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ROUNDTABLE 1A:
INTERNATIONAL PERSPECTIVES ON HOUSING POLICIES

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PROCEEDINGS

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Beginning Time: 10:20 A.M.

PRESENTATION BY STEVEN A. BERNSTEIN

MR. BERNSTEIN: Good morning. Welcome to
the international session for PD&R's Housing Policy

Conference.

My name is Steven Bernstein. I'm with the
Office of International Affairs at HUD. I'm
responsible for directing all the international
housing finance programs which HUD is involved in
right now. We've got our hands in a lot of things.
And I think today we'll be talking about some of
them.

I'm also flanked with some of the best
housing finance experts in the world. I've got,
from HUD, on my lefthand side, Marilyn Carlson and
George Anderson, from Ginnie Mae; Bob Van Order --
he's chief economist with Freddie Mac; and that's
Sally Merrill, who's with The Urban Institute; Bruce
Ferguson with the Inter-American Development Bank;
John Geraghty, who's the director of the Office of
International Affairs at HUD; Stephen Malpezzi is a
professor at the University of Wisconsin and also a
long-time World Bank person; and Bertrand Renaud,
who is a housing finance advisor with the World
Bank.

So we'll get started here. And just --
the format of this -- it's going to be fairly
informal. We've got some presentations that we're
going to be doing, but we encourage you to ask
questions as we go along. Feel free to interrupt.
We don't want to deviate too much, but I think it's
important to get some type of interaction going
here.

We're here to talk about HUD's role in the
international arena -- specifically, what are our
programs, what are we doing, and how they relate to
the development of housing and housing finance in
developing countries.

HUD has always had a role in
international. People say, you know, "What's a
domestic agency doing here in -- working in
international markets?" Well, since the beginning
of HUD, in the '60s, the Kennedy Administration
actually had designated an international role for
HUD. And that role was to -- for exchange of
information, for research on international trends,
and -- in order to help our partners, international
partners -- and also to help the United States
develop new and innovative programs. This is actually written into our congressional charter.

Through the years, the program has ebbed and flowed. We had a lot of activity in the 1970s with detente, with the opening of China, and -- but unfortunately, the program started to diminish in the '90s. Fortunately, in the past two years, Secretary Cuomo has put an added emphasis in developing international -- the international program. And we're here today.

Right now, the department has, I think, about seven or eight full-time members, a number of expert appointments, and we're working in over half a dozen countries. We're very excited about our programs, and we'll be talking about those in just -- briefly, in a minute.

But right now, our objective for international affairs is threefold. We have primarily -- and this is what our objective has been for almost 40 years -- has been an exchange of information. We want to establish reciprocal links with other countries to understand housing finance systems and housing systems. We want to develop a research agenda that we can use to develop state-of-the-art research that could be used throughout HUD
and throughout the United States government and
private sector.

And finally, we have a mission and mandate
from Congress to help in disaster relief. Our most
recent, and actually our first foray into this area,
has been the disaster relief assistance funds we've
been given to assist Central America and the
Caribbean in the wake of hurricanes Mitch and
George. And this is a fairly exciting program in
which HUD has been given $10 million to assist
Dominican Republic, Honduras, Nicaragua, El
Salvador, and Costa Rica to recover from the effects
of hurricanes Mitch and George.

What's really interesting about this
program is we're taking a long-term look at disaster
recovery. We're not just going in and building
emergency houses, but we're taking a holistic
approach. We are working with on-the-ground NGOs,
local governments, to develop long-term plans for
building, construction, technology, community
development and, my area, housing finance.

Another major initiative in our department
is the issue of binational relations, and we have
established quite a few. And this is sort of the
cornerstone to our program. And I want to have John
Geraghty talk about each of our programs and the
countries in which we're working.
PRESENTATION BY JOHN GERAGHTY

MR. GERAGHTY: Thank you, Steve, and good morning. Before I get into the bilateral programs that we have, I'd like to say a few words about how much the world has changed in our dealings with other countries.

In the '70s and '80s, the world was divided into East and West, and it affected the way all of these programs were administered -- the international cooperative programs. The world was half market oriented and half what they call "command economy" or controlled by a strong central government. It wasn't clear in those days that this system would ever change, and it came as a big surprise when the whole thing collapsed about ten years ago. Today everyone works on a market economy model, and that has changed all international relations, and it's reflected in our own programs.

This new consensus is seen at the -- or was seen is Istanbul in 1996 at the World -- at the Global Conference on Cities -- when the agenda came up with a very market-oriented approach, very democratic approach, to solving a lot of problems in housing and urban policy. And this was the world consensus. There were about 170 governments there,
and this was the consensus of views. So the old
model -- the old divide had been -- has been
completely erased.

The current HUD programs are, with Mexico,
under an existing U.S./Mexico bilateral commission.
Secretary Cuomo has revitalized the entire office
and given new life -- not only to the programs that
existed, but has created several new ones. The
secretary has met with his counterpart in the
Mexican government, and we have initiated a number
of activities in the border area -- planning and
development activities along the 2,000-mile border.
It's the fastest growing area of Mexico and one that
directly affects our country, so we hope to sponsor
a lot of new activities there relating to housing
and planning.

We are also working with the Mexican
government, and have been for a few years, on the
development of a secondary market, which others at
this table know more about than I do and will be
able to speak about that.

The other programs -- the China program
grows out of President Clinton's speech in Shanghai
in 1998 saying that one of the areas that the U.S.
and China should work on is housing. So he began a
housing initiative, and Secretary Cuomo has done
much to give life to that initiative.

The secretary has met with the Chinese
minister here in Washington and signed the new
bilateral agreement between HUD and the ministry of
construction in China. The secretary traveled to
China in May to discuss the two major projects that
we have going with the Chinese. One is a project on
design and construction in which we work with
private architectural firms in the United States and
with the Chinese government and developers to build
a model building -- two model buildings -- one in
Shanghai and one in Beijing. We also worked with
the Chinese on a mortgage securitization project,
and George Anderson here and Steve Bernstein will be
speaking more about that.

One of the models that we're using in
China is a residential building counsel, which is a
counsel composed of about 18 members of the private
sector in the United States, and these are all
experts in the fields of housing and construction
and planning and who work with governments in the
implementation of these projects. We hope to use
this model, forging a closer link with the private
sector, as we continue with these cooperative
exchange programs.

The South Africa program is -- the
secretary traveled to South Africa in April of '99
and signed an agreement with the minister of housing
in South Africa. We work through the U.S. Aid
mission at the embassy in Pretoria in our dealings
with the Department of Housing. The South Africans
are very interested in our legal and regulatory
practices in regard to fair housing and fair lending
and have credited HUD with help in developing a
homeowners disclosure law which should be passed
shortly by the South African parliament.

The latest is -- well, there are two very
recent ones. One, the secretary went to Israel in
late June to establish, a first time for HUD, a
direct link with the ministry of housing and
construction in Israel. And the emphasis there will
be on housing finance, on the real estate investment
trusts, and on the reform of public housing.

A binational commission is being created
as a result of this agreement. And the membership
of this committee will be named in November. There
will be about 20 Americans -- again, prominent in
housing and real estate -- who work with the
government in the implementation of cooperative
projects with Israel.

The most recent initiative -- there has been no meeting yet, but it will take, I think, place shortly -- next week?

VOICE: Next week.

MR. GERAGHTY: -- next week -- is with the Dominican Republic government. The secretary met with the president of the Dominican Republic in New York about a month ago. They discussed the idea of HUD working with the Dominican government on housing finance and housing policies. And those discussions will start again next week.

So this is an overview of -- to give you an idea of the range of programs we have, and our interests. Housing finance is prominent among them, but there are many others -- interests that we're pursuing. Thank you.

MR. BERNSTEIN: Thanks, John. Yeah, just to reemphasize, we've got our hands in a lot right now, and I think it's -- things are going to be heating up even more into next year.

One of our most exciting projects, I think, is our China initiative, which is a Clinton Administration initiative. And we don't have anybody here to talk about our building initiatives
here, but we do -- have just gotten back from our
third mission to China.

We have been assisting the Chinese
government in the development of a pilot or test-
mortgage-backed security. It's by no means a true
MBS in any sense of the word, but it's an experiment
to see if the Chinese actually have the technology
and the infrastructure to go through and issue an
MBS which, given current trends in the country right
now -- liquidity will be an issue in that country in
a few years, and they will have to look to other
sources of funding for mortgage lending besides
their deposits, which we just discovered are
shrinking, contrary to what the Chinese had been
saying before.

But anyway, I'd like George, who was --
helped -- came along on that mission and help lead
it, to say a few words.
PRESENTATION BY GEORGE ANDERSON

MR. ANDERSON: Alright, thanks, Steve. I would just like to follow up on some of the things that John was saying here, that I've been at HUD a long time, as well as John -- been in Ginnie Mae for 20 years. And during even my first days at Ginnie Mae, there was interest around the world in the secondary mortgage market. Back then it was mostly coming from Canada and Western Europe. The British, the French, the Canadians got a visit from the Australians. It was more or less, you know, "This-mortgage-bank-security, what-is-it?" kind of thing. That was back when the program was first created. And then there was sort of a lull, and there were years that nobody came.

I must say within the last, say, three years, there's been an absolute steady stream of visitors from all over the world -- from Asia, Africa, from little countries within Africa, countries within countries -- that are coming, trying to learn about the secondary mortgage market. I think, to me, that sort of signifies a realization of the importance of the role of housing in emerging economies and then the -- of course, the ability to finance it.
I think Bob is going to talk some more about the flows of money and things like that from Freddie Mac's perspective, but it's -- to me, it appears that the trend is definitely on the upswing for more and more economies being concerned about the mortgage market and the secondary mortgage market, and it's going to be at an increasing rate.

So it's been an exciting time for HUD and Ginnie Mae, in particular, especially for us. We're a small organization. For those of you who don't know about Ginnie Mae, we are only 65 employees; but our 65 employees -- we finance 95 percent of FHA's production of the Veterans Affairs and the Rural Housing Service. In effect, we are the financiers for government-backed mortgages. I think it's that model of how we do what we do with so few that was of interest to the Chinese -- how would a small organization do something the way we do it? And so we did go to China, but as part of the delegation.

What I found most intriguing aspect of the Chinese was, I guess, some of the issues that they had to deal with were at the very basic level. The solution that we sort of struck upon -- for those of you -- but once it's done, and you read upon it -- anybody who's done any kind of public financing will
go, like, "That's pretty basic" -- almost, "Yes, we
can understand how that would work. We've been
doing that for 50 years," or something like that.
But in China, I guess, the -- I think our major
contribution that I feel that we actually made a
contribution to was the flow of information among
the respective elements of government that there was
and continues to be.

But I guess I'm hopeful at a lesser level.
Some distance -- I mean, in America, we had --
somebody wrote a book on it, the "Bureaucracy of
Strangers" -- that we may be in the same building,
but we work in a different component. You never
talk to anybody outside of your element -- a lot of
cylinders, a lot of stove pipes. Well, that's not a
unique American phenomenon.

But our visit to China -- I think we were
able to overcome some issues that the Chinese found
difficult to effectively communicate amongst each
other. And we were absolutely neutral parties that
we could convey the information from one element to
another to really find out that basically everybody
was on the same page, everybody wanted the same
thing.

And then for us to come out with a
structure that more or less tied the pieces together
made us all feel -- I wouldn't say overly
optimistic, but we were -- we were quite sanguine
that we think we were able to have a major
breakthrough to give the Chinese something that will
work for them and prove -- or set a stage for them
to prove out a number of these principles that John
has alluded to in a market economy that does make a
significant difference.

I was impressed at their willingness to
really take this on, and I think they're really
going to give it their best shot. So I'm quietly
optimistic that a lot of good things are going to
come out of this that would be a good example for
other emerging or command economies that have
converted to a market-driven economy.

So it's -- while several iterations, I
think, later this fall, the prospects are quite high
that something could actually materialize from that.
So I think that's -- I don't want to take too much
time. If there are further questions -- or any
questions on it, we will be glad to talk about it.

But Steve pulled together a good team of
government people and private-sector folks to go
over and, in effect, quell or qualm the concerns of
the various government agencies to come out with a
securitization effort that I think will be quite
significant for the Chinese people and the
government.

MR. BERNSTEIN: Thanks, George. Yeah, the
China project has been quite interesting, because
we're actually leveraging on work that's been
ongoing in China for almost two years now. What --
our role has turned from both consulting or -- I
don't want to say "technical assistance," but sort
of an information-exchange mechanism to also
somewhat of an interlocutor between various
government agencies within China that don't seem to
communicate too well.

And I think, as George said, by the time
we left China on this last mission -- we just got
back, what, two weeks ago -- they were all on the
same page and having very fruitful discussions. So
I think that, according to the Chinese, they are
interested in actually having a live project going
by the end of the year. We are cautiously
optimistic on that.

Another very big project -- and it's going
to -- this will segue into our discussions with our
experts around the table, too -- is -- kind of hits
more on sort of the basic problems of housing finance, and that is really addressing the needs of housing and housing finance to those in very poor developing countries. And it's something that I've been working on for over ten years now in international work before HUD in the private sector doing projects for the World Bank and other institutions.

And particularly in Latin America, we have, as I mentioned before, quite a lot of assistance for HUD that is going into redevelopment of the housing and housing finance systems in Central America and the Dominican Republic.

Some of the live projects we're working on are very, very interesting, and they tend to do a couple of things. One is to bring in the NGO sector -- the non-governmental organizations -- into more the formal banking sector. And these two areas have really been seen as quite distinct And we tend to view them as -- they should be addressing pretty much the same issues. The second is to address the informal sector of the economies which often, in these Latin countries, are -- 50, 60, 70 percent of the entire economy are what is considered informal and very low income. We would like to see these
households be integrated into the formal financial sector somehow.

We would like to see more housing finance so that capital could be better utilized and ultimately help springboard economies. We're trying, in our own little way, to address some of these issues in the Dominican Republic.

We've been working with another government agency called the Overseas Private Investment Corporation to develop some new ways to finance housing, provide liquidity for low-income sectors in developing markets. We've been doing quite a number of the iterations, and the work isn't finished yet, but specifically on issuing debt in the U.S. to help fund local currency mortgages in the Dominican Republic. Now there's prerequisites for something like that to work -- and one is a stable exchange rate, which could be a killer if things blow up, vis-a-vis, the dollar; however, we think we've made quite a lot of progress on this, and we hope to have a project done by the end of the year.

We're also working on -- with one of our partners in our project, ACCION International, which is a large NGO in the United States that works in Latin America to develop programs for assisting low-
income borrowers attain mortgages and loans for
reconstruction of housing, progressive housing, and
micro-credit -- or micro-enterprise development.

Some of these projects are -- they're
ongoing; we're developing them as we speak. And I'm
very excited about this. We should have a lot going
on in this area in next year.

That kind of leads us into sort of -- the
more general discussion is -- there's a number of
questions: What are the trends right now in
developing countries? What is happening in the
development of the primary markets? What is
happening in the development of the secondary
markets? What are the bottlenecks to further
developing -- to further develop these economies?
And what can the role be of the United States
government in assisting in the development?

So what I'd like to do now is turn it over
to our panel of experts. And each one of them has a
very good and unique perspective based upon many
years of research in this area. And we could -- and
we'll just go through these one at a time, and
please feel free to ask questions as we go along or
bring up anecdotes or whatever you feel would add to
this conversation.
I'd like to turn it over to Bertrand Renaud. Bertrand is an economist with the World Bank. He's been working the international housing finance area for many years. He has experience in dozens and dozens of countries. I've been able to work with Bertrand extensively, both in the Dominican Republic and in Mexico. Bertrand is going to -- will talk about his views on the trends right now in developing countries. Thank you.
PRESENTATION BY BERTRAND RENAUD

MR. RENAUD: Thank you, Steve. It's very
telling of a session about HUD and national policies
that the first speaker is from the World Bank and
speaks with a non-American accent.

(Laughter.)

MR. RENAUD: So let me give you a sense of
how I see the trends worldwide and the kind of
markets we're looking at worldwide.

I fully agree with John Geraghty's
perspective about how much the world has changed
over the last ten years, but from a personal or
institutional point of view, I could say that 20
years ago, you could say that housing finance was
probably the most boring field you could look at
anywhere, both domestically and internationally,
because everything was regulated, everything was
segmented, everything was regulated in the bowels of
finance ministries by the most junior officers who
did not know what they were -- what impact they were
having on the system. And a massive revolution has
taken place.

I like John's point about the fact that we
are all market economies, but they are. They have
different ways on public and private role.
And another thing that is extremely interesting is that the way of cutting up housing-finance issues and the housing-programs issue is quite different from the past. I had the opportunity of looking back a few weeks ago about the kinds of discussions we used to have at OECD about social-housing policies. It's amazing how the papers feel obsolete and aged, because we do not approach the problems the same way. The countries do not approach the problems the same way.

So if we step back, I would say, "How do countries look at HUD and the U.S., in general?" I would say they look at the U.S. like it's Ali Baba's cave, in the sense that you have tried everything, you had experimented with everything, you have analysis of every case. So the problem is to find out who did the right analysis for the country at that time. And essentially, a lot of the work that goes on internationally is a form of reverse engineering. Why did it work in the U.S.? But the country is different, so, therefore, we do not start from the same premises. But certainly we know that a lot of the U.S. experiences are very significant.

I would often take to task some of the famous agencies of the U.S., especially secondary
market agencies that speak only about themselves. 
But when they have visitors, I would urge them to 
say, "Look, this is the entire spectrum of 
experiences we have."

It would be very interesting, also, when 
the U.S. is discussing about the role of government 
in markets, making markets. Markets do not come out 
of thin air. You have to create markets. You have 
to create the institutions of the market. And if 
you look at the history of the U.S., the first two 
Attempts to create secondary mortgage markets just 
crashed because the government was not part of the 
picture. It's only the second time around that it 
worked.

So those kind of stories are invaluable to 
our member countries. But the Ali Baba -- 
(inaudible) -- is very important to see how people 
look at the U.S. And there is a reason. The 
countries we look at are incredibly small. 
Recently, finally -- I congratulated some of my 
colleagues -- we had a retreat, and the paper was, 
"What kind of financial systems are we looking at?"
And one of the questions -- the first question was 
how many countries have financial systems -- not 
housing finance systems; financial systems -- that
have a balance sheet that is smaller than the World Bank Credit Union? Sixty.

(Laughter.)

MR. RENAUD: How many member countries have a balance sheet that is smaller than a larger S&L in California? Hundred and twenty. So the market scales, the question of macroeconomic relativity, and so on, everything that we do has to be very cognizant of where we are. It is not entirely by chance, I would say, that the countries that approach you for help tend to be the larger countries, because they have markets that are deep enough that they can really draw the lessons.

Another point that is very interesting and I would expand on -- John again saying that we are all markets now. But another thing that is very important -- you could argue that until 1990 and the crash of the Soviet system, the issue was how to do things. And the country says, "We all agree about where we want to go." And this is a big turning point. This is, "How do we do it?"

So when George says, "I was in China, and they were back to basics," I say yes, because 20 years ago, would you believe, that the first World Bank report there was a footnote, and one Chinese
just jumped. He says, "This is a great idea, so we just have to finance long-term investment on a cash-flow basis? We can have long-term finance? This is what long-term finance means?" They didn't know, because essentially, under the Soviet system, everything was done on an annual basis.

So the notion -- I'm not surprised.

Announcing that amused me greatly, but it's more than amusing; it's really fundamental, and I would urge the U.S. community, in general, beyond HUD -- you said when you came, you brought all the agencies around the table. The experience of the World Bank, ADB, is that typically when we lend in town, this is the only time when these guys get together in the same room. So making the connection, in addition to bringing the technical solutions, is very much a part of the agenda.

The other interesting point that probably will be developed by Bob Van Order even more is that the distinction between secondary market and primary market is seen very differently. And in the World Bank, an accelerator of that integrated view of primary and secondary market is that the Asia crisis has emphasized again that you would want to have several channels of funding.
So secondary markets have various benefits. They are not immediately doable in many countries, because the primary market infrastructure is not in place. But typically -- I presume some of you will talk about that in transition economics, like Poland -- you work on both agendas together.

And the reason is that, in countries where you have pension reforms, you can do things in housing finance you couldn't do 20 years ago. And the value of the secondary markets is to bring the capital markets perspective -- more transparencies, better pricing, alternative sources of funding.

Most of these systems are still deposit-based, but the strategic option of having access to a secondary market in case of a shock in the system is very fundamental. So it's very interesting, because I said -- and this is a personal view -- you have a lot of investment bankers trying to do deals. This is, "Why don't you slap a government guarantee on my paper? Trust me, it will work."

(Laughter.)

MR. RENAUD: You say, "Well, what have you done? What have you achieved?" I mean, so essentially, very often we look at the discussion of secondary mortgage markets as a CAT-scan. What is
defective in your system? What is it that you need
to fix first? What are the strategic alternatives
that you have?

And the word that we use very often that
is quite relevant to your international work is that
all these financial systems are path-dependent, in
the sense that the kind of legal structure they
have, the institutions they have had, and so on will
have an impact on what you -- where you make the
next step.

So you will come back with your, you know,
Ali Baba's treasure trove, and so on, but you'd have
to decide, "Well, in this country, at that time, we
think that maybe this is likely to work best." And
the tendency of having a cookie-cutter approach --
"I have two weeks. I land in that country, and I
tell them what to do, and I fly off" -- guaranteed
to fail. The guys will have a good time. They'll
see nice people, but the impact on the country will
be close to zero. Maybe sometimes connections will
be established, and they will start again, but doing
the due diligence in the country is important.

What other points I would want to make?

I've mentioned the markets are very small. The
economies are -- (inaudible). Indirectly, also,
what people have mentioned is that the income
distribution is very bad.

And when we speak of access to housing,
one of the problem I have is that a lot of people
forget that there are two dimensions to afford-
ability. Is the product cheap enough and
affordable, and then is finance available? And many
of these countries, the informal sector is very
large, because the urban system is really not
structured properly.

And in Latin America, it's a very big part
of the agenda as -- what we see is that 50, 60
percent of the countries really do not have a market
infrastructure yet. So I would say even if we look
at housing finance, we should look, also, at the
infrastructure.

And I would close there in saying that in
the U.S. environment and in OECD countries, we see
of marketing as putting ads on television about blue
jeans and that -- or the Internet. But we forget
that 50 years ago, when people spoke of marketing,
they were speaking of creating value in time, form,
and space. That is to say creating infrastructure,
and that's what we are at in housing finance. Thank
you.
MR. BERNSTEIN: So basically what -- are you seeing then, in the work that you're doing, that there's being -- there's a trend now to addressing sort of the pathologies in primary mortgage markets, in that do you see -- do you see that, for example, state housing banks are being revamped or gotten rid of, or what is the trend there?

MR. RENAUD: Well, on that specific point, there is a broad consensus that banks are not well managed by the public sector, because the structure of incentives in unmanageable. You'll get incentives that are going to be wrong. So there is a push to essentially privative public institutions -- (inaudible) -- so that they should be managed as companies and not as government bureaus.

What you can do in different countries will vary. Typically, I would say -- but it could be a little bit of an overstatement -- that housing banks will tend to be closed when there is a crisis and they realize the government was not getting a fair value out of it.

I would say that macroeconomic stability is also another push for looking at government programs very differently.

And I would like to stop there, because my
colleagues probably have a lot more to add.

MR. BERNSTEIN: Sure. I guess we -- this is a good point to have Steve Malpezzi talk really about the prerequisites for functional housing finance.
PRESENTATION BY STEPHEN MALPEZZI

MR. MALPEZZI: Okay, thank you, Steve. I think my points will be a little different but will compliment what Bertrand and the others have to say.

As Bob and Steve and Bertrand can confirm, I'm not a financial economist. I'm a -- I guess, a non-financial economist. I study, you know, the -- what we call the "real side" of the economy. You may say, "What is reality," but what we're talking about are -- how does the economy work? You know, how does tangible and human capital come together? How are the goods and services in our economy produced?

And at a one -- at a very simple textbook level, we could say, "Alright, we have this real side of the economy that makes things and services and distributes them, and then we have a financial side which is about -- at one level, at the simplest level -- about deciding on who has claims over that output, you know, what the bondholders get paid, you know, what the mortgage holders get paid, who gets what."

But it actually goes quite beyond that, even at the textbook level, which is -- once you note that the financial system is about who has what
claims, you also realize that when you have a well-functioning financial system, the pie gets bigger, and the pie gets distributed -- another way of defining it -- in better ways.

And so I guess what I'd like to talk about for a few minutes, and just a few, is the "real side" -- that that's the main point we need to consider, but rather it's a piece of the puzzle that people working in the housing finance area need to keep in the back of their minds and sometimes bring to the front to think about.

I've got about a dozen points, and I have a paper that should be available, I think, shortly through whatever medium.

MR. BERNSTEIN: We have about three or four papers that will be coming out within the next few weeks that will be available in the conference proceedings.

MR. MALPEZZI: So what I'd like to do is just take a few of these points and touch on them briefly, and maybe we could come back to interesting ones, in discussion.

The first one is -- we talk about housing finance all the time, but -- you know, I'd like to say, "Well, we need to step back and think a lot
more about real estate finance." Everything is
correlated with everything else. And some of the
previous speakers have talked about, you know, the
issues that arise in segmentation.

Now we need specialization. You know, we
need institutions and processes to handle finance in
different parts of the economy, but housing finance
and, in particular, something many of us are
particularly interested in, low-income housing
finance and moderate-income housing finance doesn't
exist in a vacuum from the rest of the financial
system and the rest of the real estate market.

I'd say there's been a lot of progress
made, in terms of thinking of housing finance as
part of the financial system, but we also have to
think on the real side in terms of housing as part
of the overall real estate market and as the -- a
part of the overall capital stock.

Probably most people in this room do know
that real estate is about -- in most countries,
about 70 percent, plus or minus, of the capital
stock -- of the tangible capital. And housing is
about half of the capital stock, not just in the
U.S., but in other countries.

So, yeah, at one level, if you're trying
to get the attention of a macro-economist, often a
difficult thing to do, you whack them up the side of
the head with a two-by-four to get their attention
and say, "This is half the capital stock. If we
screw it up, this is a bad thing."

Again, we need to think about how other
land uses interact with housing. And again, there
are many examples -- Alland Berteau (phonetic) and
Bertrand have a very nice paper -- that probably
many of you have seen -- taking a look at socialist
land markets, particularly focusing on Moscow. It's
sort of a nice exposition of the kinds of problems
you can have when you have what we could call a "set
of pathologies" in the way land is allocated between
housing and industrial uses and commercial uses.

And if you kind of ignore that or think,
"Well, that's only about profit. It's not about
things I'm worried about in the housing market,"
then I think, you know, we missed the boat.

Again, we also need to think about the
fact that housing is part of a broader process of
development. It's not only part of the capital
stock; it's tied in intimately with the patterns of
urbanization, GNP growth, generally. And again, a
lot of work, fundamental work, was done by Burns and
Grubber, you know, some 30 years ago, but -- and
Bertrand has also contributed to that literature. I
think it's something we need to come back and remind
ourselves of.

These processes are not linear. And it's
ironic that in many respects housing finance and
real estate finance are most critical in some ways
when economies are starting to develop, because
that's when investment in this kind of capital
begins to accelerate.

I think another issue is -- and this is
tied to the earlier points about different land uses
-- is that these land uses are dynamic, and they
change. In many countries, we see that policymakers
and often financial institutions are focused
primarily on financing new green field development --
certainly an important thing to do, particularly
in growing economies; but dynamic economies need to
recycle land uses. And economies that don't, suffer
great welfare losses ultimately -- not always well
understood, but still quite large. You know, for
example, recycling some of the industrial land uses
in Krakow and Moscow and other parts of Eastern
Europe are well known.

In a very different context, you know, a
lot of land-use changes are going to take place in
distorted markets such as those in South Africa over
the next 20 or 30 years. And how we -- when I say
"we," I mean primarily the South Africans -- but
how, you know, the world deals with these issues is
quite fundamental.

Another point I'd like to touch on very
briefly, and I can expand on at enormous length, as
many of you know, is the effect development and
land-use regulations have on these markets --
directly and indirectly on housing-finance markets.
To give just one example, if you have a very
convoluted system of land-use and development
regulations, that can lead to a boom-and-bust cycle
that has obvious bad implications for any system of
housing finance or real estate finance. And these
things are interconnected. They can feed on each
other. Again, some of the recent experiences in
Asia, where we have a bit of a laboratory, can be
instructive here.

A final point -- again, just to try to
stay brief -- and a point that I think is well known
to many is, you know, we always have multiple goals
for what we do in public and private activities, and
we have to be careful when we may inadvertently
confuse them.

I think it's well known, from a lot of work over the last 20 years, that if you want to subsidize housing, the financial system is not the place to do it, and the tax code is not a particularly good place to do it. Some of Bruce Ferguson's work in Latin American housing subsidies, I think, are some good illustrations of this.

Maybe I'll just stop there. Those are some of the points, and we could come back to some in discussion, if you like.

MR. BERNSTEIN: Thanks, Steve. And actually, the subsidy issue has been one that's been very paramount on our agenda in the HUD programs. Particularly in Central America, we have been trying to deal with national governments who have really been used to providing financial subsidies, such as interest rate subsidies, and having many discussions over roundtables saying, "You don't want to do this. You don't want to saddle your banks with assets that are under water."

It just -- it's a big problem, and it's something that's sunk many institutions. We've been -- over the past few years, have worked in Mexico, when I was doing some contract work for the World
Bank, looking at one of their institutions, called FOVI, which was saddled with -- their entire portfolio was under water -- subsidized interest rate mortgages. How do you get that out from -- above water? It's a very hard problem.

But I'll turn it over now to Bruce Ferguson with the Inter-American Development Bank, and he can talk about some of these issues and what the IADB is doing right now in Latin American.
PRESENTATION BY BRUCE FERGUSON

MR. FERGUSON: Great. Well, my name's Bruce Ferguson, and I'm -- I develop housing programs for the Inter-American Development Bank. I'm in charge of developing housing programs in Mexico, Central America, and the Dominican Republic, and beginning to work with Steve and HUD and hope to work more with them.

What I have to say -- I think I have to compliment you, Steve, on sort of adlibbing the sequence of the presentations, 'cause I think mine fits very well in line with Bertrand's and now Stephen's.

Along the theme that Stephen raised, which is that housing is more than finance, one has to -- before approaching housing finance, primary and secondary markets, one has to back up a little bit and look at housing systems. I want to simplify, but -- simplify for a moment, but describe in broad terms how housing systems in much of developing countries are quite different -- the processes are quite different from what they are in high-income industrialized countries -- and how that affects finance.

In most developing countries, housing gets
built by the great majority of the population, the
low-moderate income majorities, I like to put it --
60, 70 percent of the population; up to 80 percent
in many countries -- progressively. That is, houses
-- households get access to a lot through purchasing
a clandestine -- through purchasing it
clandestinely, often in illegal subdivisions where
they invade land or they purchase it legally.

And then they build a house, starting with
a makeshift unit and going forwards over a period of
five to fifteen years to consolidate that unit and
-- jointly with other households in their
neighborhood, to consolidate their neighborhood by
pressuring government for services. That, in very -
- extremely briefly, is the process of housing in
developing countries.

Now, let's contrast that with housing in
high-income industrialized countries. It has become
a product delivered by a very sophisticated system
of private firms and public-sector institutions.

Now, that difference, to simplify it,
causes some fundamental misunderstandings in housing
policies in developing countries, which have been
alluded to. The typical housing policy in
developing country is that government comes along,
and the private sector is not producing because of all the distortions. In other words, high costs, lack of markets in many different components of housing, from regulations to basic services to subsidies, to credit -- many things are screwed up, and they create higher costs.

And as a result, private sector debt has minimal production and only -- for the upper middle -- typical for the -- typically, for the upper-middle class, if you're a builder, and for the upper-middle class, if you're a financial institution, or maximum-middle class, which represents only 20 percent of the population.

What do governments do? They come along and think, "This is terrible. Our people don't have housing. We've got to build housing. We, the government, are going to do it." And they create large subsidy systems. And in Latin America, as an example, subsidy systems are -- the traditional ones have been, essentially, salary taxes. From two to five percent -- six percent of the salaries of all the formal-sector employees get captured and channeled through a housing fund. This is what -- (inaudible) -- which Steve was referring to -- in Mexico was. These funds are all over the place,
still. There's NHT, in Jamaica. There's they --

(inaudible) -- in Venezuela, Brazil.

The result is that in these funds finance
housing by extending typically below-market interest
rate loans to developers -- those lucky developers
-- and households for housing.

Well, this system -- I think you can get a
sense of the mischief that this sort of system
creates -- this system also produces new houses --
fairly expensive new houses that end up going to
middle and upper income -- upper-middle class
families instead of the low-income families that the
rhetoric of the government has supposedly targeted
them towards.

So this is what we're dealing with when we
go into countries. It's countries like Mexico and
Brazil, amazingly, even right now have miniscule
private sector intermediation. I'd say less than
five percent of the -- of even house -- of even
mortgage loans that get made in those countries are
done at market rates. All the rest is subsidized.

In other words, it's based on something that is
unsustainable. Well, that's the broad problem.

Well, what does this context mean for
mortgage finance? I have to say that the news is
not -- yes, there is room for pushing more
traditional mortgage finance, including primary
markets and secondary markets, down market from the
five percent that is now the market -- that is now
served to 20, 30 percent of the population.

However, once you get to about the 60th or
-- percentile -- or the 40th percentile, the
problem you start having is that that -- is that
households cannot afford a mortgage in most
developing countries -- cannot afford to pay for a
mortgage for 80 percent of the most minimal
contractor-built unit. And this is, of course, one
of the reasons that housing is progressive in these
countries, that they built it over five to fifteen
years.

But the result is that the mortgage market
has definite problems going below a certain
threshold in these countries. Also, these
households live in an environment of great
instability. There's health crises. There's job
loss. Most of -- many of these low-mod- --
households in the low-moderate income majority do
not want a long-term -- a 30-year mortgage, which
requires large payments for a complete unit over a
long period of time. That is very dangerous for
them, and they don't want it, even if it were available, which usually it's not.

So in this context, what does one do? There is substantial room to go down market, both -- for both the primary and secondary mortgage market, but there are also some interventions -- Stephen alluded to some -- that are possible to move towards markets in these systems. I'm going to briefly mention two.

One is what is -- micro-finance of housing -- what Stephen has -- is now funding a Mario Otero, which is a firm to engage in in Central America, which IDB also hopes to become active in. What micro-finance of housing is -- is short-term loans. These are usually two- to eight-year loans. At market interest rates, two households, generally for improvement, the range of housing solutions that suit the progressive housing process -- everything from service lot to improvement to -- (inaudible) -- to extensions to replacement of a house that is deteriorated to construction of a house on an existing lot that the family owns -- those are all low-cost solutions. And if you do the math, these households often -- can typically afford micro-finance, which accompanies, you might say, the
process of progressive housing.

Another -- there's roughly 40 studies have been done. There's roughly 40 of these micro-
finance programs efforts that have been documented in Asia and Middle Africa, the Middle East, Latin America, and the Caribbean, and there are doubtless more.

A second possibility -- and this goes directly to what Stephen was talking about, development regulations -- is low-income land development. It will come as no surprise to housing experts in the United States that land development and housing development in developing countries is cumbersome, complex, adds tremendous cost both from bribes and formal sector regulations. However, this is very new in developing countries.

Most governments have no concept of what we have just said. They don't realize it. This -- which is a broadly assumed axiom of housing work in the United States -- is just not in the minds -- it has not reached people in emerging country governments, generally.

However, I want to talk very briefly about one exception. In El Salvador, apparently the message got through. Things got so bad that they
really had to restructure their systems in basic ways. They reformed their land and property-rights system and development-regulation system to allow progressive development of low-income lots. In El Salvador, it is possible to develop a 100-square-meter lot with water-stand pipes, with a -- say, a dirt road and individual sanitation.

What this means is that there's -- this has prompted a low-income land development industry that now has 200 firms in it. This industry produces 40 percent of the lots and finances over 40 percent of -- actually, with take-back mortgages -- of the housing in El Salvador now. These lots sell for $800 U.S. -- around, as an average, which is affordable to families that earn $1500 to $3500 U.S., which is the income range of these families.

And this production has gotten ahead -- has gotten ahead of demand for housing. There are more lots at this price than people want to buy, and land prices have gone down. And for those of you that have done work in developing countries, that is remarkable. Land prices -- usually the result is much the reverse.

So, in conclusion, both of these are market-oriented solutions that move us in the
correct direction.

Since Steve originally said that we should have lessons for the U.S., I developed one that I'm going to mention very briefly which is that progressive housing -- in the U.S. we are used to the product model of housing which has great advantages. The U.S. financial system and housing is the envy of the world.

It does have drawbacks for low- and moderate-income households. They pay more in their income -- 35 to 50 percent of income, typically -- than -- households -- than low-income households or moderate-income households would pay in developing countries for their housing -- far more.

It -- the, sort of, high-standard development also eats up land. There is room -- or one thing that was suggested in the meeting yesterday, by Jim Carr and others, is that alternative lower-cost solutions may be one solution to the challenges of housing in the new millennium in the U.S. also.

For instance, a core unit that is expandable is a bit reminiscent of the low-income solutions that Levittown was for the veterans when they returned from World War II -- that housed so
many people, including my nuclear -- my own family
in Rockville, Maryland, in one of those Levittown-
like subdivisions out there.

So I'll just end now and -- (pause) --

MR. BERNSTEIN: Thanks, Bruce. That was
great.
COMMENTS BY STEVEN A. BERNSTEIN

MR. BERNSTEIN: I guess I'd like to sort of touch upon our Dominican program a little bit more, because it hit upon a couple of things that Bruce and Steve were both saying.

One of the things we've found that's been interesting in trying to get this -- trying to get housing -- proper housing into the informal and very low-income sectors in the Dominican Republic is -- is the developers. And in the past, the low-income sector has been monopolized by a government-run institution called the Instituto Nationale de -- (inaudible), or INVI. And INVI actually contracted to builders to build houses. And it's similar to the -- (inaudible) -- scheme in Mexico and the Fuguavi scheme, I think, in Guatemala -- the Fuguavi didn't actually build -- or -- (inaudible) -- in Nicaragua. But anyway, we're finding that contractors were cutting deals to make housing for $15,000-$20,000 equivalent U.S. dollars.

So we had some contractors go out to the Dominican Republic and say, "Well, for 36 square meters, for, you know, a basic house with utilities, how -- what's the lowest price you could do this for?" And we found that with construction, that's
acceptable for the social environment there, which means -- in Latin America, typically concrete construction -- that you could -- excluding the cost of land, you could put up a house -- a pre-fab concrete house -- a very nice one, resistant to the elements -- for about $2,000.

So there's -- the fact that the governments are involved in producing housing. and then all the deals that get cut between developers, tend to distort the actual cost of building homes, tremendously -- absolutely tremendously -- and developers getting rich, and people aren't receiving housing.

We feel that, even with the land cost, we could probably produce homes for about $5,000 for 36 to 45 square meters in the Dominican Republic. HUD's not going to do that, by the way. We're making suggestions to the private sector to come and invest. And that's going to be taken over by OPIC, which is -- part of their mandate is to bring U.S. investors into overseas markets. Hopefully we'll be able to coordinate with OPIC the development of affordable housing so that the HUD finance programs could actually finance these homes.

But just another issue there, what we've
also found out is some interesting data. In the
barrio regions in Santo Domingo, very low-income
households, people are always concerned about --
what can they pay? They don't have verifiable
income, et cetera. Well, there's a couple of
things.

There are lessons learned from other
countries, and we always come to these conferences
and talk around and talk about what we've learned,
but no one seems to put it all together. One good
lesson is from the mortgage banks in Mexico, the
safoles. They have learned how to service low-
icome mortgages. They've done quite a fantastic
job. And if the numbers are to be believed, they
have less than one-percent default rate on their
portfolios right now.

Part of that's due to their very good
hands-on servicing of the mortgages. You want to
make it easy for these -- for the low-income
households to pay their mortgage. These countries
don't have -- people don't have checking accounts.
You can't rely on sending cash through the mail.
And if you want to make a payment to a bank,
typically you have to take a day off from work, go
stand in line -- and I've done this before -- I've
done this in the Dominican Republic and in Mexico --
where you go, and you take a number, and it could be
four hours before somebody will call your name up.
You go up to the teller, and if you're lucky,
they'll be able to pull your record, calculate how
much you owe on your mortgage, and you make your
payment.

So you've got a choice -- you can either
lose your job or you can go pay your mortgage. You
know, so -- you know, hence, high defaults in a lot
of these countries, but what -- you have -- you
don't -- it's not that it's an inability to pay.
It's -- from a financial perspective, it's an
inability to pay from a -- you know, a dilemma
regarding your job or your mortgage.

But the safoles, what they've been able to
do is -- you know, it's a very simple lesson -- they
just stuck a kiosk in the middle of housing
developments. They've kept it open after regular
hours -- you know, 8:00, 9:00 at night. They even
give some incentive sometimes. If you pay your
mortgage for six months, we'll give you a token
gift. And, you know, that works really well. And
if there's -- if you do have a problem, we'll send a
guy over to your house and say, "Is there a problem?
Can we work something out?"

And this is another issue that we've been
talking to our international partners with -- is the
alternatives to foreclosure and things that FHA is
working on, in that we prefer -- we prefer
renegotiating mortgages rather than foreclosing.

And, given the legal situation in most countries,
this is a preferable method in a lot of Latin
America.

We want -- we're bringing these lessons
back to our Dominican project. And hopefully when
we put this together, we'll find that we can
maintain -- credit risk is going to be minimal. We
could actually provide market rates for mortgages.
I was going to touch upon that. We found that -- in
the lowest income sectors, we found that along the
River Azama in Santo Domingo, people were paying
upwards of $100 to $120 a month equivalent in rent
to the local jeffe to rent a cardboard shack.

We could capture those payments and --
these people have been doing it for 10, 20 years --
we could capture these payments and bring them into
the formal financial sector. I think we will have
done quite a good job.

And we're going to initially target one
barrio. I don't know how many households are in there. Do you know, Madeline (phonetic)? We're looking probably to affect at least three to four thousand households if our OPIC project goes through.

That said, I actually have one question, and -- I have some ideas, but I want to throw it to the panel -- and then we'll go on to Sally and Bob.

But, you know, the NGO model is -- been around for a long time, and they really work with the low-income sector. But why have not the banks in -- let's -- we'll just take Latin America as our case -- why have not the banks actually engaged in this real low-income lending? Is there --

MR. FERGUSON: I have -- I think one -- I'm sure there's many reasons. One is -- though, is that, to a certain extent, in countries where the financial sector has become really competitive -- I think they have -- I feel like it -- and where the institutional infrastructure exists -- for instance, Bolivia is a country where it's an exception -- but, indeed, the financial -- financial institutions have done micro-credit and lent to low-income households and are increasingly doing that.

In other countries, I would say, perhaps,,
you know, the lack of competition. And then there's
a traditional problem of, well, how are you going to
make money on small loans? You have to raise the
interest rates. And if you raise the interest
rates, then you get bad press, because people say
you're being usurious and robbing low-income people.

And, of course -- and they're not. It's
-- also, I think, learning a business -- the
financial -- most formal-sector financial
institutions are so oriented to a different type of
business that learning, to low-income business, is
difficult.

And maybe it's not -- it may not quite be
as lucrative in the short-term as what they're
doing, and so they don't see any reason to do it.

MR. BERNSTEIN: I guess in the -- from the
-- (inaudible) -- example, we do see some of the
Mexican mortgage banks, or safoles, going down
market, but, you know, there's a lot of issues
there. Does anybody have any else -- any comments
on that? Yeah?

MS. THEODORE: Can I just add a little bit
to that?

MR. BERNSTEIN: Sure. This is Leslie
Theodore. She's from ACCION, and she's working with
us on our Dominican and Honduran programs.

MS. THEODORE: Okay. We've been operating
in micro-finance for 35 years in Latin America, and
we have 18 affiliates within Latin America, and
there are several different models.

Originally, we worked with NGOs to help
them have their services be sustainable. And then
the model has been, over the last few years, to help
those institutions transform into regulated
financial institutions. So half of our network now
actually are regulated institutions that are
providing micro-finance services.

The other model which I think will become
more prevalent in the future is working with for-
profit banks to go down market. And we have been
working with them. As Bruce said, it can be very
difficult for them to understand the methodology
that's required and to get over these barriers of
thinking that there's no way to make money off of
this type of program.

So it really has been the NGOs and the
transformed institutions that have proven that
that's not the case. And then, having that proven,
it's less risky for the commercial banks to now go
down market. And we're working with several
institutions to do that.

And we think, going forward, that this model of the transformed NGO might not exist, and we might just start directly as a commercial institution doing micro-finance.

MR. BERNSTEIN: Great. Go ahead.

MS. MARTINEZ: I'm Sylvia Martinez. I really want to echo what you said and what Bruce has said.

MR. BERNSTEIN: Can you pass a microphone? Can you speak into the microphone? The court reporter is recording this, so --

MS. MARTINEZ: Okay. I really want to echo what Bruce said and what -- I'm sorry --

MR. BERNSTEIN: Leslie.

MS. THEODORE: Leslie.

MS. MARTINEZ: -- Leslie just said. I worked on a sites-and-service project in Mexico, and I was born and raised there, so I fully understand waiting in line not only for your mortgage, but also to pay the light, to the pay the phone --

MR. BERNSTEIN: Your income taxes.

MS. MARTINEZ: -- and everything else, you know, so -- but when we look at finance in this country, and we try to impose models of a developed
economy, we're going to get a great deal of frustration. And I think if we were to step to the beginning of our finance system in the 1930s, we would find that our finance system would be a luxury. The 1930s finance system would be a luxury in many other nations.

And so starting small and -- incremental housing and having the service light -- lot, which is the sites and services, I think is the way to go, as opposed to taking some of the more sophisticated financial instruments that took many years to develop and which are really a reflection of what our history has been in this country.

And to echo that, I think one of the things that I want to do one of these days is go back and take photographs of the sites-and-service project I worked on, when people were starting and -- and it was basically a service lot, because having driven there now, it is completely part of an urban setting. You cannot tell that it is any different from any of the housing around there.

And so I would hope that in our discussion, we would veer more towards some of these lesser -- less grandiose schemes, I think -- they seem to be less grandiose but which I think have
great promise. And that is the role of the NGOs as
the financial intermediary and the role of the
government in a different role, because I still
think there's a different role for the government to
play to step back in there, but not a state banks or
not a subsidized housing providers, which doesn't
work.

And so -- but I just -- I just don't want
that point to get lost, because it -- they're really
important.

MR. BERNSTEIN: Yeah, I think Bertrand
wants to make a comment on that.

MR. RENAUD: Just expanding on Sylvia
Martinez's point. Another change over the last 15,
20 years is the changing role of governments. You
need governments in the system, but essentially the
model of the '60s and '70s was the government was a
producer and was the financier and was the regulator
and was not regulating. And essentially what is
driving the system now is to flip around the role of
government of creating infrastructure for the
private sector.

Another romantic notion is that whatever
is noninstitutional is, by definition, more worthy,
socially and otherwise. The NGO model -- the
romantic -- (inaudible) -- the John Turner
(phonic) vision -- everything that is against the
state is right because the state's were so wrong 20
-- or 40 years ago -- that is also disappearing from
the picture completely.

And the third point that has also been
brought up is that we're much more explicit about
managing risks, the risks for the households that
are very much low income, the risk for the lender
that is also undercapitalized, especially the low-
income lenders -- every time there is macro-economic
shocks, they can go under because they don't have
enough capitals -- and eventually, the risk to the
governments.

And another quick line that I would say,
it's very interesting that in many countries the
reason why they emphasize private ownership of
housing, as opposed to public rental programs or
other types of rental programs, is that it simply is
cheaper for the government, and it works better.
Essentially, the structural incentives is there.

But the key point is, indeed, to get the
governments into -- out of direct production and out
of direct financing, because -- but it doesn't mean
that the government is out of the picture. It's a
very different picture.

MR. BERNSTEIN: Go ahead, Bruce.

MR. FERGUSON: Yeah, I want to -- one comment on, sort of, this -- I think we have set up a dichotomy that's useful in talking about things but is not -- does not reflect what emerging reality in -- is going to be. We talked about micro-finance, and we've -- I did this; it's my fault -- but we've talked about micro-finance and the NGO model and the -- sort of the institutional models -- mortgage finance.

I think in reality what's happening is that there is a spectrum, a -- in between, that goes all the way from micro-finance of a $300 addition to an existing house all the way to purchase new construction of a house for the upper-middle class.

And what we see in the U.S. is that -- as a contrast, is that really the mortgage finance -- it's being -- of course, you know, the programs of Fannie Mae's and others have adapted it more and more to needs of low-moderate-income households, so it has gone down market here substantially.

But I think even more so in developing countries, there's room for a wide range of institutions and organizations to fill various
niches along that path that is a path of many, many
diverse types of housing solutions and many, many --
and an income range that is also very wide.

So I don't think we're talking about just,
you know, $500 micro-finance loans and $20,000 or
$30,000 loans to the upper-middle class. It's a

much wider range of -- a much broader spectrum, and
you have -- (inaudible). You've got, you know,
credit unions. You've got -- in addition to -- you
have micro-finance lenders and multi-national banks
on one side, you have everything from credit unions,
financial NGOs that become regulated financial
institutions and many other sorts of institutions in
between, filling this.

Now -- and, in a way, our job is to do
that -- is to fill that -- you know, fill that wide
range.

MR. BERNSTEIN: That's an excellent point.

One of the things Bertrand hit on, too, is this --
is the -- you know, managing the risks. And I think
in the past, NGOs had somewhat of a bad rap because
they were seen as not pricing risk properly and
subsidizing interest rates. And I see that
changing.

I know the HUD programs -- we're very
cognizant of trying to measure risk -- credit risks,
exchange risks, liquidity risk, the entire gamut.
And it's sort of a new world, going into countries
that don't have a lot of data with which to work.

There's a lot of programs out there. We
had -- at HUD, had commissioned a study that Sally
Merrill, at the -- with the Urban Institute, did for
us to look at different types of lending models in
the United States and in international markets. And
these are potential programs that HUD could
leverage, or leverage pieces of, to -- on a go-
forward basis in developing a new agenda.

So, Sally, if she -- you could talk about
some of this, I would appreciate it.
PRESENTATION BY SALLY MERRILL

MS. MERRILL: I think this is an important sign of HUD's new interest in international. I've actually never participated in anything like this before.

Talk about segmentation -- to get the domestic housing group at the Urban Institute to work with the international housing group and actually try to talk to each other and compare lessons learned and try to figure out whether anything that the United States does -- and now I'm really focusing on low- and moderate-income housing finance -- is transferable abroad and, if so, in what context?

And as the study went on, we found that vice versa was maybe even as important, or maybe even more important. There are remarkably ingenious things going on in many emerging nations, who have very different situations from our own but they have adapted much of the sophistication in interesting ways that our system affords us.

Anyway, this large team of domestic housing economists and international housing economists looked at the United States, South Africa, Chile, Mexico, India. And then, as things
went on, we brought in examples from other
countries, all the way from Poland to Bangladesh and
Ghana.

And I have to say that the transferability
issue is a terribly useful question, and we should
keep banging away at it. But this team, which isn't
used to being speechless, really was spinning its
wheels for a while just because the differences in
the sophistication of the U.S. system and in income
level, if nothing else, made it hard to figure out
what we were talking about.

What barrier is it that low- and moderate-
income housing finance is trying to overcome? Is it
simply low income? Is it access to a financial
sector? Is it an -- a financial sector hardly in
existence? Is it similar to some of the things that
have been talked about yesterday in the United
States, bankable households who do not have access
to mainstream housing finance because of geographic
segregation, geographic discrimination, racial
discrimination? Is it a lack of -- inability of
many households to relate to or understand a
financial system, which is -- the fault may lie both
with the household and with the financial system.

So we ended up, for better or for worse,
trying to create a distribution of households that's
mainly based on income, but it -- we were -- tried
to make it free of nominal dollars of income and
focus on the different barriers all the way from
bankable households without access to the system --
and in many emerging countries, that means that,

although there are mainstream institutions and a
primary market developing, there simply isn't enough
capital to serve everybody -- all the way down to
the poorest of the poor, which is mostly what Bruce
was focusing on, where provision of housing and
housing finance is an entirely different game
wrapped up in a very holistic issue having to do
with availability of land, availability of
infrastructure, and a different role, of course, on
the part of institutions that might help finance
them.

Let me just skip to some of the findings.
Most of the international team that I worked with
has been working in international housing finance
trying to just put the basics in order -- the basic
legal systems, financial infrastructure,
administrative infrastructure that we understand
here is what makes a housing finance system work.
And one of our other colleagues long ago dubbed this
the "enabling framework." And I agree with John
that everybody talks "market" now, but we can -- we
can sing that song. It's not so -- it's not so
easy. Not all of these countries are there.

What's surprised me over the years is the
amazing similarities and stubborn problems, whether
you're in Russia, Poland, Algeria, or Zimbabwe. Old
habits die hard. They want price controls on their
housing. They want subsidized interest rates. They
want cross-subsidization of interest rates.

Foreclosure laws may go on the books, but to effect
them is another story. There are strong social
traditions that have to work themselves out.

And these pose barriers that, if nothing
else, certainly make a U.S. economist have to stop
in his or her tracks and just take stock of what's
able to be accomplished. So that, certainly,
continuing with assistance in that enabling
framework, I think, is the first step.

But that said, there's a lot else going
on. In most of the countries, we found one very
distinct difference from the U.S. They're --
traditional mainstream banks going down market is
probably not the answer right now, at least not on
their own. South Africa is the only country that I
know about where CRA-type legislation is actually being drafted, but it's very controversial as to whether it's relevant.

So that there are tremendous barriers, perhaps not the least of which often are the fiscal and monetary policies of the government who require these banks to hold all manner of government paper, and they don't invest -- they don't lend their funds. They sit there holding their T-bills and go out in the afternoon and play golf. And so there's stuff like that that the governments have to get right, as well.

But there's also a tremendous movement now, as these -- echoing what many of my colleagues have said -- competition is absolutely key here. Once competition is introduced into that mainstream sector, you do find them going down market more in some countries. And in other cases, such as South Africa, where there's tremendous moral suasion on the part of the government to develop public-private partnerships, there is quite an effort at outreach.

And what has happened -- and this will come back to the comments made by the ACCION people -- is partnerships -- partnerships all over the place. It's quite amazing.
The NGO model of serving the poorest of
the poor, I think is recognized everywhere as too
self-limiting and too focused on a project-by-
project kind of a basis which really can't
accomplish anything at scale, but they have certain
comparative advantages which can be used to great
advantage by community development finance
institutions.

And, to echo Bruce's comments, on the
continuity, you find almost three distinct fields
that we're talking about here -- mainstream banks
going down market to some extent to reach moderate-
income households, a group of community development
finance institutions -- and there are two extremely
strong examples -- or more, in fact, in South Africa
-- whose dedication to the market is to reach the
moderate-income market -- and then a whole variety
of other institutions, whether they be credit unions
or community banking or whatnot. A most amazing
variety of partnerships is emerging amongst these
institutions so that each of them, I think, can
operate on their comparative advantage and just some
of these specifics and some of these lessons
learned.

Okay, I've hit on the strengthening of the
community-development finance institutions. I think that these institutions are smack in the middle of this whole low- and moderate-income market, but some of the methodologies that are used, whether they're CDFIs or banks in partnerships with NGOs, or what have you, are mandatory savings schemes.

This is extremely important abroad -- much more so than in the U.S. These are used as down payments. These are used as proof of ability to pay. They substitute the underwriting function when it isn't as developed as we have it here.

Counseling, consumer education followed by aggressive servicing, customer awareness, customer empathy to overcome tremendous mistrust, discrimination on the part of mainstream bankers in very poor households -- the twain will never meet.

Community institutions and NGOs have a tremendous role to play in all of these transaction-heavy elements of the housing finance decision.

Credit enhancement mechanisms -- a whole variety of very interesting stuff -- and this feeds on both strengthening the primary market and the secondary market -- in the U.S., there's an excellent example of a credit union in North Carolina that uses a Ford Foundation grant as a
credit enhancement to sell mortgages that wouldn't otherwise be eligible into the secondary market.

A very similar activity is underway in South Africa. I think an issuance hasn't been made yet, but this is -- it's called "gateway homes," and it's a public-private partnership. And it's goal is to provide mortgages to the moderate-income households and package those, sell them on the secondary market. But they will have a whole variety of credit enhancements to assist this, because South Africa, otherwise, its banks haven't really developed the secondary market.

A primary market example is in India where a very famous NGO has entered into an agreement with -- well, I guess it's not a secret -- Citibank, which is providing them a line of credit. The line of credit is at prime rate, which is a subsidy. And that is viewed by this -- by Citibank -- really, that element the difference between the real cost, probably, of what that line of credit should be at and prime rate is the charitable element of this in Citibank.

In addition, there are foundation funds that, again, provide a credit enhancement against the on-lending of these funds to -- I don't want to
call this a CDFI, because it isn't formalized that way -- but it's NGO's searching for ways to be -- to enter the traditional financial sector.

Okay, some of the other findings are -- risk-based pricing is extremely important. I'm looking forward, this afternoon, to going and listening to what we have to say here about the sub-prime market. But it's not viewed that way in many other countries.

There's a bank -- cash bank in South Africa who has developed a very formal set of rates which -- well, there are two banks that do this, actually -- and the rates end up being anywhere from six percentage points to ten percentage points above what a mainstream bank would lend for a mortgage. And it's all carefully delineated by both transaction cost and risk elements, what kind of collateral there is, if any, and whether counseling has been offered.

There are other examples of having the price differ when counseling is mandatory, versus not mandatory -- non-mortgage loans, where the house is not the collateral -- other collateral is used, whether it's a pension fund, jewelry, or, in some cases, none at all, payroll deduction -- all of
this, of course, is -- are examples of flexible underwriting.

Let me just finish with this and stress again the partnership efforts that are going on amongst all of these institutions with different comparative advantage, but it's also the manner in which the public sector, in many of the enlightened countries, are relating to the private sector. The public-private partnerships are extremely important. As Bertrand said, the government can't go away from the housing sector, it just has to do it differently.

The means of risk sharing, which, in the old days, were all on the state, and then, in an extreme market model, would all be stuck on the private sector. There's a lot more sophistication in dealing with sharing the risk amongst the lending institution, the government, and the household itself.

With that, I'll stop -- millions of examples.

MR. BERNSTEIN: Actually, you get me going on this stuff, 'cause we had a lot of discussions based on Sally's study. And, you know, so -- when we were designing our Central America work, things
we emphasized where mandatory savings schemes,
aggressive consumer education -- which ACCION is a
pioneer in doing, by the way -- and progressive
servicing.

We're even -- I mean, we can't get into
risk-based pricing in some of these other countries,
but that's something always in the back of our
heads. It's very, very important.

The last topic -- and it's not the least,
but it's sort of in the progression of how we think
about housing finance -- is, sort of, issues on
secondary mortgage markets. Right now, HUD is --
and we've got to make this fast; we only have about
ten minutes, or a little less -- HUD has, in
addition to having its reciprocal agreements for
exchange of information on primary markets, we also
do a lot on secondary market issues.

And some of these have come to fruition.
We talked about our China project, which is, you
know, your basic housing secondary-mortgage-market
issue. And we're also working with the Israeli
government.

I'm in the process of setting up a policy
work group on secondary market issues that -- to
date, what's happened in Israel is that the
government has taken most of the obstacles out for
securitization mortgages. There are some public-
policy issues, however, that need to be addressed in
what is the government's role in going down market.
And hopefully we'll be able to establish a dialog
with the Israeli government to help them sort that
out. We obviously have a lot of experience with
George's group and with our FHA.

We're also -- we're asked continually
about information on secondary markets from -- for
study tours, et cetera -- and I asked Bob if he
could talk about, sort of, the prerequisites about
secondary mortgage markets. It's -- we tend to just
assume them; but in a lot of countries it's really
not -- they're not appropriate to talk about, or, if
they are appropriate, we may be talking about them
in the wrong way. So, Bob?
PRESENTATION BY ROBERT VAN ORDER

MR. VAN ORDER: I'm pretty gnostic about the role of secondary markets in other countries. I think -- I'm going to say a little bit about lessons in -- from the United States and then some more about the ways of thinking about the role of secondary markets in other countries.

But whatever the lesson is, it's a subtle one; it's not the lesson that going around the world creating Freddie Macs or, even worse, Fannie Maes -- (Laughter.)

MR. VAN ORDER: -- is -- that's a joke, not an editorial -- (Laughter.)

MR. VAN ORDER: -- is -- I mean, a little GSE humor -- but that's -- that's actually -- there may be cases where something like that is the case, but there's a huge, not only regulatory, but legal and other infrastructure that goes along with us that lots of places are a long way away from. That doesn't mean you can't use secondary markets, and I'll give some advantages, but it seems to me the lessons are more subtle ones.

And the first one is -- Bertrand talked about how boring housing finance was 20 years ago.
It was about then I started studying it. It was, indeed, quite, quite boring. Much of it involved, in the United States, looking for pots of money. The S&Ls were a pot of money. The public policy issue was something like a deposit-rate differential that ensured they had the pot of money. Part of the reason for wanting a secondary market was the pension funds where a pot of money. The life insurance companies were a pot of money -- could we get to that pot of money?

What's happened to the secondary markets is -- that's really irrelevant. A major lesson is we're just a part of the capital markets, and that's all we are. And that is, indeed, all we are. We are a part of allocating capital efficiently. Initially, to some extent, the secondary market was sold as a way of allowing American home buyers to compete with the capital markets. It's also forcing them to. It goes both ways, and that's an important lesson to learn. There's the integration with capital markets. Housing, after all, is just one of several kinds of capital investments we can have, and you want to make sure the capital is allocated efficiently.

Second, the legal structure is extremely
important. What I mean by that is things like
registration and all of that, but especially
foreclosure and eviction. It's extremely important
that you be able to throw people out of their
houses, if you want to have a mortgage market.
And if you look at the evolution of the
United States and home -- you know, the biggest
advice I can give another country is that what they
really need is 800 years of Anglo-Saxon common law.
And then they'll be fine. But if you look at the
rise of home ownership in the United States, the
action really hasn't happened since Fannie and
Freddie. I think we've contributed, but the home
ownership rate in the United States was in the low
40s in the second World War, but then it went up to
62 percent by 1960.
Why? Well, there were -- of course, there
were a lot of reasons. There were demographics and
things, but an awful lot of it was we had a good
mortgage system and a good legal structure. We
didn't know about -- I wasn't around then -- well,
at least not as a grownup -- but we didn't know
about credit history and credit scoring and swaps
and guarantor programs, but we had a legal system
that said if you put 20 percent down on your house,
you have a relatively stable economy and a savings
and loan history that can attract funds, that's
pretty stable. We'll throw you out of your house if
you don't pay. And the result of that is on the
order of about only two percent of the mortgages in
the United States go through foreclosure. That's
important.

Third, you can make money at this. You
don't need to -- there are subsidies in the mortgage
market -- and, of course, there always had been, but
they're very small. You can make money at this and
save the serious subsidies for the people who need
it.

Okay, so thinking about secondary markets
and where they might fit, a point I think that's
important to make in the United States, but in other
countries, as well, the distinction between primary
and secondary markets is actually not very
important. It's increasingly unimportant in the
United States. Who originates the loans is
extremely uninteresting. Almost all the loans are
originated in roughly the same way by roughly the
same people.

What matters is there are simply different
ways of moving money into the mortgage market. The
dichotomy between the secondary market and, say, the
depositories, which have been the main other
alternative, is traditionally, in the United States
-- or traditionally, meaning the last 20 years, with
Frannie and Freddie -- the vehicle was
securitization and going into the capital markets,
whereas the vehicle was depositaries. They were
both there. And the distinction was that.

That's increasingly -- by the way, an
increasingly unimportant distinction, as well.
Fannie and Freddie are moving away, basically, from
the entirely securitization and are funding a lot of
their stuff simply with debt -- complicated debt,
but debt.

And the depositaries -- first of all,
deposit markets can be pretty competitive, but
they're moving in the direct, also, of using capital
markets through the home-loan banks as a source of
funds, as well. This distinction is less important
than simply what's an efficient way of moving the
money around. And there's no particular answer to
that. These are capital markets. There's no
inherent reason why one vehicle has to be better
than the other. And I think that's the way to look
at things in other countries and to look at a very
eclectic way.

Bertrand mentioned "past dependence."

That's a sexy term in the economics. It's even gained some notoriety among peers. But where you start matters, because the more you try to get away from it quickly, of course, the more mistakes you can make.

In Russia -- Russia is a country that's tried to do mortgage markets without a legal structure, without a primary market, and without a secondary market. They're working hard on, sort of -- some people are working on all -- on all at the same time. A problem in Russia, for instance, was how did you evict people? There was a problem with evicting people. Maybe you can take control of the property.

When I visited there, one of the things they talked about the mechanism that many of the lenders had was they had people they called "lawyers" who helped the people move out of their apartments -- not the way you want to build, necessarily, a world-class market.

They think they can write contracts now that can actually be enforced, so that maybe there is a legal framework. There's a secondary market
institution of a sort that's growing up that's
developing the primary market at the same time
through the banks, and it's working on underwriting
standards. Fannie Mae has worked with the Urban
Institute in Moscow, has been a part of it, and some
of it came, indeed, from a pot of money from the
U.S., but that's an area where all of the things are
happening at once.

In Trinidad, there was a banking system,
and there were banks. The banks didn't want to do
mortgages. They lobbied for a secondary market.
They did, indeed, create an institution rather like
Freddie Mac where the banks originated loans, sold
them to this institution in Trinidad. A few years
later, they discovered, "You know, this is pretty
good business, and these guys are competing with us.
We really don't want them anymore" -- reminiscent of
things in the U.S. That was entirely opportunistic.

In Egypt, there are banks -- private banks
are developing. You may not need anything like a
second -- new institutions at all. You may not want
to create them. You might want to use the existing
banks, either because they can issue deposits or
they can issue bonds in the newly developed bond
market. But this isn't really a secondary-market
institution, but it's a capital-market institution.

In Ghana, there's an institution that started as something that was supposed to be rather like a secondary market, but it really isn't. It's a good institution, but it's developing simply as a mortgage lender, as something like a bank that does mortgages and is raising funds in different ways.

There are lots of ways you can put these things together. You need to have, ultimately, the legal structure, and you need, of course, to get the incentives right. In all of the cases I talked about, these are -- none of these are sort of parastatal institutions. They're either private or close to private, and they're operating, basically, on greed, which is another thing we've probably learned from the American secondary markets, that greed can actually be harnessed effectively to move money to people.

And so I think I'll stop there.

MR. BERNSTEIN: That's great. I have -- yes? I just wanted to say that the legal infrastructure is paramount, and it, sort of -- it wasn't a flippant remark on the -- about the Anglo-Saxon law, because typically, there are provisions in Anglo-Saxon law that make it easier to do
mortgage lending and to enforce contracts.

Other types of legal structures we see are
the Roman -- based on Roman law or the Napoleonic
law, which we find in the Caribbean and South
America, that basically everything has to be
legislated before you can do it. Whereas, in our
system, everything can be done until there is a
prohibition against it. It just makes for a huge
difference in the lending environment. Any
questions?

MS. MARTINEZ: I have an issue here that I
want to throw out, and that is the whole issue --
Robert was talking about the whole issue of access
to the capital markets. One of the biggest
challenges in the access to the capital markets, of
course, is going to be -- and can people hear me?
I'm sorry.

MR. BERNSTEIN: You might want to take the
mike.

MS. MARTINEZ: I'm going to throw this
issue out, and that's the whole issue of access to
the capital markets, because one of the problems
that the countries face is currency changes. And it
was mentioned at first, but it's a huge issue. It
was a huge issue in Mexico.
And then the question is who bears the risk of the currency change? Mexico had a dual-index mortgage in which, basically, the consumer was the one who absorbed the risk. And, of course, there were foreclosures, and people just walked away from their homes. And so there was a problem there.

They've -- I think they've adjusted it in ways that are more -- perhaps more palatable, but I don't think it's a complete solution.

And so that in looking at these -- I know Bertrand has some thoughts on that -- and I think that's one of the things that we need to look at. Sally, you talked about the perception of risk, the real risk, and who bears the risk, and how you share the risk. And I think unless that basic problem of the currency changes and changes in fragile economies is addressed, that we're really not going to get into a broader housing finance system.

MR. BERNSTEIN: I just want to -- I kind of agree with you. One of the issues we're really dealing with is how do you spread the risk, and I should have talked this a little bit more. But we do believe that in a lot of policy -- it's been contra to this in various countries -- is that the borrower should share at least part of this risk.
And we believe in pricing some of the risk into the mortgage instruments, et cetera.

You have kind of skewed versions. In Mexico, the borrower assumed very little of the risk in the traditional dual-index mortgage because -- well, there was two types of dual-index mortgages.

There's the one where the mortgage is indexed to the -- (inaudible) -- in which the borrower had -- that was almost a free ride. And then you had the other dual-index mortgage where it was -- where all of the risk was put on the borrower, in which the mortgage was indexed to inflation. And when Mexico experienced -- they had two pretty bad episodes -- the first hit in '92, but then, obviously, the '94 and '95 crisis just completely decimated their mortgage sector.

So the allocation of this risk is incredibly important. You know, they're -- obviously, who takes risk has more hazard implications, and you get into all sorts of digressions, but -- anyone else want to talk?

MR. RENAUD: I have two quick points. First of all, I would go back to Bob's. One of the advantages of doing international work is that you understand your national system better. And it's
not flippant what I'm trying to say.

For instance, you have to understand that securitization in the U.S. was partly a consequence of the unique banking system and the need to reallocate savings across the system. Other smaller countries that are much more compact may use different solutions, but they still need access to the capital market. So that's why Fannie and Freddie may be wrong if you go to Trinidad. You know, the island would sink.

(Laughter.)

MR. RENAUD: So the question is that there is an implicit and explicit -- in Bob's presentation -- is that when we look at access to capital markets, there's a full spectrum of options. That's why I went back -- I started my presentation with the reference to Ali Baba's cave, because the U.S. has experimented with practically every single solution.

The other point's about risk sharing. I think -- (inaudible) -- has put on the table something that's very important in our international work -- microeconomic instability is here to stay.

And, therefore, the real issue is, what is the role of the government in managing this risk for
the housing finance system? Because if you have a

    crisis -- let's say Colombia, today -- if you shut

    off the financial -- the whole mortgage-finance

    system, which is 30 percent of the banking access of

    Colombia, and you have 20 percent unemployment, you

    are going to get more if you shut off the system.


    And so I think that wherever we are, it's

    very important that we try to figure out who bears

    the risks and why.

    MR. FERGUSON: Yeah, I -- this one? Yeah,

    I'd like to echo that. I think -- you know, as they

    say in Mexico, if -- foreign exchange risk is "el

    giste" -- it's "the joker." I mean, it's what kills

    access to international capital markets for many

    countries -- not just for housing. I mean, we're

    talking about housing as a subset of financial

    institutions.

    MR. RENAUD: My point was not about access

    to capital markets.

    MR. FERGUSON: Okay.

    MR. RENAUD: If you have a volatile
domestic economy to -- (inaudible) -- the exchange
rate, you are going to get huge spikes in the
domestic interest-rate structure. And then, housing
being the most sensitive sector to interest rates,
is going to be wiped out.

MR. FERGUSON: Okay.

MR. RENAUD: I'm not referring to, you know, New York investment bankers --

MR. FERGUSON: Okay.

MR. RENAUD: -- trying to do deals. I'm looking at the growth of the domestic market.

MR. FERGUSON: Okay, I agree totally. I mean, it kills your access to the capital markets -- international and domestic. I don't know -- I mean, there's always the -- you know, I think that's -- there's a lot of reforms that are proposed at a very macro level, I think, to party deal with that.

Dollarization -- the whole debate around dollarization in Latin America has that as one of its fundamentals.

And there's proposals to create regional currencies now out that have really -- if you look underneath them, housing and housing finance is one of the things driving it, because it's the asset that requires -- at least, you know, for the upper 30 percent of the population -- the longest term.

MR. RENAUD: If I may step in here, I think one contribution that the U.S. could make is in countries where the markets are quite small, like
in Central America, and they have a hard time
getting to a regional structure. What is it that
could be done to have some regional capital markets
in small -- so I'm throwing that question -- can you
contribute something as a capitalist? I don't know.

MR. VAN ORDER: In one sense, not. But,
of course, one solution is to do loans in dollars.
That limits where the market can go, but it helps
develop it. But some of the -- the Russian model
that I was talking about, actually they're talking
about doing loans in dollars.

I have one quick -- one final comment
about risk sharing -- to be really careful about
risk sharing, because risk sharing can end up being
risk shifting. And if risk sharing and shifting
risks from people who know more about it to people
to who know less about it, that -- as has -- as is,
of course -- as is, of course, typically the case,
that can be quite dangerous. You want to be careful
about institutionalizing that. A lot of the -- well
--

MR. RENAUD: Isn't it one of the U.S.
contributions to the debate the notion of toxic
waste?

MR. VAN ORDER: Absolutely. We still have
some bad multi-family loans that vouch for that.

MR. BERNSTEIN: Well, I -- there's so many
more things to talk about, but I'm sorry that we
have to close it off now. But you -- feel free to
talk to anybody out -- after we break up here, but
thank you for coming. I really enjoyed this. Thank
you to my speakers. Thank you to everybody in the
audience. Have a good day.

(Applause.)

(Whereupon, the proceedings were adjourned
at 12:10 p.m.)