.[9] While the population in the country has grown at an average rate of 2.4%, the housing stock has grown at the rate of 3.7%, some 50% faster than the growth of the population. There are now—on average—4.2 persons per dwelling unit in the country, compared with 4.9 persons in 1988. This has made it possible to accommodate the reduction in household size from 5.5 to 5.0 during this period.

While it appears that housing stock growth has not reduced the percentage of households who shared *occupied* dwelling units, it clearly increased the vacancy rate. As can be seen from table 2, the number of *unoccupied* dwelling units in the country increased from 109,850 in 1988 to 225,360 in 2001. This increase could be attributed in some part to the large number of empty units constructed in the aftermath of Hurricane Mitch, to the number of units abandoned by people who moved away or migrated abroad, and to the large number of unsold units now on the market. The high level of vacancies could also be attributed, at least in part, to the possibility that post–Mitch Government–backed housing projects may not have paid adequate attention to actual demand.

Given the rapid rates of growth of dwelling units in Honduras in recent years, we can conclude that a massive supply–driven house construction program by the formal sector aimed at reducing the *quantitative* housing deficit in the country is not a high housing policy priority at this time. While there is clearly a significant and growing demand for housing in Honduras—mostly concentrated in urban areas—this demand appears to be satisfied by the combined efforts of formal and informal suppliers of land and housing.

Is Honduras investing adequate amounts of resources in housing? The provisional answer is an unqualified 'yes,' although the available data from the national accounts on the one hand and from estimates of the replacement cost of housing in the informal sector on the other cannot be reconciled. This is largely due to the fact that the bulk of investment in housing takes place in the informal sector, for which no accurate statistics are collected at present by the Central Bank. According to the Central Bank, annual construction investment averaged US$243 million (L.4 billion in current prices) during the past five years [Banco Central, 2002]. Average formal residential construction in a typical year may have formed, on average, 33% of the total or US$81 million (L.1.3 billion in current prices), amounting to 1.5% of GDP.[10] A study completed in 2001 by the *Instituto Libertad and Democracia* estimated that the replacement cost of the 380,000 informal dwelling units in urban areas of Honduras was of the order of US$4.3 billion (L.71 billion in current prices) [ILD, 2001, 30, 39–40]. If we assume that 5% of that amount was invested on average every year, it would imply that some $215 million are now invested annually in the construction of urban informal housing. This would add another 4% to GDP, bringing the total housing investment as a percent of GDP to 5.5%, a very high figure by all accounts.

What are the costs of residential construction? The *direct* construction cost (materials, labor and equipment) of a median–priced formal house in Tegucigalpa is currently of the order of L.1,800 ($110) per m^2, and the sale price of 1 m^2 of a completed house ranges between L.2,400 and L.3,000 ($146–183). The average construction sale price per m^2 is $165, which is roughly the average price for the region as a whole but a high price when compared with the low median incomes in the country. Construction costs in the informal sector appear to be similar. A recently constructed 72m^2 brick house in Colonia Nueva Suyapa, for example, with a zinc roof, tile floors, plastered walls, and an outdoor latrine cost L.140,000 or L.1,945 ($119) per m^2.[11] The *replacement* cost of existing informal sector houses in Tegucigalpa was estimated in a recent study to vary between L.2,200 and L.3,500 ($135–215) per m^2 [ILD, 2002, vol.1., 35]. Yet while these costs are certainly high and out of the range of families in the lowest–income deciles, a basic 36m^2 starter house in a new invasion, like *Alta de la Laguna* mentioned earlier, with thin wooden walls, zinc roofs, and an earthen floor costs only L.10,000, or L.275 ($17) per m^2.]

There are several programs in operation in Central America that construct basic houses on plots already owned and occupied by poor families in both rural and urban areas. The Programa Integral de Mejoramiento Habitacional Urbano (PRIMHUR) in Honduras, for example, constructs basic 34 m^2 houses with concrete block walls, a cement floor and zinc roof, a basic kitchen and a toilet/bath for L.61,200 ($3,709) or L.1,800 ($109) per m^2. A similar program focusing mainly on rural areas is operated by the Ministry of Housing (MIVI) in Panamá, which constructs a basic 36m^2 house on a cement floor with no bath or kitchen for L.27,000 ($1,650) or L.750 ($46) per m^2. Given these differences, there may still be considerable room for experimenting with cost reduction.

3. *The availability of mortgage finance*:

The chronic shortage of affordable, accessible, and reliable housing finance is the key bottleneck that constrains the development of the formal housing sector in Honduras, and the main reason why more than two–thirds of urban housing production takes place in the informal sector. Informal construction is necessarily gradual. Building materials are bought over several years at the going prices, without access to housing finance and therefore without the payment of any interest at all. In contrast, lending interest rates in the banking system are still 23–28%, even though inflation has been reduced to single digits. At these rates, as we shall see in the following section, a median–income family in Tegucigalpa cannot afford even the cheapest land–and–house package offered on the market.

It is difficult to estimate, given the present data–gathering practices of the banking system and the *Superintendencia de Bancos, Seguros e Instituciones Financieras* (Superintendency of Banks, Insurance Companies and Financial Institutions of CNBS), what is the total volume of **[out: mortgage loans and the total value of]** ***new*** **[in italics]** loans issued annually throughout the system. Table 10 below provides initial estimates, calculated from available data and corroborated through discussions with knowledgeable persons. By the end of 2001, the total mortgage portfolio in Honduras was of the order of L.12 billion ($747 million). Of this, L.6 billion ($378) was in commercial banks and S&Ls, L.2.7 billion ($168 million) was in two public pension funds (INJUPEMP and IMPREMA), L.1.1 billion ($68 billion) was in the *Regimen de Aportaciones Privados* (Private Contributions Regime, or RAP), and L.1.6 billion ($99 million) was in the *Fondo Nacional para la Producción y la Vivienda* (the National Fund for Production and Housing, or FONAPROVI). In addition, two funds administered by the *Fundación para el Deasarrollo de la Vivienda Urbana y Rural* (the Foundation for Urban and Rural Housing Development of FUNDEVI), PRIMHUR and PVMR[12], held portfolios of L.436 million ($27 million) and L.100 million ($6 million) respectively.

The total number of new housing loans in 2001 was estimated at 17,000. These loans included loans for new **and second–hand** housing, loans for housing construction and improvements, loans for refinancing existing mortgages, and home equity loans. It was not possible to estimate the number of loans available for **the purchase of *new*** housing, but discussions with developers indicate that practically all **the** new land–and–house packages built by developers for sale were supported by housing finance. This suggests that the number of loans for new formal–sector housing in 2001 was of the order of 7–8,000. However, given the paucity of data, the numbers provided here should be treated with caution. It is important to note, however, that if these numbers are indeed reasonable then the commercial banks and S&Ls were managing to issue a large number of mortgages—6,000 in 2001—at the prevailing commercial interest rates. If this is true, it is indeed hopeful because it suggests that as inflation rates stabilize and as the banking system becomes stronger, mortgages at market rates may indeed become the main form of mortgage credit in the country.

Table 10: Housing Credit Portfolio and New Housing Loans in Honduras in 2001

Institution	Total Housing Portfolio (L. mills.)	($US mills.)	Volume of New Loans (L.mills.)	($US. Mills.)	Number of New Loans	Average Loan Amount (Lemps.)	($US)
Commercial Banks/ S&Ls	6,046†	378	1,650*	103*	6,000*	275,000*	17,188*
INJUPEMP	1,237†	77	117	7	554†	210,700†	13,169
IMPREMA	1,463†	91	525	33	3,000†	175,000†	10,938
RAP	1,086	68	283	18	1,144	247,727	15,483
FONAPROVI	1,587	99	463	29	2,158	214,509	13,407
PRIMHUR	436	27	79	5	2,509	31,400	1,963
PMVR	100	6	10	1	1,621	6,250	391
Total/Average	11,955	747	3,127	195	16,986	165,798	10,362

Sources: FONAPROVI, 2001, *Informe Annual de Labores—Año 2001*; FUNDEVI, 2002, "Informe de Avance PRIMHUR–PVMR; Superintendencia de Bancos, 2001, *Boletin Mensual de Estadistica del Sistema Financiero y de Seguros;*. Note:. Numbers with a cross (†) were provided by Marco Antonio Aguirre of RAP. Numbers with an asterisk (*) are gross estimates by the author based on the available information, **using prevailing ratios of new loans to total loan portfolios**.

For now, however, Commercial banks and S&Ls have no incentive to reduce their mortgage lending rates or to expand their lending. Some are saddled with a high proportion of bad loans and need the profits from high intermediation rates to remain in business. Some are simply inefficient. None have ready sources of long–term funds except for pocketbook savings. Even pension and insurance funds hold only short–term instruments, and there is no demand for securitized mortgages. Government bond yields remain high, averaging 15.3% in 2001 [The Economist, 2002], reducing the incentive to lend altogether. In short, there is no immediate prospect for a rapid reduction of mortgage interest rates or for the expansion of the mortgage market.

4. House Prices, Rents and Affordability:

Data on the distribution and dynamics of house prices and rents in Honduras is sorely lacking, making it difficult to assess levels of housing affordability, and therefore difficult to design programs of housing assistance. At this stage, it is only possible to provide gross estimates for Tegucigalpa, based on real estate listings [Listado Carussel 2002], on recent interviews and on the results on a recent study of house values in informal communities [ILD, 2001]. A median–income family in Tegucigalpa had an annual income of L.81,712 ($5,309) in mid–2001 (see table 3). If it occupied a house in an informal community in the city, its median value would be of the order of L.230,000 ($14,000).[13] If, on the other hand, that family applied for a mortgage loan at prevailing commercial terms (23–28% annual interest rate for 20 years, with an average interest rate of, say, 25%), it could only afford to pay L.102,000 ($6,200) for a house, not enough to buy any land–and–house package offered by the private sector in Tegucigalpa in 2002.[14] In other words, the *median* value of a house in Tegucigalpa at the present time is approximately L.275,000 ($17,000).[15] Yet a median–income family in the city could only afford a house worth slightly more than one–third of this value if it wanted to finance it with a mortgage loan under the present terms.

A commonly used comparative measure of housing affordability is the house price–to–income ratio, which compares the value of the median–priced house to median income. Given the above figures, this ratio in Tegucigalpa is of the order of 3.2. As table 8 above shows, it is high in comparison with other cities in Central America and with values in Latin America as a whole, suggesting that housing affordability in Honduras is relatively low. Part of the reason, as noted earlier, may be that Hondurans invest more in their houses than their neighbors, possibly making use of **some** remittances from abroad. At any rate, they have now become owners of valuable residential properties.

The result is that middle–income families seeking to buy a house, for example, expect a relatively high quality of housing, much higher than what they can afford in the private market at present interest rates. There is, no doubt, a housing crisis for middle–income families in Honduras at the present time. Most would prefer a new land–and–house package valued at L.250,000 ($15,250) rather than building a house in an informal settlement over a period of years, but even with a subsidized RAP– or FONAPROVI–backed loan at 19% interest, such a house is only affordable by the 10th decile of the income distribution. In short, the informal sector—with its usual limitations, insecure tenure, illegal building, and low quality of urban services—offers Hondurans valuable access to housing, but only if it is built over time.

Have private–sector developers gone down–market to meet the needs of lower–income families or are they only serving higher–income groups? The cheapest land–

and–house package offered by the private sector in Tegucigalpa at present is priced at L.110,000 ($6,700), amounting to 1.3 median incomes. The bulk of new housing produced by the private sector in San Pedro Sula is priced at L.175–200,000 ($10,700–12,200), or 1.9–2.1 median incomes. These are very low figures, suggesting that private–sector developers indeed target lower–income households, and that housing in Tegucigalpa and San Pedro Sula is not expensive in comparative terms. The fact that private sector housing is not affordable is simply due to the high prevailing interest rates.

There is no information available on rents in Tegucigalpa. Interviews with real estate agents and the examination of the consolidated list of rental properties [Listado Carussel, 2002] suggest that median rents are of the order of L.1,200 per month, or 16.5% of median monthly incomes. This is a reasonable rent–to–income ratio in comparative terms, leading to the conclusion that rents are generally affordable.

House prices and rents in Honduras have generally appreciated at the same rate as the overall rate of inflation. The consumer price index for housing published by the Central Bank increased almost exactly in parallel with the overall price index between 1980 and 2000, in some years exceeding it, in some years falling behind, but on average moving at the same average rate [Banco Central, 1998, 57 and 2001, 41]. Several of the people interviewed noted that there was a sharp increase in rents following the destruction brought about by Hurricane Mitch in late 1998. Indeed, in 1997 and 1998 house prices and rents moved slower than the overall rate of inflation, increasing by 26% in two years as against 34%. But in 1999 and 2000 they increased faster than inflation—30% in two years as against 23%. This suggests that there are no serious housing supply bottlenecks that artificially raise housing prices faster than the prices of other goods and services.

5. *Dwelling Units and Living Space:*

The discussion of the available number of dwelling units is critical for our understanding of the presence (or absence) of quantitative housing deficits in Honduras. And both the number of dwelling units and the amount of floor area per person (or, alternatively, the number of persons per room or per bedroom) are necessary to understand the degree of overcrowding. According to the 2001 census, by that year there were some 1.46 million dwelling units in Honduras, housing 1.26 million households. There were 16% more dwelling units than households in the country, and 3% more dwelling units than households in Tegucigalpa. Overall, therefore, there was no shortage of dwelling units. However, many of the dwelling units were vacant. The vacancy rate in Tegucigalpa, for example, was 6.7% in 2001. As a result, the number of households actually exceeded the number of *occupied* dwelling units in 2001, by 2.0% in the country as a whole and by 4.0% in Tegucigalpa.

In general, the quantitative housing deficit should refer only to households requiring settlement in *new* dwelling units, excluding houses that now occupy a plot of land and that can be improved, extended or rebuilt without requiring resettlement. It should include (a) all homeless households; (b) all households sharing a dwelling unit; and (c) the share of households in flood–prone areas and in areas in serious danger of mudslides that cannot be protected with public works (e.g. by drainage canals, levies, or retaining walls). First, we note that there is virtually no homelessness in Honduras. Second, if we assume that doubled–up households are sharing a dwelling unit against their will and would prefer to live independently, then according to table 2 there was a *quantitative* deficit of 24,000 dwelling units in the country and 8,000 in Tegucigalpa in 2001. Third, while it is very difficult to provide an accurate estimate of houses subject to unacceptable environmental risk, if the damage caused by Hurricane Mitch can be taken as a yardstick, there may be some 30,000 houses in the country and 5,000 houses in Tegucigalpa that require immediate resettlement because they are situated in areas of intolerable environmental risk. **But that number may be much larger, possibly twice as large.** Further study is needed to assess levels of environmental risk in the housing stock, to agree upon a risk management strategy **that can determine what risks are sustainable given the resources available to mitigate them**, and to **agree on** the share of the stock that needs to be **replaced through resettlement** to avoid disaster.

Given the above preliminary estimates, the overall quantitative housing deficit **could** be of the order of 50–**100,**000 units in the country as a whole, and 12–**25,000** in Tegucigalpa, **depending largely on the method for estimating how many units in high–risk areas require total replacement through resettlement**. It is by no means as high as the 342,000 suggested by Macdonald [2000,16], for example, **or the 200,590 suggested by UNDP [UNDP, 1999, table 4.1, 75]**. Macdonald assumed that housing units which are overcrowded need to be replaced, while in the majority of cases they only need to be extended by constructing either additional rooms or an additional floor. She also assumed that houses with insecure tenure or with inadequate services are part of the quantitative deficit, but these houses only need tenure regularization and infrastructure improvements; they do not need to be replaced with new housing. Finally, she assumed that houses on owned plots of land that are made of low–quality materials need to be totally replaced, but many of these houses need only need physical improvements. **The UNDP report does not elaborate on the sources of the quantitative deficit, but acknowledges that only 6.7% of the stock is made up of *improvised* houses [UNDP, 1999, 75**]. **Given the size of the stock shown in table 2 earlier, this would amount to 98,000 units, many of which would not need to be replaced by a new house–and–land package.** In short, most of what is considered to be a quantitative deficit in Honduras is in reality **[out: only]** a *qualitative* deficit. The quality of housing in Honduras will be discussed in greater detail in the following section.

To what extent are houses in Honduras overcrowded? Table 11 below estimates the amount of floor area per person and the number of persons per bedroom in the country as a whole and in Tegucigalpa. The median floor area per person in Tegucigalpa is estimated to be 10.4m², the median house size to be 51m², and the median number of persons per bedroom to be 2.1. As table 8 showed, these values are not very different from values in countries with similar per capita incomes, but they are smaller than the average values for Latin America and the Caribbean. Still, as table 11 clearly shows, there is very considerable overcrowding in the capital city and even more overcrowding in the country as a whole. It is quite possible that in 10 percent of the households in the country, 6 or more persons share a single bedroom. In Tegucigalpa, in 10 percent of the households 4.6 or more persons share a bedroom.

Table 11: Estimated Floor Area per Person and Persons per Bedroom in the Country and in Tegucigalpa, 1998

Household Decile	Floor Area per person (m^2)				Persons per Bedroom			
	Country as a Whole		Tegucigalpa		Country as a Whole		Tegucigalpa	
	From	To	From	To	From	To	From	To
1st	0	3.7	0	4.8	6.03+		4.6+	
2nd	3.7	4.9	4.8	6.3	4.51	6.03	3.5	4.6
3rd	4.9	5.6	6.3	7.2	3.95	4.51	3.0	3.5
4th	5.6	7.0	7.2	9.2	3.13	3.95	2.4	3.0
5th	7.0	8.6	9.2	10.4	2.56	3.13	2.1	2.4
6th	8.6	10.1	10.4	14.4	2.18	2.56	1.5	2.1
7th	10.1	18.0	14.4	19.9	1.22	2.18	1.1	1.5
8th	18.0	23.3	19.9	24.0	0.94	1.22	0.9	1.1
9th	23.3	28.3	24.0	28.9	0.78	0.94	0.8	0.9
10th	28.3+		28.9+		Less than	0.78	Less than	0.8

Source: Estimated by the author from data in Dirección General de Estadistica y Censos, 1998. *Decimonovewna Encuesta Permanente de Hogares—Marzo 1998*, draft version, table 34, 44 and 212.[16]

Given the information used to construct this table, we can also estimate the level of overcrowding in terms of the additional amount of floor space needed to elevate the housing stock up to a desired standard. Preliminary calculations suggest that the estimated total residential floor areas in the country and in Tegucigalpa are 58 million m^2 and 11.2 million m^2 respectively. To ensure that there are not more than 2.5 persons per bedroom, every person in the country has to occupy at least an 8.8m^2 living area. At this standard, a family of five, for example, would occupy a 2–bedroom dwelling unit of 44m^2. To meet this standard, there is a need to add 15 million m^2—26% of the total—to existing overcrowded houses. In parallel, to ensure that every person in Tegucigalpa has at least an 8.8m^2 living area, there is a need to add 1.5 million m^2—13% of the total—to existing overcrowded houses. If we estimate the basic cost of adding rooms to be of the order of L.800/m^2 ($48/$m^2$), then the total cost of removing overcrowding in the country amounts to L.12 billion ($730 million), and the cost of removing overcrowding in Tegucigalpa amounts to L.1.2 billion ($73 million). Serious concern should be given to targeting the gradual reduction of overcrowding as an integral part of the country's Poverty Reduction Strategy.

6. *The Quality of Housing:*

In general, there is no precise way of calculating a *qualitative housing deficit* because it is not a number. The housing stock has certain quality characteristics, and we can only speak with confidence about the presence or absence of a certain characteristic—e.g. a piped water supply or an earthen floor—in part of the stock. There is no reason to write off houses as part of an imaginary qualitative deficit because of the absence of one or more desirable quality characteristics. At the very least, the plot on which they are situated, the road access to the plot, the available services, the social capital in the community, the yard and garden, and the shelter provided by the structure itself must all have some value.

The National Institute of Statistics in Honduras (INE) collects data on a number of quality attributes of the housing stock: the materials of the exterior walls, the roofs and the floors of houses; and the type of water supply, sewerage, and electricity available. By examining these attributes and the changes in their presence over time, we may gain some insight regarding the overall quality of the housing stock and the choice of an appropriate strategy for upgrading that quality.

Table 12 below summarizes the key measures of housing quality in Honduras for which selected data exist for 1988, 1995, 1996 and 2001. In Tegucigalpa in 1995, for example, 70 percent of the houses had masonry walls, 25 percent had wooden walls, and 6 percent had adobe walls; 85 percent had asbestos or zinc roofs; and 80 percent had masonry floors. A recent World Bank survey in the city found that only 2 percent of exterior walls were made of non–permanent materials [World Bank, 2001, 50], suggesting that the number of permanent structures—those that can be expected to last twenty or more years—may be 90 percent or higher, a percentage comparable to the prevailing numbers in Latin American and the Caribbean (see table 8). In parallel, 96 percent of the houses in the city were connected to the water–supply network; 75 percent had indoor toilets (73 percent connected to the sewerage network, and 2 percent to septic tanks); and 98 percent had electrical connections. These numbers are close to the prevailing numbers in the region and in countries with similar per capita incomes. Housing quality in Honduras is certainly not below its expected level, especially considering its low per–capita income.

Table 12: Quality Characteristics of Houses in Honduras, 1988–2001

	Country Total			Rural Areas			Urban Areas			Tegucigalpa		
House Characteristics	1988	1995	Change	1988	1995	Change	1988	1995	Change	1988	1995	Change
Exterior Walls												
Masonry	25	47	+22	8	31	+23	48	66	+18	53	70	+16
Adobe	23	24	+1	29	31	+2	14	14	0	6	5	-1
Wood	22	12	-9	17	9	-8	27	16	-11	37	25	-12
Other	31	17	-14	46	29	-17	11	3	-7	4	0	-4
Roof												
Shingles	–	41	–	–	58	–	–	21	–	–	6	–
Asbestos	–	12	–	–	4	–	–	21	–	–	40	–
Zinc	–	45	–	–	35	–	–	56	–	–	45	–
Other	–	3	–	–	3	–	–	2	–	–	8	–
Floor												
Masonry	43	60	+17	23	38	+15	71	84	+13	75	80	+5
Wood	5	1	-4	5	1	-4	6	2	-4	5	2	-2
Earth	51	34	-16	72	55	-17	22	11	-11	19	10	-9

Other	1	4	+4	1	6	+6	1	2	1	1	7	6
Infrastructure Services	1996	2001	Change	1996	2001	Change	1996	2001	Change	1996	2001	Change
Water Supply												
Public Connection	57	51	-6	30	28	-2	88	74	-14	92	96	+4
Private Connection	31	39	+8	51	54	+4	9	24	+15	4	2	-2
Well	5	4	-1	9	7	-2	1	1	-0	0	1	1
Other	7	6	-1	11	11	0	2	1	-1	5	1	-3
Sewerage												
Indoor	49	53	+4	32	30	-2	68	76	+9	67	75	+9
Outdoor Latrine	35	29	-6	41	43	+2	28	14	-13	31	15	-16
None	16	18	2	26	27	1	5	9	5	2	10	7
Electricity												
Public Connection	62	71	+10	33	47	+14	95	96	+2	98	98	0
Private Connection	0	1	0	1	2	1	0	0	0	0	0	0
None	38	28	-10	67	51	-16	5	4	-1	2	2	-0

Sources: For 1988 data on exterior walls and floors, Dirección General de Estadistica y Censos, *Censo Nacional de Vivienda – 1988*; for 1995 data on exterior walls, roofs and floors, Dirección General de Estadistica y Censos, 1995, *Encuesta National de Ingresos y Gastos de los Hogares*; for 1996 data on water supply, sewarage and electricity, Dirección General de Estadistica y Censos, *Decimosexta Tercera Encuesta Permanente de Hogares*; for 2001 data on water supply, sewerage and electicity, Instituto Nacional de Estadistica, 2001, *Vigésimo Tercera Encuesta Permanente de Hogares*.

When we look more closely at housing quality in Tegucigalpa, however, we can identify several serious problems that are not revealed by the statistics that are regularly collected. Most of the problems are not with the houses themselves, which are of relatively good quality, but with the infrastructure that serves them. First, 35 percent of the houses in the city are located on streets with no direct vehicular access. Second, 41 percent of the houses are located on non–asphalted roads [World Bank, 2001, 50]. Third, piped water supply is intermittent and does not reach houses in higher elevations, forcing many people to rely on water vendors. In *Colonia Nueva Suyapa* for example, on the Eastern slopes of the city, piped water is rarely available. A 55–gallon drum costs L.13 and a typical family buys two drums per day, or 60 per month, as a total cost of L.780 ($48). By comparison, the average payment for piped water in the city is L.72 ($4.40) per month [World Bank, 2001, 54]. Fourth, the continuing absence of a piped sewerage network in established settlements forces people to relocate the latrines in their back yards every year. One 20–year resident in *Colonia Nueva Suyapa* described his backyard as a minefield of excreta. Community leaders cited the urgent needs for improvement to be (a) a sewerage network; (b) a regular piped water supply; and (c) street pavement, in that order of priority.

Still, despite the persistence of serious problems, there is no question that the quality of houses and residential infrastructure in Honduras is improving over time. As table 12 shows, between 1988 and 1995 for example, the percentage of houses with masonry walls increased substantially everywhere, especially in rural areas where it increased from 8 percent to 31 percent of the total. In parallel, the percentage of earthen floors declined rapidly. Both developments suggest that if there is indeed a qualitative deficit, it is gradually diminishing rather than growing. As for infrastructure services, two important improvements can be observed in the table. First, between 1996 and 2001, the percentage of outdoor latrines in urban areas declined rapidly, from 28 percent to 14 percent. Second, the percentage of rural houses connected to the electrical grid increased from 34 to 49 percent. Given the short time span, these are no mean accomplishments.

On the whole, quality improvements to the housing stock must focus, first and foremost, on improving residential infrastructure; and second on enabling and empowering people to improve the quality of their houses by themselves. House improvements and extension to reduce overcrowding or to start small home–based businesses can be accelerated through improved tenure, through micro–loans, through small and well–targeted house–improvement subsidies, and through technical assistance where necessary. What is clear is that housing policy in Honduras should respect the quality and the value of the existing housing stock and focus on its improvement, rather than writing it off and calling for its replacement with new construction.

7. Tenure:

As table 8 above shows, the share of owner–occupied housing in Tegucigalpa—79 percent in 1998—in high in comparative terms, considerably higher than the estimated 65 percent for the region as a whole. Table 13 below provides data on the changes in tenure status in the country between 1988 and 1998. On the whole, the share of owner–occupied housing increased. It increased from 82 to 86 percent in the country as a whole; from 90 to 96 percent in rural areas; and from 71 to 75 percent in urban areas. San Pedro Sula remained an exception. It had a relatively low rate of owner–occupancy before—66 percent in 1988—and this rate has persisted without change into 1998.

Table 13: Changes in Housing Tenure in Honduras, 1988–1998

	Owner-Occupied (%)			Rented/Leased (%)		
Area	1988	1998	Change	1988	1998	Change
Whole Country	82	86	+4	18	14	–4
Rural Areas	90	96	+6	10	4	–6
Urban Areas	71	75	+4	29	25	–4
Tegucigalpa	71	79	+7	29	21	–7
San Pedro Sula	66	66	0	34	34	0

Sources: Calculated from Dirección General de Estadistica y Censos, 1988, *Censo Nacional de Vivienda—1988;* and Dirección General de Estadistica y Censos, 1998, *Decimonovena Encuesta Permanente de Hogares—Marzo 1998,* table 33a. Note: Owner–occupied properties include mortgaged properties, freely-ceded properties, and legalized and non–legalized properties.

As in other countries, the relatively high rate of owner–occupancy can be partially attributed to the persistence of illegal occupation of lands in Honduras, largely through organized invasions and to a lesser extent through fake 'invasions' in collaboration with or at least with the acquiescence of landowners. But while invasions have become a thing of the past in many countries in the region, they appear to continue unabated in Honduras at the present time, and, in general, the central government and the municipalities have not adopted a consistent policy vis–a–vis invasions. Many of the invasions are indeed benign, to the extent that they occupy unused or unusable land and put it to productive residential use. But in some cases, they have been known to seriously interfere with the orderly development of the housing sector.

The recent invasion of the half–completed housing project of the *La Vida Nueva* Foundation in San Pedro Sula is one such example. The project, a well–planned post–Mitch subdivision for 4,200 dwelling units and their associated public services financed largely by donations from abroad, was in the early stages of construction in early 2002. 600 housing units where completed and half the lots were provided with basic infrastructure services. Once 500 families were moved in from temporary shelters, the rest of the serviced lots including the 90 remaining houses were invaded and occupied. The invaders claimed that the donors promised free housing, while the Foundation was seeking to recover some of the costs by selling houses and plots to targeted beneficiaries. The organizer of the invasion—a prominent local politician, who as a member of the National Election Tribunal is immune from prosecution—is charging L.15,000 ($915) for a serviced plot, and organized gangs are presently vying for control of different sections of the project.[17]

In contrast, many invasions are more benign. Organizers often arrive at an agreement with the landowner on a price for the legal transfer of the land, which is then subdivided and sold to the invading families at cost. The invasion of *Alta de la Laguna*, on the southern fringe of Tegucigalpa, is one such example. In other cases, landlords invite professional 'invaders' to occupy their land and then sell plots to the invading families at a discounted price and to latecomers at the full price. In this manner, they avoid the need to wait or to pay for official land subdivision permits, as well as the need to complete the subdivision to the high official standards.

Profit levels are often much higher in projects that sell partially–serviced, 'invaded' land. *Lotificadora Monterrey*, a 360–lot project on the fringes of San Pedro Sula, is one such example. The landowner, a developer who is also the president of a local bank, invited 'invaders' to bring people to the site as a means of marketing his project. His total investment cost for a 135m^2 lot was L.20,000 ($1,220)—L.10,000 ($610) for the raw land and L.10,000 ($610) for basic infrastructure (water, sewerage, drainage, unpaved roads, and electricity). The first few were sold when there were still no services at all at L.25,000 ($1,525), at a 25 percent profit on investment. In April of 2002, when services were being completed, plots were selling for L.40,000 ($2,440), at a 100 percent profit on investment.[18]

The continuing tradition of invading land for housing in Honduras has resulted in a confusing and disorganized land tenure regime. Table 14 below examines the legal tenure status of residential properties in Tegucigalpa, for example.

Table 14: Legal Tenure Status of Residential Properties in Tegucigalpa, 2001

Type of Residential Property	Number	Percent
Illegal Land Occupation and Unauthorized Construction	95,998	46.1

Illegal Occupation of Ejidal or Public Lands	48,706	23.4
Illegal Occupation of Private Lands	44,417	21.3
Illegal Occupation of Lands with Uncertain Ownership	2,875	1.4
Authorized construction with Unclear or Restricted Titles	27,194	13.1
Properties without Proper Titles or with Prohibitions on Transfer	25,096	12.1
Properties with Unclear Titles	2,098	1.0
Unauthorized construction on Legally Occupied Land	2,036	1.0
Properties Constructed without Proper Permits	2,036	1.0
Legal and Authorized Land Occupation and Construction	82,842	39.8
Properties with Clear Registered Titles	82,842	39.8
Total	208,070	100.0

Source: Calculated from Instituto Libertad y Democracia (ILD), 2001, *Activos Perdiales y Empresariales Extralegales en Honduras*, Vol. 1, "Informe de Diagnostico, table I–3, 27. Data for the total number of dwelling units from Comisión Precidential de Modernización del Estado, *XVI Censo de Población y Vivienda 2001 – Resultados Preliminares*.

Information for the table was obtained from the recent study of illegal properties by the Instituto Libertad y Democracia [ILD, 2001]. According to the study, some 46 percent of all residential properties in the city were obtained through illegal land invasion. Yet another 13 percent have unclear or restricted land titles. Only 40 percent of the residential properties in the city have proper legal titles and authorized construction. It is difficult to judge the accuracy of the ILD estimates without further study. In the recent Tegucigalpa household survey by the World Bank, only 18 percent of surveyed households admitted to not having a properly registered title [Word Bank, 2001, 47–9]. Others have provided estimates of the order of 30 percent. Still, there is no doubt that the illegal occupation of land through invasion remains the most important form of providing residential land to low–income urban households in Honduras at the present time.

The growing share of owner–occupied housing in Honduras may also be attributable to the prevalence of rent control legislation that by fixing rent levels discourages the construction of new rental housing, and—more specifically—the construction of rental housing for low–income families. The 1966 *Ley de Inquilinato* [the Rent Law], for example, fixed monthly rents at 0.25% of the value of the land plus 1% of the value of construction for houses valued at less than L.40,000. Decree 866–89 of 1989 mandated rent reductions of 15–30% for houses valued at less than L.80,000. And Decree 310–98 of 1998 fixed the rent of houses valued at less than L.300,000 at 1.5% of their declared cadastral value.[19]

* * *

This concludes the discussion of the conditions in the housing sector. The next part of this paper will focus on the response of the Honduran government to housing conditions in the country through an examination of the status of housing policy.

III THE STATUS OF HOUSING POLICY

The Evolution of Housing Policy in Honduras:

Like other countries in the region, Honduras created an independent housing agency in 1957—the *Instituto Nacional de la Vivienda* (the National Housing Institute, or INVA)—with a mandate to finance, construct, and manage social housing. The Institute focused on building an insignificant number of dwelling units in comparison to housing needs, and did not concern itself with other actors in the sector or with the formulation of housing policy. Like similar housing agencies elsewhere, the allocation of contracts as well as completed units was politicized, mortgages were granted at below–market interest rates, and defaults soared.

The Constitution, promulgated in 1982, recognized "the right of Hondurans to a decent home," and committed the State to (a) the formulation and execution of social housing programs; (b) the regulation of mortgage credit terms for the benefit of borrowers; and, more specifically, (c) the creation of a Social Fund for Housing.[20] It refrained from committing the State to *protecting* the "right to housing" of all its citizens, or *guaranteeing* the "right to housing" through the expenditure of public resources.

The *Fondo Social para la Vivienda* (the Social Fund for Housing or FOSOVI) was created in 1992[21] to replace INVA, and to redefine the role of the state in the housing sector as a *facilitator* working through intermediaries, rather than a direct producer of housing. It was designed as a trust fund and expected to generate financial resources for housing by issuing bonds and channeling them to approved intermediaries—private sector developers, non–government organizations, and municipalities. INVA assets were transferred to FOSOVI. The FOSOVI law committed the State to the formulation of housing policy for the sector as a whole with the creation of the *Consejo Nacional para la Vivienda* (National Housing Council). It also created a new mechanism for generating funds for housing through a mandatory saving scheme for employees. The government, on its part, did not allocate budgetary resources to FOSOVI. Neither was FOSOVI able to transform the INVA portfolio into working capital for housing. Members of the National Housing Council directed the limited funds available to their pet projects and paid little attention to the formulation of housing policy. FOSOVI was gradually discredited, and the Council eventually stopped meeting. The value and quality of the FOSOVI portfolio is unknown. It has been conjectured that it may be worth as much as L.3,000 million ($183 million). It is presently a subject of a legal battle with no immediate resolution in sight. Its staff, now reduced to some 60 persons, is presently inactive.

Only the mandatory saving–for–housing fund, renamed the *Régimen de Aprotaciones Privadas* (the Private Contributions Regime or RAP), continued to operate. It evolved into an independent second–tier institution in 1993[22] and now lends mortgage funds to commercial banks and savings and loan associations. A parallel second–tier institution—the *Fondo Nacional para la Producción y la Vivienda* (the National Fund for Production and Housing or FONAPROVI) was set up in 1997[23] with the aim of using its own capital, the capital from overseas trust funds as well as bonds to provide loan funds to commercial banks and savings and loan associations. Both have been successful at fulfilling their limited mandates and did not concern themselves with housing policy issues other than those involved in lending for housing. Both institutions now lend at interest rates below those of commercial banks, both charge high intermediation rates for their funds, both are highly profitable, both have a high capital/portfolio ratio, and both have limited funds for lending.

Responsibility for the formulation and execution of housing policy was officially transferred to the Ministry of Transport, Public Works and Housing (SOPTRAVI), created in 1996 as part of the Modernization of the State. The Ministry was not allocated a budget for housing, and did not generate any new housing policy initiatives. In the aftermath of Hurricane Mitch, however, it rapidly geared up for a massive housing construction program, largely financed by contributions from abroad. A special unit was created in the Ministry in December of 1998—the *Unidad de Programas y Proyectos de Vivienda* (UPPV) to oversee the execution of these projects. By the end of 2001, it managed no less than 1,345 housing projects with a total of 81,918 units, of which 35,795 were completed, 24,831 were in various stages of execution, and 21,292 were ready for execution [UPPV, 2002, 21 and Annex 7]. Still, because of the conditions of emergency and the influence of external donors on the design and execution of projects, no coherent housing policy emerged from this experience.

At present, there are several drafts of a new Housing Law being circulated. One such draft seeks to create three new instruments: (a) the *Consejo Superior de la Vivienda* (the Superior Housing Council or CONSUVI) that will take on the role of formulating and executing housing policy; (b) the national system of one–time direct housing subsidies to beneficiaries, with a regular annual allocation from the General Budget of at least L.150 million ($9 million); and (c) the *Programa de Vivienda Complemento al Esfuerzo Propio* (the Housing Program to Complement Self–Help or PROVICEP) which combines subsidies with household savings and mortgage credit to assist low–income families in tenure legalization, lot purchase, house building, house purchase, or house extension and improvement. This draft mandates that 65 percent or more of the annual subsidy budget will be directed towards the PROVICEP program. The Law also envisions bringing the FOSOVI assets and the housing portfolio of FONAPROVI under the jurisdiction of the proposed Council.

As it stands, this proposed Draft Law does not create an adequate legal framework for the conduct of an effective housing policy in Honduras at the present time. To better understand whether such a framework can adequately address the key housing policy issues now facing the country, we must now focus on the status of housing policy in the country along its six critical dimensions:

1. The property rights regime;
2. The housing finance regime;
3. Housing subsidies;
4. Residential infrastructure;
5. The legal and regulatory regime governing the housing sector; and
6. The institutional framework for government intervention in the sector.

1. *The Property Rights Regime:*

As we saw earlier, a considerable share of the housing stock, estimated to be of the order of 60 percent in Tegucigalpa for example, is without proper titles. The absence of legal title documents in informal settlements continues to impede housing market transactions at full value, to prevent the use of the house as collateral for loans, to limit investment in house improvements, to diminish residential mobility, to give rise to property-related disputes, to prevent effective property taxation, and to create an overall environment of illegitimacy and disrespect for the law [World Bank, 1998,4]. The regularization of tenure must therefore become an integral part of housing policy, and in recent years virtually all countries in Latin America have created tenure legalization programs of one form or another.

Honduras has responded positively to tenure legalization. The 1990 Law of Municipalities, for example, authorized municipal corporations to take over *ejido* lands within their boundaries, and to sell occupied plots of land to their inhabitants at a price no less than 10 percent of the latest assessed value of the land (exclusive of the improvements on the land).[24] The Department of Tenure, Administration and Legalization of Lands at the Municipality of Tegucigalpa now regularly engages in legalization on its own lands, on *ejido* lands, and on private lands were invaders and landowners have reached sale agreements. A national legalization program, PROLOTE, also initiated in 1990, has not been activated and, all in all, legalization has been irregular and at a scale not commensurate with need.

At present, there are two parallel approaches to the legalization issue in Honduras, each serving a separate objective: (a) the targeted legalization of informal settlements; and (b) the unification of the Property *Register* and the Property *Cadastre* and their gradual upgrading. The first approach focuses on the actual transfer of ownership of lands to low–income settlers in informal settlements. It is a program targeted at the poor, and—given the wealth–creation element of the program—a key strategy for poverty alleviation, and a key candidate for receiving housing subsidies. The second approach focuses on the real estate sector as a whole rather than on housing the poor. It is aimed at (a) increasing the efficiency and reliability of housing transactions; (b) creating collateral out of 'dead capital;' and (c) improving property taxation.

The Municipality of Tegucigalpa formulated a proposal for the targeted legalization of 23,805 lots in 1998. The proposal aimed at tenure regularization on municipal lands, on *ejido* lands under municipal jurisdiction, on private lands belonging to an identified landlord, and on private lands with uncertain ownership. The 'social' value of municipal lands was estimated at L.15 per square vara ($1.10/m²), and the purchase price for private lands was estimated at L.60 per square vara ($4.40/m²). Given the costs of surveying and title registration, the legalization cost for a 250–square vara (175m²) plot on municipal and *ejido* lands was estimated at L.6,400 ($460), and for a plot on private lands at L.16,700 ($1,210) [Kehew et al, 1998b, 29].

A 1990 survey of informal settlements in Tegucigalpa found that approximately half the settlements were on private lands [Kehew at al, 1998a, table 4, 14], a similar finding to that displayed in table 14 above. The average cost of legalization in Tegucigalpa should therefore be of the order of L.13,000 ($800) in present prices. If 25 percent of that cost was subsidized, considering that there are some 96,000 plots in Tegucigalpa that require legalization, a five–year metropolitan legalization program for Tegucigalpa would require a total subsidy of $19.2 million. If people had to pay the municipality or an assigned bank for 5 years in a hire–purchase arrangement with a 10% down payment and a 10%interest to protect against inflation, their monthly payments would amount to L.190 ($11.5) per month.

In parallel, there is a need to gradually reform the property register and cadastre system by their unification into a single database, by mapping of properties using a Geographic Information System (GIS), and by computerizing it. A law establishing the new system will be presented to Congress in the near future, and financial support from the World Bank is available for commencing operations. Unlike targeted legalization, however, this initiative should not be financed from the limited subsidy resources available for poverty alleviation.

There is also a need to reform existing rent control legislation, so as to revitalize the construction of low–cost rental units targeted at low–income families. The maintenance of low rents should be the result of the ample supply of rental housing, rather than the result of artificial ceilings on rents. Rent ceilings discourage both new construction and residential mobility, while encouraging extra–legal rentals and extra–legal transfer fees in the exchange of rent–controlled units.

2. *The Housing Finance Regime:*

The Government of Honduras has acted diligently to reduce the overall level of inflation through tight monetary policy, and aims at keeping inflation in single digits in 2002–3. As a result, commercial lending rates are gradually coming down and are forecast to be of the order of 21% in 2002–3, but levels of intermediation remain high because of the vulnerable position of many banks. The Government is acting to improve prudential regulations in line with the Basel Protocol, but there are no indications that levels of intermediation will come down in the near future. This keeps mortgage lending rates very high. They were still at 23–28% in mid–2001. In principle, since the rates are adjustable, they should be expected to come down to the level of ordinary commercial lending rates. For now, they have not, but at 21% the demand for mortgage loans should be expected to increase significantly; and there is no question that the supply of mortgage credit can expand to meet that demand only if mortgage credit is given at market rates.

The persistence of high interest rates in the commercial banking sector has lead to the creation of two second–tier institutions that lend mortgage funds at below–market rates, FONAPROVI and RAP.

FONAPROVI acts as a second–tier institution that lends funds to commercial banks and S&Ls at 14–16% for 10 or 20 years. It was set up in 1997 to finance productive activity and housing with overseas contributions and locally–floated bonds. By the end of December 2001, it had a total portfolio of L.4.283 billion ($455 million) of which L.1,587 billion ($99 million) was in housing loans [FONAPROVI, 2001, Anexo 6]. FONAPROVI is restricted in expanding its credit base. By December 2001 its housing portfolio was limited to its own capital (L.569 million or $35.5 million) and to two trust funds—the Taiwan Fund (L.540 million or $34 million) and the Middle–Class Housing Fund (L.477 million or $30 million). It lends its own capital at 'market rates,' calculated to be 3% above the average deposit rate, and its trust fund resources at 'below–market' rates although it is difficult to determine what the market rates mean. These rates are certainly below commercial mortgage lending rates. Its lending rate to banks was 15.5% in 2000 and 15.1% in June 2001, and banks added 4%, so that the final beneficiary obtained the funds at 19.5%. FONAPROVI's own margin of intermediation was 8.5% in 1999, 6.3% in 2000 and 7.3% in June of 2001 [Morris, 2001, 11].

Unlike second–tier institutions in other countries, FONAPROVI insists on examining every individual mortgage that it funds although it carries no credit risk. To become a second–tier mortgage banking institution, FONAPROVI needs to become more efficient, and to reduce its dependence on overseas trust funds at concessionary rates that cannot be replenished to meet demand. To increase its access to new funds, it can float bonds, but the Government bond yield was 15.4% in December of 2000, a rate equivalent to FONAPROVI's lending rate to banks which already included its intermediation rate.

RAP relies on collecting monthly contributions from employees and their employers and keeping them in saving accounts at 3%, an interest rate well below inflation. This allows it to issue loan funds now at an average interest rate of 15%, implying a very high level of intermediation that makes RAP a profitable enterprise. In 1999, for example, its annual interest income on its loans amounted to 20%. Its profit of L.151 million amounted to 17% of its portfolio and was of the same order of magnitude as the annual increase in employee/employer contributions—L.172 million. Its accumulated own capital amounted to 53% of total contributions by the end of its sixth year of operation.[25] There is also no question that the average size of RAP house–purchase or house–construction loans in 2002— L.250,000 ($15,200)—is not affordable by median–income families, and that therefore lower–income employees are subsidizing the higher–income ones. The total number of long–term loans issued by April 2002 was 21,344, and hence the probability of obtaining a mortgage loan was about 1 in 8, not atypical for a mandatory savings fund in the region. Like other such funds, savers subsidize borrowers and these subsidies appear to be highly regressive, as we shall see below. To correct this distortion, RAP will need to increase its rate paid on deposits to a positive one, i.e. above the inflation rate, and to reduce its intermediation rate concomitantly. With positive real deposit rates (which would safeguard the real value of savings), it will also be able to function as a life insurance fund and possibly to attract additional savings. Otherwise, given the limited volume of new employee/employer contributions every year, RAP will have no mechanism for expanding its credit base to meet demand.

In 2001–2, commercial banks combined their own market–rate funds with FONAPROVI and RAP funds to offer mortgages at 19–25% interest with an average value of 22.5%. Both FONAPROVI and RAP funds depend on availability and cannot be relied on. Developers of housing estates cannot be assured, therefore, that mortgage funds will be available to their customers when they are needed. Table 15 below displays the structure and volume of loans financed with FONAPROVI and RAP funds in 2001 and 2002. As the table shows, loans for the purchase and construction of housing averaged L.330,000 ($20,800) and L.250,000 ($15,200) in FONAPROVI and RAP respectively. These loans were clearly not affordable by median–income urban households even at the subsidized interest rates, and were directed mostly at upper–income households. Only loans for lot purchase and house improvement were affordable by lower–income households.

Table 15: The Structure and Volume of New FONAPROVI and RAP Housing Loans, 2001–2002

Loan Portfolio	Number of Loans	Volume of Loans (Lempiras)	(US$)	Average Loan Size (Lempiras)	US%	Percent of Loans	Percent of Volume
FONAPROVI New Loans (2001)							
Lot Purchase	363	21,025,400	1,314,088	57,921	3,620	16.8%	4.5%
House Purchase/ Construction	1,649	422,647,100	26,415,444	332,791	20,799	76.4%	91.3%
Lot Purchase & House construction	61	25,937,200	1,621,075	425,200	26,575	2.8%	5.6%
Lot & House Purchase	1,356	318,170,300	19,885,644	234,639	14,665	62.8%	68.7%
House construction on Owned Lot	232	78,539,600	4,908,725	338,533	21,158	10.8%	17.0%
Refinancing Mortgages	–	–	–	–	–	–	–
House Improvement	146	19,238,300	1,202,394	131,769	8,236	6.8%	4.2%
Total/Average	2,158	462,910,800	28,931,925	214,509	13,407	100.0%	100.0%
RAP New Loans (2002, 1st Trimester)							
Lot Purchase	100	13,410,936	817,740	134,109	8,177	14.4%	11.8%
House Purchase/ Construction	303	81,249,775	4,954,255	249,640	15,222	43.5%	71.6%
Lot Purchase & House construction	–	–	–	–	–	–	–
Lot & House Purchase	169	41,768,734	2,546,874	247,152	15,070	24.3%	36.8%
House construction on Owned Lot	109	34,953,725	2,131,325	320,676	19,553	15.7%	30.8%
Refinancing Mortgages	25	4,527,317	276,056	181,093	11,042	3.6%	4.0%
House Improvement	293	18,830,341	1,148,192	64,267	3,919	42.1%	16.6%
Total/Average	696	113,491,052	6,920,186	163,062	9,943	100.0%	100.0%

Sources: FOVAPROVI, 2001, *Informe Annual de Labores – Año 2001,* Annex 1; RAP, 2002, First Trimester Statistics, unpublished.

A third institution that lends for housing is the *Fundación para el Desarrollo de la Vivienda Social Urbana y Rural* (the Foundation for the Development of Urban and rural Social Housing or FUNDEVI). The program combines financial resources from the German and the Swedish governments to provide credit and technical assistance for the construction of low–cost houses in urban and rural areas. Urban houses are typically 34–42 m² and cost L.1,800 ($109) per m² or L.61,200–65,600 ($3,730–4,000) and are aimed at families near or below the poverty line. Rural houses are typically 33m² and cost L.1,480 ($90) per m² or L.49,000 ($2,970) and are aimed at families below the poverty line. No commercial banks or second–tier institutions lend to this target group.

FUNDEVI loan funds are supplemented by household savings and subsidies. In February 2002, they ware lent at 21% (10.5% to maintain their value against inflation, 6% to cover the operating cost of the program, and 4% for managing the portfolio add comma passed on to a commercial bank) [FUNDEVI 2002, 20]. By that time, a total of L.337 million ($20 million) was lent for urban housing and L.69 million ($4.2 million) for rural housing. During 2000–2001, the program provided loans for 2,080 new homes and 1,630 home improvements annually, higher than the average annual rate of RAP and similar to that of FONAPROVI. But levels of arrears on mortgages were very high in comparison to the 2.5% level on mortgage loans by commercial banks and S&Ls: 66

percent of the mortgages in the urban program and 28 percent in the rural program were in arrears in February 2002 [FUNDEVI, 2002, Annex 10]. The donors are planning to increase funding for FUNDEVI by some $30 million, and the Inter–American Development Bank is committed to complement these funds with $10 million loan for one–time upfront subsidies.

All three programs are in the nature of stopgap measures. Unfortunately, given the magnitude of present and future housing needs in Honduras, none of these government interventions in the housing finance regime is sustainable without additional contributions from abroad or from local deposits at preferential rates. In the longer run, the only hope for a *sustainable* source of housing finance is commercial banks lending at market rates. This can only happen gradually, as inflation is brought under control and as the banking system is strengthened and made more efficient.

One possibility that requires further thinking at the present time is the expansion of dollar–denominated loans. There is clearly no shortgage of supply in capital markets for dollar–denominated mortgage funds, and three Honduran banks have had success with a dollar–denominated loan program funded by the Central American Development Bank. The foreign exchange risk of such loans could be covered if such loans were to be paid with the dollar earnings of Hondurans living abroad. It is quite possible that the high level of investment in housing in Honduras is in fact due in **some [out: large]** part to dollar remittances from abroad, considering that a large share of remittances the world over is used for the purchase of land and the construction of houses. The Economist [2002] estimated that Hondurans in the U.S. sent an estimated $600 million to Honduras in 2001, equivalent to over 9% of GDP. **Preliminary inquiries suggest that a significant portion of these transfers was made by new post–Mitch expatriates that are still repaying debts or purchasing household appliances.** If 25% of this amount could **eventually** be directed to mortgage payments on dollar–denominated loans with a 9% interest,[26] it would result in tripling the total mortgage portfolio in the country at the present time,[27] would make it possible to securitize these mortgages and sell these securities abroad, and would make it possible for median–income families to afford median–valued houses. There is a need, therefore, to study the use of remittances for housing in Honduras **and in neighboring countries**, to investigate possible ways—e.g. hire–purchase arrangements—for using remittances from abroad to make regular housing payments, to explore ways of delivering mortgage products without the inflated margins now common in the banking sector, and to examine possible avenues for securitizing dollar–denominated mortgages.

3. *Housing subsidies:*

In the Peace Accords signed in Guatemala in 1996, for example, the Government was committed to allocate 1.5% of its budget annually to the housing sector. Housing subsidies in Argentina formed 1.7% of the Federal Budget between 1995 and 1999. In comparative terms, if the Government of Honduras allocated 1.5% of its *current* budget for housing subsidies it would amount to L.260 million ($16 million). During the past two years, it has been allocating L.100 million ($6 million), and in one of the new drafts of the Housing Law it is committed to allocate L.150 million ($9 million). These amounts are inadequate if housing policy is to have a significant effect on poverty reduction.

Housing policy in Honduras cannot attain even minimal goals without adequate housing subsidies.

Given the commitment of the Government to a Poverty Reduction Strategy, housing subsidies are efficient and well–targeted instruments for (a) increasing the *assets* of the poor (and therefore their economic security) through tenure regularization; (b) reducing *overcrowding* through a program of constructing adding living space to houses on owned lands; and (c) providing for *basic needs*—especially for water, sanitation and storm drainage— through upgrading residential infrastructure in low–income communities. It is therefore essential that the Government of Honduras resolve to allocate more resources for housing subsidies in the years to come, both as part of its regular General Budget, as part of its Poverty Reduction Strategy, and in the form of external assistance—from the Inter–American Development Bank (IDB) for example—dedicated to housing subsidies.

It has not been possible to determine from available data how much money was allocated to housing subsidies in Honduras over the past decade, or how that money was spent. In the aftermath of Hurricane Mitch, as we noted earlier, the Government embarked on a massive program of housing construction, initiating no less than 1,345 housing projects throughout the country. It has not been possible to ascertain how much was spent on these projects to–date, what was it spent on, and what were the relative shares of external donors and the Honduran Government on these projects. It has also not been possible to ascertain the efficiency of the subsidies involved, their effectiveness in generating multiplier effects and in leveraging non–subsidy resources, and the accuracy of their targeting to needy families.

While it is not possible to provide precise data on housing subsidies in Honduras, it is clear that several programs now in operation involve subsidies of one form or another. For example, transferring municipal and *ejido* lands at 10% of their cadastral values to sitting residents is a subsidy, and in this case usually a well–targeted one. The use of the trust funds given to FONAPROVI at concessionary rates to finance housing is another form of subsidy. The use of employee savings at negative real interest rates in RAP to finance housing is another subsidy, and in this case, a regressive one. FUNDEVI now provides well–targeted subsidies for the building of new homes or improving existing homes on individually–owned plots, associated with savings and credit.

There is a need to rationalize and systematize the use of housing subsidies in Honduras along similar lines to that of FUNDEVI, as an integral part of housing policy. The Draft Housing Law discussed earlier introduces a subsidy *system*, commonly known as ABC (Ahorro+Bono+Credito), where a one–time up–front subsidy is targeted at low–income savers in conjunction with a loan. The loan can be a mortgage loan or a micro–loan. The proposed subsidy system is transparent enough and flexible enough to provide support for a large variety of housing programs with a broad reach and a low per–unit cost, targeted at the poor. More specifically, it can be used in combination with savings and loans for: (a) supporting tenure legalization; (b) extending houses to reduce overcrowding in combination with savings and micro–loans; (c) constructing new minimal housing on owned lots; (d) purchasing serviced lots; (e) purchasing house–and–land packages; and (f) improving water and sanitation services in established communities.

A recent proposal for a national housing program for 2002–2005 [Argüello et al, 2002] advocates a massive expansion of housing subsidies, averaging L.890 million ($54 million) a year over the next five years, and amounting to 5.1% of current Government expenditures. It is proposed that L.500 million ($30 million) per year would be allocated during 2003–2006 to housing as a component of the Poverty Reduction Strategy, to be combined with external funds and municipal contributions of lands.

Table 16 below describes the overall parameters of the program. The program is designed as an investment program aimed at reviving the construction sector, reversing the recession in the sector through the injection of new mortgage funds, and creating employment. It is divided into a social housing program and a middle–class housing program. The former relies on savings and subsidies but not on credit, while the latter relies on savings and credit with no subsidies.

The average cost of a house in the proposed middle–class housing program is L.243,000 ($14,817). Down payment requirements appear to be high, averaging L.72,900 ($4,445) or 30% of the house price. Monthly payments for a mortgage loan at 16% for 20 years would amount to L.2,370. If they formed 25 percent of income, these houses would be affordable by the 4 upper deciles of the urban income distribution, most of which cannot afford such houses at the prevailing interest rates. It is not clear from the proposal whether the interest rate is subsidized or not. It is lower than prevailing interest rates, and if it is indeed subsidized then the subsidies implied in the proposal are very large and regressive. It is also unclear how the required L.6.5 billion ($400 million) in new low–interest credit can be mobilized at this time.

The social housing component of the program focuses on new land–and–house packages in urban areas, where 90 percent of the total investment in the programs is directed. As a result, the program will only be able to reach 90,000 families in five years, at an average subsidy of L.49,400 ($3,310) per family, a high level of subsidy given the number of families in need. A program that focused on partial housing solutions—such as serviced lots, house improvements to reduce overcrowding, and house construction on privately–owned plots—and on legalization would be able to reach a higher number of poor families at a lower subsidy per family. If credit or micro–credit was made available, then subsidy levels per family could be even lower.

Table 16: Subsidies, Savings and Credit in the Proposed Housing Program for 2002–2006

	Housing Solutions		Total Investment			Average per Solution	
Program Element	Number	% of Total	(L.mill.)	($ mill.)	% of Total	(Lempiras)	(US$)
Legalization	5,400	4.2	38	2	0.3	7,000	427
House Improvement	9,000	7.0	222	14	1.6	24,700	1,506
Urban Social Housing	66,600	51.9	4,470	273	31.3	67,000	4,085
Rural Social Housing	9,000	7.0	231	14	1.6	25,700	1,567
Social Program Subtotal	90,000	70.1	4,961	302	34.7	31,100	1,896
Savings			518	32		5,800	350
Subsidy			4,443	270		49,400	3,310
Credit			0	0		0	0
Middle–Class Housing	38,400	29.9	9,334	569	64.3	243,000	14,817
Savings			2,799	171		72,891	4,445

Subsidy			0	0		0	0
Credit			6,534	398		170,156	10,375
Total	128,400	100.0	14,295	872	100.0	117,600	7,171

Source: Calculated from Argüello et al, 2002, "Sector Vivienda—Propuesta para Plan de Gobierno Lic. Ricardo Maduro, Periodo Presidencial 2002–2005," 8.

4. *Residential infrastructure:*

Residential infrastructure affects housing sector performance in two important ways: (a) the availability and quality of infrastructure impinge directly on the quality of houses and neighborhoods, as well as on the economic value of houses; (b) infrastructure shortages, especially on the urban fringe, limit the supply of serviced residential land and increase its price, thereby making housing less affordable for everyone. In addition, acute infrastructure shortages—particularly shortages of water supply and sewerage—are important dimensions of poverty and their alleviation is critical to any Poverty Reduction Strategy. Residential infrastructure upgrading and the timely expansion of infrastructure networks into the urban fringe must therefore form integral parts of housing policy.

Although residential infrastructure has been improving in recent years, there are still critical shortages in both rural and urban areas. The most visible infrastructure needs in existing urban communities are a regular, reliable and affordable water supply and a piped sewerage system, combined with a storm drainage system. While most roads in informal settlements are still unpaved, street pavement does not appear to be a high priority at the present time. Water and sewerage in Honduran cities is supplied by the *Servicio Nacional de Aguas y Alcantarillas* (National Water and Sanitation Service or SANAA), which does not charge for the real cost of water supply.

In Tegucigalpa, for example, SANAA collected an average of L.72 ($4.50) per month for an average of 47m^3 of water in 2000 [World Bank, 2001, 54], or L.1.5 ($0.09) per m^3. There is considerable resistance to increasing rates, although as noted before water supply is unreliable and low–income people need to resort to buying water from water vendors at exorbitant prices, as high as L.60 ($3.60) per m^3. There is no question that water rates must be increased so that adequate investments can be made—whether by SANAA or by a private corporation that takes over from it—in both extending water and sewerage networks and creating new sources of water. In higher elevations, where water may need to be pumped, the use of water wells and water towers should be considered as means of providing a reliable water supply. No information could be obtained at the time of writing on the availability of ground water or on the cost of drilling, pumping and storage.

An urban upgrading program focusing on creating a reliable water supply and a sewerage/drainage network in existing informal settlements is indeed a cost–effective strategy for poverty alleviation at this time. Such a system would target organized communities (*patronatos*) rather than individual families. It could also benefit from a small per–family subsidy, combined with household savings and credit. Alternatively, investment in a water and drainage system could be financed by a loan to the supplier and paid back by the community through higher water charges for a fixed time period.

The extension of residential infrastructure to new settlement areas has a critical influence on the housing sector. The rapidly growing cities in Honduras must be allowed to expand at their natural rate of growth, and not be subject to infrastructure bottlenecks—particularly those associated with roads and water supply. The Municipality of Tegucigalpa in particular must prepare and approve realistic land use and infrastructure plans—plans that allow for the physical expansion of the city at the needed rate, 530 hectares per year for the remainder of the decade—as soon as possible. The failure to prepare urban expansion plans in the near future, the failure to service them with infrastructure in a timely fashion, and the failure to clear up the tenure status of these lands are most likely to create serious land supply bottlenecks, which are likely to increase both land and house prices to levels no longer affordable by the majority of households. The Government can support municipalities in the preparation of urban expansion plans with funds and technical assistance, and with the creation of incentives that will induce municipalities to complete their plans on schedule so as to become eligible for housing funds.

5. *The Legal and Regulatory Regime Governing the Housing Sector:*

Despite numerous legal and regulatory advances in the 1990s, the housing sector in Honduras still lacks the legal and regulatory framework that is necessary for the well–functioning of the sector. No less than **eleven** legal and regulatory initiatives—initiatives that require attention both at the municipal level and at the central government level— have been identified, a number of which are already being advanced at the present time. Surely, they cannot all be given the same priority and go forward simultaneously. Together they form a legislative program for the housing sector in Honduras that needs to be put into place gradually over the next several years, but some of them could be effectively incorporated into the new Draft Housing Law now being circulated.

Three of these initiatives concern the property rights regime governing the housing sector:

(a) The creation of a *legal framework for the legalization of tenure* and the issuance of titles to families occupying lands without proper documentation. There are already several procedures in operation by municipalities for the regularization of land tenure on municipal lands, on *ejido* lands under municipal control, and on private lands where settlers and landlords have reached a sale agreement. There is a need to streamline these procedures; to back them up with a special court that can quickly resolve land disputes; to create a legal incentive for the quick resolution of property disputes; to create a legal mechanism for determining the market value of occupied lands belonging to private individuals; and to facilitate the involvement of private sector and civic–sector intermediaries in the process through official accreditation.

(b) The unification and reform of the *Property Register and the Cadastre*. As noted earlier, the Property Register is incomplete and unreliable, resulting in an artificial shortage of land for residential development, in high legal fees and cumbersome transfer procedures, in a high number of unresolved property disputes, and in delays in the legalization of titles in informal settlements. The Register is kept separately from the

Cadastre that is used by municipalities to collect property taxes. In May 2002, agreement in principle has been reached among the three branches of Government to unify the Register and the Cadastre into one system under the Executive Branch, to create a judicial mechanism for resolving property disputes efficiently, and to computerize the system. A law establishing the new system will be presented to Congress in the near future, and financial support from the World Bank is available for commencing operations.

(c) The *reform of rent control legislation.* There is a need to reform existing rent control legislation, so as to encourage the construction of low–cost rental units targeted at low–income families. The maintenance of low rents should be the result of the ample supply of rental housing, rather than the result of artificial ceilings on rents which discourage new construction and residential mobility, while encouraging extra–legal rentals and extra–legal transfer fees in the exchange of rent–controlled units.

Four of the regulatory reform initiatives concern the development and sale of residential land and housing:

(d) The creation of a *legal framework for the management of urban growth*. Municipalities must be supported and encouraged to create and administer plans for urban growth that allocate sufficient land for the rapid expansion of cities and their doubling in size in the next 15 years. This may require the creation of Growth Management Commissions at the municipal level that will need to determine the annual amounts of land needed for urban expansion given present trends and practices; to assess the environmental risk associated with lands in different locations and to manage that risk given the costs of different development alternatives; to delimit high–risk areas unsuitable for development; and to approve adequate land reserves for future urban development. The composition of such Commissions must reflect environmental concerns, the budgetary constraints of the municipality and the infrastructure agencies, the needs of low–income groups for cheap land and housing, and the established practices of land occupation and development in the country. Municipalities should be given financial incentives to complete the work of their Growth Management Commissions within an agreed–upon timeframe.

(e) The reform of *land subdivision regulations* to allow for a minimum initial level of urban services and for their progressive development over time. The absence of such regulations encourages developers to continue to operate outside the system altogether, and to develop land as an 'invasion' that is then not subject to any form of planning or control. A number of countries in the region have adopted progressive land development regulations that can serve as models. In parallel, there is a need to establish procedures for subdividing lands already occupied.

(f) The reform of the *permit–granting system* for land subdivision and housing projects to streamline it and reduce its cost. At present, the issuance of permits by most municipalities, with the possible exception of San Pedro Sula, is still cumbersome and costly. There is a need to unify all permit–granting functions in a single window, first within the municipality and later to include all the central government agencies involved in giving permits for residential land development (e.g. the *Secretaria de*

Recursos Naturales y Ambiente, The Ministry of Natural Resources and the Environment or SERNA). There is also a need to examine the possibility of privatizing the permit–granting system. In Guatemala City, for example, the permit system was offered for an international bid and is now operated by a Dutch firm.

(g) The reform of the duties, legal fees and taxes associated with the *sale or transfer of housing property*. It has been estimated that these may total more than 10% of the value of the property. They include stamp fees, registration fees, lawyers' and notaries' fees, transfer taxes, appraisal fees, and bank application fees [Argüello et al, 2002, 7; Erb, 2002, 10–11]. In order to bring down the cost of housing and make it more affordable, there is a need to reduce these expenditures significantly. This will partly be accomplished by reforming the Property Register, a process that will considerably reduce the legal fees associated with property transfers.

Three of the regulatory reform initiatives concern the development of the housing finance regime:

(h) The creation of a legal framework for *standardizing mortgages, guaranteeing them, and securitizing them*, in conjunction with a legal framework permitting insurance and pension funds to invest in long–term financial instruments. There have been a number of attempts to create a secondary market for mortgages in Honduras. They have been hampered by conditions in the financial sector as a whole and by the fear of inflation, both of which have created strong preferences for short–term financial instruments. There is a need to create conditions in the financial system for investing in longer–term securities, for example by freeing insurance and pension funds to invest with a longer–term perspective than their present one. It should also be possible to explore the creation of dollar–based mortgages, to be paid with the support of overseas remittances. Such mortgages could easily be standardized and possibly securitized abroad, because they are free of foreign exchange risk.

(i) The creation of legal framework for *transforming the housing arm of FONAPROVI* into a second–tier housing finance institution. At present FONAPROVI provides loans for both housing and production, and there are clear advantages in separating the two. They require different approaches and different kinds of expertise. The housing arm of FONAPROVI should be transformed into a true second–tier institution by streamlining its Board of Directors, by removing the requirement that each mortgage be examined independently, by standardizing mortgages, and by reducing intermediation costs. The reduction of intermediation costs should allow it to float bonds that could be used for mortgage lending. These proposed reforms should also go hand in hand with advances toward securitization, both of local currency and dollar–denominated mortgage loans.

(j) The passage of a decree that will facilitate *the rescue of the FOSOVI portfolio*. One of the drafts of the proposed new housing Law establishes a Liquidation Commission to oversee the liquidation of FOSOVI assets and their transfer to a newly–established housing entity, the *Consejo Superior de la Vivienda* (CONSUVI). These assets, for which a precise inventory does not exist, may have a value in excess of L.3 billion ($180 million). They are presently frozen in a complicated court dispute, and the prospects of resolving it in the near future, with or without a new government initiative, remain unclear.

Finally, the last one of these initiatives concerns the institutional framework for government intervention in the housing sector:

(k) The passage of a *new housing law* governing the content of housing policy, the mode of government intervention in the housing sector, and the regular budgetary support for housing. At present, there is a draft housing law in circulation, the *Ley Marco Sector Vivienda* (Draft Housing Sector Law), which is meant to replace a similar law passed in 1991, the *Ley del Fondo Social para la Vivienda* (the Social Fund for Housing Law). The new Draft Law does not define the role of the State as a facilitator in the housing sector. It lists many possible interventions in the sector (Article 4), but does not clearly establish the content or the key priorities for intervention—the legalization and regulation of property rights in housing; the support and regulation of market–based housing finance; the regular allocation of a housing budget in a system of subsidies; the upgrading of residential infrastructure; the protection of high–risk areas from residential settlement; and the preparation of adequate lands for urban expansion; the development of a legal and regulatory framework for the housing sector; and the development of government institutions for overseeing, guiding, monitoring, regulating and supporting the sector. While in principle it could have contained a significant number of the ten legal initiatives described here, it was restricted to very few of them, notably the regular allocation of subsidy funds for housing and the rescue of the FOSOVI portfolio. Institutional development is also given a high prominence in the new Draft Law and will be discussed in greater detail below.

6. *The Institutional Framework For Government Intervention In The Housing Sector*:

For better or for worse, government intervention in the housing sector in Honduras in recent years has been minimal. In 1991, the Government formally disengaged from the direct construction and management of public housing, clearly a step forward in the conduct of housing policy. Although there has not been a formal legal acknowledgment of a *facilitator* role for Government in the housing sector, the FOSOVI Law of 1991 clearly established the principal Government role in housing as one of creating favorable conditions for housing action, working through intermediaries, and promoting the participation of the private sector and the civic sector in solving housing problems [Article 2]. This by itself was an important development.

A second principle, also embedded in the 1991 FOSOVI law, established the Government role in housing as one of *attending to the housing sector as a whole*. While paying singular attention to the housing problems of the poor, the Government placed itself in the position of formulating policy for the entire housing sector, incorporating state and local institutions, private banking interests, private developers, other public, private and civil organizations, and communities involved in housing [Article 4]. In this sense, it moved away from a singular emphasis on housing the poor to a broader emphasis of creating a well–functioning housing sector that is attentive to the needs of all the key stakeholders in the sector. This was also an important development.

The FOSOVI Law opted to forego the creation of a housing agency that is an integral part of the Executive Branch of government, and instead organized Government intervention in the sector under a *Consejo Nacional para la Vivienda* (a National Housing

Council) composed of the key stakeholders in the sector. The Council was given broad authority in the 1991 Law to manage Government housing funds and to direct its housing efforts. This proved to be unsatisfactory, as the members of the Council did not have an adequate incentive to agree on a common housing policy and to act in concert toward the solution of housing problems. Instead, housing policy—a low priority for government intervention at the time—quickly became hostage to the private agendas of the various members. The Council lost its credibility and eventually ceased meeting altogether. FOSOVI as an organization is gradually being disbanded, and its staff, now reduced to 60, is now inactive.

One version of the new Draft Housing Law now being circulated also opts for a council as a means of focusing Government intervention in the housing sector. It envisions a *Consejo Superior de la Vivienda* (the Superior Housing Council or CONSUVI), operating as an independent agency within the ambit of the Ministry of Transport, Public Works and housing (SOPTRAVI) with the Minister as its President. It is not clear that this approach—rather than, say, creating a housing secretariat or a vice–ministry within SOPTRAVI—is the preferred way of government intervention in the housing sector. At present, there are two critical needs: (a) to ensure that *all* the key stakeholders in the sector are empowered to participate in the formulation and oversight of housing policy; and (b) to strengthen the professional and technical capacity of the Executive Branch by creating a cadre of full–time, committed and well–informed officials that can operate and execute housing policy through intermediaries in the private and civic sector. It is not at all clear that a part–time Council, composed of people with a wide spectrum of agendas, can fulfill these needs.

The 1996 Law on the Modernization of the State placed housing within the Ministry of Transport, Public Works and Housing (SOPTRAVI). The Ministry was not allocated a regular budget for housing, and did not generate any new housing policy initiatives. In the aftermath of Hurricane Mitch, however, it rapidly geared up for a massive housing construction program, largely financed by contributions from abroad. A special unit was created in the Ministry in December of 1998—the *Unidad de Programas y Proyectos de Vivienda* (the Housing Programs and Projects Unit or UPPV) to oversee the execution of these projects. At present, the UPPV is the only housing agency within the Government hierarchy. The new Government has also appointed a Minister Without Portfolio to energize the implementation of its housing agenda. In addition, FOSOVI still formally exists. Unfortunately, a *natural* home for a housing agency cannot be established from first principles.

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What is critical at this point is the placement of the key housing functions of Government under *one roof*, so as to focus the limited human resources available on the rapid implementation of the Government's housing agenda. A government agency charged with the housing mandate should be allowed to develop its own expertise and its own working culture, which would by nature be different from that of the ministry in which it finds itself. If the housing agency remains within SOPTRAVI, there are good reasons for upgrading it into a secretariat or a vice–ministry, able to recruit qualified personnel with the necessary broad expertise needed (a) to formulate and oversee the conduct of housing policy; (b) to allocate housing subsidies in an efficient, equitable and transparent manner through intermediaries; (c) to promote and pass the broad legal and regulatory agenda necessary for the smooth functioning of the sector; (d) to collect data for monitoring the sector as a whole and for supervising the subsidy program; (e) to ensure that high–risk lands remain undeveloped and that sufficient lands are approved for urban expansion; (f) to involve municipalities in the conduct of housing policy through financial transfers, information exchange and capacity–building activities; and (g) to increase the awareness of housing issues in the country, in Congress, and among Government agencies.

The key issues at present are to enlist *all* the stakeholders in the sector in the formulation and oversight of housing policy; to strengthen the official capacity to conduct, implement and monitor national housing policy; and to carry out the Government's housing initiatives with a renewed vigor. And while this may be facilitated by creating a Council with a broad mandate to *advise* on housing policy, the Council will not be an alternative to building a cadre of housing officials that will be charged with the day–to–day conduct of the policy. This would require an aggressive recruiting campaign, an aggressive capacity–building campaign, and the temporary use of local and foreign consultants.

* * *

Having reviewed the status of housing policy in Honduras and having outlined the necessary policy reforms required along each one of its key components, we now translate these suggested reforms into a set of guidelines for action on housing policy at the present time.

IV GUIDELINES FOR ACTION

A Two–Pronged Housing Strategy: The Government of Honduras should assume a proactive approach to housing in a two–pronged strategy: (a) using housing programs targeted at the poor as a central tool in its Poverty Reduction program; and (b) acting to reduce mortgage lending rates as a means of increasing housing demand, stimulating residential construction and employment, and spurring economic growth.

A Single Government Housing Agency: There should be one government agency charged with the conduct of housing policy and the execution of the Government's Poverty Reduction housing program. This agency should be part of the Executive Branch of government at the level of a secretariat or a Vice ministry—possibly within the Ministry of Transport, Public Work and Housing (SOPTRAVI) as specified by the Law on the Modernization of the State—and have a regular budget.

The Key Functions of the Housing Agency: The key functions of the housing agency would be (a) to formulate housing policy and oversee the housing sector; (b) to allocate housing subsidies for various programs through intermediaries; (c) to collect data for monitoring the sector as a whole and for supervising the subsidy programs; (d) to promote and pass the legal and regulatory agenda necessary for the smooth functioning of the sector; (e) to ensure that high–risk lands remain undeveloped and that sufficient lands are approved for urban expansion; (f) to involve municipalities in the conduct of housing policy; and (g) to build professional capacity for the conduct of housing programs.

An Independent Status For a Second–Tier Housing Finance Agency: The housing arm of FONAPROVI should be transformed into a second–tier housing finance agency, charged with supplying long–term loan funds to financial intermediaries in the private sector and in the civic sector. Being part of the banking system, it should be subject to regulation by banking authorities. It need not be under the housing agency's umbrella, but may be required to have the head of the housing agency on its Board of Directors.

The Two Guiding Principles in the Conduct Of Housing Policy: First, the Government should continue to adopt a *facilitator* role in the housing sector, relying on private–sector and civic–sector intermediaries to implement all its housing programs and refraining from constructing, financing, or administering housing programs by itself. Second, it should focus its interventions on the *housing sector as a whole*, with a special but not an exclusive emphasis on the housing problems of the poor.

The Reduction of Overcrowding: The previous analysis has shown that there is no significant *quantitative* housing deficit in the country[28], and therefore no immediate need for large–scale new housing construction. Overall, housing *quality* was also found to be good. There is, however, a serious need to reduce overcrowding by adding rooms or small dwelling units on owned lots and by adding new serviced lots in both urban and rural areas.

The Legalization of Titles in Informal Settlements: Low–income Hondurans are investing ample funds and efforts in their houses and have now accumulated considerable wealth in housing assets. This wealth protects them by providing them with a level of economic security. But to make it fungible it needs to have proper documentation. Secure titles can transform the houses of the poor into valuable assets.

The Reduction of Mortgage Interest Rates: There is a serious shortage of affordable mortgage credit and a critical need to reduce mortgage interest rates in commercial banks and S&Ls to affordable levels—not more than 7–8 points above the inflation rate. The reduction of interest rates is they key instrument for energizing the sector. It will help the middle class—which at present rates cannot afford the lowest–priced housing units built by the formal sector—enter the market in large numbers. Unfortunately, it was not possible to determine whether this was a realistic option at the present time.

The Role of Housing in Poverty Reduction: Housing assistance as a tool in the Government's Poverty Reduction program should focus on two complementary strategies: (a) The Overcrowding Reduction Strategy—the construction of additional rooms and small housing units on owned lots and the supply of minimally–serviced lots; and (b) The Titling Strategy—the transfer of legal titles to low–income families aimed at transforming their housing wealth into a form of economic security. It is proposed that a third housing strategy aimed at poverty reduction—the Water+Sanitation+Drainage Strategy aimed at upgrading informal communities—should be introduced at a later date, once these two strategies are put into operation.

The Housing Subsidy System: All housing assistance programs will employ one single mechanism, the ABC subsidy system (*Ahorro+Bono+Credito*). All beneficiaries will be expected to accumulate savings as a condition for participating in the programs, and their savings will be combined with a one–time up–front subsidy, as well as with some credit. Credit may be in the form of mortgage credit or shorter–term micro–credit, and extending it to low–income families may involve higher administrative costs rates and a higher risk of arrears.

The Available Volume of Housing Subsidies: Subsidy funds for the operation of the housing assistance program could not be estimated. They could be as high as L.900 million ($55 million) per year if the Government agreed to budget 1.5% of current government expenditures (L.250 million or $15 million per year) and to add L.500 million or $30 million per year from Poverty Reduction funds. External funding by bi–lateral and multi–lateral agencies could be of the order of L.250 million or $15 million per year, and could be used to fund subsidy programs (L.150 million or $10 million) as well as non–subsidy initiatives (L.100 million or $5 million).

The Average Size of a Housing Subsidy: The average subsidy level per beneficiary household was also impossible to estimate, but could be of the order of L.25,000 ($1,500). This level of subsidy, coupled with savings and micro–credit, should be sufficient on average to finance room additions, serviced lots, legalization of titles and house construction on owned lots, enabling many as 36,000 households to benefit from the housing program every year. But operating at this level would require expanding the program very rapidly and administering it very efficiently.

Proposed Housing Programs and Initiatives: During the coming four years the housing agency could start as many as six new programs and as many as **nine** new initiatives. The six proposed programs are: (a) The Titling Program; (b) The House Extension on Owned Lot program; (c) The House Construction on owned lot program; (d) The Serviced Lot program; (e) The Monitoring program; and (f) The Capacity Building program. Possible initiatives are: (a) the Housing Law initiative; (b) The Growth Management Commissions Initiative; (c) The Construction Cost Reduction initiative; (d) The Permit Streamlining initiative; (e) The Transfer Cost Reduction initiative; (f) The Subdivision Regulatory Reform initiative; (g) The Building Code Reform initiative; **(h) the Rent Control Reform initiative; and (i)** The FOSOVI Portfolio Rescue initiative.

The Titling Program: There are already several procedures in operation by municipalities for the regularization of land tenure. There is a need to streamline these procedures; to back them up with a special court that can quickly resolve land disputes; and to facilitate the involvement of private sector and civic–sector intermediaries in the process through official accreditation. The aim of the program would be to collaborate with municipalities in the issuance of an average of 8–10,000 land titles annually during the next four years. The average cost of titling is of the order of L.5–8,000 ($300–500) on municipal and *ejido* lands, and L.13–20,000 ($800–1,200) on private lands.

The House Extension on owned lot program: This program would be operated at the regional or municipal level, receiving applications from needy families that can demonstrate a condition of overcrowding and that can save for housing. The families would be provided with technical assistance to plan the extension of their homes. They would then be provided with a credit and a one–time subsidy, following the model now in practice by FUNDEVI. The aim of the program would be to assist an average of 12–14,000 households per year in extending their houses during the coming four years.

The House Construction on owned lot program: House construction on owned lots will also follow the model created by FUNDEVI and more specifically by PRIMHUR (*Programa*

Integral de Mejoramiento Habitacional Urbano). It will combine savings with an upfront subsidy and a mortgage credit. To accelerate the program and to reduce construction costs, alternative means of house construction will be tried, including the house kits now in operation in Panamá. The aim of the program would be to build an average of 6–8,000 housing units per year during the coming four years.

The Serviced Lot program: This program should assist families in the purchase of a minimally–serviced lot on the urban fringe provided by private sector or civic sector intermediaries. The program will be targeted at overcrowded households with more than one family sharing the house. It will also be targeted at families in high–risk areas that require resettlement. Its aim would be to generate 6–8,000 serviced lots per year.

The Monitoring program: There is already an embryonic monitoring program at the UPPV that focuses on housing markets. It is proposed that the housing agency will set up a well–funded and well–staffed monitoring program with a set of established procedures and a set of agreed–upon indicators. The monitoring program will oversee the housing sector as a whole as well as the programs and initiatives undertaken by the agency. It will publish annual reports on conditions in the housing sector, based on household surveys, auditors' reports, satellite imagery, and consultancy reports as well as regular information on program performance.

The Capacity Building program: It is proposed that the housing agency design and implement a broad capacity–building program aimed at developing the human resources needed for the rapid implementation of the housing agency's agenda. The program will make use of educational institutions and outside consultants, both at the design and the implementation stages of the program. It will produce teaching materials as well as organize courses and workshops throughout the country.

In addition to these five key programs, the housing agency could fund and support a number of important initiatives that are necessary to advance the housing policy agenda in Honduras at the present time:

The Housing Law initiative: At present, there are already several drafts of the Housing Sector Law in circulation. This initiative proposes to expand the draft Law so as to establish the necessary legal framework for key interventions in the sector—the legalization of property rights to housing in informal settlements; the regular allocation of a housing budget in a system of subsidies; the delineation of lands unsuitable for residential development; the preparation of adequate lands for urban expansion; and the development of a regulatory framework for land subdivision and house construction.

The Growth Management Commission Initiative: Municipalities should be supported with funds and technical assistance from the housing agency and encouraged to create and administer plans for urban growth that allocate sufficient land for the rapid expansion of cities and their doubling in size in the next 15 years. This initiative proposes to support the creation of Growth Management Commissions in one or more municipalities and to assist them in their operations, with the double aim of preventing settlement in high–risk areas and approving adequate land reserves for future urban development within an agreed–upon timeframe. A second aim of this initiative would be to create appropriate uniform legislation that could then be adopted by other municipalities.

The Construction Cost Reduction initiative: The construction cost for a basic house is still high by regional standards. This initiative seeks to explore means of reducing the construction cost of a basic house by creating a pilot project and inviting local and international firms and NGOs to build habitable yet low–cost demonstration houses that meet cost targets. Successful builders could then participate in the House Construction on Owned Lot program. It is proposed that the pilot project contain some 60 houses and aim to reduce construction costs to L.700–900 ($43–55) per m^2.

The Permit Streamlining initiative: At present, the issuance of permits by most municipalities is still cumbersome and costly. This initiative proposes to unify the entire permit–granting functions in a single window in one or more municipalities. It could also experiment with including in the single window all the central government agencies involved in giving permits for residential land development (e.g. the *Secretaria de Recursos Naturales y Ambiente,* The Ministry of Natural Resources and the Environment or SERNA). The possibility of privatizing the permit–granting system or opening it up to an international bid will also be examined.

The Transfer Cost Reduction initiative: It has been estimated that stamp fees, registration fees, lawyers' and notaries' fees, transfer taxes, appraisal fees, and bank application fees associated with the transfer of housing property now total more than 10% of the value of the property. This initiative seeks to find ways and propose means of systematically reducing these expenditures, going beyond the cost reduction that is expected to result from reforming the Property Register.

The Subdivision Regulation Reform initiative: This initiative seeks to reform land subdivision regulations in one or more municipalities, so that regulations allow for a minimum initial level of urban services and for their progressive development over time. The absence of such regulations encourages developers to continue to operate outside the system altogether, and to develop land as an invasion that is then not subject to any form of planning control. In parallel, the initiative seeks to establish procedures for subdividing lands already occupied in preparation for title registration.

The Building Code Reform initiative: In collaboration with one or more municipalities, this initiative seeks to create and disseminate a user–friendly building code for low–cost and self–built housing that is normally constructed without a building permit. Instead of making the code more technical, it would focus on essential methods and simple techniques for protecting low–cost houses against natural disasters. The initiative could include testing the proposed code with potential users, its approval by the authorities, and its publication and dissemination.

The Rent Control Reform Initiative: **This initiative seeks to examine the effect of rent control legislation on the operation of the shrinking rental market for low–income families in Honduras, with particular emphasis on the prevalence of illegal practices in the market and on the artificial shortages created by discouraging new construction of rental housing. It seeks to propose new legislation that would energize the construction of new rental housing by removing the price fixing imposed by the present legislation, and by encouraging the development of enforceable contractual agreements in the existing rental market.**

The FOSOVI Portfolio Rescue initiative: This initiative seeks to accelerate the rescue of the FOSOVI portfolio through legislative, legal and political means. A precise inventory of this portfolio does not exist and its quality is unknown, but it has been claimed to have a value as high as L.3 billion ($180 million). These assets are presently frozen in a complicated court dispute, and the prospects of resolving it in the near future remain unclear. Their rescue, clean–up and transfer to the housing agency would allow it to generate income for its Poverty Reduction housing programs.

In addition to the programs and initiatives that apply to the housing agency, there are several programs and initiatives that could apply directly to the housing arm of FONAPROVI, presently the only central government institution with a mandate to provide mortgage finance.

Proposed Housing Finance Programs and Initiatives: It is proposed that in the coming four years the housing arm of FONAPROVI begin one new program and as many as four new initiatives. The new program is the Credit for the *Ahorro+Bono+Credito* program. Possible initiatives are: (a) The Second–Tier Mortgage Institution initiative; (c) The Pension Fund Reform initiative; (d) The Intermediation Rate Reduction initiative; and (e) The Remittances for Mortgages initiative.

The Credit for the Ahorro+Bono+Credito program: The *Ahorro+Bono+Credito* program operated by the housing agency will also require both mortgage credit and micro–credit for its operation. The amount was difficult to estimate, but could possibly be of the order of L.500 million ($30 million) per year. Since this credit is to be given to low–income people, it will carry a higher degree of risk. FONAPROVI should take part in issuing credit through intermediaries to these low–income groups, and such loans may need to be insured.

In addition to the new credit program, the housing arm of FONAPROVI could fund and support a number of important initiatives that are necessary to reduce mortgage rates as a means of increasing housing demand and stimulating residential construction and employment:

The Intermediation Rate Reduction initiative: Intermediation rates in both RAP and FONAPROVI and in the commercial banks and S&Ls that lend for housing are high in comparative terms. The average lending–to–deposit spread in the banking system as a whole in 2001, for example, was 11.4%, down from 17.9% in 1996. These high intermediation rates have been attributed to the expectations of the return of double–digit inflation and to the shaky financial environment. This initiative seeks to explore ways of bringing down levels of intermediation on mortgage loans to 4–5% from their present levels that are considerably higher.

The Second–Tier Mortgage Institution initiative: The housing arm of FONAPROVI should be separated from the production arm and transformed into a second–tier mortgage institution. This initiative will seek to separate it and then transform it into a true second–tier institution by streamlining its Board of Directors, by removing the requirement that each mortgage be examined independently, by standardizing mortgages, and by reducing intermediation costs. These proposed reforms should also go hand in hand with advances toward securitization, both of local currency and dollar–denominated mortgage loans.

The Pension Fund Reform initiative: The two pension funds, INJUPEMP and IMPREMA, have a considerable housing mortgage portfolio, but maintain all their liquid assets in short–term financial instruments. They hold no long–term funds at all as their regulations mandate them to seek the greatest return on their investments. This initiative will seek to change their mandate so as to make it possible for them to invest in long–term instruments. This will in turn create a ready market for the securitization of mortgages and the sale of mortgaged–backed securities to these institutions.

The Remittances for Mortgages initiative: It was estimated that Hondurans in the U.S. sent $600 million to Honduras in 2001. If 25% of this amount could **eventually** be directed to mortgage payments on dollar–denominated loans it would result in tripling the total mortgage portfolio in the country at the present time, and would make it possible for median–income families to afford median–valued houses. This initiative seeks to study the use of remittances for housing in Honduras **and in neighboring countries**, **to** investigate possible ways for using remittances to make regular housing payments, and **to** examine possible avenues for securitizing dollar–denominated mortgages.

* * *

These proposed Guidelines for Action this report. The Guidelines provide a possible outline for an ambitious housing agenda for the new government of President Ricadro Maduro, attempting to transform his vision for the sector into a promising set of programs and initiatives that could have robust impacts on both Poverty Reduction and economic growth, as well as lasting impacts on the performance of the housing sector and the effectiveness of government intervention in the sector.

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NOTES

1 The exchange rate at the time of writing, May 2002, was 16.40 Lempiras for US$1.00. When nominal values are given in Lempiras in the report, the exchange rate prevailing at the time is used instead.

2 The income distribution in Honduras had a Gini Index of 0.48 in 2001 [INE, 2001, 60], which was slightly lower than the Gini Index for Latin America and the Caribbean as a whole (51.6).

3 The Gini index was 0.40 in urban areas in 2001, compared to 0.49 in rural areas [INE, 2001, 61–2].

4 World Bank, 2001, Vol.2, table 5.2, 68.

5 1.42 square varas = $1m^2$. 16.40 Lempiras = US$1.00 in early May 2002.

6 Interview with Alta de la Laguna community leader, Mr. Arnaldo Sorto, 26 April 2002.

7 An additional 12,000 units are built in the rural areas, largely without formal private sector participation.

8 Telephone interview with Mr. Luis Fernando Rivera, San Pedro Sula, 22 May 2002.

9 **Calculated by the author from Government of Honduras, 1989, *Censo Nacional de Población y Vivienda—1988*, "Población Total y Número de Viviendas por Departamento y Municipio: Resultados Definitivos," 1, 53; Comisión Presidential de Modernization del Estado, 2002. *XVI Censo de Población y Vivienda 2001—Resultados Preliminares*, 1.**

10 This would correspond to an average annual construction of 7,500 units at an average investment of US$10,700 (L.175,000 in current prices) per unit, not including land.

11 Interview with the owner/builder, Mr. Jesus Antonio Aguillar, *Colonia Nueva Suyapa*, 26 April 2002.

12 *The Programa Integral de Mejoramiento Habitacional Urbano* (the Integral Program for Urban Housing Improvement, or PRIMHUR) provides credit, in association with up–front subsidies for urban houses and improvements. The Programa de Vivienda Mínima Rural (The Rural Minimum Housing Program, or PMVR) provides credit, in association with up–front subsidies, for rural houses and improvements

13 Calculated by the author from data in ILD, 2001, Vol. 1, 33–37, corrected to include the starter houses at the low–end of the market.

14 Assuming the family paid 25% of its income to repay the loan, it could afford a monthly payment of L.1,700. At 25% annual interest for 20 years, this payment would secure a loan of L.81,100. With a down payment of 20%, this loan could finance a house worth L.101,000.

15 Calculated by the author from data in ILD, 2001, Vol. 1, 33–37, corrected to include the starter houses at the low–end of the market; from data in the real estate listing *Listado Carussel*; and from field observations and discussions with real estate agent.

16 In calculating floor area, it was estimated that the average bedroom size in Tegucigalpa is $10m^2$, and that an additional living area of $12m^2$ is associated with every bedroom. This implies that a typical one–bedroom unit will have $22m^2$ of floor area, a 2–bedroom unit will have $44m^2$, and a 3–bedroom unit will have $66m^2$.

17 Information obtained by the author during visit to Foundation headquarters in San Pedro Sula, 28 April 2002.

18 Information obtained by the author during visit to the project, 28 April 2002.

[19] **See Republic of Honduras, 1966, "Ley de Inquilinato," Article 21; Republic of Honduras, 1979, Decree No. 866–79, Article 1; and Republic of Honduras, 1998, Decree No. 310–98, Article 1.**

[20] Government Of Honduras, 1982. *Constitución De La República De Honduras*, 1982, Decree No. 131–82, Articles 178–181, Tegucigalpa: 11 January.

[21] Government of Honduras, 1991. *Ley del Fondo Social para la Vivienda*, Decree No. 167–91, Tegucigalpa: 30 October.

[22] Government of Honduras, 1993, Decree No. 53–93, Tegucigalpa: 5 November.

[23] Government of Honduras, 1997, Decree No. 53–97, Tegucigalpa: 19 May.

[24] Government of Honduras, 1991. *Ley de Municipalidades*, Article 70, published in *La Gaseta*, Tegucigalpa: 1 January.

[25] RAP, 2000, balance sheet as of 31 December 1999.

[26] The prevailing interest rate on mortgage loans in Panama, for example, in May 2002.

[27] An annual payment of $150 million at 8.5% interest for 20 years has a present value of $1.4 billion.

[28] Except for the need to resettle families living in high–risk locations.