



The role of housing finance in addressing the needs of the urban poor: lessons from Central America

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ABSTRACT This paper analyzes three forms of low-income housing finance implemented in Central America: up-front and targeted state subsidies for mortgage finance to access new housing; small, repeated loans for incremental housing improvements; and co-financing methods for the introduction of infrastructure and basic services. It shows that technical assistance for self-help construction, when combined with sound inclusive financial methods, can open new opportunities to make land, shelter and services affordable to different urban poor sub-groups.

KEYWORDS Central America / co-financing / housing subsidies / microfinance / mortgaged loans

I. INTRODUCTION

Central America is characterized by high rates of urbanization, extreme vulnerability to natural disasters, and income distribution that is among the most unequal in the world. It is also a region where low-income households have difficulties accessing affordable, secure land, basic services and shelter. Paradoxically, in this context, a variety of novel financial forms for housing and local development for the urban poor have been developed and tested. Through an analysis of a number of housing finance modalities in five countries of the region, this paper considers forms of low-income housing finance that can be both financially sustainable and socially inclusive. It illustrates how the following issues are being addressed:

- access to affordable and secure land tenure;
- mobilization of state subsidies for new housing;
- lending for new housing and housing improvements; and
- leveraging of local resources for the introduction and maintenance of basic infrastructure through co-financing schemes between local authorities and urban poor communities.

For an understanding of these novel housing finance forms, the paper also examines the evolution of the main housing policies and programmes in the region during the last decades, and attempts to draw conclusions regarding their appropriateness and the limitations for improving the shelter conditions of different urban poor sub-groups.

II. THE STATE AS A PROVIDER: NATIONAL HOUSING INSTITUTIONS AND SOCIAL SAVINGS FUNDS

State interventions in housing in Central America started in the early 1960s with the establishment of social programmes executed by central governments through various autonomous housing institutions. Urban land was subsidized and completed housing units were allocated to lower-middle class families, sometimes through non-transparent methods motivated mainly by political reasons. The schemes neither reached the urban poor nor were financially sustainable and, by the early 1990s, the majority of these housing institutions had either disappeared or gone bankrupt, or had been restructured or absorbed by new institutional frameworks emerging from structural adjustment policies.

From the 1970s to the 1990s, social housing savings funds were also created in the region, but were targeted exclusively at workers and employees from the formal private and public sectors. Funds could eventually be lent to the affiliates of the savings funds through authorized formal banking institutions for the purchase of existing housing or for serviced land and the building of new housing and, more recently, for housing improvements. Although social housing funds contributed to the creation of a savings culture in the region, their target population was low-income families with stable monthly incomes. Thus, wide sectors of society working within the informal sector of the economy were excluded from accessing available resources for housing.

III. SITES AND SERVICES

Since conventional forms of housing finance were not reaching the urban poor, alternative self-help, low-income housing programmes were set up in the 1970s. The best known of these experiences is the Salvadoran Foundation for Low-income Housing and Local Development (FUNDASAL), which began with loans provided by the World Bank. Through assisted mutual help processes,⁽¹⁾ FUNDASAL benefited thousands of low-income urban families from the formal and informal sectors by accessing affordable housing solutions through sites-and-services projects. Apart from their labour and in-kind contributions, the programme also required urban poor families to repay a loan.⁽²⁾ For the first time, the programmes made it possible to foresee institutional and financial frameworks for low-income housing that could be structured with a long-term operational perspective.⁽³⁾ In spite of its success, by the late 1980s FUNDASAL faced two main problems: it had not been able to influence national housing policy; and the sites-and-services programmes were clearly reaching higher-income groups among the poor.⁽⁴⁾

IV. PUBLIC AND PRIVATE RENTAL HOUSING

The majority of families in Central America aspire to be homeowners, irrespective of their level of income. Home ownership rates in the region are among the highest in all Latin America: in Nicaragua, 84 per cent; in Honduras, 80 per cent; in Panamá, 76 per cent; in El Salvador, 70 per cent; in Costa Rica, 66 per cent; and in Guatemala, 65 per cent.⁽⁵⁾ The drive for

1. Assisted mutual help is a social and technical process in which families work together in groups (20–30 families), contributing their effort and time to build their own houses. Contributions are equivalent to a down payment of 10 per cent of the total cost of the housing solution. See Stein, A (1991), "A critical review of the main approaches to self-help housing programmes", Working Paper No 27, Development Planning Unit, UCL, London.

2. The loan included direct and indirect costs for the purchase of land, the provision of infrastructure and the core housing unit. Interest rates were lower than market rates, and the costs for social promotion activities by FUNDASAL were subsidized with resources from European non-governmental organizations. See Bamberger, M et al. (1982), "Evaluation of sites and services projects: the evidence from El Salvador", World Bank, Washington DC.

3. FUNDASAL was founded in 1968 and still operates today. From 1975 to 1985, it assisted in the production of 75 per cent of the national output of sponsored self-help housing with costs below US\$ 2,000. See reference 1, Stein (1991).

4. UN-Habitat (2005), *Financing Urban Shelter. Global Report on Human Settlements 2005*, United Nations Human Settlements Programme, Earthscan, London and Sterling, Va, USA.

5. Villoria Siegert, N (2004), "What to do with public rental housing? Challenges and options", Inter-American Development Bank, Washington DC.

6. Gilbert, A (2001), "Housing in Latin America", Mimeo, Inter-American Development Bank, Washington DC; also Angel, S (2001), "Hacia una política habitacional para Honduras", Inter-American Development Bank, Washington DC.

home ownership is historically one of the main reasons why there is a lack of public rental housing in the region. However, in self-help built settlements there is a flourishing tenancy market.⁽⁶⁾

Renting is a survival mechanism for urban low-income families, as rooms are added on in order to rent out, thus generating additional income. The rental market is also an option for an increasing number of migrants who do not aspire to be "owners" in the host country or city but need access to a suitable and affordable place to live while they work and decide whether to settle or to move to another place. Central American migration flows are not only taking place to the USA, Canada or Europe. Increasingly, workers from Honduras and Nicaragua are migrating to Guatemala and El Salvador, and from Nicaragua to Costa Rica. That is probably the main reason why Costa Rica, which has experienced a significant influx of Nicaraguan migrants over the past 15 years, has also the highest level of private rental accommodation in the region. Housing improvement therefore seems to be an option for financing and increasing access to shelter for the poor through the informal rental market.

V. ENABLING POLICIES AND DEMAND-DRIVEN HOUSING SUBSIDIES

During the 1980s, a fundamental shift regarding the role of the state – from being a provider of housing solutions to becoming an enabler of the housing market – took place as part of broader structural adjustment policies promoted by international funding agencies. The state was to be responsible for setting the norms and regulations and for facilitating core funding, including new forms of subsidies, for the provision of land, basic infrastructure and services and shelter. Delivery of these components would be provided by private companies or non-governmental organizations, or even poor families.⁽⁷⁾ This approach redefined the way housing policies have been structured in Central America in the past 20 years.

a. Costa Rica

Costa Rica was the first country in Central America to establish a policy based on demand-driven and focalized state subsidies that would be complemented with self-help efforts from participating families and mortgaged loans from formal regulated banks. The scheme followed the Chilean model promoted since the late 1970s, in which the state is responsible for setting the regulatory framework and allocating substantial resources for housing, while private building companies are responsible for the delivery of new housing units.

Costa Rica institutionalized four different types of housing subsidy: ordinary subsidies (that combine subsidies with loans); "ABC" subsidies that combine A (*ahorro* or savings), B (*bono* or subsidy) and C (*crédito* or loan); fully subsidized houses for handicapped people, the elderly or for emergency situations; and subsidies for the eradication of slum areas, in certain cases without loans. The percentage allocated to each type varied according to the priorities of each incoming administration. In 2004, 16 per cent of the total volume of subsidies was used for slum upgrading; in 2005, the new government allocated only 6 per cent to this goal.⁽⁸⁾

7. See reference 4.

8. FUPROVI (2006a), "Situación de vivienda y desarrollo urbano en Costa Rica en el 2004 y el 2005", Aporte al informe 12 del Proyecto Estado de la Nación, FUPROVI, San José, Costa Rica.

From 1987 to 2005, the Costa Rican government allocated housing subsidies to 229,002 families,⁽⁹⁾ an average of 12,722 families a year. The average value of the subsidy varied during these years from a nominal value of US\$ 4,454 in 2000 to US\$ 6,166 in 2005.⁽¹⁰⁾ In 2005, about 71 per cent of the total number of subsidies went to families earning less than US\$ 350 per month and 25 per cent to families earning between US\$ 351 and US\$ 600 per month.⁽¹¹⁾

For a country that, in 2003, had 4.33 million people and about 1.076 million households, this meant that about 21 per cent of all households had benefited from resources allocated by the government for their housing needs. A key issue in this achievement has been the national commitment to prioritizing housing by the two main political parties that have alternated power in the past 20 years.

b. El Salvador

A similar housing policy followed in El Salvador, as it deregulated its economy and privatized the banking system. In 1992, the National Fund for Popular Housing (FONAVIPO) was created to mobilize state resources to authorized financial intermediaries, to address the shelter credit demand from low-income families in the informal sector. FONAVIPO structured a demand subsidy scheme that financed the equivalent of 10 minimum wages (US\$ 2,000 per new housing solution) in one instalment. Savings equivalent to a month's wages over a period of one year were a pre-condition for a state subsidy and a loan by the formal financial system.⁽¹²⁾ Since a significant number of applicants came from very poor neighbourhoods and contributed with their labour to building their homes in new organized settlements (NAOs), compulsory savings were not required.

A problem in El Salvador was the source of finance. FONAVIPO's investment capital came from selling assets of the National Institute for Urban Housing (IVU). These resources were rapidly used up and the result was long queues of applicants with unresolved cases. By the end of 2005, the internal fiscal resources allocated to subsidies totalled about US\$ 2 million, substantially below the annual requirements.⁽¹³⁾

Another consequence of this housing policy was a steep rise during the 1990s in the production of cheap, affordable and completed small housing units known as *urbanizaciones*, supplied by private builders in areas relatively far from the main cities of El Salvador. Fortín-Magaña⁽¹⁴⁾ found that in the late 1990s and early 2000s, these settlements became extremely violent places, plagued with crime and juvenile gangs. She argued that a probable cause was that the housing units, backed with mortgage state finance, were purchased by formal sector workers and, in most cases, both parents had to leave their children unattended during working hours. By contrast, unserviced plots of land that were subdivided by private owners (*lotificadores*) and sold either for cash or rental with a sales option to formal and informal sector workers who built their own housing units, consolidated more rapidly and became more secure neighbourhoods.⁽¹⁵⁾ In this case, no state funds were available and the private land developer loaned money to the families for land and building materials.

Until 1992, these *lotificaciones* were considered "illegal" sub-divisions of land, although they were tolerated. In 1992, housing legislation was

9. See reference 8.

10. See reference 8.

11. See reference 8.

12. By the end of 1998, only 5,300 families had saved and the average sum was US\$ 38. See Sorto, F A (1999), "Alternativas de políticas para fortalecer el ahorro de los hogares de menores ingresos: el caso de El Salvador", Serie Fomento del Desarrollo No 89, CEPAL, Santiago, accessible at <http://www.cepal.org/publicaciones/xml/4/4514/lcl1265e.pdf>.

13. Castillo, L (2006), "El microcrédito de vivienda: una herramienta viable y efectiva para la atención del déficit cualitativo de vivienda en sectores de pobreza en Centroamérica", Agencia Sueca de Cooperación Internacional para el Desarrollo (Asdi), Documento de Referencia, San Salvador.

14. Fortín-Magaña, G (2003), "Low-income housing in El Salvador", in *Revista Harvard Review of Latin America*, Winter 2003, accessible at <http://drclas.fas.harvard.edu/revista/articles/view/199>.

15. See reference 14.

16. Sevilla, M (2001), "El Salvador private development: the case of Argoz", *Urban Upgrading*, a reference for administrators, policy makers and decision makers, accessible at <http://web.mit.edu/urbanupgrading/upgrading/case-examples/ce-es-arg.html>.

17. Cerritos, P (1999), "El Salvador: a private developer looks for a far-reaching answer to the housing problem of the urban poor", accessible at <http://www.worldbank.org/urban/upgrading/argoz.html>.

18. See reference 16.

19. See reference 13.

20. Inter-American Development Bank (2006), "Documento conceptual de proyecto Honduras, programa de vivienda de interés social", Internal Document, IADB, Washington DC, 13 March.

21. See reference 20.

adopted that legalized these incremental land urbanizations on the outskirts of the main urban centres. Argoz, a private developer, enabled about 300,000 families to gain access to urban land between 1977 and 2000.⁽¹⁶⁾ The majority of these families earned between one and two minimum wages, not all of them in the formal sector. Argoz either provided infrastructure to the land (investing 18 per cent of its profits for the improvement of basic services in these settlements)⁽¹⁷⁾ or identified private landowners, providing them with engineering designs for plot sub-divisions. Argoz assumed responsibility for advertising, identifying potential and effective demand, analyzing affordability and families' credit track records, and contracting and collecting payments.⁽¹⁸⁾

Similar housing policies were established in the rest of the countries of the region, although they have not been as successful as those in Costa Rica and El Salvador. A major constraint has been the lack of clarity exhibited by central governments in identifying a reliable source of fiscal resources, on a yearly basis, for the up-front subsidies.⁽¹⁹⁾

c. Nicaragua

The state subsidy is a more recent introduction. In the past few years, the state has opted to cover the total cost of the solution, as the pilot attempts to introduce the ABC scheme (savings, subsidies and credits) met with difficulties, mainly due to the reluctance of the financial institutions to manage subsidies combined with loans. The total number of solutions remains very modest given that the government is solely dependent on donor funds or international loans for its subsidy programme. A serious internal effort to provide fiscal resources has not been attempted.

d. Honduras

In the past few years, the government has allocated about US\$ 4.4 million per annum to housing subsidies for two programmes. The first – a complementary subsidy to self-help efforts programme (PROVICEP) – covers up to US\$ 1,831 per housing solution. The family contributes 10 per cent of the total cost and the rest is paid for from a loan, for a total cost of up to US\$ 6,000.⁽²⁰⁾ The target population for these subsidies is families that earn up to four minimum wages. The second scheme, known as housing for the people programme (PVPG), covers up to US\$ 2,000 per housing solution as a direct subsidy. The housing solution is built by private developers and financed by banks for a total cost of US\$ 10,000. However, the interest rates are subsidized, which generates an extra hidden subsidy of US\$ 4,000. The PVPG reaches families in the upper four income deciles. As in the case of Nicaragua, internal resources allocated by the Honduran government have declined and the bulk is financed through international loans from IADB or donations from Taiwan.⁽²¹⁾

e. Guatemala

The Guatemalan government has also structured an ABC scheme. However, a significant percentage of families cannot save enough money to access the subsidy, and many of them borrow from microlending institutions in

order to access it. The government is beginning to raise funds for subsidies through a tax on petroleum.⁽²²⁾

A feature that characterizes subsidy programmes throughout the region is the role of the private building sector, which, in every case, has been the main lobby group pressing for a housing policy based on up-front state subsidies for building new housing. Thus, the subsidy schemes have not been driven as much by end-users as by the economic interests of the construction sector.

VI. PRIVATE NON-PROFIT SHELTER FINANCE

During the late 1980s and the 1990s, a huge volume of resources channelled by multilateral and bilateral agencies to support the peace agreements that ended decades of internal conflict in Central America resulted in a significant increase in the number and type of governmental and private non-profit social programmes. As part of this process, from 1988 to 2005, the Swedish International Development Cooperation Agency (Sida) allocated more than US\$ 52 million to promote and finance urban low-income housing and local development programmes in Central America.⁽²³⁾

The Swedish cooperation worked under the assumption that there were reinforcing dynamics between the increasing levels of vulnerability of the urban poor, social disintegration and political unrest in the region. Therefore, it was expected that by addressing some of the causes of urban poverty, especially financial and social exclusion, the democratic processes would be strengthened.⁽²⁴⁾

The resources from Sida were channelled through the following institutions:⁽²⁵⁾

- **The Housing Promotion Foundation (FUPROVI) in Costa Rica.** This NGO – created in 1987 as a specialized housing agency – produces the solutions it finances, covering the full cycle of housing production from the organization of the client families, through assisted self-help methods, to post-construction advisory services for community strengthening and development. FUPROVI also contributes funds of its own and works through the formal banking system in Costa Rica (mutual funds, banks and cooperatives). FUPROVI also lends directly to participant families, although certain modalities have been modified during its 20 years of existence.
- **The Salvadoran Integral Assistance Foundation (FUSAI) in El Salvador.** This NGO was created in 1992 to assist in the reintegration of displaced persons affected by the civil war. It grew rapidly into an implementing agency financing both rural and urban groups for new housing, housing improvements and income-generating activities. In 2002, FUSAI, together with other international and national investors, created a microfinance institution (MFI) called Integral (soon to become a bank) to capture savings, intermediate remittances and to provide credit for new housing, housing improvements and for production and income-generating activities. Meanwhile, it retained FUSAI to provide non-financial services, especially technical assistance and social follow-up for housing and local development.
- **The Foundation for the Promotion of Local Development (PRODEL) in Nicaragua.** PRODEL started as a government programme in 1993

22. See reference 13.

23. Data provided by Per Fröberg of Sida's Urban Division in April 2006. The support to the urban sector was part of a Swedish bilateral assistance package to Central America that, for the period 1999–2001, totalled more than SEK 2.2 billion, about US\$ 273 million. See Ministerio de Asuntos Exteriores (2001), *Estrategia Regional: América Latina y el Caribe. 1 de enero de 2001 a 31 de diciembre de 2005*, Regeringskansliet, Ministerio de Asuntos Exteriores, Stockholm.

24. Interviews held in April and November 2006 with the ex-director of Sida's Urban Division and two former counsellors responsible for Swedish cooperation in Central America.

25. For a more detailed description of the characteristics of the institutions supported by Sida and their low-income housing programmes, see Stein, A and L. Castillo (2005), 'Innovative financing for low-income housing improvement: lessons learned from Central America', *Environment & Urbanization* Vol 17, No 1, April, pages 47–66.

and became a non-profit private institution in 2003. It functions as a second-tier organization, providing lines of credit to seven MFIs for housing improvements and income-generating activities. It also provides technical assistance to these MFIs and to end-users of credit. PRODEL also provides finance to 10 small and medium-sized municipalities for the introduction, expansion and maintenance of basic services and infrastructure, with the strong involvement of beneficiary communities.

- **The Urban and Rural Social Housing Development Foundation (FUNDEVI) in Honduras.** This started as two separate public low-income housing programmes: PVMR for rural areas in the 1980s and PRIMHUR for urban areas in 1992. Originally, both programmes were supported by the Kreditanstalt für Wiederaufbau (KfW) and the government of Honduras. Sida started its support in 1998, immediately after Hurricane Mitch. In 2002, FUNDEVI became a public interest foundation, working as a specialized lending institution providing credit and technical assistance for new housing and housing improvements, and recently also for the introduction of basic services through municipalities and microfinance for housing improvements.
- **The Local Development Trust Fund (FDLG) in Guatemala.** Since 1999, this has functioned as a second-tier institution with a number of roles. It provides credit lines to nine MFIs, formal savings and lending cooperatives for housing improvements, and income-generating activities to poor households in both urban and rural areas. It is involved in new product development for low-income segments, including the provision of technical assistance to these MFIs and to the end-users of credit, and it supervises and rates retail institutions. Legally, it is a trust fund and a formal bank administers its resources. An independent technical unit follows up the performance of the programme and provides assistance to the MFIs.

The common characteristics of the Central American experiences have been:

- the strong involvement of the target population in the decision-making process and in the design and execution of the programmes; also in the cost recovery of individual household solutions and collective infrastructure investments, and in the operation and post-project maintenance of basic services;
- the efforts made by Sida in conjunction with other donor agencies, governments and the organizations themselves to ensure that the programmes are institutionalized so as to be operationally and financially viable and sustainable once the external support provided by donor agencies has diminished; and
- the attempts made by Sida and the institutions that manage the resources to influence policy change by showing alternative private non-profit mechanisms that work and finance the urban poor.

VII. CREDITS FOR HOUSING

Housing finance products are relatively similar in the five countries. All are based on mortgage-backed loans to low-income families for new housing, and small micro and repeat loans with flexible forms of collateral for the

improvement or expansion of existing houses. The housing improvement lending uses the concept of incremental and gradual housing solutions compatible with the participating families' capacities for savings, loan repayments and in-kind, monetary and labour contributions.

The institutional arrangements vary between countries but the range is as follows:

- loans are given directly to the end-users in the cases of FUPROVI and FUNDEVI;
- FUSAI organizes the demand by identifying and providing technical assistance for housing improvements and new housing to clients, while Integral, the MFI created by FUSAI, is responsible for screening clients and giving and recovering the loans; and
- PRODEL and FDLG channel resources to specialized microfinance intermediary institutions, cooperatives and banks that provide short- and medium-term loans to end-users.⁽²⁶⁾

Credits are sometimes combined with targeted housing state subsidies (as in the cases of FUPROVI, FUNDEVI and FUSAI and, most recently, pilot schemes in FDLG). All credits, irrespective of whether subsidies are available, are complemented by monetary savings, self-help and in-kind contributions from participant households.

Credits for new housing and housing improvements are given at market interest rates. The rates reflect, but do not necessarily match, the market interest rates for mortgage lending in the formal banking sector. In 2004, they ranged from 14 per cent per annum for clients in Nicaragua to 23 per cent in El Salvador. In Nicaragua, however, the effective interest rate that MFIs charge clients has increased substantially in the last three years. In 2007, the interest rate (including direct legal and administrative fees for the MFI) was 31 per cent for a housing improvement loan of less than US\$ 1,500. Yet, this rate is low relative to the 24 per cent non-regulated MFIs are allowed to charge by the Nicaraguan Central Bank. Some MFIs add an extra 15 per cent in commissions and fees, so the rate is almost 39 per cent. Interest rates are therefore becoming an issue as they can capture capital at market rates between 9 and 10.5 per cent and disburse to the borrower at 39 per cent. In Nicaragua, there is no real competition from the banks and, while demand far outstrips supply, rates will remain high, unlike in El Salvador and Costa Rica, where competition and a wide choice of lenders results in significantly lower interest rates.

The MFIs accept a wide variety of collateral and security from the households (especially mortgages, pawned goods and co-signed loans). The flexibility in the type of collateral has allowed the inclusion of low-income households (monthly family incomes between US\$ 100 and US\$ 500) even if they have not fully resolved the legal status of land occupation and possession.

In Nicaragua, the MFIs, working with funds from PRODEL, have signed collective agreements with small companies and the ministries of health and education so that payments for the housing improvement loan can be deducted from monthly salaries. A teacher in Nicaragua earns about US\$ 140, nurses and doctors between US\$ 250 and US\$ 300, and tobacco workers between US\$ 90 and 120. In the absence of real guarantees (full registered land title), this automatic deduction reduces the default risk and increases accessibility.

26. The number of MFIs has increased dramatically in the past decade. In 2005, Navajas and Tejerina estimated there were about 89 consolidated MFIs in the five countries, managing an overall portfolio of US\$ 1.093 billion and about 1.1 million clients. See Navajas, S and L Tejerina (2006), *Microfinance in Latin America and the Caribbean: How Large is the Market?* Best Practice Series, Sustainable Development Department, Inter-American Development Bank, Washington DC. By mid-2005, the main MFIs in Nicaragua had an outstanding portfolio of US\$ 216 million. In 2006, 10 per cent of the total volume of loans given by a core group of 30 MFIs in Nicaragua managed US\$ 150 million in housing credits, the majority working with PRODEL. See Boman, K and R Rahman (2007), "Exploratory study for innovative financial instruments to increase the poor's access to microfinance in Central America", Report to Sida, Stockholm.

The calculation of monthly household income takes into account not only the income of the household head but also other sources of income, including remittances from family members living abroad. If the MFI cannot verify these remittances then, for purposes of calculation, only a percentage of the declared income is considered, although this percentage varies from one institution to another. For example, if during loan screening a borrower declares receipt of US\$ 200 as remittances from abroad, some MFIs might include only US\$100 of this extra income in their calculations.

As loans (both capital and interest) are recovered, the resources (once operational and administrative costs have been deducted) are reinvested as new loans for other families with similar income levels. This has allowed the creation of various revolving funds.⁽²⁷⁾

27. According to PRODEL, housing loans increased by 90 per cent per year from 2001 to 2005, from US\$ 1.9 million to US\$ 20.5 million, and reached about 26,136 clients. See reference 26, Boman and Rahman (2007).

VIII. CO-FINANCING FOR INFRASTRUCTURE AND BASIC SERVICES

In the case of PRODEL in Nicaragua, funds are channelled as incentive grants to municipalities for the provision and improvement of basic services in existing low-income settlements, under the modality of “co-financing funds”. Both the municipality and residents of poor neighbourhoods identify and agree on the priorities and types of projects to be executed through microplanning exercises, and each contributes a proportion of resources (money, in-kind and labour) to match every dollar transferred by the fund managed by PRODEL. Usually, PRODEL finances up to 50 per cent of the value of an infrastructure project, and the municipality together with the community the other 50 per cent. However, although the proportion of each of their contributions may vary, the municipality cannot contribute less than 15 per cent and the community not less than 10 per cent of their half share.

IX. LAND ISSUES

The degree to which secure land tenure (including titling) is a prerequisite to accessing finance varies from country to country. The models of intervention are certainly related but they respond to the specific contexts in which they operate.

In Costa Rica, the government is relatively tolerant towards land invasions and squatting. Yet, all housing projects require land title so that families can qualify for a mortgage loan and a subsidy from the state. Likewise, government institutions cannot provide infrastructure and basic services if land tenure is not properly authorized, recognized and legalized. Therefore, FUPROVI specializes in orienting and giving legal assistance to individual families and to organized groups, to solve their land tenure problems and for the introduction of basic services in existing squatter areas. FUPROVI tries to “play by the rules” and will not provide a loan if tenure is unclear. This clearly has financial consequences, especially for low-income families wanting access to small loans for housing improvements, as the cost of mortgaging is high.

A FUPROVI innovation in Costa Rica in 1988 was the provision of financial and technical assistance to squatter families to improve their services, infrastructure and shelter, in parallel with the process of assisting them to legalize land tenure. FUPROVI used Sida’s resources as a sort of

“risk” fund to make squatter renewal or upgrading feasible, including the introduction of basic services and infrastructure, while families waited for full land title. Once they had received title, they claimed the subsidy and reimbursed the amount advanced by FUPROVI.⁽²⁸⁾

In Nicaragua, the law is more tolerant of illegal invasions and squatting, and less strict regarding land titling as a pre-condition for accessing finance and the introduction of basic services. However, the Nicaraguan housing subsidy programme requires land title as a prerequisite for accessing its subsidy, which covers the whole housing cost, and the poorest and most marginal neighbourhoods with unclear legal tenure status have been excluded. For housing improvements, the situation varies and there are MFIs that do not require legal title for the loan. In terms of housing improvements, the important aspect of the Nicaraguan context is that about 80 per cent of households have tenure rights to the land they occupy, although not necessarily registered legal title. This is the result of Sandinista land reforms in the 1980s. However, there are huge problems with identifying the real owners of the land.⁽²⁹⁾

In Guatemala, the issue of land tenure is more critical, as there is almost no government tolerance of illegal land invasions or squatting. FDLG does not provide legal assistance to end-users, but some MFIs do. For example, the solidarity groups promoted by Génesis Empresarial, one of the MFIs through which FDLG operates in Guatemala, has legal assistance as one of its main products, so that the entire group of borrowers has the possibility of solving land tenure issues.

In Honduras, the government is relatively tolerant towards urban land invasions. Moreover, the main political parties, when in opposition, traditionally have promoted illegal invasions in urban areas. Although land title is a requirement for access to state subsidies for new housing, many basic services and infrastructure are provided even in unauthorized settlements.⁽³⁰⁾ FUNDEVI provides legal assistance for land titling, especially in rural areas. In urban areas, it has agreements with the municipalities where it operates that accelerate the legal titling process for families and organized groups. In a new development, land title is not a prerequisite for small house improvement loans.

In El Salvador, land invasions are less tolerated than in Costa Rica, Honduras and Nicaragua but more so than in Guatemala. As in Honduras, many illegal settlements and squatter areas receive basic municipal services over time. FUSAI provides legal advice to individual families and organized groups for land tenure regularization, which is also a pre-condition for accessing state-backed subsidies.

X. TECHNICAL ASSISTANCE

A common feature of all the modalities is that financial resources are complemented by technical assistance to families and communities for the improvement and expansion of houses and basic services. In Nicaragua and Guatemala, there are still subsidies for technical assistance to construction, not to the loan clients but to the MFI branch offices, so that they can break even. The break even point involves a number of factors, such as the volume of credit operations or the decision to cross-subsidize for the benefit of households that can only afford very small loans. Nevertheless, the subsidy scheme is tracked and, for accounting and financial reasons, kept separate from the credit operations. In the case

28. According to a conversation held with the ex-director of Sida's Urban Division, the model of using Sida's resources as sort of “risk” funds was repeated in other countries.

29. Inter-American Development Bank (2002), “Programa de vivienda social en fases múltiples: propuesta de préstamo”, Internal Document, IADB, Washington, DC.

30. In the case of Tegucigalpa, the capital city of Honduras, in 2001 about 60 per cent of the housing stock did not have land-registered titles. See reference 6, Angel (2001). Nevertheless, the majority of households, especially in Tegucigalpa, were investing significant amounts of resources in improving their housing.

of PRODEL, technical assistance is provided by professionals who do not necessarily work for the lending institutions (MFIs); in Guatemala, FDLG has trained staff in the MFIs to provide the technical assistance to families as part of their lending process.

There are advantages to having technical assistance and loan analysis carried out by the same person:

- it diminishes costs;
- during discussions on housing improvements, the loan analyst can gain insight into the constraints a household might encounter during construction and repayment;
- follow up of the construction process can also help the loan repayment; and
- the technician is aware of the financial complexities of a loan.

There are, however, some intrinsic social constraints to this arrangement:

- it is more difficult for a family to distinguish between the two separate roles of technical assistance and pressure to repay;
- the inadvertent priority of the technician may be to secure a good financial deal for the MFI and not necessarily a suitable technical housing improvement solution for the family;⁽³¹⁾ and
- the professional will be pressured by the MFI to minimize as much as possible the time dedicated to the technical assistance process and to quickly move forward to screen other potential loan clients.

In newly created formal settlements, FUNDEVI, FUPROVI and FUSAI are involved in the planning and layout of the new settlements, providing directly or through state or local autonomous institutions the necessary infrastructure and basic services, assisting in land titling and providing technical assistance for self-help construction and resettlement. In all three cases, the financial and technical assistance are separate. In some cases, the gap between the financial and social staff is also reflected in the mixed messages that the population receives. This has provoked confusion among communities on the nature of the organization: is it a financial or a social institution?

XI. SYNERGIES BETWEEN SHELTER FINANCE AND TECHNICAL ASSISTANCE

Synergies are promoted between individual microlending for housing improvements and income-generating activities and collective infrastructure provision, as in the case of PRODEL in Nicaragua and, to a lesser degree, FUSAI in El Salvador. This way, poorer groups can be reached through basic services, while low-income households with relatively higher incomes can access loans.

The reason for this is that most neighbourhoods where PRODEL works with infrastructure and basic services are, from an income level perspective, highly heterogeneous, even the most marginal ones. In some cities and in some neighbourhoods, basic services and infrastructure have been introduced with little possibility for housing improvement loans given the income level of the target population. But experience suggests that where infrastructure is provided, housing improvements

31. Technical assistance provided by PRODEL has helped households to manage budgets – buying good quality building materials and learning how to use these materials – and learn how to negotiate with masons and construction workers. See FIDEG (2006a), “Evaluación diagnóstica retrospectiva de los diez primeros años de PRODEL 1994–2003”, Internal Document, PRODEL, Managua, February. In Guatemala, clients see technical assistance from the MFIs as important for understanding the financial conditions of the loan (interest rates, guarantees, repayment periods, etc.) and the possible consequences of defaulting. (Based on a field visit by Alfredo Stein in July 2006 to the cities of Jutiapa and Guastatoya.)

are also sought, not only via the loans from the MFIs that work with PRODEL's resources but also as part of diverse self-help efforts by very poor families.⁽³²⁾

Thus, the introduction of basic services is seen by PRODEL as an appropriate strategy for local development in places where there is a highly unregulated housing framework, weak territorial planning and a qualitative housing deficit. It is rather different from the more formal housing markets and regulated building codes that exist, for example, in Costa Rica and that FUPROVI has to take into consideration. In any case, the different approaches seem to work both with formal and informal settlements, and with poor and very poor families.

Finally, FUPROVI provides advisory services to communities post-construction in the "neighbourhood identity" programme, which fosters and enhances the sense of community belonging and directly improves neighbourhood security and other non-material factors. These advisory services are "free of charge".

The impact of housing subsidies is also affected by the way resources are handled and by the social and technical assistance methods that are used to promote and ensure community participation. A recent study in Costa Rica identified family and community factors that might contribute to the success of low-income housing programmes supported with up-front state subsidies.⁽³³⁾ Eight communities established with state housing subsidies between 1987 and 2004 in San José (not all of the communities had worked or had been promoted by FUPROVI) were classified as "successful" or "unsuccessful" according to the general conditions and the level of improvement of the houses, the existence of a community organization working to consolidate the neighbourhood both physically and socially, the condition of the infrastructure and green zones, and the level and management of basic services.⁽³⁴⁾

In most cases, private contractors had delivered "unsuccessful" projects, with no community participation. Families received completed housing units and the design did not take into consideration the incremental improvements and expansions that take place in the latter stages of the household's life. The study found that families living in "unsuccessful" projects invested more in rebuilding their homes than in improving or expanding them. This was linked to the use of rigid pre-fabricated panels that had to be demolished by families wanting to expand their living space. Thus, families had to practically rebuild their houses instead of improving them. Pre-fabricated panels were also used by FUPROVI in early projects to speed up the mutual help process, but in later phases this was changed.

While 81 per cent of families had improved their floors in "successful" projects, only 58 per cent had done so in "unsuccessful" ones; 66 per cent of families in "successful" projects had good quality external walls compared to 34 per cent in "unsuccessful" projects; and 75 per cent had good ceilings in "successful" projects compared to 37 per cent in "unsuccessful" ones.⁽³⁵⁾ About 32 per cent of families in "unsuccessful" projects perceived that their community was insecure with regard to crime and that their quality of life was inferior; only 11 per cent felt that way in the "successful" projects. The study did not find clear linkages between income level and the physical condition of the settlement, although a significant number of families in "unsuccessful" projects were experiencing income difficulties at the time of the research. In those settlements with high levels of

32. This confirms the mounting evidence that the effects of investments in infrastructure and basic services in poor urban communities have a multiplying effect on poor households. See Calderón, C and L Servén (2004), "The effects of infrastructure development on growth and income distribution", Central Bank of Chile Working Paper No 270, Santiago.

33. Programa Estado de la Nación (2006), "Estado de la nación en desarrollo humano sostenible. Un análisis amplio y objetivo sobre la Costa Rica que tenemos a partir de sus indicadores más actuales (2005)", Programa Estado de la Nación, San José.

34. FUPROVI (2006b), "Estudio exploratorio del bono familiar de la vivienda en 8 proyectos de interés social y sus habitantes, en el período 1989-2005", Research Report, FUPROVI, San José.

35. See reference 34.

community participation in infrastructure and other community works after the houses had been built, stronger levels of social consolidation existed. Finally, the study found that “successful” communities had been established without strong intervention from political agents who, during election campaigns, promised to allocate state subsidies according to partisan affiliation.⁽³⁶⁾

XII. SOCIAL IMPACT

According to the different reports produced by the five programmes, between 1989 and 2005 more than 110,000 low-income families in the main urban areas had access to resources for improving their habitat conditions.⁽³⁷⁾ This represented about 3 per cent of the total urban population of the five countries in 2005, and about 6.5 per cent of the urban poor.

During the same period, about 89,000 families received a housing loan (for new housing or housing improvements) with resources from the programmes, either directly or through MFIs (Figure 1). In Costa Rica,

36. See reference 34.

37. This number includes families that had access to loans for new housing, housing improvements and basic infrastructure and services (in the case of PRODEL). Another significant number benefited from loans for income-generating activities given by all programmes except FUNDEVI, which has no lending to microentrepreneurs, and FUPROVI, where an income-generating programme was discontinued in the late 1990s. For the purposes of the current paper, only households benefiting from new housing, housing improvements and basic infrastructure are considered.

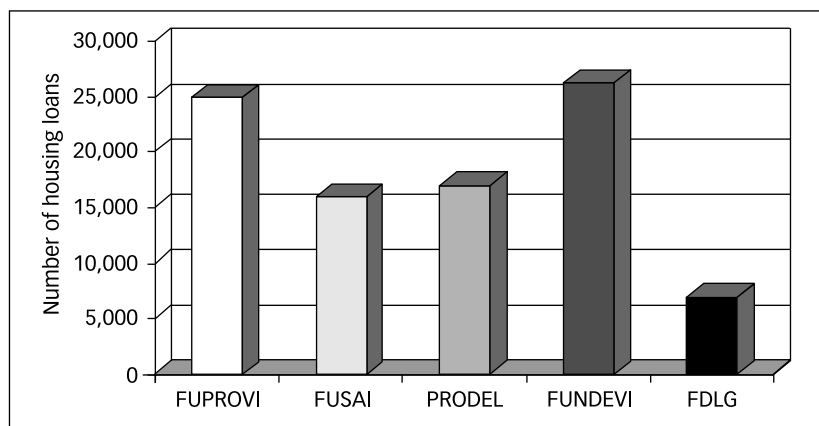


FIGURE 1
Accumulated number of housing loans in urban areas, by programme (1989–2005)*

*In the case of FUNDEVI, this also includes loans given with resources from the Kreditanstalt für Wiederaufbau (KfW).

SOURCE: Authors’ elaboration based on data from FUPROVI (2004), *Dignificando la Vivienda, Promoviendo la Participación*, FUPROVI, San José; also Castillo, L (2006), “El microcrédito de vivienda: una herramienta viable y efectiva para la atención del déficit cualitativo de vivienda en sectores de pobreza en Centroamérica”, Agencia Sueca de Cooperación Internacional para el Desarrollo (Asdi), Documento de Referencia, San Salvador; Dewez, D, S Reisa and R Reddy (2006), “Acción: hallazgos del análisis de la pobreza: apoyo integral, El Salvador”, *InSight* No 18, January; PRODEL (2004), *Informe de Cierre Segunda Fase Período 1998–2003*, PRODEL, Managua; Boman, K and R Rahman (2007), “Exploratory study for innovative financial instruments to increase poor’s access to microfinance in Central America”, Report to Sida, Stockholm; FUNDEVI (2005), *Ejecución Física y Financiera por Años*, FUNDEVI, Internal Document, Tegucigalpa; and Canek, M (2005), “El microcrédito de vivienda y su aporte a la inclusión indígena en Guatemala”, Paper presented at the 6th N-AERUS Conference, Lund University, Lund, Sweden.

programmes reached 24 per cent of total urban poor families; in El Salvador, 4.5 per cent; in Guatemala, 1.6 per cent; in Honduras, 7.1 per cent; and in Nicaragua, about 8.2 per cent. These are small numbers relative to the huge potential demand for new housing and housing improvements, and the introduction of basic services and infrastructure in the region, but they are still significant.

The majority of low-income families that accessed a loan could afford repayments based on their monthly family income. In monetary terms, they earned between one and four minimum wages per month (in Central America, the minimum wage varies between US\$ 90 per month in the case of Nicaragua, the lowest, to about US\$ 150 in the case of Costa Rica, the highest). Invariably, some households are too poor to afford loan repayments and they are assisted through other means, mainly the infrastructure and basic services component (for example, as with PRODEL in Nicaragua).

From the time it began operations in 1992 until the end of March 2006, FUNDEVI assisted 39,515 families (about 177,102 people) – 27,118 families in urban areas and 12,397 in rural areas. This is an average of 2,000 families per year in urban areas. Seventy-three per cent of these households earned less than three minimum wages per month (US\$ 300 per month, or US\$ 2.20 per person, per day).⁽³⁸⁾

In four countries, the majority of housing loan programme clients are women: in Costa Rica, 60 per cent; in Nicaragua, 62 per cent; in Honduras, 60 per cent; and in El Salvador, 55 per cent. This reaffirms a global reality: women are the main users of microcredit both for income generation and housing improvements; and the fact that some loan screening processes take place where the poor live is also helpful. It eliminates both the need to travel and a cumbersome loan approval process, something that is especially difficult for woman-headed households.

In a recent external evaluation of PRODEL, interviews were conducted with 189 households benefiting from the introduction of basic services

38. FUNDEVI (2006), *Informe de Avance No 16*, FUNDEVI/GITEC CONSULT GMBH, Tegucigalpa, January–March. The minimum wage in Honduras in 2005 ranged between Lps 61.26–79.3 per day, or US\$ 3.22–4.17. See BCH (2005), "Boletín estadístico", *BCH Subgerencia de Estudios Económicos* Vol LV, No 4, April.

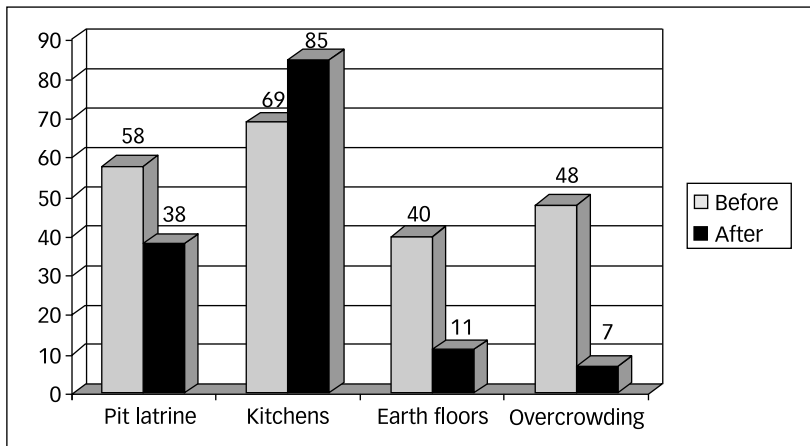


FIGURE 2
PRODEL: Effects of housing improvement loans (% of households)

SOURCE: FIDEG (2006b), "Reducción de la pobreza y mejora urbana en Nicaragua", Evaluation Report, PRODEL, Managua.

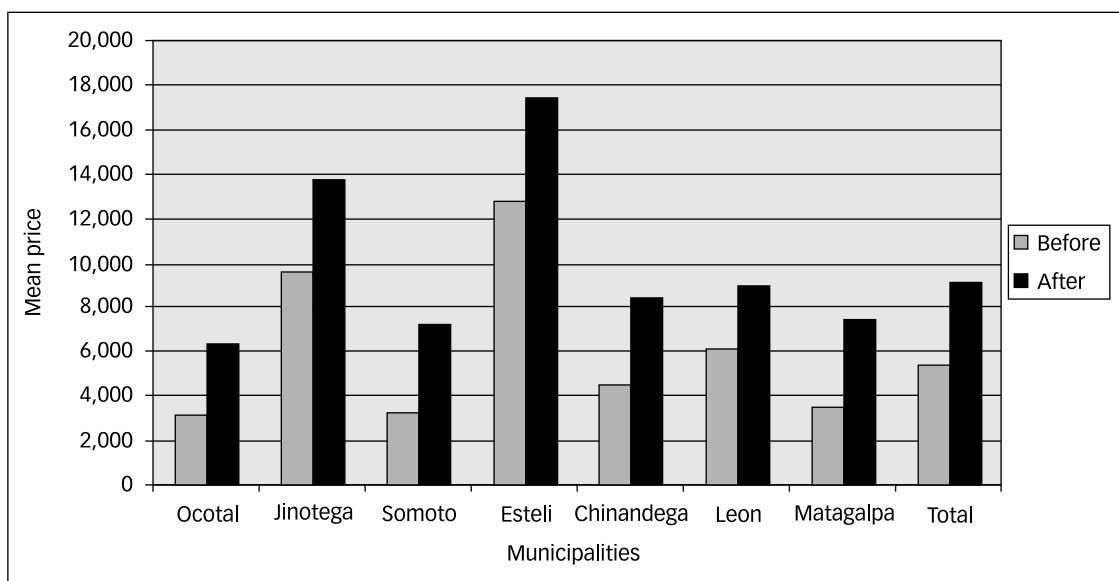


FIGURE 3
Average price of houses before and after improvements (in US\$) in different Nicaraguan cities where PRODEL works

SOURCE: Authors' elaboration based on data from FIDEG (2006a), "Evaluación diagnóstica retrospectiva de los diez primeros años de PRODEL 1994–2003", PRODEL Internal Document, Managua, February.

39. See reference 31, FIDEG (2006a).

and with 229 housing improvement loan clients.⁽³⁹⁾ About 48 per cent of the houses were overcrowded before improvement and this decreased to 7 per cent after improvement. About 40 per cent of families had earth floors before improvement and this decreased to 11 per cent after improvement (Figure 2). The average value of the houses increased as a consequence of both the housing improvements and the introduction of basic services, from US\$ 3,783 before improvement to about US\$ 7,654 after improvement (Figure 3).

XIII. CONCLUSIONS

The following are some preliminary conclusions from these Central American experiences.

Urban poverty and housing improvements. Recent studies⁽⁴⁰⁾ show a strong correlation between the income levels of urban poor families and the overall qualitative housing deficit in Central America. Poorer families have:

- less access to secure land tenure and home ownership;
- less access to basic services and infrastructure (safe water systems, electricity, sanitary systems, etc.);
- lower quality and less durable houses; and
- higher densities of inhabitants per room.

For that reason, the efforts to overcome the qualitative deficit by financing housing improvements and the provision of basic services

40. See reference 6, Angel (2001); also Solo, T et al. (2006), "Entre la exclusión financiera y el desarrollo comunitario", World Bank and Cities Alliance, Washington; and see reference 13, Castillo (2006).

and infrastructure seem to be strategically more important than the construction of new housing from any poverty reduction strategy perspective. It is important that governments in general, and housing ministries in particular, understand the concept of housing deficit in terms that do not encourage the idea that "... houses with some unsatisfactory physical conditions must be replaced by new ones."⁽⁴¹⁾ This is the typical argument used by the private building sector, sometimes in complicity with housing officials, to portray the "real" housing problem in the region as one requiring new housing solutions rather than improvements.

Housing subsidies and transparency. A housing policy that works effectively requires certain institutional capacities that are not necessarily linked to the housing finance sector. As Gilbert⁽⁴²⁾ suggests, they include "an honest and efficient civil service", a "tax system" that functions, a stable "political system" with a "degree of continuity within and between administrations", and methods for "identifying", screening and selecting those poor families that are entitled to receive the up-front and targeted state subsidies. In this sense, it requires a society that is ready to deal with public corruption, with a good system of checks and balances that protects subsidies from being seized exclusively by upper-income groups or lobby groups related to big building companies. Continuity in housing plans, capable technical staff and a constant and reliable flow of resources from taxes have not been achieved in the majority of countries of Central America – on the contrary. Compared to Costa Rica and El Salvador, countries such as Guatemala, Nicaragua and Honduras have higher tax evasion rates among their upper-income groups; their populations also lack confidence in their national governments. In its barometer for 2006, Transparency International⁽⁴³⁾ located Costa Rica as 55th among 165 nations (number one being the most transparent and 165 the least transparent). El Salvador was ranked 57th; but Guatemala and Nicaragua shared the 111th position and Honduras was 121st.

Financial inclusion. The experiences show that social exclusion in urban areas is connected to the degree of "financial exclusion" from banking services provided by formal financial institutions, but it cannot be reduced to that. Financial inclusion requires that lending institutions refine their understanding of individual, household and collective assets of the poor, and adapt the lending process cycle (targeting, screening and analyzing loan requests, and recovering loans) to the incremental way in which the poor build their homes over a relatively long period of time. Indeed, difficulties in accessing finance for housing improvements is associated with a lack of solid collateral on the part of the urban poor, as suggested by de Soto,⁽⁴⁴⁾ and their lack of stable income. But the experiences in Central America show that it is also associated with other factors, specifically:

- the perception by the banking system that housing improvement is not a profitable business;
- that it involves overly high administrative costs;
- that even if mortgage loans are given, guarantees in cases of default are impossible given the type of settlements where the poor live; and
- that the prevailing norms that regulate the banking system are not designed to attend these sectors.

41. See reference 6, Gilbert (2001), page 22.

42. See reference 6, Gilbert (2001), page 63.

43. Transparency International (2007), accessible at <http://www.transparency.org>.

44. de Soto, H (2000), *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, Basic Books, New York.

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