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A FUNDAMENTAL HUMAN RIGHT: EXPANDING ACCESS TO AFFORDABLE HOUSING FOR LATIN AMERICA'S LOW- AND MIDDLE-INCOME FAMILIES

*Jordan Rand**

THERE is a critical need for an overhaul of Latin American housing policy to address the dearth of available and affordable housing for low- and medium-income families. The severe housing shortage has far-reaching effects on the Latin American economy as a whole. The availability of adequate housing is of vital importance to a prosperous society, and recognition of the relationship between adequate housing and human dignity is not new.¹ In fact, access to adequate housing was first recognized by the United Nations as a fundamental human right in 1948.² This fundamental human right, however, is not being met by current Latin American policies.

Nearly 65 percent of the Latin American population cannot afford to buy even the cheapest new homes.³ Equally discouraging is the fact that nearly every Latin American country faces a dire shortage of housing, as measured by available "dwelling units."⁴ As this comment will demonstrate, the housing crisis in Latin America is attributable to a combination of ineffective housing and finance policies, and legislative and judicial barriers to an efficient marketplace.⁵ Latin American governments, policy makers, and financial institutions must take immediate action to remedy this housing crisis. The situation is rendered even more imperative by the fact that Latin America's urban population is growing at a rate of 4.5 percent per year, with urban-dwellers accounting for three-fourths of

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1. See, e.g., Miloon Kothari, Special Rapporteur to United Nations's Third Conference in Brussels on Least Developed Countries: Adequate Housing as a Component of the Right to an Adequate Standard of Living (May 14-20, 2001), <http://www.unhchr.ch/housing/stat24ga.htm>.

2. Universal Declaration of Human Rights, G.A. Res. 217A (III), pt. 1, art. 25(1), U.N. GAOR, 3d Sess., U.N. Doc. A/810, at 76 (Dec. 10, 1948).

3. Bruce Ferguson, *Housing Finance Options for Low and Medium Income Families: Analysis of the Latin America Experience*, 18 HOUSING FIN. INT'L 11, 11-12 (2004).

4. Gerardo M. Gonzalez, *Building Sustainable Housing Finance Markets: Proceedings of the Housing Finance Roundtable in the Andean Region*, 19 HOUSING FIN. INT'L 7, 8 (2005).

5. *Id.*

the total population.⁶ In fact, “[b]y 2015, the United Nations projects nine Latin American cities will have 5 million or more residents, with a combined population of more than 100 million people.”⁷

The focus of this comment will be an analysis of the current state of the Latin American housing and mortgage finance markets, and an exploration of some viable options to increase the availability of affordable housing and the accessibility of mortgage options for low- and medium-income Latin American families. The needs of this segment of the Latin American population are not being met by current policies. The solution to the current problem is two-fold: introducing legislation to encourage the development of sustainable residential mortgage markets in Latin America, and increasing the number of available dwelling units to meet the anticipated population demands.

This comment recommends that the former be accomplished by lessening judicial and legislative restrictions on foreclosures and evictions for defaulting borrowers, and encouraging the continued development of a secondary mortgage market to diversify risk. The latter part of the solution can be accomplished through a variety of means, such as direct housing subsidies, direct government subsidization for the lowest-income Latin Americans, increasing micro-financing options to enlarge and improve existing structures, and reducing legislative barriers to land titling and ownership.

I. THE HOUSING AND MORTGAGE MARKETS IN LATIN AMERICA

A. LATIN AMERICAN MORTGAGE MARKET

1. Historical Considerations

One of the major factors affecting the overall health of Latin American housing is the lack of robust mortgage markets. The majority of low- to medium-income Latin American families have limited or no access to traditional mortgage financing; this is one of the most significant factors contributing to the lack of adequate and affordable housing in Latin America.⁸ The relationship between the financial markets and the availability of housing is symbiotic—one needs the other. When you consider that the average home in Latin America costs close to six times a typical family’s annual income,⁹ it is shocking that “less than one-fourth of all housing in Latin America is financed through formal mechanisms, and

6. Jorge A. Brea, *Population Dynamics in Latin America*, POPULATION BULL. (2003), http://www.findarticles.com/p/articles/mi_qa3761/is_200303/ai_n9173891.

7. *Id.*

8. ANOOP SINGH ET AL., *Latin American Financial Systems: Crises and Reforms*, in STABILIZATION AND REFORM IN LATIN AMERICA: A MACROECONOMIC PERSPECTIVE ON THE EXPERIENCE SINCE THE EARLY 1990s 63 (Int’l Monetary Fund, Occasional Paper 238, 2005) <http://www.imf.org/external/pubs/ft/op/238/index.htm> [hereinafter *Latin American Financial Systems*].

9. Inter-American Development Bank, Research Department, *Housing Finance in Latin America: Time to Build a Better Market*, 4 IDEA (IDEAS FOR DEVELOPMENT

housing mortgage credit accounts for a small fraction of total credit.”¹⁰ Encouraging the continued, lasting development of the residential mortgage market, thereby increasing access to financing and reducing the massive burden on homeownership, is thus of paramount importance to any sound Latin American housing policy.¹¹

Mortgages are the primary means of financing housing throughout much of the world, including the United States, Europe, and most of Asia.¹² The mortgage instrument has been in use for several hundred years, and mortgages have historically played a tremendous “role in improving . . . [the] . . . economy and society.”¹³ Like the United States, mortgages in Latin America consist of loans payable over a “fifteen to thirty year period for the acquisition of new housing for families from the formal sector”¹⁴ But despite the undeniable importance of mortgages in acquiring housing, the development of a residential mortgage market in Latin America has been exceedingly slow. For example, in the United States, “mortgage loans as a percentage of GDP is [*sic*] almost fifty percent.”¹⁵ In Argentina, Brazil, Chile, and Mexico, the percentages are 2.1 percent, 2.4 percent, 9.5 percent, and 8 percent, respectively.¹⁶ This situation is representative of a severely underdeveloped mortgage market. The reasons for this are two-fold: Latin America has historically suffered from serious financial instability, and many of Latin America’s low- and medium-income families do not have access to credit from traditional banks.¹⁷

2. Banking Systems

The financial systems in Latin America are primarily based on public and private banks,¹⁸ and Latin American countries generally have poorly-developed and illiquid securities markets.¹⁹ Moreover, Latin America’s “banking systems are shallow and the scope of their activities is very nar-

IN THE AMERICAS) 1, 1, available at <http://www.iadb.org/res/publications/pubfiles/pubi-vol4e.pdf>. [hereinafter *Housing Finance in Latin America*].

10. *Id.*

11. Gerardo M. Gonzales Arrieta, *Mortgage Loans and Access to Housing for Low-Income Households in Latin America*, 85 CEPAL REV. 111, 112 (2005) [hereinafter Arrieta, *Mortgage Loans*].

12. Ferguson, *supra* note 3, at 11-12.

13. Morris G. Shanker, *Will Mortgage Law Survive? A Commentary and Critique on Mortgage Law's Birth, Long Life, and Current Proposals for Its Demise*, 54 CASE W. RES. L. REV. 69, 70 (2003).

14. Ferguson, *supra* note 3, at 12.

15. Georgette Chapman Poindexter & Wendy Vargas-Cartaya, *En Ruta Hacia El Desarrollo: The Emerging Secondary Mortgage Market in Latin America*, 34 GEO. WASH. INT'L L. REV. 257, 262 (2002).

16. *Id.* at 262-63.

17. *Latin American Financial Systems*, *supra* note 8, at 63.

18. *Id.*

19. *Id.*

row.”²⁰ Latin America’s “banking systems remain relatively small compared with GDP, and the depth of intermediation is particularly low.”²¹ Compared with the “East Asian emerging markets” with ratios over 90 percent, “Deposit-to-GDP ratios” in Latin America are less than 50 percent.²²

Latin America experienced tremendous credit growth in the 1990s, but a series of banking crises crippled the industry and drastically reduced the availability of credit.²³ Throughout this time of financial upheaval, Latin American capital markets were unable to serve as sources for “medium to long-term funding.”²⁴ Over the long-term, “[t]he pattern of credit growth in Latin America has been marked by boom-bust cycles.”²⁵ “Argentina, Brazil, and Mexico all follow this pattern,” while Chile’s credit growth has been much more uniform due to economic stability and reforms in its financial markets.²⁶ During the constriction of Latin America’s capital markets, lenders looked to the United States and Europe for investors, because most foreign investors did not find Latin America’s tumultuous financial markets a risk worth taking.²⁷

Latin America’s banking system operates in an environment that actually appears to discourage lending.²⁸ This is due to a combination of both governmental and financial factors. Latin America’s “historic experience with inflation, social instability, and currency weakness” has undermined public faith in the banking system.²⁹ Also, an “inefficient judiciary” has repeatedly failed to protect the interests of creditors in the region.³⁰ The civil law legal systems found in all Latin American countries “have the weakest legal protections of investors” when compared with common law systems.³¹ In common law systems, the interests of creditors are adequately protected against defaulting borrowers; in the event of default, a creditor can foreclose on the property that serves as security for the loan amount. But in many Latin American countries, due to legislative and judicial restraints on the ability of a creditor to foreclose on a home, the creditor must engage in a multi-year battle before finally obtaining a foreclosure.³²

Banks in Latin America do retain a strategic “advantage in the costly collection and processing of information that is central to financial inter-

20. Joseph J. Norton, *An Interim Filling the Gap in Multilateral, Regional, and Domestic Hard Law Deficiencies. Respecting Financial Services Integration within the Americas*, 12 L. & BUS. REV. AM. 153, 169 (2006).

21. *Latin American Financial Systems*, *supra* note 8, at 64.

22. *Id.*

23. *Id.*

24. Poindexter, *supra* note 15, at 260.

25. *Latin American Financial Systems*, *supra* note 8, at 64.

26. *Id.*

27. Poindexter, *supra* note 15, at 260.

28. *See* Norton, *supra* note 20, at 169.

29. Poindexter, *supra* note 15, at 259.

30. Norton, *supra* note 20, at 169.

31. *Id.*

32. *See infra* text accompanying notes 75-87.

mediation.”³³ But Latin American banking systems still remain relatively inefficient in terms of their ability to engage in credit transactions.³⁴ In 2000, the “Central Bank of Brazil reported that roughly one third of the cost of commercial credit (with rates in excess of thirty percent) was attributable to the creditors’ inability to collect on loans or to realize on loan collateral.”³⁵ Latin American “[b]anks’ operating costs . . . [amount] to more than 90 percent of operating income, which is about a third higher than banks in advanced countries.”³⁶ This inefficiency is estimated to cost Latin American countries over 10 percent of their GDP.³⁷ The weak performance by Latin American banks is due, in part, to its “continued reliance on interest earnings.”³⁸ Competition from industrialized nations, new sources of funds from Asia, and globalization in the banking sector have driven down the margins on traditional bank products.³⁹

Also because of high inflation, Latin American banks have historically shied away from lending money for terms longer than three years.⁴⁰ As a result, mortgage credit is totally unavailable to approximately 50 to 70 percent of the Latin American population.⁴¹ Where mortgage credit is available, borrowers are often required to put as much as 50 percent down to qualify for a loan.⁴² “The unavailability and high cost of credit” in Latin America is a reflection of risk and the “inability to obtain payment in . . . consumer loans quickly and inexpensively.”⁴³

Even if potential Latin American borrowers could afford the huge down payment and qualify for the mortgage loan, with interest rates hovering in the range of 15 to 20 percent, mortgage loans are prohibitively expensive.⁴⁴ The situation is even worse in Brazil, where the interest rate charged on a one-year consumer loan averaged nearly 62 percent as of May 2006.⁴⁵ Just a year earlier, the average rate of a one-year consumer loan was 69 percent.⁴⁶ Because of these incredibly high interest rates, there is evidence showing that as of 1998, only “one to fifteen percent of the houses in Latin America had mortgages.”⁴⁷ In Panama, for example,

33. *Latin American Financial Systems*, *supra* note 8, at 63-64.

34. See Boris Kozolchik, *Meeting of OAS-CIDIP-VI Drafting Committee on Secured Transaction Conference Transcript*, 18 ARIZ. J. INT’L & COMP. L. 321, 324 (2001) [hereinafter *OAS-CIDIP-VI Drafting Committee*].

35. *Id.*

36. Norton, *supra* note 20, at 169-170.

37. *OAS-CIDIP-VI Drafting Committee*, *supra* note 34, at 324.

38. *Latin American Financial Systems*, *supra* note 8, at 68.

39. *Id.*

40. Poindexter, *supra* note 15, at 260.

41. Ferguson, *supra* note 3, at 11-12.

42. Poindexter, *supra* note 15, at 262.

43. *OAS-CIDIP-VI Drafting Committee*, *supra* note 34, at 324.

44. Poindexter, *supra* note 15, at 262.

45. Guillermo Parra-Bernal, *Brazil Bank Loans Rise Fastest in Five Months in May (Update 3)* BLOOMBERG.COM, June 26, 2006, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=arbDmqkIen4>.

46. *Id.*

47. Poindexter, *supra* note 15, at 262.

"only 10% of homes are mortgaged."⁴⁸ The rate of mortgaged homes is even lower in the Dominican Republic, only accounting for 2 percent of the households in that country.⁴⁹ In Mexico, widely believed to be at the forefront of affirmative mortgage financing policy, "only 'one in five homes . . . carries mortgage financing.'"⁵⁰ And in Argentina, "only five to ten percent of homeowners have mortgages."⁵¹

3. *Causes of Financial Instability in Latin America*

This situation is a result of the convergence of a variety of distinct factors. By itself, each factor may or may not play a substantial role in suppressing the mortgage market. But in unison, these factors have all contributed considerably to the present situation. Weakness in the Latin American financial systems,⁵² high risk of default by borrowers, barriers to recovering money from delinquent borrowers, exceedingly low incomes, a disconnect between the "typical maturities of savings deposits and credits," the lack of property titles, and legislative barriers to evicting delinquent borrowers have all contributed to the stagnation of the residential mortgage market in Latin America.⁵³

Compounding the financial troubles facing the struggling mortgage market is the fact that a secondary market for mortgages is only recently beginning to emerge.⁵⁴ The importance of a secondary mortgage market cannot be overstated. By solely relying on banks, without a robust secondary mortgage market to spread risk, Latin America cannot meet the demands of a burgeoning mortgage market.⁵⁵ Gerardo M. Gonzales Arrietta explains:

Loans originated by these institutions remain as assets on their balance sheets for the entire length of the loan. Lending institutions also take charge of administering and collecting payments on these loans. In other words, they perform all the functions of the mortgage process: funding and loan origination and servicing. That these institutions grant long-term loans with short-term savings [from deposits] exposes them to potential risks of mismatch of maturities, and possibility of rates, where ceilings exist on mortgage interest; these risks are concentrated in lending institutions.⁵⁶

The secondary market for mortgages serves to reduce these risks by getting the loan off the bank's balance sheets before maturity, thereby allowing the bank to make new loans.⁵⁷ But the fragility of Latin America's primary mortgage markets cannot be overlooked. The pri-

48. Ferguson, *supra* note 3, at 12.

49. *Id.*

50. Poindexter, *supra* note 15, at 262 (internal citation omitted).

51. *Id.*

52. *Latin American Financial Systems*, *supra* note 8, at 70.

53. *Housing Finance in Latin America*, *supra* note 9, at 1.

54. See generally Poindexter, *supra* note 15.

55. See Arrieta, *Mortgage Loans*, *supra* note 11, at 113.

56. *Id.* (translated by the author).

57. *Id.*

mary mortgage market is the engine that drives a secondary market for mortgage backed securities.⁵⁸ Without high-quality loans that can be securitized and sold into the secondary market, the health of the Latin American housing and financial markets will not improve.

Other systemic factors contributing to the overall weakness of the Latin American financial systems are low levels of savings, "macroeconomic instability," "risk perceptions," and "volatile capital flows."⁵⁹ The low overall level of savings in Latin American countries is largely a result of low wages in the region.⁶⁰ But there is not a clear link between per capita GDP and the rate of savings and, importantly, "countries with higher savings rates also had larger loan-to-GDP ratios."⁶¹

Macroeconomic instability in Latin America is largely a result of the financial crises so common throughout the region.⁶² The 1994 devaluation crisis in Mexico is a prime example of one of the many problems the region has faced.⁶³ "In 1994 Mexico's crawling peg exchange rate system collapsed and plunged the country into a deep recession despite massive financial assistance from the international community."⁶⁴ In an event known as the "tequila effect," many of Mexico's Latin American neighbors "experienced significant capital outflows."⁶⁵ During this crisis, the "default rate of mortgages soared, banks abandoned mortgage lending, and costly governmental intervention took place."⁶⁶ This occurrence demonstrates the catastrophic effects that similar events have on the overall macroeconomic health of the region. And Mexico is not alone; many countries throughout Latin America still have "inflexible exchange rate regimes and excessive fiscal deficits" and are constantly confronted with the risk of inflation or hyperinflation.⁶⁷ In Latin America, the typical response in the mortgage markets to these inflationary pressures is the creation of "floating rate . . . [or] single- or double-indexed mortgages."⁶⁸ These schemes have reduced the ability of borrowers to pay for their loans, and have threatened the stability of the mortgage markets.⁶⁹ As a result, Latin America is plagued with chronic inflation and heavy economic losses leading to widespread fear that Latin America is too risky an investment.⁷⁰

The risk perceptions are a major factor in the underdevelopment of primary mortgage markets in Latin America.⁷¹ The repeated financial

58. See *infra* Part II.B.1.

59. *Latin American Financial Systems*, *supra* note 8, at 70-73.

60. *Housing Finance in Latin America*, *supra* note 9, at 2.

61. *Latin American Financial Systems*, *supra* note 8, at 70.

62. *Id.*

63. Poindexter, *supra* note 15, at 261.

64. *Id.* at 261 n.14.

65. *Id.*

66. Gonzalez, *supra* note 4, at 9.

67. *Latin American Financial Systems*, *supra* note 8, at 70.

68. Gonzalez, *supra* note 4, at 9.

69. *Id.*

70. *Latin American Financial Systems*, *supra* note 8, at 70.

71. OAS-CIDIP-VI Drafting Committee, *supra* note 34, at 324.

crises in Latin America “followed by deep restructuring has resulted in a lack of adequate information on potential borrowers,” and “[m]any long-time bank customers disappeared; and the new ones . . . did not have long credit histories . . . or did not have good collateral.”⁷² The risk perceptions were also increased due to unprofessional practices in originating loans, such as basing creditworthiness on personal relationships rather than sound lending principles.⁷³ Moreover, the inefficient laws addressing bankruptcy and foreclosure frightened away potential investors. As a result of these occurrences, banks in Latin America became extremely risk-averse at a time when the demand for credit was drastically increasing.⁷⁴

Compounding the ups and downs of the Latin American financial sector was the roller coaster-like influx of capital from abroad. During the 1990s, the “implementation of exchange rate-based stabilization programs, the introduction of structural reforms, and often high domestic interest rates triggered a rapid buildup of short-term capital inflows to Latin America.”⁷⁵ These inflows, which went from U.S. \$10 billion in 1983-90 to U.S. \$62 billion in 1996, triggered rapid expansion in Latin America, and led to high inflation during the 1990s.⁷⁶

In addition to the systemic factors suppressing the growth of mortgage markets, legislative controls that prevent mortgage lenders from evicting defaulting borrowers and foreclosing on their properties are additional factors that greatly suppress growth.⁷⁷ In many Latin American countries, various legislative policies enable defaulting borrowers to delay or outright prevent lenders from evicting them for many years.⁷⁸ Argentina has yet to harmonize its eviction laws, and “costs and time involved . . . varies from one jurisdiction to another because of different rules and regulations.”⁷⁹ In 2001, Argentina’s lawmakers even went so far as to institute a twenty-one month ban on mortgage foreclosures.⁸⁰ In 2003, Argentina’s President sought to extend the ban.⁸¹

Even without active executive intervention against foreclosures, the foreclosure process in Argentina can take as long as two years to complete. The same is true for Mexico, where the foreclosure process takes almost two years.⁸² The situation is even more dire in Uruguay, where legal proceedings to evict a non-paying borrower can take as long as six

72. *Latin American Financial Systems*, *supra* note 8, at 72.

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *Housing Finance in Latin America*, *supra* note 9, at 1-2.

78. *Id.* at 1.

79. *Id.*

80. *Argentina to Extend Ban on Mortgage Foreclosures (Update 1)*, BLOOMBERG.COM, Sept. 30, 2003, http://quote.bloomberg.com/apps/news?pid=10000086&sid=a8Dx3H2p6XSk&refer=latin_america#.

81. *Id.*

82. Poindexter, *supra* note 15, at 262.

years.⁸³ Brazil is by far the worst, with foreclosure laws delaying recovery for up to seven years.⁸⁴ These policies, while intended to protect debtors from losing their homes, only serve to stifle residential mortgage lending and exacerbate the existing shortage of mortgage options and available housing. As an example of the economic cost of these ineffective policies, the foreclosure-associated "legal fees and related costs in some countries" can be as high as "one-third [to] one-half of the total value of mortgages worth \$50,000 or less."⁸⁵ Because of this incredible potential risk to lenders, it is not surprising that many are unwilling to lend money to the low- and medium-income families that truly need the mortgage financing.⁸⁶

Adding to the financial and regulatory factors affecting the availability of mortgage financing is the low income level of most potential buyers in Latin America.⁸⁷ "About half of Latin America's population lives with per capita earnings of less two dollars per day, while 10 percent of the population earns 50 percent of the region's total annual income."⁸⁸ This earning discrepancy prevents low- and medium-income families from qualifying for traditional loans and mortgage credit, and further contributes to the lack of adequate funding options for low- to middle-income families.

The combination of factors affecting the development of a mortgage market in Latin America must be immediately addressed to create the type of vigorous and sustainable market the region so desperately needs. The banking systems that currently support the vast majority of lending in Latin America are not capable of meeting the future lending needs of Latin American families. There is a need for an array of modern lending programs that can adapt to: (1) the overall low income levels in the region; (2) the existing instability of the Latin American financial markets; and (3) the nontraditional building and home expansion patterns of Latin American families. But in unison with modifying the Latin American lending system, the housing market must be addressed as well. Aggravating the situation is the increasing shortage of adequate and available housing to meet the growing Latin American population, especially in the urban centers.⁸⁹

B. AVAILABILITY OF ADEQUATE HOUSING IN LATIN AMERICA

It is estimated that, worldwide, personal residences account for nearly 75 to 90 percent of total household wealth.⁹⁰ But in many Latin Ameri-

83. *Housing Finance in Latin America*, *supra* note 9, at 1.

84. Poindexter, *supra* note 15, at 262.

85. *Housing Finance in Latin America*, *supra* note 9, at 2.

86. *See id.*

87. *See id.*

88. *Id.*

89. *See* discussion of blossoming urban population in Latin America, *infra* text accompanying notes 6-7.

90. Gonzalez, *supra* note 4, at 8.

can countries, there is a tremendous lack of adequate and available housing to satisfy the needs of low- to moderate-income families.⁹¹ The inadequate housing situation so common in Latin America is a major contributor to the perpetuation of poverty and substandard living conditions throughout the region.⁹² Because many of the low- and medium-income families cannot “easily buy, sell, or borrow against their housing[,] [t]hey are thereby denied the benefits of financial leverage in real estate, a means of upward mobility for many in other regions.”⁹³ Furthermore, Latin American families without homes are unable to take advantage of other sources of revenue a home provides, such as its use for micro-enterprise or as an income-producing asset.⁹⁴ “The vast majority of the working poor are self-employed and do not have fixed incomes.”⁹⁵ For these Latin Americans, access to adequate housing is not just a right, it is essential for their very livelihood.

“While most people in the region are housed in some fashion, there is a large qualitative and quantitative housing deficit.”⁹⁶ The quantitative housing deficit in Latin America was estimated in 1995 to be approximately 28 million units.⁹⁷ In Columbia, for example, there is nearly a 28.7 percent “quantitative deficit” for urban households.⁹⁸ Also, in Peru, “26 percent of total housing deficit is explained by lacking dwelling units and, in addition, there is a new demand for housing of about 90,000 units yearly.”⁹⁹ From 1960 to 1987, Peru’s population jumped from 4.5 to 14 million people.¹⁰⁰ Presently, 73 percent of Peru’s population lives in urban areas, and the current total housing shortage is estimated at 1.5 million homes.¹⁰¹ In Argentina, Chile, and Uruguay, and Brazil, the urban

91. *Id.*

92. Inter-American Development Bank, *Housing Challenges and Opportunities at the Base of the Pyramid*, http://www.iadb.org/bop/Area4_text.cfm?language=En&parid=2&itemlid=2&-item2id=5 (last visited Sept. 25, 2007) [hereinafter *Housing Challenges*].

93. *Id.*

94. JENNIFER DUNCAN, HABITAT OF HUMANITY LATIN AMERICA & THE CARIBBEAN CAUSES OF INADEQUATE HOUSING IN LATIN AMERICA AND THE CARIBBEAN 27 (World Bank 2004), available at http://povlibrary.worldbank.org/files/15210_causes.pdf.

95. CTR. FOR URBAN DEV. STUDIES, HARV. UNIV. GRADUATE SCH. OF DESIGN, HOUSING MICROFINANCE INITIATIVES. SYNTHESIS AND REGIONAL SUMMARY: ASIA, LATIN AMERICA AND SUB-SAHARAN AFRICA WITH SELECTED CASE STUDIES 93 (MicroLINKS (Microenterprise Learning, Information, and Knowledge Sharing 2000)), available at http://www.microlinks.org/ev_en.php?ID=7454_201&ID2=DO_TOPIC (follow “housing_microfinance_initiatives” hyperlink) [hereinafter HOUSING MICROFINANCE INITIATIVES].

96. *Housing Challenges*, *supra* note 92.

97. Gerardo M. Gonzales Arrieta, *Access to Housing and Direct Housing Subsidies: Some Latin American Experiences*, 69 CEPAL REV. 141, 142 (Dec. 1999) [hereinafter Arrieta, *Access to Housing*].

98. Gonzalez, *supra* note 4, at 8.

99. *Id.*

100. Bernadette Atuahene, *Legal Title to Land as an Intervention Against Urban Poverty in Developing Nations*, 36 GEO. WASH. INT’L L. REV. 1109, 1137 (2004).

101. *Id.*

population is 89, 84, 80, and 78 percent respectively.¹⁰² Across Latin America as a whole, the housing deficit is estimated to be fifty million units.¹⁰³

Exacerbating the housing shortage is the fact that, as previously stated, nearly 65 percent of the Latin American population cannot afford even the least-expensive new homes.¹⁰⁴ In low-income Latin American countries, nearly one-third of the population lives in "inadequate structures," and nearly half live in what are described as "poor housing conditions."¹⁰⁵ During the period from 1980 to 1997, the number of poor Latin Americans rose from 136 to 204 million.¹⁰⁶ One third of Latin Americans are impoverished—15 percent extremely so.¹⁰⁷ The situation in urban areas is even bleaker: 64 percent of urban dwellers are impoverished, and the number is quickly increasing.¹⁰⁸ Overall, thirty million Latin American households live in inadequate and sub-standard conditions.¹⁰⁹ Some estimates even state that half of the Latin American population is living in "unsatisfactory conditions."¹¹⁰

The typical housing situation for many low- and medium-income Latin American families is undoubtedly bleak. Because most of these families cannot qualify for a mortgage loan or other traditional bank-based financing, their typical housing conditions "consist of a plot of land with toilet, the improvement or extension of an existing house, or the replacement of a house in a state of deterioration."¹¹¹ The Latin American "legal and regulatory systems" only serve to discourage the development of affordable housing and hinder the wide availability of mortgage credit for new housing and home improvement.¹¹² Lost in the economic costs, however, is the tremendous toll that insufficient housing has on living conditions in Latin America.¹¹³ "Inadequate housing and overcrowding are associated with a variety of public health issues, such as poor sanitation, contagious disease, domestic violence, . . . high rates of infant mortality" and high rates of crime.¹¹⁴ Moreover, "[r]esearchers have found that the cost of purchasing services such as water and electricity outside of the formal sector is significantly higher than in the formal sector, and so further increases poverty in settlement areas."¹¹⁵ According to the U. N. Centre for Human Settlements–Habitat, there are over 130 million

102. HOUSING MICROFINANCE INITIATIVES, *supra* note 95, at 91.

103. Poindexter, *supra* note 15, at 259 n.7.

104. Ferguson, *supra* note 3, at 11.

105. *Housing Challenges*, *supra* note 92.

106. DUNCAN, *supra* note 94, at 26.

107. *Id.*

108. *Id.*

109. *Housing Challenges*, *supra* note 92.

110. Arrieta, *Access to Housing*, *supra* note 97, at 142.

111. Ferguson, *supra* note 3, at 11.

112. *Housing Challenges*, *supra* note 92.

113. *Id.*

114. *Id.*

115. DUNCAN, *supra* note 94, at 27.

people living in "slums" in Latin America and the Caribbean.¹¹⁶

A number of factors contribute to the lack of adequate housing in Latin America. The most obvious factor—the growing Latin American population—is unavoidable, and is beyond the scope of this comment. But factors such as low incomes, excessive governmental regulation of land, and notoriously difficult and time-consuming bureaucratic hurdles to titling and purchasing land, can be rectified by affirmative governmental policies. The low income levels in Latin America are only part of the equation; the inequitable distribution of wealth in the region is also to blame. Latin America "has the worst income distribution in the world" and the "[g]reatest concern about the . . . region's pattern of economic and social development is not poverty per se, but rather the way income is distributed."¹¹⁷ Change is desperately needed because these factors are pushing the possibility of land ownership further and further out of the reach of the typical low- to medium-income Latin American family.¹¹⁸

II. WHAT NEEDS TO BE DONE?

A. REFORMS TO INCREASE THE SUPPLY OF ADEQUATE HOUSING IN LATIN AMERICA

Even if it were possible to immediately reform the lagging mortgage lending system in Latin America, the simple fact remains that most low- and medium-income Latin American families cannot afford to purchase new housing. With the current state of the Latin American building market, the price of a new housing structure in "Mexico City, Guadalajara or Monterey, is equivalent to ten times the cost of extending a house."¹¹⁹ While this price is representative of the huge cost in Mexican cities, it can be extrapolated to Latin America as a whole.

Because of this situation, any reformation of the Latin American housing policy must initially focus on other means of enabling low- and medium-income Latin Americans to afford adequate housing that meets their shelter and sanitation needs. One of the quickest and, at the present time, most realistic ways to accomplish this monumental task is to focus energy in the short-term on extending and improving existing housing to meet the needs of Latin American families.¹²⁰ This can be accomplished through a renewed housing regime focusing on a direct housing subsidy system, governmental housing programs for the lowest-income families, and the encouragement of micro-financing programs to enable families to

116. Gustavo González, *Latin America: Building Unity – and Decent Housing*, INTER PRESS SERVICE NEWS AGENCY, June 23, 2006, <http://www.ipsnews.net/news.asp?idnews=33747>.

117. DUNCAN, *supra* note 94, at 29.

118. *Housing Challenges*, *supra* note 92.

119. Ferguson, *supra* note 3, at 11.

120. *See id.* at 11-12.

expand, build, and refurbish their own homes.¹²¹

1. *Direct Housing Subsidies*

Direct governmental housing subsidies are one approach to curb the present Latin American housing shortage. Direct housing subsidies, as opposed to more traditional social housing, are “an explicit, once-only, non-repayable contribution given by the State to families that comply with certain established requirements in order to provide them with a purchasing power greater than that afforded by their own income . . . thus [it is] a demand subsidy, not a subsidy for supply.”¹²² But due to huge demand in Latin American countries where direct housing subsidies have been instituted, there is often a long wait to qualify for these subsidies.¹²³

The primary function of direct housing subsidies is to increase the purchasing power of low- and middle-income Latin Americans, those who comprise the majority of potential housing demand, and encourage the growth of private development in the housing sector.¹²⁴ These subsidies also can be used to help these low- and middle-income families to improve their existing homes, or help qualify for mortgage loans for new dwellings.¹²⁵ The subsidy “cover[s] the cost for provision of services, acquisition of land, and building of a top structure.”¹²⁶ But the direct housing subsidies must be portable, thus giving families the right to choose whether to upgrade or move to a new home. Furthermore, these subsidies must also be supplemented with other types of credit assistance such as micro-loans.¹²⁷

The focus on direct subsidies, rather than the more paternalistic involvement traditionally played by the state, is a function of the historic failure of programs in which the state was heavily involved in providing low-cost housing to low- and medium-income Latin American families.¹²⁸ Programs in which the state “played a direct role in building and financing dwellings . . . by offering loans at subsidized interest rates or subsidizing the prices of the dwellings” were inefficient and failed to produce the goals sought.¹²⁹

Under state-controlled mortgage and housing markets, the state “over-regulated the operation of the markets and agents involved—by establishing ceilings for the interest rates . . . for example—and played a direct role in building and financing dwellings . . . by offering loans at subsidized interest rates or subsidizing the prices of the dwellings.”¹³⁰ In fact, such

121. *See id.* at 12.

122. Arrieta, *Access to Housing*, *supra* note 97, at 143.

123. *See* Atuahene, *supra* note 100, at 1158.

124. Arrieta, *Mortgage Loans*, *supra* note 11, at 115.

125. Arrieta, *Access to Housing*, *supra* note 97, at 143.

126. Atuahene, *supra* note 100, at 1158.

127. Ferguson, *supra* note 3, at 14.

128. Arrieta, *Access to Housing*, *supra* note 97, at 142-43.

129. *Id.* at 142.

130. *Id.*

programs were counterproductive and led to the state displacing private sector companies and investment.¹³¹ "Publicly-owned mortgage lenders usually have poor quality underwriting, politically motivated lending, inappropriate instruments, and weak or non-existent risk management."¹³² The net result of these paternalistic government programs was to drive builders and financial institutions out of the low- and medium-income marketplace. This was not only counterproductive to the intended goals; it also hindered the long-term growth of the housing industry in the countries where these policies were utilized.

The direct subsidy program prevents the negative effects of direct government involvement in the financing of housing to low- and medium-income families. By increasing the purchasing power of these families, the direct housing subsidy program works through the market, rather than displacing the market. Demand subsidies are considered "more efficient than supply subsidies (in the form of State-provided housing), since they entail fewer losses in terms of the consumer's welfare, less detriment to the consumer's sovereignty and lower housing costs."¹³³ Another benefit of a direct housing subsidy over the traditional concept of social housing is that the governments are able to budget for the identifiable and measurable subsidy amount, as opposed to attempting to budget for fluctuating interest rates.¹³⁴

In countries where demand housing subsidy systems have been implemented, such as Chile, Columbia, Costa Rica, Ecuador, Guatemala, Venezuela,¹³⁵ El Salvador, Uruguay, and Paraguay,¹³⁶ it has been quite successful. But there has often been a lack of commitment by the state to fully fund the programs.¹³⁷ Fortunately, that is not true across the board. Chile, Costa Rica, and Columbia all funded demand subsidies with over 1 percent of their respective budgets, and did so for more than a ten-year period.¹³⁸ This long-term commitment by Latin American governments is the key for successful implementation and continued success for direct housing subsidies. For direct housing subsidies to make a difference in curbing the shortage of adequate and available housing, Latin American governments must commit to fully funding the programs for a sufficient period of time to allow the subsidies to work. Moreover, there also must be a vigorous primary market for mortgages, a fully functioning secondary market for mortgages in general, and, in particular, for the "low-cost dwellings of the type covered by the subsidies."¹³⁹ Without these factors, the direct subsidy program will only serve to push players out of the market, just as traditional subsidies often do.

131. *Id.* at 142-43.

132. Gonzalez, *supra* note 4, at 13.

133. Arrieta, *Mortgage Loans*, *supra* note 11, at 115.

134. Ferguson, *supra* note 3, at 13.

135. *Id.*

136. See Arrieta, *Access to Housing*, *supra* note 97, at 146.

137. Ferguson, *supra* note 3, at 13.

138. *Id.* at 14.

139. Arrieta, *Access to Housing*, *supra* note 97, at 150.

2. Governmental Housing Programs for the Lowest Income Families

Despite the problematic nature of direct governmental involvement in the provision of housing for low-income families, there is a need for such involvement when it comes to providing homes for the lowest-income Latin American families. These families, often falling within the two-dollars-a-day-range,¹⁴⁰ are not able to take advantage of traditional funding sources due to their extremely low incomes. Supply-side housing subsidies have the potential to assist this segment of the population in obtaining homes where demand subsidies fail. For example, “[t]he demand subsidies system has allowed considerable access to housing for the medium-low income group, that is, families with incomes of 3.5 to 6 times the minimum wage, depending . . . on the country in question . . . but, generally they have not reached low-income families.”¹⁴¹ Therefore, supply subsidies are a necessary supplement to demand subsidies. “For the low-income market segment, subsidies should focus on [both] improving living conditions and increasing new suitable housing options.”¹⁴²

Historically, government subsidies in Latin America have predominantly addressed the upper-middle income population.¹⁴³ This is likely because that segment is better able to take advantage of the government subsidies and use them to qualify within the traditional financing system. While this may make economic sense, it fails to meet the needs of the segment of the population that needs government assistance the most. A more prudent approach to government aid would be to focus government subsidies and direct government involvement on the lowest-income families, and allow direct housing subsidies and reforms of the financial markets to fulfill the needs of higher-income individuals and families. In other words, the subsidies must be appropriate for the particular population segment they seek to assist.

As an example of government-sponsored housing programs directed at the needs of extremely low-income Latin Americans, Venezuela dedicated over \$500 million for government housing projects in 2004.¹⁴⁴ This program was in response to an estimated housing shortage in Venezuela of 1.8 million units.¹⁴⁵ These housing projects meet the aims of increasing new housing options for low-income Latin Americans. Such programs

140. See *supra* text accompanying note 86. These families, due to their low incomes, cannot qualify for any traditional mortgage loans or other financial assistance. The direct housing subsidies program provides modest assistance for renovating or expanding their existing homes and flats. But with this extremely low-income group, the conditions of their housing are often quite poor. See *supra* text accompanying note 112 regarding the unfortunate conditions associated with very low standards of living, such as “poor sanitation, contagious disease, domestic violence, . . . high rates of infant mortality” and high rates of crime.

141. Ferguson, *supra* note 3, at 15.

142. Gonzalez, *supra* note 4, at 12.

143. *Id.* at 13.

144. Robin Nieto, *Public Housing Program Attempts a Housing Revolution*, VENEZUELANALYSIS, Sept. 6, 2004, <http://www.venezuelanalysis.com/news/685>.

145. *Id.*

are most likely to succeed when the finance “model recognizes that the State alone is incapable of solving the housing deficit, so that State action must be such as to stimulate private investment.”¹⁴⁶

3. *Micro-financing Programs*

Most low- and middle-income Latin Americans are excluded from the traditional financial and lending system, and are wholly reliant upon personal savings and other acquired wealth for meeting their housing needs.¹⁴⁷ Moreover, in Latin America, like other developing countries, “low income households usually prefer to improve and expand their current homes rather than purchase new units.”¹⁴⁸ This is because the families have already developed social and economic ties to their existing neighborhood.¹⁴⁹ Moreover, many families prefer to refurbish and expand on their existing homes because the quality of social housing is often quite poor due to mass production and budget restraints.¹⁵⁰ It is estimated that in developing countries, 70 percent of development occurs this way.¹⁵¹ Because that is the case, efforts to broaden the availability of traditional mortgages for the purchase of new homes will either not appeal, or will be out of reach, to a broad segment of the Latin American population. Micro-financing is therefore a viable solution that allows low- and medium-income Latin American families to obtain the financing that they need to improve and expand their existing homes.

Micro-financing is a technique whereby the financing entity grants “small loans, generally from U.S. \$500 to \$5,000, for low-cost solutions such as improvement, extension, and construction of a house on a family’s own plot of land.”¹⁵² The interest rates charged on micro-loans, usually only 2 to 3 percent, are far lower than the 15 to 20 percent interest rates charged by banks and other more traditional lenders.¹⁵³ The primary aims of microfinance and micro-credit are reducing poverty through housing finance and enabling low- and medium-income families to protect themselves against economic risk.¹⁵⁴ Microfinance gained renown in

146. Arrieta, *Access to Housing*, *supra* note 97, at 143.

147. Ferguson, *supra* note 3, at 15.

148. Michael Goldberg & Marialisa Motta, *Microfinance for Housing: The Mexican Case*, 5 J. MICROFINANCE 51, 51 (2003), available at <http://marriottschool.byu.edu/esrreview/articles/article79.pdf>. See also Ferguson, *supra* note 3, at 11 (“Surveys consistently demonstrate that low income families notably prefer to improve their current home in their present neighbourhood instead of relocating to a new unit under social housing programs.”) Because of this factor, microfinance programs are far better suited to the needs of the people and the realities of their situation.

149. Ferguson, *supra* note 3, at 11.

150. *Id.* at 12.

151. Donatus Okpala, Naison Mutizwa-Mangiza & Iouri Moisseev, *Financing Urban Housing: United Nations Global Report on Human Settlements*, GLOBAL URBAN DEV. MAG., Mar. 2006, at 14, available at <http://www.globalurban.org/GUDMag06Vol2Iss1/Okpala,%20Mutizwa-Mangiza,%20&%20Moisseev.htm>.

152. Ferguson, *supra* note 3, at 12.

153. *Id.* at 13.

154. Michael S. Barr, *Microfinance and Financial Development*, 26 MICH. J. INT’L L. 271, 273-74 (2004).

the 1980s due to successful micro-credit “programs such as the Grameen Bank, launched by Mohammed Yunus.”¹⁵⁵

There are two key benefits to micro-loans. One is the fact that because “housing microfinance has typically short-term maturities, microfinance institutions can better fit the terms of their assets and liabilities, thereby overcoming the typical mismatch involved in traditional mortgage lending when funded with short-term liabilities.”¹⁵⁶ The second relates to the realities of making loans to low- and medium-income households—namely the inability of this segment of the population to qualify for traditional funding.¹⁵⁷ With micro-loans, the underwriting process is streamlined because of the small amount of the loans. Unlike traditional mortgage loans, micro-loans do not require the extensive verification of a “permanent, sufficient and verifiable source of income” and “legal tenancy of the property.”¹⁵⁸ This verification is often extremely difficult in Latin America due to the inconsistency of titling laws and real estate ownership. The majority of “low- to medium-income families cannot sustain the payment of a [traditional] loan for the acquisition of a new, low-cost home produced by the formal sector, and frequently do not possess title deeds, nor have formal income.”¹⁵⁹ Micro-financing is a viable alternative to the more traditional means of obtaining credit. “[S]hort-term maturities and small-sized amounts associated with housing microfinance, together with additional instruments such as non-traditional collateral and innovative criteria to determine credit eligibility, can ease the accessibility to this sort of housing finance for lower-income families.”¹⁶⁰

In a 2004 study by ACCIÓN International, the average balance for micro-loans in Latin America was \$634.¹⁶¹ Micro-financing has traditionally focused on providing access to credit for low- and medium-income individuals, rather than emphasizing savings programs.¹⁶² This type of lending enables these low-income groups to take advantage of financial and housing opportunities that would otherwise be unavailable to them were they to rely on traditional financial markets. “In Latin America, where commercialization has advanced most rapidly, commercial banks and regulated MFIs provide some 74% of total microfinance across the region as of 2001, when not long ago microfinance was provided almost exclusively by NGOs and unregulated cooperatives.”¹⁶³

The Dominican Republic represents a case study in successful microfinance initiatives. The country has many of the institutional factors

155. *Id.* at 273.

156. Gonzalez, *supra* note 4, at 12.

157. *Id.*

158. *Id.* at 13.

159. Ferguson, *supra* note 3, at 12.

160. Gonzalez, *supra* note 4, at 13.

161. Emily Berkman, Note, *Microloans as a Community Reinvestment Act Compliance Strategy*, 3 N.Y.U. J. L. & Bus. 329, 329-30 (2006).

162. Aaron Jones, Note, *Promotion of a Commercially-Viable Microfinance Sector in Emerging Markets*, 13 GEO. J. ON POVERTY L. & POL’Y 187, 189 (2006).

163. *Id.* at 195.

that facilitate the establishment and success of microfinance ventures.¹⁶⁴ For example, there are already "five sound microfinancing entities, two private development banks, and 13 rural savings and lending entities."¹⁶⁵ Moreover, the programs currently being implemented in the Dominican Republic provide not only for micro-loans and micro-credit, but also for funds aimed at improving infrastructure in the low- and medium-income neighborhoods.¹⁶⁶ Organizations such as FIE in Bolivia and PRODEL in Nicaragua are currently working to serve the housing microfinance needs of low-income groups by "supporting housing improvement activities of municipal authorities and community groups and by offering short-term loans to individuals sufficient for small-scale upgrading and repairs such as building new roofs, improving floors, or adding a new room."¹⁶⁷ In Guatemala, Fundacion Genesis Empresarial is providing micro-loans for the development of infrastructure such as electricity and water.¹⁶⁸

Unfortunately, as is the case in the Dominican Republic and much of Latin America, "microfinance is estimated to reach only 25% of the total potential market across the region."¹⁶⁹ The capability of micro-financing entities to provide much needed assistance to Latin America has been proven time and again where micro-loans have been used. But the reach of microfinance entities must be broadened to reach a larger proportion of the Latin American populace.

4. *Legal Reforms Relating to Land Ownership*

Two of the most important legal reforms for improving the conditions and availability of adequate housing in Latin America are establishing, or harmonizing, the region's land titling laws, and providing access to more land for low- and medium-income families. The land titling reforms serve to provide security for Latin Americans living in traditional and non-traditional housing situations. Furthermore, providing more access to land for low- and medium-income families will result in a more equitable distribution of land throughout the wealth strata.

Land titling reform is an often overlooked yet extremely important aspect of a successful Latin American housing policy. For instance, "[l]and titling resulted in higher investment in land in Costa Rica, Brazil . . . Honduras, and Jamaica, and in increased land values in Brazil, Honduras

164. Ferguson, *supra* note 3, at 13.

165. *Id.* at 12.

166. *Id.* at 15. The approach taken in the Dominican Republic is a sound one. The microfinance programs are teamed up with other government subsidies to address several factors contributing to the substandard housing conditions. The first factor is the poor quality of many of the homes in the region. The second factor is the general state of disrepair, as well as the lack of basic sanitation and other necessary infrastructure that perpetuate the dismal conditions. By providing subsidies for basic services, the Dominican Republic is providing an impetus for self-help home repair, which in turn can bring more funding to the area.

167. HOUSING MICROFINANCE INITIATIVES, *supra* note 95, at 93.

168. *Id.*

169. Jones, *supra* note 163, at 195.

[and] Peru.”¹⁷⁰ The United Nations, in its Best Practices Handbook 2003, describes land titling, or secured land tenure, as ““(i) protection against eviction; (ii) the possibility of selling, and transferring rights through inheritance; (iii) the possibility . . . (of having a) . . . mortgage, and access to credit under certain conditions.”¹⁷¹ Land titling or secured land tenure can be formal or informal, depending on whether the jurisdiction recognizes legal title to land.¹⁷²

Proponents of secured land tenure or legal titling “argue that:

(1) families who have legally secure title to their home are more likely to make improvements to it, as they are less concerned with eviction; (2) families with secure title no longer have to spend scarce time and resources defending the rights to their land and home; (3) families with secure title are able to access commercial financing through mortgages and short-term loans; and (4) providing secure legal title increases the value of the land and house, thus increasing wealth to the home-owning family.¹⁷³

But like with everything else in life, titling programs have a potential downside.

One of the more serious issues with titling programs is the possibility of pricing the low- and middle-income segment out of the market. This occurs when title formalization increases the value of land so much that these low-income families cannot afford to own land.¹⁷⁴

In addition to land titling reform, increasing access to land for low- and middle-income Latin Americans is vital to rectifying the present housing shortage. The “[l]ack of access to land by the poor is the second most noted cause of poverty housing in Latin America.”¹⁷⁵ The unavailability of land in both rural and urban areas serves to exclude low-income families from the housing market. In rural areas, a few wealthy individuals hold the majority of the land.¹⁷⁶ Additionally, charitable organizations and mining companies also hold a large percentage of rural lands.¹⁷⁷ In contrast, the high price of land in urban areas precludes the poor from obtaining adequate housing, and marginalizes them to “illegal or ‘squatter’ settlements.”¹⁷⁸ When confronted with the available options, low- and medium-income families must choose between poor, over-crowded slums, or resort to the aforementioned land invasion.¹⁷⁹ Surprisingly, state ownership of urban land is quite limited, and urban lands owned by the state have frequently been lost to squatter settlements.¹⁸⁰

170. Atuahene, *supra* note 100, at 1112.

171. DUNCAN, *supra* note 94, at 30.

172. *Id.*

173. *Id.* at 31.

174. *Id.*

175. *Id.* at 30.

176. *Id.*

177. HOUSING MICROFINANCE INITIATIVES, *supra* note 95, at 91.

178. DUNCAN, *supra* note 94, at 30.

179. HOUSING MICROFINANCE INITIATIVES, *supra* note 95, at 91.

180. *Id.*

B. REFORMS TO ENCOURAGE THE DEVELOPMENT OF RESIDENTIAL
MORTGAGE MARKETS

1. *Expand the Primary Mortgage Markets in Latin America*

As previously discussed, the primary mortgage markets in Latin America are severely underdeveloped. As an example of the room for expansion of the primary mortgage markets, Gonzalez found that "more than 20% out of the total approved subsidies in Columbia has not been disbursed because of lack of access to mortgage credit for beneficiaries."¹⁸¹ There is a scarcity of credit available to the majority of the Latin American population, and the credit that is available is extremely expensive due to the generally high risk of default and mismatch of maturities. Expanding the primary mortgage markets in Latin America is crucial if the future financial needs of low- and medium-income Latin Americans are to be met.

Strengthening the primary mortgage markets will enable Latin American lenders to advance mortgage loans to a broader segment of the population. Moreover, "[t]he expansion of primary mortgage markets is also important given the relevance of a well-developed primary market to support the creation of a secondary mortgage market which allows the establishment of linkages with the capital market."¹⁸²

Peru represents a case study in the typical underdeveloped primary mortgage market in Latin America. The Peruvian primary mortgage market is, like many of the Latin American countries, an "incipient market."¹⁸³ In 1999, the total volume of the portfolio of Peruvian mortgages was U.S. \$1 billion.¹⁸⁴ While this may seem like a large amount for a developing country, in comparison with its neighbors with more fully-developed primary mortgage markets—namely Chile and Colombia with \$6 billion and \$8.3 billion respectively—Peru is just beginning to develop.¹⁸⁵ The embryonic status of Peru's primary mortgage industry is further illustrated by the fact that its "mortgage portfolio only represents 7% of the total banking portfolio, while 78% of the total mortgage portfolio is concentrated in only four banks."¹⁸⁶

Across Latin America, there are measures in place to increase access to the primary market for low- and medium-income families. Governments and private sector institutions alike are taking measure to increase financial access. In November 2006, the International Finance Corporation and Merrill Lynch Capital, Inc. signed a \$100 million line of credit with Metrofinanciera, S.A. de C.V. to fund mortgages for low- and medium-

181. Gonzalez, *supra* note 4, at 10.

182. *Id.* at 13.

183. Gerardo M. Gonzales, *Considerations for the Development of a Mortgage Market in Peru*, 15 HOUSING FIN. INT'L 45, 48 (2000).

184. *Id.* at 48.

185. *Id.*

186. *Id.*

income Mexicans.¹⁸⁷

2. *Encourage the Continued Development of A Secondary Market For Mortgages*

a. The Secondary Mortgage Market

“The development of a secondary mortgage market can play a significant role in creating sustainable housing finance activity.”¹⁸⁸ In order for a housing market to operate efficiently, the market needs long-term investors and instruments.¹⁸⁹ Despite Latin America’s rocky financial past, the potential investors are likely there. The key, therefore, is modernization of Latin America’s secured financing laws. But before a sustainable secondary mortgage market can exist in Latin America, four conditions must be met: “(a) a sufficient legal, tax, and regulatory framework; (b) a robust primary mortgage market; (c) capital market preparedness and appetite for mortgage-backed debt instruments; and (d) economic incentives for secondary market participation.”¹⁹⁰ The expansion of a secondary mortgage market is essential for successful housing policy in Latin America.

Latin America, however, still faces significant roadblocks to the establishment of efficient secondary markets. For instance, “in many countries there are not enough mortgages to pool together.”¹⁹¹ These are the challenges that Brazil and Mexico are currently facing. Also, Latin American mortgage markets have a long way to go in harmonizing lending guidelines, establishing a uniform credit system, and standardizing the mortgage underwriting process.¹⁹²

b. The Securitization Process

Securitization is a technique originally developed in the United States during the 1970s.¹⁹³ Initially used for the resale of mortgages, securitization has subsequently spread to “other types of cash flows.”¹⁹⁴ Currently, there are two general forms of securitizations: “mortgaged-backed and asset-backed securitizations.”¹⁹⁵ The most common mortgaged-backed security (MBS) is the “pass-through” security that is representative of ownership in a pool of mortgages, thus enabling the owner to realize

187. *IFC, Merrill Lynch Sign Warehousing Line of Credit with Metrofinanciera*, EMERGING MARKETS ECONOMY, Nov. 29, 2006, http://www.emeeconomy.com/Latin_America/97048-IFC_Merrill_Lynch_sign_warehousing_line_of_credit_with_Metro_financiera.htm.

188. Gonzalez, *supra* note 4, at 16.

189. *Housing Finance in Latin America*, *supra* note 9, at 1.

190. Gonzalez, *supra* note 4, at 16.

191. Poindexter, *supra* note 15, at 279.

192. *Id.*

193. Claire A. Hill, *Whole Business Securitization in Emerging Markets*, 12 DUKE J. COMP. & INT’L L. 521, 523 (2002).

194. *Id.*

195. Erica W. Stump, *Securitizations in Latin America*, 8 U. MIAMI BUS. L. REV. 195, 200 (2000).

profit from the collection of payments.¹⁹⁶ The security is of the “pass-through type because ‘the loans are passed-through to the investor.’”¹⁹⁷ Not all of the profit passes to the investor, however, as a small percentage is reserved to pay for expenses.¹⁹⁸

In the 1980s, emerging markets such as Mexico began securitizing such cash flows. “The first transaction was done by the Mexican telephone company TelMex” where “TelMex securitized its rights to receive payments from AT&T for the Mexican portion of telephone calls made to Mexico from the United States—that is, the portion taking place between the United States-Mexico border and the Mexican destination.”¹⁹⁹ As part of the transaction, “TelMex sold its rights to the payments from AT&T to a pool; the pool sold interests in the payments to investors, and paid to TelMex the amount it received from the investors.”²⁰⁰

Securitization of a mortgage is the “‘process of packaging individual loans and other debt instruments, converting the package into a security or securities, and enhancing their credit status or rating to further their sale to third-party investors.’”²⁰¹ Poindexter and Vargas-Cartaya give an insightful walk-through of the securitization process:

The first step involves the origination of mortgages to be used as collateral for the securities. The mortgages are then pooled and sold to an SPV (also known as a special purpose entity). At this stage, a rating agency evaluates the investment risk of the pool. Then, the mortgage pool is tranching (i.e., divided into classes) with various combinations of mortgages and subordination levels. The issuer takes into account the capital market forces at that moment and considers if there is a need for credit enhancement, and if so, what form it will take. Once this is done, the SPV sells an interest in the pool to third party investors. The securities are then traded in the secondary market.

Other parties in the transaction include the trustee, the master, and special servicers. The trustee represents the trust or SPV that holds the legal title to the collateral for the benefit of the investors. The trustee’s duties include holding the mortgage collateral, passing the funds gathered by the loan servicers to investors, and supervising the loan servicers, including the appointment of a new servicer if the terms between the parties are violated. The master servicer must service the mortgages that collateralize the securities on behalf of and for the benefit of the investors. Duties include collecting the mortgage payments, passing the funds to the trustee, and providing mortgage performance reports to investors. Some transactions also

196. Mark Adelson, *MBS Basics, in NUTS & BOLTS OF FINANCIAL PRODUCTS 2007: UNDERSTANDING THE EVOLVING WORLD OF CAPITAL MARKET & INVESTMENT MANAGEMENT PRODUCTS* 359, 364 (Clifford E Kirsch & Robert S Risoleo eds., 2007).

197. *Id.*

198. *Id.*

199. Hill, *supra* note 194, at 523.

200. *Id.*

201. Poindexter, *supra* note 15, at 257 n.1.

make use of a special servicer, who assumes servicing responsibilities when a loan goes into default and carries out the workout or foreclosure process.²⁰²

The benefit of securitizing mortgages and selling the security into a secondary market is that it gives the originator the ability to improve its balance sheet through the sale of the assets to another entity and the receipt of cash for the transaction.²⁰³ Latin American governments recognized the limitations of their traditional financial systems, and “since 1994 many of the countries in the region have modified or created new laws to encourage and simplify the securitization of financial assets, including mortgages.”²⁰⁴ There are already securitization programs underway in Columbia, Mexico, and Peru “where the agenda for publicly-owned second-tier institutions is markedly set towards replacing their typical funding role for an innovative guarantor role.”²⁰⁵

3. *Increasing Legal Protections Afforded to Mortgage Creditors*

Reforming the secured transaction laws in Latin America is one of the key facets of an effective overhaul of the financial industry. But without similar changes in the system of judicial enforcement of debts, lenders will not be willing to risk their investment dollars in Latin America. A country's foreclosure laws have a direct impact on the willingness of lenders to engage in mortgage transactions in that jurisdiction.²⁰⁶ The ease of obtaining judicial enforcement of a debt is not the only concern; the time required by the foreclosure process is also a pressing matter for creditors. As was observed from the historical experience of creditors attempting to foreclose on a defaulting borrower, Latin American governments placed many hurdles in the path of creditors' attempts to get their money back. Reforming these inefficient systems will require streamlined processes for eviction and foreclosure.

As Poindexter and Chapman explain, the efficiency of a county's foreclosure law and protections afforded creditors have a direct and substantial impact on a lender's willingness to enter that market:

A major factor in the pricing of any mortgage-backed security is derived from the loss expectations in the collateral pool supporting the securities. In this context, loss is a function of the following: (1) the percentage of the pool balance that experiences delinquency; (2) the percentage of the delinquent loans that go into default; and (3) the loss severity associated with those defaulting loans. Overall portfolio loss is the delinquency percentage multiplied by the default ratio multiplied by the loss severity. Foreclosure laws impact on this percentage as jurisdictions with effective and timely foreclosure laws have a greater possibility of reducing the loss severity and conse-

202. *Id.* at 264.

203. Stump, *supra* note 196, at 198-99.

204. Poindexter, *supra* note 15, at 267.

205. Gonzalez, *supra* note 4, at 10.

206. Poindexter, *supra* note 15, at 266-67.

quently the loss percentage of the portfolio. Issuers in these jurisdictions will be in a better position to ensure the continued servicing of the debt.²⁰⁷

The Latin American legal systems have failed to create a positive environment for creditors to recover their investments and evict delinquent borrowers.²⁰⁸ In turn, because lenders do not have these necessary protections, they are not likely to invest in this region. The solution to this problem will likely require a combination of legislative and judicial changes to increase the protections for lenders, along with social programs to encourage respect for the credit system and the responsibility to pay debts when they become due.

Several proposals have been put forth to remedy these legal shortcomings. "One option involves the creation of extra-judicial mechanisms to speed the process of recovering mortgage credit guarantees."²⁰⁹ Some Latin American countries, seeking to institute such a program, passed legislation allowing lenders to place a clause in the mortgage contract allowing the lender to evict the borrower and repossess the property if the "borrower becomes delinquent chronically."²¹⁰ The meaning of "delinquent chronically" is up for interpretation, but the fact remains that legislation such as this is a tremendous step forward in the struggle to modernize Latin America's mortgage industry.

Another such proposal works in much the same way as a deed of trust functions in the United States.²¹¹ It works by delaying the issuance of legal title to the borrower until the mortgage is paid in full.²¹²

Leading the way for reform of the foreclosure laws in Latin America is Argentina.²¹³ In 1995, Argentina passed the Trust Law, which instituted a "non-judicial foreclosure procedure and summary eviction proceeding."²¹⁴ The process allows a creditor to file for foreclosure after the borrower is sixty days in default.²¹⁵ After the filing, the debtor has fifteen

207. *Id.* at 266.

208. *Housing Finance in Latin America*, *supra* note 9, at 4.

209. *Id.* at 5.

210. *Id.*

211. See generally GEORGE GLEASON BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 29 (rev. 2d ed. 2006).

It is sometimes stated . . . that a mortgagee under a common law mortgage, having a lien on or title to the mortgagor's property for the purpose of securing the payment of a debt, is a trustee. This seems clearly inaccurate . . . he does not hold it for the benefit of another but rather for his own advantage. The sole purpose of the transaction is the protection of the mortgagee-creditor . . . [t]he relation between the mortgagor and mortgagee is not a fiduciary one . . . [r]ather it is a business relationship, in which transactions with regard to the property and between the parties are valid in the absence of fraud or some other positive invalidating cause. *Id.*

212. *Housing Finance in Latin America*, *supra* note 9, at 5.

213. Poindexter, *supra* note 15, at 271.

214. *Id.*

215. *Id.*

days to cure default or the creditor can obtain a court order.²¹⁶ Despite the progress that the Trust Law represents, old ways die hard. Remember that in 2001, Argentina's lawmakers instituted a twenty-one month ban on mortgage foreclosures.²¹⁷ And in 2003, Argentina's President sought to extend that ban.²¹⁸ But when you consider that, historically, the average length of foreclosure proceedings in Argentina was two years, the new Trust Law is a large leap forward in protecting the rights of creditors.

Mexico has seen its own share of progress in terms of modifying its antiquated foreclosure laws. The majority of Mexican states have changed their foreclosure laws to allow for more efficient foreclosures.²¹⁹ While the Mexican process is not extra-judicial like Argentina's, it allows a lender to begin foreclosure proceedings when a borrower has been in default for two months, and seeks to streamline the foreclosure process from "an average of five years to a time frame of six to twelve months."²²⁰

Changes in Mexico's secured lending laws have been ongoing for quite some time. Beginning in 1992, the "National Law Center for Inter-American Free Trade (NLCIFT) began to consult with the Mexican government . . . shortly prior to the approval of NAFTA, on how to harmonize Canada, Mexico, and U.S. laws of secured transactions."²²¹ An initial meeting to plan for the harmonization of Mexican secured financing laws was held that year, and as a result of the process, several changes in Mexican secured financing law were instituted.²²² The changes involved "imaginative provisions which proved that Mexico's substantive law of secured transactions could be modernized without harm to Mexico's civil law tradition."²²³ Also, the changes "recognized the distinction between ownership and possessory rights . . . set forth simple and inexpensive attachment, perfection, and priority procedures and carved out an exception for purchase money security interests."²²⁴

Brazil also enacted a new secured transactions law, Law 9514, that "updated the procedures to seize and liquidate the property upon a debtor's default."²²⁵ The new law reduces the foreclosure process from six or seven years down to one year.²²⁶ This law represents a marked change from Brazil's past foreclosure policies, as Brazil had the honor of having one of the lengthiest foreclosure processes in Latin America. Changes

216. *Id.*

217. *Argentina to Extend Ban on Mortgage Foreclosures*, *supra* note 80.

218. *Id.*

219. Poindexter, *supra* note 15, at 272.

220. *Id.*

221. Boris Kozolchik, *The Basis for Proposed Legislation to Modernize Secured Financing in Mexico*, 5 U.S.-MEX. L. J. 43, 48 (1997).

222. *Id.* at 49.

223. *Id.* at 50.

224. *Id.*

225. Poindexter, *supra* note 15, at 272.

226. *Id.*

similar to those discussed are occurring all over Latin America as governments realize that mortgage-backed securitization is not just a passing trend, but the modern direction for international securities markets.²²⁷

III. CONCLUSION

Latin America has made some significant gains in modernizing and expanding its mortgage markets and addressing the pressing issues of poverty and lack of available housing for low- and medium-income Latin Americans. There is still a long way to go, however, before the quality of housing in Latin America will meet adequate standards. The low- and middle-income population of Latin America constantly struggles to find and maintain the safe and sanitary housing that is so fundamental to an enjoyable and full life.

The Latin American housing and finance markets are inexorably intertwined, and any successful modernization policy must address both issues. The housing market and poor housing conditions in Latin America can be rectified through a four-part reform of housing policies. A program of direct housing subsidies must be adopted and fully funded to enable low- and medium-income Latin Americans to repair and expand their current homes, and purchase new ones. For the extremely low-income segment of the population, supply-side government involvement, in the form of social housing programs, is needed to create adequate housing. Moreover, social programs that invest development money for infrastructure in the most impoverished areas will dramatically improve the living conditions in some of the worst Latin American slums. Similarly, micro-lending institutions prove invaluable in assisting with home repair and replacement, and infrastructure development. Lastly, land titling reforms and increased access to land will enable low- and medium-income Latin Americans to obtain land outside of the urban slums and feel secure in knowing that they possess legal title to the land.

Despite the bumpy road that Latin America's financial markets have traversed, they possess tremendous growth potential. Modernization of the financial markets requires a three-step process. The primary mortgage markets must be more fully developed to provide credit to a broader segment of the Latin American population. Next, Latin America's secured lending laws need to be modernized and harmonized to provide stable secondary markets for residential mortgage-backed securities. Lastly, in line with reforming Latin American secured lending laws, legal protections for secured creditors must be put in place.

Many Latin American governments have taken great leaps in meeting these goals and satisfying their country's housing and mortgage finance needs. Yet there remains a long way to go before the poorest Latin Americans have the same opportunities for safe and sanitary living conditions that the wealthiest do.

227. *See id.* at 257.