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U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

HOUSING POLICY IN THE NEW MILLENNIUM

Hilton Crystal City

Arlington, Virginia

October 2-3, 2000

ROUNDTABLE 1A:

INTERNATIONAL PERSPECTIVES ON HOUSING POLICIES

Reported by: Ray Heer

Transcribed by: Janet S. Dickens

1 P R O C E E D I N G S

2 Tuesday, October 3, 2000

3 Beginning Time: 10:20 A.M.

4 PRESENTATION BY STEVEN A. BERNSTEIN

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

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

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

1 who is a housing finance advisor with the World
2 Bank.

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

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

16 HUD has always had a role in
17 international. People say, you know, "What's a
18 domestic agency doing here in -- working in
19 international markets?" Well, since the beginning
20 of HUD, in the '60s, the Kennedy Administration
21 actually had designated an international role for
22 HUD. And that role was to -- for exchange of
23 information, for research on international trends,
24 and -- in order to help our partners, international
25 partners -- and also to help the United States

1 develop new and innovative programs. This is
2 actually written into our congressional charter.

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

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

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

1 and throughout the United States government and
2 private sector.

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

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

22 Another major initiative in our department
23 is the issue of binational relations, and we have
24 established quite a few. And this is sort of the
25 cornerstone to our program. And I want to have John

1 Geraghty talk about each of our programs and the
2 countries in which we're working.

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1 PRESENTATION BY JOHN GERAGHTY

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

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

19 This new consensus is seen at the -- or
20 was seen is Istanbul in 1996 at the World -- at the
21 Global Conference on Cities -- when the agenda came
22 up with a very market-oriented approach, very
23 democratic approach, to solving a lot of problems in
24 housing and urban policy. And this was the world
25 consensus. There were about 170 governments there,

1 and this was the consensus of views. So the old
2 model -- the old divide had been -- has been
3 completely erased.

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

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

22 The other programs -- the China program
23 grows out of President Clinton's speech in Shanghai
24 in 1998 saying that one of the areas that the U.S.
25 and China should work on is housing. So he began a

1 housing initiative, and Secretary Cuomo has done
2 much to give life to that initiative.

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

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

1 exchange programs.

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

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

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

1 projects with Israel.

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

5 VOICE: Next week.

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

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

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

22 One of our most exciting projects, I
23 think, is our China initiative, which is a Clinton
24 Administration initiative. And we don't have
25 anybody here to talk about our building initiatives

1 here, but we do -- have just gotten back from our
2 third mission to China.

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

16 But anyway, I'd like George, who was --
17 helped -- came along on that mission and help lead
18 it, to say a few words.

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1 PRESENTATION BY GEORGE ANDERSON

2 MR. ANDERSON: Alright, thanks, Steve. I
3 would just like to follow up on some of the things
4 that John was saying here, that I've been at HUD a
5 long time, as well as John -- been in Ginnie Mae for
6 20 years. And during even my first days at Ginnie
7 Mae, there was interest around the world in the
8 secondary mortgage market. Back then it was mostly
9 coming from Canada and Western Europe. The British,
10 the French, the Canadians got a visit from the
11 Australians. It was more or less, you know, "This-
12 mortgage-bank-security, what-is-it?" kind of thing.
13 That was back when the program was first created.
14 And then there was sort of a lull, and there were
15 years that nobody came.

16 I must say within the last, say, three
17 years, there's been an absolute steady stream of
18 visitors from all over the world -- from Asia,
19 Africa, from little countries within Africa,
20 countries within countries -- that are coming,
21 trying to learn about the secondary mortgage market.
22 I think, to me, that sort of signifies a realization
23 of the importance of the role of housing in emerging
24 economies and then the -- of course, the ability to
25 finance it.

1 I think Bob is going to talk some more
2 about the flows of money and things like that from
3 Freddie Mac's perspective, but it's -- to me, it
4 appears that the trend is definitely on the upswing
5 for more and more economies being concerned about
6 the mortgage market and the secondary mortgage
7 market, and it's going to be at an increasing rate.

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

20 What I found most intriguing aspect of the
21 Chinese was, I guess, some of the issues that they
22 had to deal with were at the very basic level. The
23 solution that we sort of struck upon -- for those of
24 you -- but once it's done, and you read upon it --
25 anybody who's done any kind of public financing will

1 go, like, "That's pretty basic" -- almost, "Yes, we
2 can understand how that would work. We've been
3 doing that for 50 years," or something like that.
4 But in China, I guess, the -- I think our major
5 contribution that I feel that we actually made a
6 contribution to was the flow of information among
7 the respective elements of government that there was
8 and continues to be.

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

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

25 And then for us to come out with a

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

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

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

23 But Steve pulled together a good team of
24 government people and private-sector folks to go
25 over and, in effect, quell or qualm the concerns of

1 the various government agencies to come out with a
2 securitization effort that I think will be quite
3 significant for the Chinese people and the
4 government.

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

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

23 Another very big project -- and it's going
24 to -- this will segue into our discussions with our
25 experts around the table, too -- is -- kind of hits

1 more on sort of the basic problems of housing
2 finance, and that is really addressing the needs of
3 housing and housing finance to those in very poor
4 developing countries. And it's something that I've
5 been working on for over ten years now in
6 international work before HUD in the private sector
7 doing projects for the World Bank and other
8 institutions.

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

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

1 households be integrated into the formal financial
2 sector somehow.

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

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

22 We're also working on -- with one of our
23 partners in our project, ACCION International, which
24 is a large NGO in the United States that works in
25 Latin America to develop programs for assisting low-

1 income borrowers attain mortgages and loans for
2 reconstruction of housing, progressive housing, and
3 micro-credit -- or micro-enterprise development.

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

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

18 So what I'd like to do now is turn it over
19 to our panel of experts. And each one of them has a
20 very good and unique perspective based upon many
21 years of research in this area. And we could -- and
22 we'll just go through these one at a time, and
23 please feel free to ask questions as we go along or
24 bring up anecdotes or whatever you feel would add to
25 this conversation.

1 I'd like to turn it over to Bertrand
2 Renaud. Bertrand is an economist with the World
3 Bank. He's been working the international housing
4 finance area for many years. He has experience in
5 dozens and dozens of countries. I've been able to
6 work with Bertrand extensively, both in the

7 Dominican Republic and in Mexico. Bertrand is going
8 to -- will talk about his views on the trends right
9 now in developing countries. Thank you.

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1 PRESENTATION BY BERTRAND RENAUD

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

6 (Laughter.)

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

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

23 I like John's point about the fact that we
24 are all market economies, but they are. They have
25 different ways on public and private role.

1 And another thing that is extremely
2 interesting is that the way of cutting up housing-
3 finance issues and the housing-programs issue is
4 quite different from the past. I had the
5 opportunity of looking back a few weeks ago about
6 the kinds of discussions we used to have at OECD

7 about social-housing policies. It's amazing how the
8 papers feel obsolete and aged, because we do not
9 approach the problems the same way. The countries
10 do not approach the problems the same way.

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

24 I would often take to task some of the
25 famous agencies of the U.S., especially secondary

1 market agencies that speak only about themselves.
2 But when they have visitors, I would urge them to
3 say, "Look, this is the entire spectrum of
4 experiences we have."

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

15 So those kind of stories are invaluable to
16 our member countries. But the Ali Baba --
17 (inaudible) -- is very important to see how people
18 look at the U.S. And there is a reason. The
19 countries we look at are incredibly small.
20 Recently, finally -- I congratulated some of my
21 colleagues -- we had a retreat, and the paper was,
22 "What kind of financial systems are we looking at?"
23 And one of the questions -- the first question was
24 how many countries have financial systems -- not
25 housing finance systems; financial systems -- that

1 have a balance sheet that is smaller than the World
2 Bank Credit Union? Sixty.

3 (Laughter.)

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

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

22 So when George says, "I was in China, and
23 they were back to basics," I say yes, because 20
24 years ago, would you believe, that the first World
25 Bank report there was a footnote, and one Chinese

1 just jumped. He says, "This is a great idea, so we
2 just have to finance long-term investment on a cash-
3 flow basis? We can have long-term finance? This is
4 what long-term finance means?" They didn't know,
5 because essentially, under the Soviet system,
6 everything was done on an annual basis.

7 So the notion -- I'm not surprised.
8 Announcing that amused me greatly, but it's more
9 than amusing; it's really fundamental, and I would
10 urge the U.S. community, in general, beyond HUD --
11 you said when you came, you brought all the agencies
12 around the table. The experience of the World Bank,
13 ADB, is that typically when we lend in town, this is
14 the only time when these guys get together in the
15 same room. So making the connection, in addition to
16 bringing the technical solutions, is very much a
17 part of the agenda.

18 The other interesting point that probably
19 will be developed by Bob Van Order even more is that
20 the distinction between secondary market and primary
21 market is seen very differently. And in the World
22 Bank, an accelerator of that integrated view of
23 primary and secondary market is that the Asia crisis
24 has emphasized again that you would want to have
25 several channels of funding.

1 So secondary markets have various
2 benefits. They are not immediately doable in many
3 countries, because the primary market infrastructure
4 is not in place. But typically -- I presume some of
5 you will talk about that in transition economics,
6 like Poland -- you work on both agendas together.

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

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

21 (Laughter.)

22 MR. RENAUD: You say, "Well, what have you
23 done? What have you achieved?" I mean, so
24 essentially, very often we look at the discussion of
25 secondary mortgage markets as a CAT-scan. What is

1 defective in your system? What is it that you need
2 to fix first? What are the strategic alternatives
3 that you have?

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

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

23 What other points I would want to make?
24 I've mentioned the markets are very small. The
25 economies are -- (inaudible). Indirectly, also,

1 what people have mentioned is that the income
2 distribution is very bad.

3 And when we speak of access to housing,
4 one of the problem I have is that a lot of people
5 forget that there are two dimensions to afford-
6 ability. Is the product cheap enough and

7 affordable, and then is finance available? And many
8 of these countries, the informal sector is very
9 large, because the urban system is really not
10 structured properly.

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

17 And I would close there in saying that in
18 the U.S. environment and in OECD countries, we see
19 of marketing as putting ads on television about blue
20 jeans and that -- or the Internet. But we forget
21 that 50 years ago, when people spoke of marketing,
22 they were speaking of creating value in time, form,
23 and space. That is to say creating infrastructure,
24 and that's what we are at in housing finance. Thank
25 you.

1 MR. BERNSTEIN: So basically what -- are
2 you seeing then, in the work that you're doing, that
3 there's being -- there's a trend now to addressing
4 sort of the pathologies in primary mortgage markets,
5 in that do you see -- do you see that, for example,
6 state housing banks are being revamped or gotten rid
7 of, or what is the trend there?

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

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

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

25 And I would like to stop there, because my

1 colleagues probably have a lot more to add.

2 MR. BERNSTEIN: Sure. I guess we -- this
3 is a good point to have Steve Malpezzi talk really
4 about the prerequisites for functional housing
5 finance.

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1 PRESENTATION BY STEPHEN MALPEZZI

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

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

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

23 But it actually goes quite beyond that,
24 even at the textbook level, which is -- once you
25 note that the financial system is about who has what

1 claims, you also realize that when you have a well-
2 functioning financial system, the pie gets bigger,
3 and the pie gets distributed -- another way of
4 defining it -- in better ways.

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

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

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

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

23 The first one is -- we talk about housing
24 finance all the time, but -- you know, I'd like to
25 say, "Well, we need to step back and think a lot

1 more about real estate finance." Everything is
2 connected to everything else. And some of the
3 previous speakers have talked about, you know, the
4 issues that arise in segmentation.

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

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

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

25 So, yeah, at one level, if you're trying

1 to get the attention of a macro-economist, often a
2 difficult thing to do, you whack them up the side of
3 the head with a two-by-four to get their attention
4 and say, "This is half the capital stock. If we
5 screw it up, this is a bad thing."

6 Again, we need to think about how other

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

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

20 Again, we also need to think about the
21 fact that housing is part of a broader process of
22 development. It's not only part of the capital
23 stock; it's tied in intimately with the patterns of
24 urbanization, GNP growth, generally. And again, a
25 lot of work, fundamental work, was done by Burns and

1 Grubber, you know, some 30 years ago, but -- and
2 Bertrand has also contributed to that literature. I
3 think it's something we need to come back and remind
4 ourselves of.

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

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

25 In a very different context, you know, a

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

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

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

1 confuse them.

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

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

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

22 It just -- it's a big problem, and it's
23 something that's sunk many institutions. We've been
24 -- over the past few years, have worked in Mexico,
25 when I was doing some contract work for the World

1 Bank, looking at one of their institutions, called
2 FOVI, which was saddled with -- their entire
3 portfolio was under water -- subsidized interest
4 rate mortgages. How do you get that out from --
5 above water? It's a very hard problem.

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

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1 PRESENTATION BY BRUCE FERGUSON

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

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

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

25 In most developing countries, housing gets

1 built by the great majority of the population, the
2 low-moderate income majorities, I like to put it --
3 60, 70 percent of the population; up to 80 percent
4 in many countries -- progressively. That is, houses
5 -- households get access to a lot through purchasing
6 a clandestine -- through purchasing it

7 clandestinely, often in illegal subdivisions where
8 they invade land or they purchase it legally.

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

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

21 Now, that difference, to simplify it,
22 causes some fundamental misunderstandings in housing
23 policies in developing countries, which have been
24 alluded to. The typical housing policy in
25 developing country is that government comes along,

1 and the private sector is not producing because of
2 all the distortions. In other words, high costs,
3 lack of markets in many different components of
4 housing, from regulations to basic services to
5 subsidies, to credit -- many things are screwed up,
6 and they create higher costs.

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

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

1 still. There's NHT, in Jamaica. There's they --
2 (inaudible) -- in Venezuela, Brazil.

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

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

15 So this is what we're dealing with when we
16 go into countries. It's countries like Mexico and
17 Brazil, amazingly, even right now have miniscule
18 private sector intermediation. I'd say less than
19 five percent of the -- of even house -- of even
20 mortgage loans that get made in those countries are
21 done at market rates. All the rest is subsidized.
22 In other words, it's based on something that is
23 unsustainable. Well, that's the broad problem.

24 Well, what does this context mean for
25 mortgage finance? I have to say that the news is

1 not -- yes, there is room for pushing more
2 traditional mortgage finance, including primary
3 markets and secondary markets, down market from the
4 five percent that is now the market -- that is now
5 served to 20, 30 percent of the population.

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

16 But the result is that the mortgage market
17 has definite problems going below a certain
18 threshold in these countries. Also, these
19 households live in an environment of great
20 instability. There's health crises. There's job
21 loss. Most of -- many of these low-mod- --
22 households in the low-moderate income majority do
23 not want a long-term -- a 30-year mortgage, which
24 requires large payments for a complete unit over a
25 long period of time. That is very dangerous for

1 them, and they don't want it, even if it were
2 available, which usually it's not.

3 So in this context, what does one do?

4 There is substantial room to go down market, both --
5 for both the primary and secondary mortgage market,
6 but there are also some interventions -- Stephen
7 alluded to some -- that are possible to move towards
8 markets in these systems. I'm going to briefly
9 mention two.

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

1 process of progressive housing.

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

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

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

23 However, I want to talk very briefly about
24 one exception. In El Salvador, apparently the
25 message got through. Things got so bad that they

1 really had to restructure their systems in basic
2 ways. They reformed their land and property-rights
3 system and development-regulation system to allow
4 progressive development of low-income lots. In El
5 Salvador, it is possible to develop a 100-square-
6 meter lot with water-stand pipes, with a -- say, a
7 dirt road and individual sanitation.

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

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

24 So, in conclusion, both of these are
25 market-oriented solutions that move us in the

1 correct direction.

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

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

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

22 For instance, a core unit that is
23 expandable is a bit reminiscent of the low-income
24 solutions that Levittown was for the veterans when
25 they returned from World War II -- that housed so

1 many people, including my nuclear -- my own family
2 in Rockville, Maryland, in one of those Levittown-
3 like subdivisions out there.

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

5 MR. BERNSTEIN: Thanks, Bruce. That was
6 great.

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1 COMMENTS BY STEVEN A. BERNSTEIN

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

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

21 So we had some contractors go out to the
22 Dominican Republic and say, "Well, for 36 square
23 meters, for, you know, a basic house with utilities,
24 how -- what's the lowest price you could do this
25 for?" And we found that with construction, that's

1 acceptable for the social environment there, which
2 means -- in Latin America, typically concrete
3 construction -- that you could -- excluding the cost
4 of land, you could put up a house -- a pre-fab
5 concrete house -- a very nice one, resistant to the
6 elements -- for about \$2,000.

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

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

25 But just another issue there, what we've

1 also found out is some interesting data. In the
2 barrio regions in Santo Domingo, very low-income
3 households, people are always concerned about --
4 what can they pay? They don't have verifiable
5 income, et cetera. Well, there's a couple of
6 things.

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

17 Part of that's due to their very good
18 hands-on servicing of the mortgages. You want to
19 make it easy for these -- for the low-income
20 households to pay their mortgage. These countries
21 don't have -- people don't have checking accounts.
22 You can't rely on sending cash through the mail.
23 And if you want to make a payment to a bank,
24 typically you have to take a day off from work, go
25 stand in line -- and I've done this before -- I've

1 done this in the Dominican Republic and in Mexico --
2 where you go, and you take a number, and it could be
3 four hours before somebody will call your name up.
4 You go up to the teller, and if you're lucky,
5 they'll be able to pull your record, calculate how
6 much you owe on your mortgage, and you make your
7 payment.

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

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

1 Can we work something out?"

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

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

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

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

25 And we're going to initially target one

1 barrio. I don't know how many households are in
2 there. Do you know, Madeline (phonetic)? We're
3 looking probably to affect at least three to four
4 thousand households if our OPIC project goes
5 through.

6 That said, I actually have one question,

7 and -- I have some ideas, but I want to throw it to
8 the panel -- and then we'll go on to Sally and Bob.

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

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

25 In other countries, I would say, perhaps,,

1 you know, the lack of competition. And then there's
2 a traditional problem of, well, how are you going to
3 make money on small loans? You have to raise the
4 interest rates. And if you raise the interest
5 rates, then you get bad press, because people say
6 you're being usurious and robbing low-income people.

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

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

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

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

24 MR. BERNSTEIN: Sure. This is Leslie
25 Theodore. She's from ACCION, and she's working with

1 us on our Dominican and Honduran programs.

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

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

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

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

1 institutions to do that.

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

6 MR. BERNSTEIN: Great. Go ahead.

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

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

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

15 MR. BERNSTEIN: Leslie.

16 MS. THEODORE: Leslie.

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

22 MR. BERNSTEIN: Your income taxes.

23 MS. MARTINEZ: -- and everything else, you
24 know, so -- but when we look at finance in this
25 country, and we try to impose models of a developed

1 economy, we're going to get a great deal of
2 frustration. And I think if we were to step to the
3 beginning of our finance system in the 1930s, we
4 would find that our finance system would be a
5 luxury. The 1930s finance system would be a luxury
6 in many other nations.

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

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

22 And so I would hope that in our
23 discussion, we would veer more towards some of these
24 lesser -- less grandiose schemes, I think -- they
25 seem to be less grandiose but which I think have

1 great promise. And that is the role of the NGOs as
2 the financial intermediary and the role of the
3 government in a different role, because I still
4 think there's a different role for the government to
5 play to step back in there, but not a state banks or
6 not a subsidized housing providers, which doesn't
7 work.

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

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

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

23 Another romantic notion is that whatever
24 is noninstitutional is, by definition, more worthy,
25 socially and otherwise. The NGO model -- the

1 romantic -- (inaudible) -- the John Turner
2 (phonetic) vision -- everything that is against the
3 state is right because the state's were so wrong 20
4 -- or 40 years ago -- that is also disappearing from
5 the picture completely.

6 And the third point that has also been

7 brought up is that we're much more explicit about
8 managing risks, the risks for the households that
9 are very much low income, the risk for the lender
10 that is also undercapitalized, especially the low-
11 income lenders -- every time there is macro-economic
12 shocks, they can go under because they don't have
13 enough capitals -- and eventually, the risk to the
14 governments.

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

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

1 very different picture.

2 MR. BERNSTEIN: Go ahead, Bruce.

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

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

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

23 But I think even more so in developing
24 countries, there's room for a wide range of
25 institutions and organizations to fill various

1 niches along that path that is a path of many, many
2 diverse types of housing solutions and many, many --
3 and an income range that is also very wide.

4 So I don't think we're talking about just,
5 you know, \$500 micro-finance loans and \$20,000 or
6 \$30,000 loans to the upper-middle class. It's a
7 much wider range of -- a much broader spectrum, and
8 you have -- (inaudible). You've got, you know,
9 credit unions. You've got -- in addition to -- you
10 have micro-finance lenders and multi-national banks
11 on one side, you have everything from credit unions,
12 financial NGOs that become regulated financial
13 institutions and many other sorts of institutions in
14 between, filling this.

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

18 MR. BERNSTEIN: That's an excellent point.
19 One of the things Bertrand hit on, too, is this --
20 is the -- you know, managing the risks. And I think
21 in the past, NGOs had somewhat of a bad rap because
22 they were seen as not pricing risk properly and
23 subsidizing interest rates. And I see that
24 changing.

25 I know the HUD programs -- we're very

1 cognizant of trying to measure risk -- credit risks,
2 exchange risks, liquidity risk, the entire gamut.
3 And it's sort of a new world, going into countries
4 that don't have a lot of data with which to work.

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

13 So, Sally, if she -- you could talk about
14 some of this, I would appreciate it.

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1 trying to create a distribution of households that's
2 mainly based on income, but it -- we were -- tried
3 to make it free of nominal dollars of income and
4 focus on the different barriers all the way from
5 bankable households without access to the system --
6 and in many emerging countries, that means that,

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

18 Let me just skip to some of the findings.
19 Most of the international team that I worked with
20 has been working in international housing finance
21 trying to just put the basics in order -- the basic
22 legal systems, financial infrastructure,
23 administrative infrastructure that we understand
24 here is what makes a housing finance system work.
25 And one of our other colleagues long ago dubbed this

1 the "enabling framework." And I agree with John
2 that everybody talks "market" now, but we can -- we
3 can sing that song. It's not so -- it's not so
4 easy. Not all of these countries are there.

5 What's surprised me over the years is the
6 amazing similarities and stubborn problems, whether
7 you're in Russia, Poland, Algeria, or Zimbabwe. Old
8 habits die hard. They want price controls on their
9 housing. They want subsidized interest rates. They
10 want cross-subsidization of interest rates.
11 Foreclosure laws may go on the books, but to effect
12 them is another story. There are strong social
13 traditions that have to work themselves out.

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

20 But that said, there's a lot else going
21 on. In most of the countries, we found one very
22 distinct difference from the U.S. They're --
23 traditional mainstream banks going down market is
24 probably not the answer right now, at least not on
25 their own. South Africa is the only country that I

1 know about where CRA-type legislation is actually
2 being drafted, but it's very controversial as to
3 whether it's relevant.

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

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

22 And what has happened -- and this will
23 come back to the comments made by the ACCION people
24 -- is partnerships -- partnerships all over the
25 place. It's quite amazing.

1 The NGO model of serving the poorest of
2 the poor, I think is recognized everywhere as too
3 self-limiting and too focused on a project-by-
4 project kind of a basis which really can't
5 accomplish anything at scale, but they have certain
6 comparative advantages which can be used to great
7 advantage by community development finance
8 institutions.

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

25 Okay, I've hit on the strengthening of the

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

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

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

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

20 Credit enhancement mechanisms -- a whole
21 variety of very interesting stuff -- and this feeds
22 on both strengthening the primary market and the
23 secondary market -- in the U.S., there's an
24 excellent example of a credit union in North
25 Carolina that uses a Ford Foundation grant as a

1 credit enhancement to sell mortgages that wouldn't
2 otherwise be eligible into the secondary market.

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

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

23 In addition, there are foundation funds
24 that, again, provide a credit enhancement against
25 the on-lending of these funds to -- I don't want to

1 call this a CDFI, because it isn't formalized that
2 way -- but it's NGO's searching for ways to be -- to
3 enter the traditional financial sector.

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

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

20 There are other examples of having the
21 price differ when counseling is mandatory, versus
22 not mandatory -- non-mortgage loans, where the
23 house is not the collateral -- other collateral is
24 used, whether it's a pension fund, jewelry, or, in
25 some cases, none at all, payroll deduction -- all of

1 this, of course, is -- are examples of flexible
2 underwriting.

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

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

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

22 MR. BERNSTEIN: Actually, you get me going
23 on this stuff, 'cause we had a lot of discussions
24 based on Sally's study. And, you know, so -- when
25 we were designing our Central America work, things

1 we emphasized where mandatory savings schemes,
2 aggressive consumer education -- which ACCION is a
3 pioneer in doing, by the way -- and progressive
4 servicing.

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

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

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

23 I'm in the process of setting up a policy
24 work group on secondary market issues that -- to
25 date, what's happened in Israel is that the

1 government has taken most of the obstacles out for
2 securitization mortgages. There are some public-
3 policy issues, however, that need to be addressed in
4 what is the government's role in going down market.
5 And hopefully we'll be able to establish a dialog
6 with the Israeli government to help them sort that

7 out. We obviously have a lot of experience with
8 George's group and with our FHA.

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

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1 PRESENTATION BY ROBERT VAN ORDER

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

8 But whatever the lesson is, it's a subtle
9 one; it's not the lesson that going around the world
10 creating Freddie Macs or, even worse, Fannie Maes --

11 (Laughter.)

12 MR. VAN ORDER: -- is -- that's a joke,
13 not an editorial --

14 (Laughter.)

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

24 And the first one is -- Bertrand talked
25 about how boring housing finance was 20 years ago.

1 It was about then I started studying it. It was,
2 indeed, quite, quite boring. Much of it involved,
3 in the United States, looking for pots of money.
4 The S&Ls were a pot of money. The public policy
5 issue was something like a deposit-rate differential
6 that ensured they had the pot of money. Part of the

7 reason for wanting a secondary market was the
8 pension funds where a pot of money. The life
9 insurance companies were a pot of money -- could we
10 get to that pot of money?

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

25 Second, the legal structure is extremely

1 important. What I mean by that is things like
2 registration and all of that, but especially
3 foreclosure and eviction. It's extremely important
4 that you be able to throw people out of their
5 houses, if you want to have a mortgage market.

6 And if you look at the evolution of the
7 United States and home -- you know, the biggest
8 advice I can give another country is that what they
9 really need is 800 years of Anglo-Saxon common law.
10 And then they'll be fine. But if you look at the
11 rise of home ownership in the United States, the
12 action really hasn't happened since Fannie and
13 Freddie. I think we've contributed, but the home
14 ownership rate in the United States was in the low
15 40s in the second World War, but then it went up to
16 62 percent by 1960.

17 Why? Well, there were -- of course, there
18 were a lot of reasons. There were demographics and
19 things, but an awful lot of it was we had a good
20 mortgage system and a good legal structure. We
21 didn't know about -- I wasn't around then -- well,
22 at least not as a grownup -- but we didn't know
23 about credit history and credit scoring and swaps
24 and guarantor programs, but we had a legal system
25 that said if you put 20 percent down on your house,

1 you have a relatively stable economy and a savings
2 and loan history that can attract funds, that's
3 pretty stable. We'll throw you out of your house if
4 you don't pay. And the result of that is on the
5 order of about only two percent of the mortgages in
6 the United States go through foreclosure. That's
7 important.

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

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

24 What matters is there are simply different
25 ways of moving money into the mortgage market. The

1 dichotomy between the secondary market and, say, the
2 depositories, which have been the main other
3 alternative, is traditionally, in the United States
4 -- or traditionally, meaning the last 20 years, with
5 Frannie and Freddie -- the vehicle was
6 securitization and going into the capital markets,
7 whereas the vehicle was depositories. They were
8 both there. And the distinction was that.

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

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

1 eclectic way.

2 Bertrand mentioned "past dependence."
3 That's a sexy term in the economics. It's even
4 gained some notoriety among peers. But where you
5 start matters, because the more you try to get away
6 from it quickly, of course, the more mistakes you
7 can make.

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

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

23 They think they can write contracts now
24 that can actually be enforced, so that maybe there
25 is a legal framework. There's a secondary market

1 institution of a sort that's growing up that's
2 developing the primary market at the same time
3 through the banks, and it's working on underwriting
4 standards. Fannie Mae has worked with the Urban
5 Institute in Moscow, has been a part of it, and some
6 of it came, indeed, from a pot of money from the
7 U.S., but that's an area where all of the things are
8 happening at once.

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

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

1 institution, but it's a capital-market institution.

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

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

19 And so I think I'll stop there.

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

1 mortgage lending and to enforce contracts.

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

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

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

20 MS. MARTINEZ: I'm going to throw this
21 issue out, and that's the whole issue of access to
22 the capital markets, because one of the problems
23 that the countries face is currency changes. And it
24 was mentioned at first, but it's a huge issue. It
25 was a huge issue in Mexico.

1 And then the question is who bears the
2 risk of the currency change? Mexico had a dual-
3 index mortgage in which, basically, the consumer was
4 the one who absorbed the risk. And, of course,
5 there were foreclosures, and people just walked away
6 from their homes. And so there was a problem there.

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

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

19 MR. BERNSTEIN: I just want to -- I kind
20 of agree with you. One of the issues we're really
21 dealing with is how do you spread the risk, and I
22 should have talked this a little bit more. But we
23 do believe that in a lot of policy -- it's been
24 contra to this in various countries -- is that the
25 borrower should share at least part of this risk.

1 And we believe in pricing some of the risk into the
2 mortgage instruments, et cetera.

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

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

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

22 MR. RENAUD: I have two quick points. First of
23 all, I would go back to Bob's. One of the
24 advantages of doing international work is that you
25 understand your national system better. And it's

1 not flippant what I'm trying to say.

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

11 (Laughter.)

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

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

24 And, therefore, the real issue is, what is
25 the role of the government in managing this risk for

1 the housing finance system? Because if you have a
2 crisis -- let's say Colombia, today -- if you shut
3 off the financial -- the whole mortgage-finance
4 system, which is 30 percent of the banking access of
5 Colombia, and you have 20 percent unemployment, you
6 are going to get more if you shut off the system.

7 And so I think that wherever we are, it's
8 very important that we try to figure out who bears
9 the risks and why.

10 MR. FERGUSON: Yeah, I -- this one? Yeah,
11 I'd like to echo that. I think -- you know, as they
12 say in Mexico, if -- foreign exchange risk is "el
13 giste" -- it's "the joker." I mean, it's what kills
14 access to international capital markets for many
15 countries -- not just for housing. I mean, we're
16 talking about housing as a subset of financial
17 institutions.

18 MR. RENAUD: My point was not about access
19 to capital markets.

20 MR. FERGUSON: Okay.

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

1 is going to be wiped out.

2 MR. FERGUSON: Okay.

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

5 MR. FERGUSON: Okay.

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

8 MR. FERGUSON: Okay, I agree totally. I
9 mean, it kills your access to the capital markets --
10 international and domestic. I don't know -- I mean,
11 there's always the -- you know, I think that's --
12 there's a lot of reforms that are proposed at a very
13 macro level, I think, to party deal with that.
14 Dollarization -- the whole debate around
15 dollarization in Latin America has that as one of
16 its fundamentals.

17 And there's proposals to create regional
18 currencies now out that have really -- if you look
19 underneath them, housing and housing finance is one
20 of the things driving it, because it's the asset
21 that requires -- at least, you know, for the upper
22 30 percent of the population -- the longest term.

23 MR. RENAUD: If I may step in here, I
24 think one contribution that the U.S. could make is
25 in countries where the markets are quite small, like

1 in Central America, and they have a hard time
2 getting to a regional structure. What is it that
3 could be done to have some regional capital markets
4 in small -- so I'm throwing that question -- can you
5 contribute something as a capitalist? I don't know.

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

12 I have one quick -- one final comment
13 about risk sharing -- to be really careful about
14 risk sharing, because risk sharing can end up being
15 risk shifting. And if risk sharing and shifting
16 risks from people who know more about it to people
17 to who know less about it, that -- as has -- as is,
18 of course -- as is, of course, typically the case,
19 that can be quite dangerous. You want to be careful
20 about institutionalizing that. A lot of the -- well
21 --

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

25 MR. VAN ORDER: Absolutely. We still have

1 some bad multi-family loans that vouch for that.

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

9 (Applause.)

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

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