



Social Bond Framework for Affordable and Decent Housing

Republic of Ecuador | September 2019



The Republic of Ecuador is in the process of issuing its first Social Bond with the objective of diversifying its sources of funding for financing access to affordable and decent housing, thus reducing the housing deficit in the country. The proceeds from the bonds will be used to finance the public policy of affordable and decent housing through the provision of capital on appropriate terms for Social Interest Housing (or Vivienda de Interés Social, VIS) and Public Interest Housing (Vivienda de Interés Público, VIP) (see description below). Successive sections of this document explain in detail the Social Bond Framework for Affordable and Decent Housing of the Republic of Ecuador, developed according to the Social Bond Principles 2018¹ published by the International Capital Markets Association (ICMA) and its four main components: (i) Use of proceeds, (ii) Process for project evaluation and selection; (iii) Management of proceeds and (iv) Reporting.

This framework will be subject to external review by an institution of international renown.

The sovereign bonds will benefit from a Credit Guarantee granted by the Inter-American Development Bank (IDB), a multilateral organization with AAA credit rating.

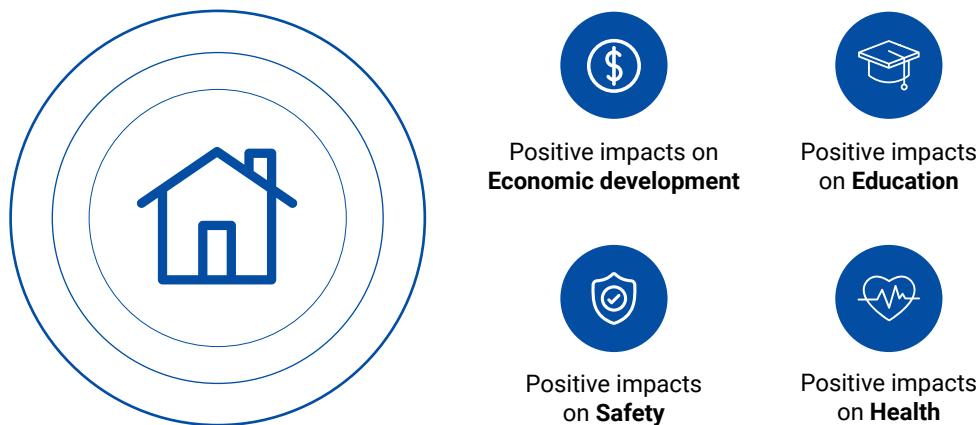
This document has been drafted by the Republic of Ecuador in collaboration with the IDB as guarantor of the Social Bond.

1. <https://www.icmagroup.org/green-social-and-sustainability-bonds/social-bond-principles-sbp>

1. Background.

Housing is essential to a decent life; and this is understood by many of the constitutions around the world, including that of Ecuador, in safeguarding that right.

Access to affordable and decent housing is vital to living in adequate conditions without having to resort to informal solutions lacking basic services and in high-risk areas. Access to affordable and decent housing is crucial for improving the quality of life and promoting social and economic development. Housing influences people's living conditions and their level of health and education, key factors in reducing poverty and advancing economic development. As shown in the graph, access to affordable and decent housing has multiple economic and social benefits, being one of the pillars of sustainable and inclusive economic growth.



This project considers the definition of 'affordable and decent housing' provided by the U.S. Department of Housing and Urban Development, that is, housing that the buyer can pay for with 30% or less of their income.

The housing gap in Ecuador is wide and continues to grow. According to data as of 2017, there were 4,360,000 households in Ecuador, 69% urban and 31% rural. The housing deficit affects almost half of households (67% in rural areas and 38% in urban areas). At the urban level, 21% of the deficit is quantitative (252,013 households in 2017), while the remaining 79% is qualitative (957,335 households in 2017)². In rural areas, 62% of the deficit is qualitative and 38% is quantitative.

2. The qualitative deficit refers to dwellings that do not have minimum standards, are overcrowded (three people per room), or do not have basic services (drinking water, sewerage, garbage collection, or electricity). While the quantitative deficit refers to the need for new housing of inhabitants who constitute new households or who need to replace their housing because it is already irrecoverable.

The housing deficit in Ecuador is estimated to increase at a rate of 40,000 households per year, mainly due to the formation of new households as a result of: (i) a high rate of population growth (even higher in urban areas)³, (ii) a very young demographic structure⁴, and (iii) a sustained reduction in the growth rate relative to the size of the housing (-1,1 %). These factors help explain why, comparatively speaking, Ecuador stands out due to the relative magnitude of its quantitative deficit, which is almost double the average in Latin America⁵.

The main causes of the housing deficit are the limited savings capacity of the population and the absence of affordable mortgage loans offered by the financial system for a large part of the population.

Buying a home is one of the most important lifetime investment decisions for the majority of the population; the ability to do so depends largely on the ability to access a mortgage loan.

However, the current situation of the mortgage market in Ecuador presents structural problems, both on the supply side and on the demand side.

On the demand side, the majority of the population does not have the necessary savings to cover the required down payment of at least 30% of the value of the home to access a mortgage loan. In total, 23% of Ecuador's population, or about 3.8 million people out of the country's 16.8 million inhabitants, live below the poverty line. The distribution of the population by income decile shows that the first two deciles do not exceed the poverty line and therefore can barely save after meeting basic consumption needs. The personal savings rate does not give positive figures until the fifth decile of the income distribution⁶.

On the supply side, the current market is short in terms and high in interest rates. Given the distribution of income in Ecuador, only 20% of families have an income greater than 1,527 dollars per month, which allows them to commit to making a mortgage payment of \$35,299 over ten years, for example.

3. The population growth rate in the last intercensal period (2001-2010) was 1.95% and is expected to adjust to 1.5% annually until 2030. Projections of the National Statistics Institute of Ecuador.

4. The population under 15 represents 27.5% of the total and at the other extreme, the population over 65 represents 7.25%. According to World Bank data (2016), the fertility rate is 2.49 children per woman, high when compared with other countries in the region such as Brazil 1.73, Chile 1.77 and Colombia 1.85.

5. For a review of the literature on the effects of access to housing on people's quality of life, see Boullón, César Patricio Editor. A space for development. Housing markets in Latin America and the Caribbean. IDB. DIA. Development in the Americas. 2012.

6. Galdeman, N. A Comparison of Saving Rates: Micro Evidence from Seventeen Latin American and Caribbean Countries (IDB Working Paper Series N° IDB-WP-602). July 2015.

Thus, the demand for credit served by private banks in the country has been mostly oriented towards segments of the population with high purchasing power, with interest rates of up to 10.78% per year. The low- and middle-income segments have been neglected by the financial system, a gap that the housing policy, and in particular with the issuance of this Social Bond, intends to address.

Public support is needed to enable the low- and middle-income population to have access to affordable and decent housing. The objective of this issuance is to enable this population to have access to housing without having to devote more than a third of their income to this purpose and, therefore, not have to sacrifice their standard of living.

The Republic of Ecuador pledges to reduce the deficit of affordable and decent housing at the national level. The Ministry of Urban Development and Housing (MIDUVI) is the government entity that leads the sector's policies in Ecuador and has implemented its housing policy through the Casa para Todos (CPT) program.

The Casa para Todos program is divided into two segments according to the price of the home.

- A segment of Social Interest Housing (VIS) for homes up to 177.66 Unified Basic Salaries (UBS⁷ - value equivalent to USD 70,000) to cover - across three different categories - a range from households whose inhabitants live in poverty or extreme poverty and whose income comes from informal work, to low-income households; and
- A Public Interest Housing (VIP) segment for homes between 177.66 and 228.42 UBS (70,001 to 90,000 US dollars), available to households with low to medium income, formally employed or self-employed, banked and able to purchase their first home with a mortgage loan if they can access appropriate terms and conditions, and that do not currently have credit for their housing in the financial sector.

Incentives differ from one segment to the other, from a total subsidy for the lowest strata (houses of less than \$21,000 - present value and equivalent to 67.56 UBS) to a preferential interest rate for the highest segment (houses of up to \$90,000 - present value and equivalent to between 177.66 and 228.42 UBS) and going through a combination of both support instruments for the intermediate segments.

The incentive is subject to strict eligibility criteria for each segment and category for both VIS and VIP housing.

7. As of December 27, 2018, the UBS increase for 2019 is formalized, from USD \$386.00 to USD \$394.00.
<http://www.trabajo.gob.ec/incremento-del-salario-basico-unificado-2019/>

Such eligibility criteria are determined by the Ministry of Urban Development and Housing (MIDUVI by its acronym in Spanish) and go beyond the maximum threshold of values mentioned above.

The main criteria are as follows:

- The home must comply with the maximum value established for the interested segment.
- The incentive will be applicable only for new homes.
- The incentive will be applicable only for the acquisition of the first and only home.
- The home must comply with the technical criteria established by the MIDUVI. These technical criteria aim to guarantee the support for the acquisition of houses complying with minimum quality criteria.
- The home must comply with the universal accessibility specifications adopted by MIDUVI.

The objective of the issuance of the Social Bond is to provide financing under appropriate terms and conditions (preferential interest rate and appropriate term) for interested VIS and VIP segments by leveraging private funds from international investors in search of investments with high social impact. Proceeds will be channeled through entities of Ecuador's financial system.

2. Rules for the use of proceeds.

Eligibility criteria for the use of proceeds must fully comply with Ecuador's housing standards and policies and the Operating Regulations defined for the Program. The proceeds obtained from the Social Bond may only finance social interest housing loans (VIS) and public interest housing loans (VIP) as defined in the norm issued for this purpose.

2.1. Eligibility criteria for mortgage loans

Mortgage loans eligible under this framework must meet the following conditions:

a. Social Interest Housing Loans (VIS)

- The granting of credits will be for purchase of first and only home.
- Home Value: Up to 177.66 Unified Basic Salaries.
- Down payment: At least 5% of the commercial appraisal of the property.
- Maximum Credit Amount: Up to 177.66 Unified Basic Salaries, and may include the expenses associated with the operation implementation, related to: legal expenses, appraisals, insurance and others, which may be financed in the same credit operation, as long as the total credit does not exceed the commercial appraisal of the property.
- Term: At least 20 (twenty) years and maximum 25 (twenty-five) years.
- Maximum initial interest rate: 4.99% annual effective, readjustable or fixed.
- Periodicity of Dividend Payments: Monthly.
- Guarantee Type: First Mortgage.
- Grace Period: up to 6 (six) months.
- Type of Home: Finished Home.

- Debtor Maximum Consolidated Gross Income: For dependent debtors: 6.34 Unified Basic Salaries. For the case of debtors that do not have relation of dependence (independent) the value will correspond to the business net margin, that is to say the business income net of the economic activity expenses. For the verification of income and expenses, the criteria maintained by the originator of the portfolio shall be used. The share of eligible credits may not exceed one third of the gross income or margin of the beneficiary household.

b. Public Interest Housing Loans (VIP)

- The granting of credits will be for purchase of first and only home.
- Value of Home: From 177.67 to 228.42 Unified Basic Salaries.
- Down payment: At least 5% of the commercial appraisal of the property.
- Maximum Credit Amount: From 177.67 to 228.42 Unified Basic Salaries, which may be included within the amount to finance the expenses associated with the instrumentation of the operation, related to: legal expenses, appraisals, insurance and others, which may be financed in the same credit operation, as long as the total credit does not exceed the commercial appraisal of the property.
- Term: At least 20 (twenty) years and maximum 25 (twenty-five) years.
- Maximum initial interest rate: 4.99% annual effective, readjustable or fixed.
- Periodicity of Dividend Payments: Monthly.
- Guarantee Type: First Mortgage.
- Grace Period: up to 6 (six) months.
- Type of Home: Finished Home.
- Maximum Consolidated Gross Debtor Income: For dependent debtors: 6.34 Unified Basic Salaries. For the case of debtors that do not have relation of dependence (independent) the value will correspond to the business net margin, that is to say the business income net of the economic activity expenses. For the verification of income and expenses, the criteria maintained by the originator of the portfolio shall be used. The share of eligible credits may not exceed one third of the gross income or margin of the beneficiary household.

- Price per Square Meter: Less than or equal to 2.49 Unified Basic Salaries, for the calculation of the value per square meter the definition established for the effect by the Superintendency of Banks will be used.

2.2. Eligibility criteria applicable to the property underlying the mortgage loan

a. Only homes categorized as VIP and VIS that meets the requirements of the Ministry of Urban Development and Housing (MIDUVI) under the Casa para Todos (CPT) program will be eligible:

- The home must comply with the maximum value established for the interested segment.
- The incentive shall be applicable only for new homes.
- The incentive will be applicable only for the acquisition of first and only homes.
- Homes must comply with the technical criteria established by the MIDUVI including universal accessibility specifications.

b. Only properties that have received the relevant permits and authorizations will be eligible.

c. For the Definition of a Finished Home, the following parameters will be used: in order for social and public interest housing to be considered as finished, at least the following must be complied with:

- Comply with Ecuadorian Construction Standards (NEC).
- Comply with the Technical Norms of the Ecuadorian Normalization Service (INEN).
- Comply with other regulations in force at both national and local level, and have at least the following finishes:
 - Roof and all doors and windows.
 - Floors: putty, with non-slip smooth finish and/or epoxy paint.
 - Walls: plastered masonry with defined edges.
 - Windows: views that are protected, according to technical standards of security.
 - Kitchen: the kitchen area must have high and low furniture, space for refrigerator, kitchen counter, where the sink is located, space for food handling and to place at least one kitchen appliance. For homes up to 177.66 Unified Basic Salaries, high and low furniture are not mandatory.

- Closets in bedrooms: are mandatory for homes between 177.67 and 228.42 Unified Basic Salaries, and optional for homes up to 177.66 Unified Basic Salaries.
- Bathrooms: all bathrooms must have sanitary parts and the necessary faucets according to their design.

Only finishes related to kitchen furniture and closets in bedrooms are established as optional, except in dwellings whose price ranges between 177.67 and 228.42 Unified Basic Salaries, in which case, it will be obligatory that the properties have such finishes.

2.3. Eligibility criteria applicable to the household benefiting from the mortgage loan (the debtors).

- a. Dividends or installments on eligible mortgages shall not exceed one-third of the gross income of the beneficiary household.
- b. The Maximum Consolidated Gross Income of the Debtors will be: for debtors in dependency relation: 6.34 Unified Basic Salaries; For the case of debtors that do not have relation of dependence (independent) the value will correspond to the business net margin, that is to say the business income net of the economic activity expenses. For the verification of income and expenses, the criteria maintained by the originator of the portfolio shall be used. The share of eligible credits may not exceed one third of the gross income or margin of the beneficiary household.

2.4. Eligibility criteria for intermediary financial institutions (IFIs)

- a. Only private, popular and solidarity economy financial institutions and public financial institutions may participate in the program.
- b. In order for IFIs to participate, they must meet the following requirements:
 - Maintain a current risk rating of at least A from an accredited risk rating agency.
 - Have audited financial statements for the last fiscal year immediately prior to the date of application to participate in the program.

- Have legal capacity and technical experience to manage the proceeds delivered, generate housing loans under appropriate conditions and appropriate management of credit risk (granting, legal improvement, administration and collection), validated by the Master Server.⁸
- Comply with at least the minimum requirements of: solvency, liquidity and capital as defined by the respective control entity.
- Statement by the IFI that credit transactions have been processed without discrimination of: age, gender, ethnicity, color, social origin, language, religion, political affiliation, sexual orientation, disability, or difference of any kind, following the constitutional principle of equality before the law.
- The IFI must commit to generate at least 15% of the social interest housing portfolio of segment 2 letter b), that is, housing whose commercial appraisal is between 57.56 and 101.52 Unified Basic Salaries of the volume of the portfolio to be financed under the present scheme.

8. As defined in the Operating Regulations of the Program, the function of Master Server will be performed by the Corporación de Desarrollo de Mercado Secundario de Hipotecas CTH S.A. (Corporation for the Development of the Secondary Mortgage Market).

3. Management of proceeds (execution scheme).

The issuance of a Social Bond directed to institutional investors, placed in the international market, observing the rules and regulations of the corresponding jurisdiction is foreseen.

The Republic of Ecuador, as issuer of the bond, and the IDB, which will act as its guarantor, will agree on the execution scheme and detail it in the operating regulations (OR). The Inter-American Development Bank, as guarantor of the issuance, will supervise the execution and compliance with the OR.

The bond issuance proceeds will be under the responsibility of the Ministry of Economy and Finance (MEF). The execution of these proceeds will be carried out through a Project Coordinating Unit (PCU), which will also be in charge of the control and monitoring of the operation.

Together with the competent public entity, the PCU will coordinate the creation of a trust to manage the issuance proceeds: the Administration Trust (Fideicomiso de Administración, or FA). The FA will be administered by the designated Trustee. The proceeds will be deposited in the Single Account of the National Treasury and subsequently transferred to the FA in an account opened in the Central Bank of Ecuador.

The proceeds will be distributed from the FA to the Securitization Trusts (Fideicomisos de Titularización or FTC) constituted by the IFIs according to the instructions given by the Constituent of the Administration Trust.⁹

If there are unused proceeds that have not been required by the IFIs and that are available in the Administration Trust (FA), they may be invested according to the following criteria:

- Initially, one third in instruments authorized by the BOARD OF MONETARY AND FINANCIAL POLICY AND REGULATION for a term of 18 months, which may consist of:
- Government bonds issued by the Government of Ecuador
 - Certificates of Deposit issued by public financial institutions

9. Currently, it has been established that the MIDUVI will be the constituent of the Administration Trust Fund.

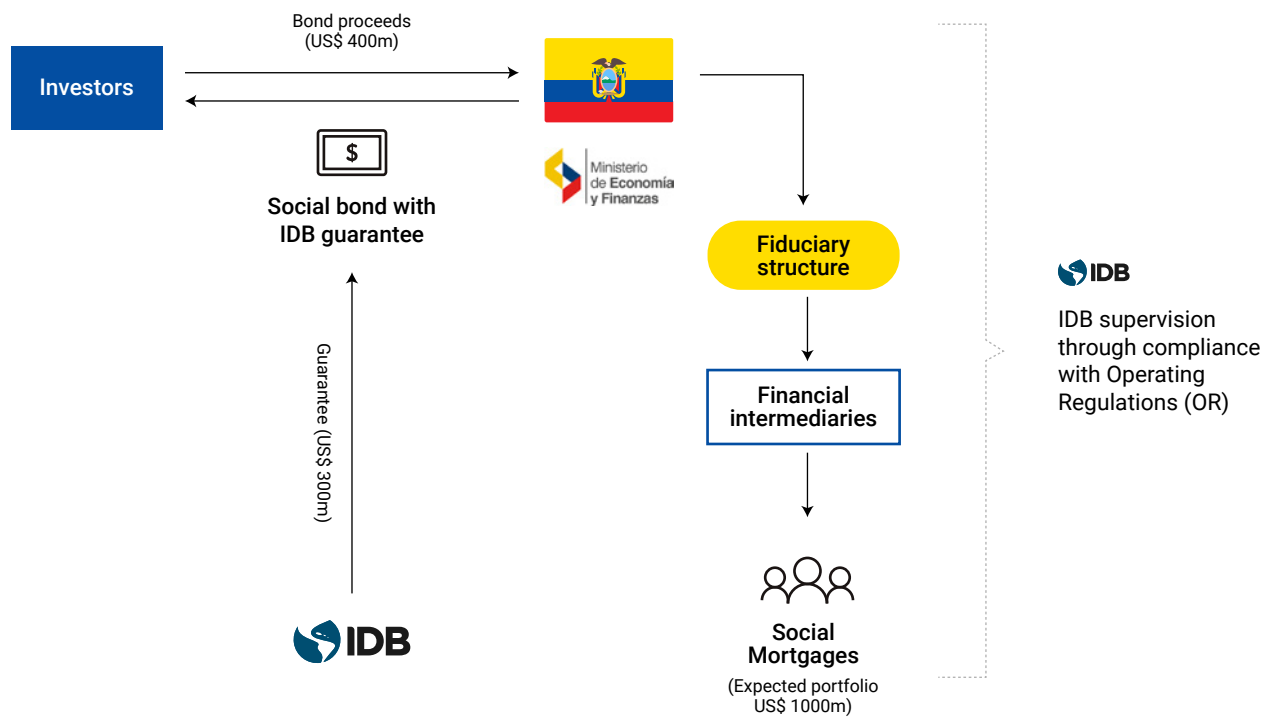
Once these investments are collected, they will be placed in installments of up to 6 months.

- Maintain in the FA account, at the Central Bank of Ecuador, the value necessary to cover the portfolio placement projections established by the participating IFIs for the next six months.
- The balance of proceeds, in instruments authorized by the BOARD OF MONETARY AND FINANCIAL POLICY AND REGULATION with terms of up to 6 months, which may be:
 - Short-term Certificates (Certificados de Tesorería, CETES) issued by the Ministry of Economy and Finance
 - Government bonds issued by the Government of Ecuador
 - Certificates of Deposit issued by public financial institutions

Such investments should ensure the availability of funds to guarantee IFIs the liquidity necessary to continue the housing program. In no case will investments be made in instruments for which it has been declared that the funds will be used to finance greenhouse gas (GHG) intensive activities or environmentally controversial activities.

The FA will be structured in compliance with applicable laws and regulations, and will be audited by an independent auditing firm, agreed by the Guarantor, in compliance with the procedures set forth in the applicable national auditing principles. The audit reports will be published on the website of the Trustee and the Ministry of Economy and Finance.

3.1. Implementation Scheme



4. Process for the Selection of participating Intermediary Financial Institutions (IFIs)

In order for IFIs to participate, they must comply with the requirements presented in section 2.4., letter b.

New IFIs applying to participate in the program must notify the program's Master Server of their interest in participating, to coordinate the review of the installed technical capacity, as well as the processes related to credit risk management and its adequate follow-up. The review to be carried out by the Master Server will focus on covering the following aspects:

- Credit Operations Approval and Disbursement.
- Documentation used.
- Portfolio Management Process.
- Collections and out-of-court and judicial procedures.
- Installed technical infrastructure.

Reports used for monitoring and control

With the review carried out, the Master Server will prepare a report of the findings obtained for the knowledge of the interested IFI, the MEF and the Constituent who will authorize, deny or condition the participation of the entity in the program.

In the request for participation the IFI must also notify the volume of projected portfolio to be generated.

5. Process for project evaluation and selection.

The proceeds will be distributed from the FA to the Securitization Trusts (FTC) constituted by the IFIs through a process supervised by the Ministry of Economy and Finance in coordination with the Constituent of the FA. This process and the eligibility criteria for selecting mortgages will be those set forth in the operating regulations and fully aligned with this framework, which will be set forth in the Contracts for the Establishment of each of the Securitization Trusts. The Master Server will verify that the IFI is contractually committed to respecting the pertinent operating regulations. Each Management Agent will supervise the compliance of the EFIs with the obligations stipulated in the legal documents of the securitization trusts.

6. Environmental and Social Risk Management System (ESMS).

In order to comply with the requirements of the IDB's Environmental and Social Safeguards Policies, the MEF will comply to the full satisfaction of the IDB with the following contractual terms and conditions constituting the ESMS.

Financing with proceeds from the mortgage loan program will only be eligible provided that:

- They meet the eligibility criteria defined in this document and in the Operating Regulations.
- They comply with the Program's exclusion list, as defined in the Annex: Exclusion List, of this Framework.
- They comply with all applicable national and municipal laws and regulations.

The Issuer will present, within its annual issuance report (see below), a section on the social performance of the issuance.

The IDB will supervise the application of the ESMS for projects financed with the Social Bond proceeds, as necessary by an IDB specialist or an external consultant contracted by the IDB. To this end, the MEF will provide and facilitate access to the IDB to all relevant documentation, personnel and projects. The MEF will be responsible for assigning a coordinator to respond to the Bank on socio-environmental issues.

If necessary, the IDB and the MEF will agree on corrective actions or measures necessary to address adverse impacts and risks and/or to improve their management.

7. Reports.

The Social Bond will be reviewed annually and independently by an audit firm appointed by the Guarantor and by an independent firm to ensure that the commitments of this framework and the ICMA Social Bond Principles are respected.

All statements and audit reports will be published on the official website of the Ministry of Economy and Finance.

The Republic of Ecuador will provide bondholders with an annual report on the use of bond proceeds and adherence to this framework. The report will evaluate progress according to outcome indicators and compliance with eligibility criteria. This report will be prepared by the PCU for the monitoring of the program and the following indicators will be required:

Description	Indicator	VIS	VIP	Total	Base Line / Goal
Credit volume Generated by segment	Amount US\$: Number: Average Amount:				Target: 1025 million Target: 17,000 Target: 60,000
Distribution by Originating Financial Entity	Entity A: Entity B: Entity C				
Distribution by Housing Value	From 20,000 to 40,000 from 40.001 to 70.000 of 70.001 and over				
Distribution by Gender in Percentage	Women: Men:				Base: 44% Women
Geographical Distribution of Credits by City in Amounts	Amount per city: Percentage by city:				Monitor

At the bond maturity, the Republic of Ecuador will provide an impact evaluation report. This report will be prepared in coordination with the IDB and in accordance with the IDB's own development impact assessment methodologies.

8. Alignment with Sustainable Development Goals (SDG).

The SDG are the 17 basic goals set by the United Nations (UN) in 2015 to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030. Ecuador's Social Bond for Affordable and Decent Housing is in line with four of the 17 Sustainable Development Goals (SDGs): ending poverty (SDG 1); clean water and sanitation (SDG 6); reducing inequalities (SDG 10); and sustainable cities and communities (SDG 11).



SDG	Goal of SDG
End poverty in all its forms everywhere (SDG 1)	1.4 By 2030, ensure that all men and women, in particular the poor and the vulnerable, have equal rights to economic resources, as well as access to basic services, ownership and control over land and other forms of property, inheritance, natural resources, appropriate new technology and financial services, including microfinance - 1.4.1 Proportion of population living in households with access to basic services
Ensure availability and sustainable management of water and sanitation for all (SDG 6)	6.1 By 2030, achieve universal and equitable access to safe and affordable drinking water for all - 6.1.1 Proportion of population using safe managed drinking water services
Reduce inequality within and among countries (SDG 10)	10.4 Adopt policies, especially fiscal, wage and salary policies of social protection, and progressively achieve a higher level of equality
Make cities and human settlements inclusive, safe, resilient and sustainable (SDG 11)	11.1 By 2030, ensure access for all to adequate, safe and affordable housing and basic services and upgrade slums

9. IDB Program.

For twenty years, the IDB has been providing technical assistance and financing to the Republic of Ecuador with the objective of achieving improvements in the housing sector and urban development, as reflected in the six loan operations and twelve technical cooperation projects executed during this period. Within the framework of this long-term relationship, the Republic of Ecuador will have the support of the IDB in all necessary aspects during the term of the bond.

9.1. Credit enhancement of the Bond.

The IDB will provide a partial credit guarantee for the bonds and support Ecuador throughout the financial structuring of the issuance. The guarantee will be granted in compliance with the IDB's environmental, social and integrity standards.

9.2. Strengthening the Issuer's implementation capacity.

The IDB has approved a \$750,000 specific technical assistance program (ATN/FG-16735-EC) to strengthen the technical execution capacity of the issuer in terms of the financial, economic, legal and institutional analysis necessary for the structuring and execution of the project. The IDB will also provide support to Ecuador through technical cooperation in all aspects related to the structuring and social certification of the issuance.

It will assist Ecuador in preparing the structure and obtaining the rating issued by the designated agency.

9.3. Use of proceeds - monitoring and impact evaluation - supervision of the program.

In its contractual agreements with the Republic of Ecuador, the IDB included the monitoring of the execution and evaluation of the impact of the program in line with the standards with which it operates. The Annual Reports prepared by the PCU for the Guarantor will be aligned with the annual report prepared for investors regarding compliance with the commitments of this framework. This alignment will include the selection of reported indicators. All the requirements demanded by the IDB to the issuer will be detailed in the operating regulations of the Program that will be published.

