

OECD Urban Policy Reviews

MEXICO

TRANSFORMING URBAN POLICY
AND HOUSING FINANCE

POLICY HIGHLIGHTS



Notes

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PART 1 |

A reform agenda for Mexico, with unprecedented attention to housing and urban policy

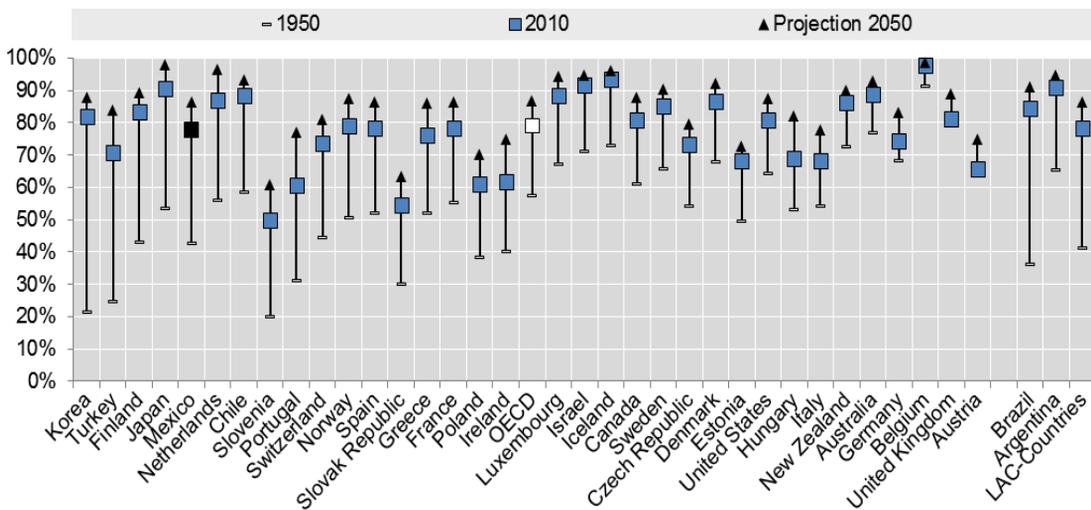
Since the signing of the *Pact for Mexico* in December 2012, Mexico has undertaken an ambitious, cross-cutting structural reform agenda – encompassing energy, tele-communications, education, labour, financial, fiscal, electoral and penal reforms – that is aimed at boosting the country’s competitiveness and economic growth. Housing and urban policy is considered a priority within this reform agenda. The authorities seek to reduce the housing deficit that affects roughly 31% of Mexican households and to ensure more efficient development patterns (INEGI, 2012a; INFONAVIT, 2013).

This new approach to housing and urban policy differs from those of the recent past by shifting from quantitative objectives for housing

to a more qualitative focus on housing and the urban environment.

These strategies are made explicit in the National Housing Policy announced at the outset of the present administration, which aims to (i) improve inter-institutional co-ordination; (ii) transition toward a sustainable and smart urban development model; (iii) responsibly address the housing gap; and (iv) provide decent housing for all Mexicans. Strategic aims of the National Urban Development Programme and National Housing Programme, released in parallel, are to develop more inclusive and sustainable cities with measures to control urban sprawl, promote well-being and sustainable mobility, boost access to adequate housing and reduce the housing gap.

Figure 1. Mexico urbanised faster than most OECD countries in the past 50 years
Share of the population living in urban areas in the OECD, 1950, 2010 and 2050 (forecast)



Source: United Nations (2014), *World Population Prospects: The 2012 Revision*, based on INEGI data (2010).

Mexico's rapid urbanisation has increased opportunities for city-dwellers

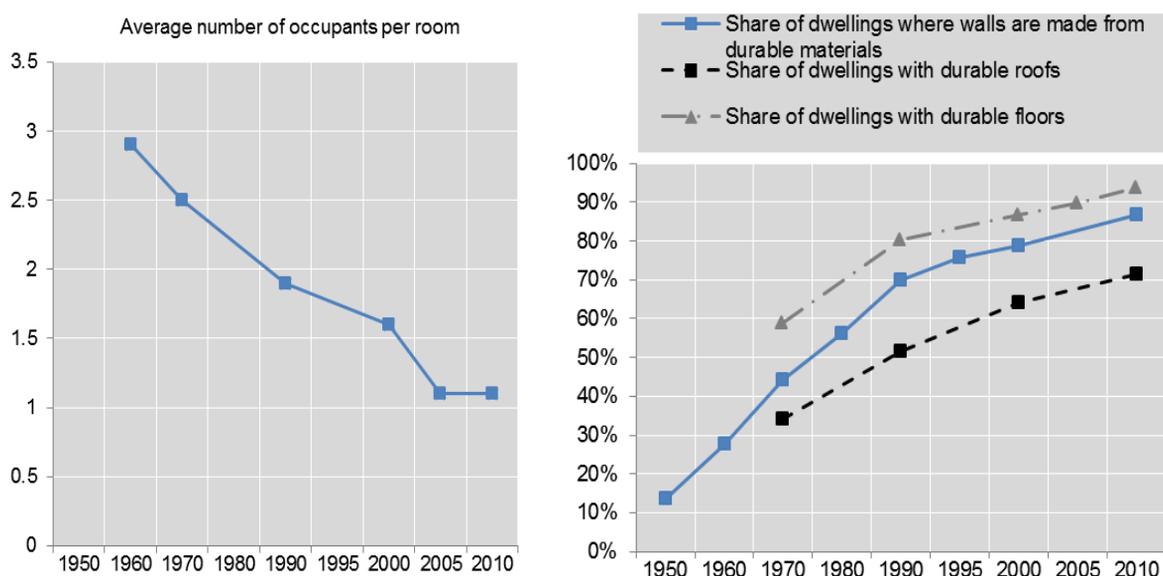
Mexico urbanised more rapidly than most OECD countries over the second half of the twentieth century (Figure 1), and by 2010 roughly 78% of the population lived in cities (United Nations, 2014 based on INEGI, 2010). Medium-sized metro areas – those with 450,000 to 1 million inhabitants – have grown the most over the last two decades (by 60% on average); the population in metro areas close to the US border – Tijuana, Mexicali, Juárez, Piedras-Negras, Reynosa-Rio Bravo and Matamoros – grew by 50% following the adoption of the North American Free Trade Agreement (NAFTA) in 1992, but have grown more slowly since the early 2000s.

Mexico's rapid urbanisation contributed to increased opportunities for city-dwellers,

Including higher incomes, increased educational opportunities and expanded access to formal housing for an increasing share of formal-sector, salaried workers.

For instance, housing quality, based on indicators relating to the durability of construction materials, access to basic services and overcrowding, has improved dramatically. Between 1950 and 2010, the average number of occupants per room steadily decreased (Figure 2, left panel). Meanwhile, just 14% of dwellings had walls made from a durable material in 1950, whereas by 2010 this share had increased to 87%. Similar trends are observable for the share of dwellings built with floors and a roof of a durable material (Figure 2, right panel).

Figure 2. Housing quality has markedly improved since 1950
Indicators relating to overcrowding and construction materials



Note: Durable materials are defined as the following: Walls - a wall, brick, block, stone, quarry, cement or concrete; roof - concrete slab with slab or joists, brick and roof with beams; floors - soil, concrete, wood, tile, and other coating. Category "not specified" is not included.

Source: INEGI (2011a, 2011b, 2011c, 2011d).

These changes have been in large measure driven by the activities of two housing institutions tasked with providing finance for formal housing, the National Workers' Housing Fund Institute (INFONAVIT) for private sector workers and the Housing Fund of the Institute for Social Security and Services for State Workers (FOVISSSTE) for federal workers. The activities of these two institutions – funded through (i) a compulsory 5% payroll tax on affiliated formal-sector workers and (ii) loan payments, alternative funding sources and interest on financial products – include both housing finance and complementary retirement income.

The rapid expansion of housing finance, led by INFONAVIT and facilitated by public policies aiming to expand access to formal housing, enabled the country's transition from informal to formal housing on a grand scale. Between January 2013 and September 2014, INFONAVIT granted about 74% of all housing loans in Mexico, for a total value of MXN 174 billion in 2010 prices (USD 12.9 billion) (BBVA Research, 2014, based on data from INFONAVIT, FOVISSSTE, ABM, AHM Banco de México and CNBV). Over time, INFONAVIT became the leading mortgage lender in Mexico (Figure 3).

Figure 3. INFONAVIT over time became the market leader in Mexican housing finance

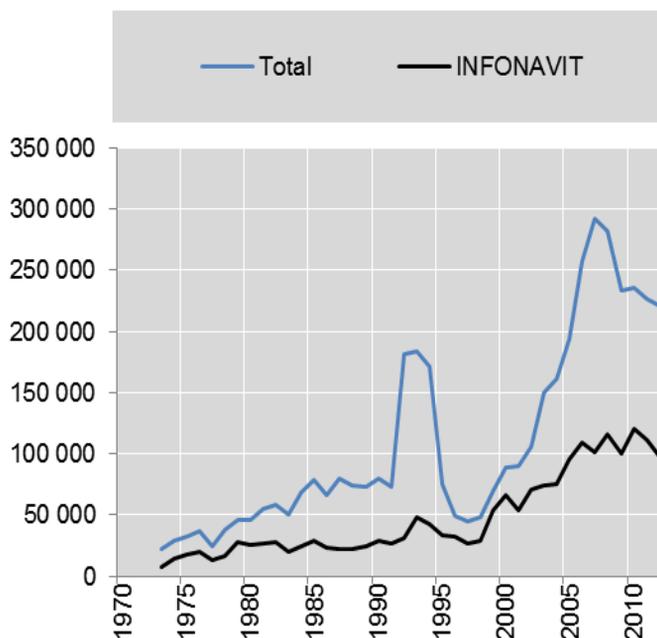
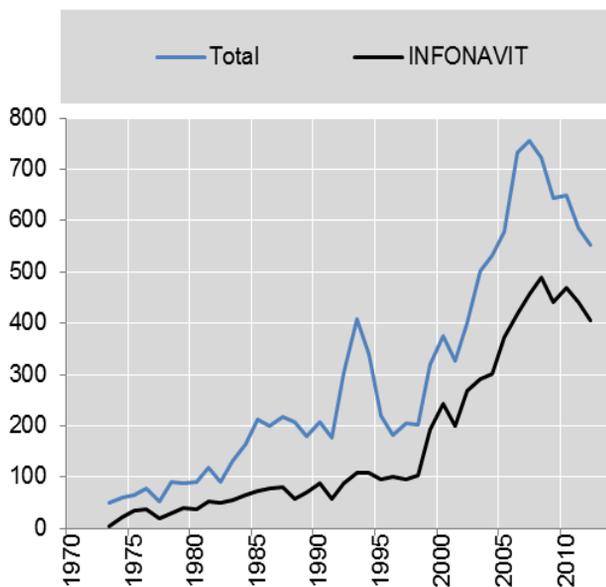
a. Number of loans for housing acquisition (in thousands), 1973-2012

Note: Numbers from CONAVI are adjusted for inflation and change in currency in 1990. Housing loans include new and used (existing) homes.

b. Value of loans for housing acquisition (MXD millions, 2010 values), 1973-2012

Note: Numbers from CONAVI are adjusted for inflation and change in currency in 1990. Housing loans include new and used (existing) homes.

Source: CONAVI (2014), [Historicos de vivienda www.conavi.gob.mx/php/mapa_interactivo/busqueda_avanzada/historicos_viviendas/mapa_interactivo.php](http://www.conavi.gob.mx/php/mapa_interactivo/busqueda_avanzada/historicos_viviendas/mapa_interactivo.php).



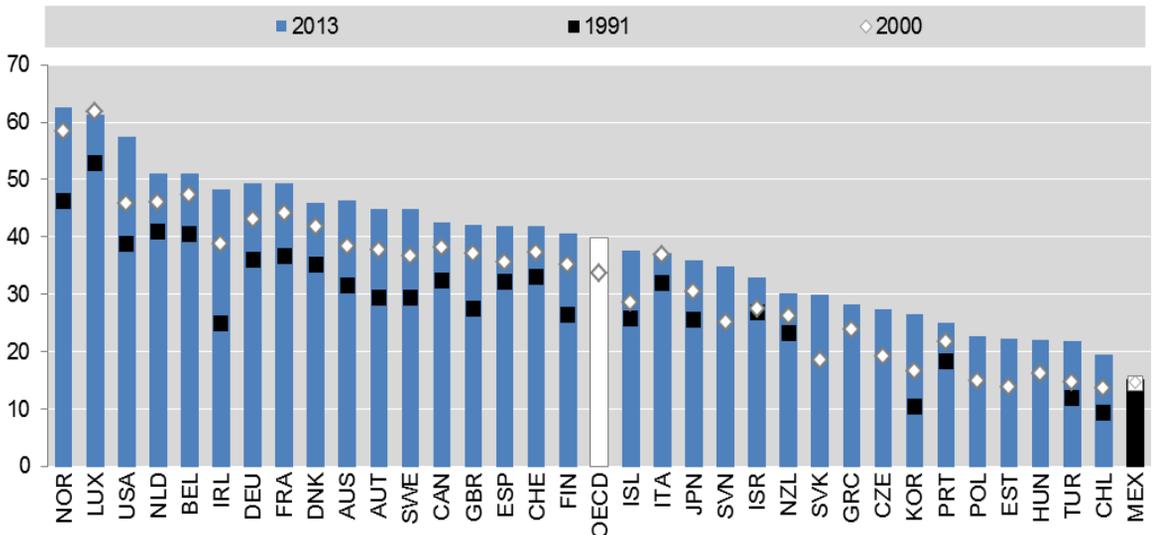
Yet cities face difficulties in capturing agglomeration benefits fully

Although urbanisation has brought undoubted benefits for tens of millions of citizens in Mexico, as in other OECD countries, Mexican cities have nevertheless not generated the kind of productivity gains that often accompany agglomeration processes. Mexico's labour productivity has stagnated over the past decades, while countries that in the past had similar levels of labour productivity (Turkey and Korea in the 1990s; Chile, Hungary, Estonia and Poland in 2000) have made steady improvements (Conference Board Total Economy Database, 2014; Arias et al., 2010) (Figure 4).

Between 2005 and 2010, labour productivity fell in all but three Mexican metropolitan areas – Centro (19%), Culiacán (7%) and Querétaro (0.7%) – in part as a result of the global crisis (OECD, 2013a). Given the contribution of metropolitan areas to national growth across the OECD, the performance of Mexican cities relative to their OECD peers significantly affects national growth performance. Even the most productive Mexican functional urban areas register labour productivity levels below the average for OECD metropolitan areas and face challenges in reaching the levels of top performers among metros with a similar population size (Figure 5).

Figure 4. Mexico's labour productivity has stagnated in recent decades relative its OECD countries

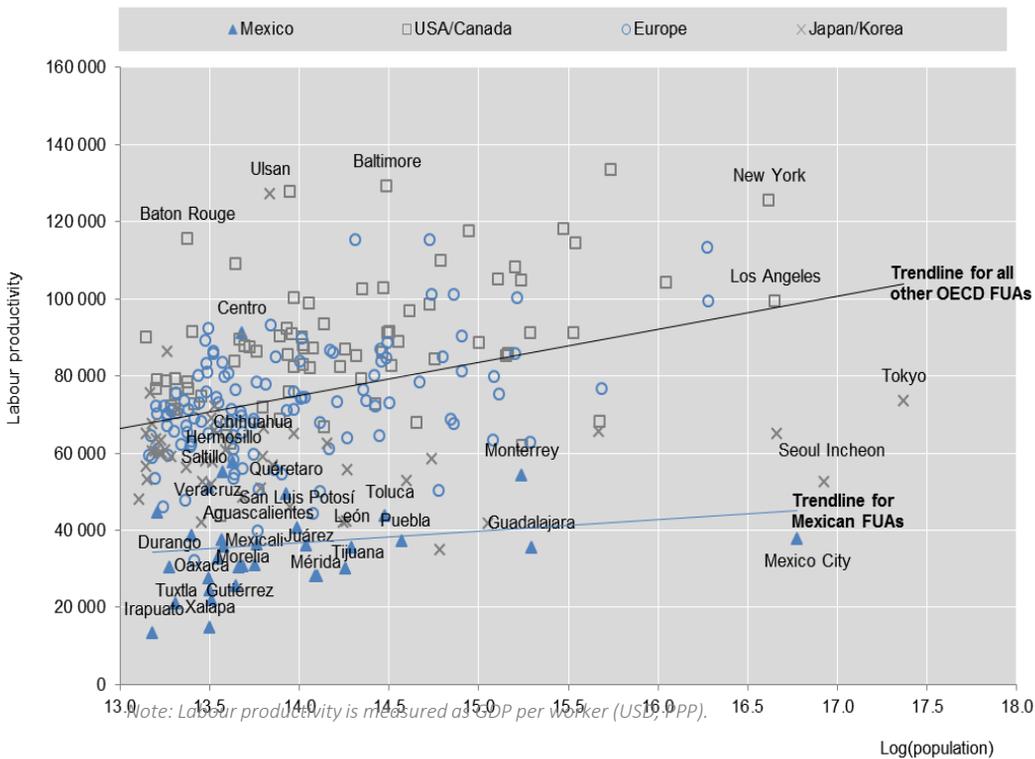
Evolution of labour productivity: 1991, 2000 and 2013



Notes: Labour productivity is measured as GDP per hour worked. USD constant prices, 2005 PPP. No data were available for 1991 for Austria, Slovak Republic, Czech Republic, Poland, Estonia and Hungary.

Source: OECD (2014f), OECD.Stat, level of GDP per capita and productivity (extracted on June 2014)

Figure 5. Mexican cities under-perform their OECD peers in terms of labour productivity
Labour productivity in OECD metro areas (2010)



Source: OECD (2013), "Metropolitan areas", OECD Regional Statistics (database). doi: 10.1787/data-00531-en; accessed 18 November 2014.

Cities need to connect residents to jobs and infrastructure

Why haven't Mexican cities realised their growth potential? Structural factors, such as a share of informal labour, institutional barriers to doing business, and levels of education, innovation and public investment, have limited growth. The reform package introduced by the government is expected to contribute to addressing these challenges.

Yet Mexican cities also underperform relative to their international peers because they fail to provide an environment that connects inhabitants to economic opportunity

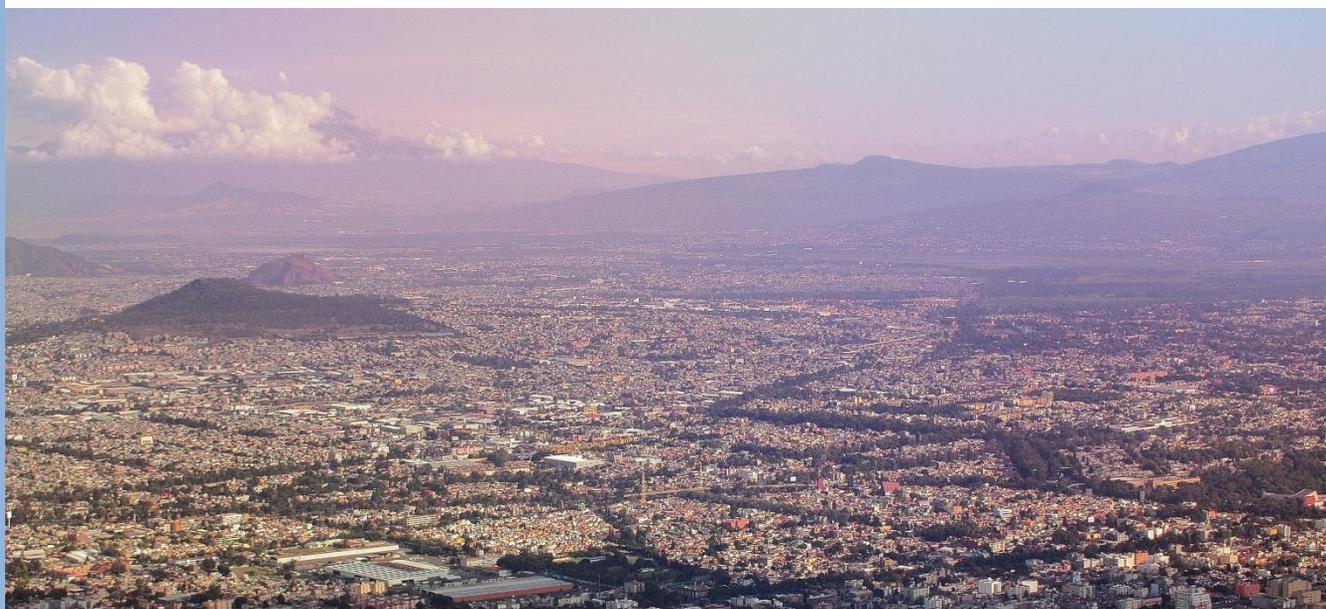
and to social and urban infrastructure, and that allows firms to reap agglomeration benefits. In other words, they face challenges in meeting the conditions needed in order for urbanisation to translate into economic development. For instance, in many cases, urban development patterns in Mexican cities have moved the population away from jobs and services, resulting in increased congestion and sprawl, productivity losses, and lower well-being (Dobbs et al, 2012).

In the past decade, Mexico had the third-highest rate of urban sprawl in the OECD

Urban expansion in Mexican cities and metropolitan zones has generated important costs and inefficiencies, requiring high levels of public and private investment in peripheral areas. This in turn has led to a hollowing out of city centres, and in some cases contribute to social segregation (Sánchez Peña, 2012). In the last decade, urban development occurred at ever greater distances from the centre city and became increasingly spatially dispersed (rather than clustered), two characteristics associated with urban sprawl. Among OECD countries, only Chile, France and Greece registered urban development patterns showing greater spatial

decentralisation and/or dispersion (Figure 6) (Veneri, forthcoming).

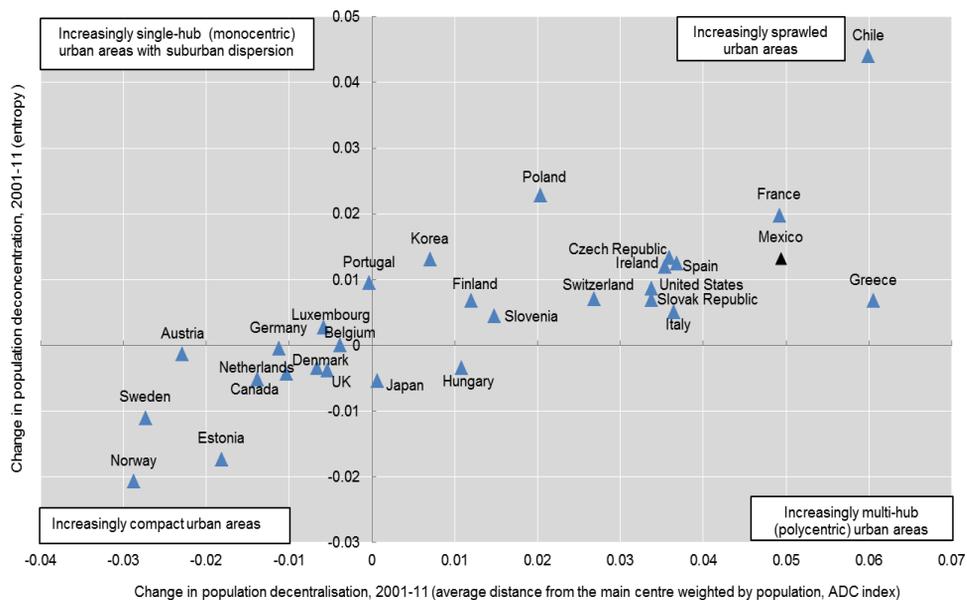
Mexico's urban growth has occurred predominantly on the periphery of metro zones at the expense of depopulating (or de-densifying) centre-city locations. Between 2000 and 2010, across metro zones with at least 500,000 inhabitants, the centre-city area registered an average 7.5% fall in population density; in contrast, population densities in areas located more than 10 km from the city centre increased by 6.8% on average (Figure 7) (INEGI, 2000 and 2010).



Sprawl is the result of multiple factors. On the one hand, mortgage lending and housing subsidies have made important contributions to sprawl and the hollowing out of city centres by facilitating the construction of new formal housing on the periphery of cities. According to data in the *Registro Único de Vivienda (RUV)*¹, in 46 of Mexico's 59 metropolitan zones, more than 70% of homes registered in the new housing registry between 2006 and 2013 were built either in the outskirts or the periphery. Moreover, roughly 90% of the housing stock consists of individual homes, which continue to make up the majority of all new development (INEGI, 2010).

On the other hand, many other factors have contributed to sprawl: rising income levels and lower transport costs; a fiscal and regulatory bias toward single family, owner-occupied homes; the prevalence of irregular settlements, hampering effective urban growth management; municipal capacity gaps and ineffective local land use controls for urban development; and a high level of municipal fragmentation within metropolitan areas, making co-ordinated land-use and transport planning across neighbouring jurisdictions a challenge.

Figure 6. Urban development patterns in the OECD: increasingly sprawled or compact?
 Change in population between 2001 and 2011, measured in terms of distance from city centre (x axis) and degree of spatial dispersion or clustering (y-axis)²



Source: Veneri P. (forthcoming), "Urban Spatial Structure in OECD cities. Is urban population decentralising or clustering?" *OECD Regional Development Working Papers*

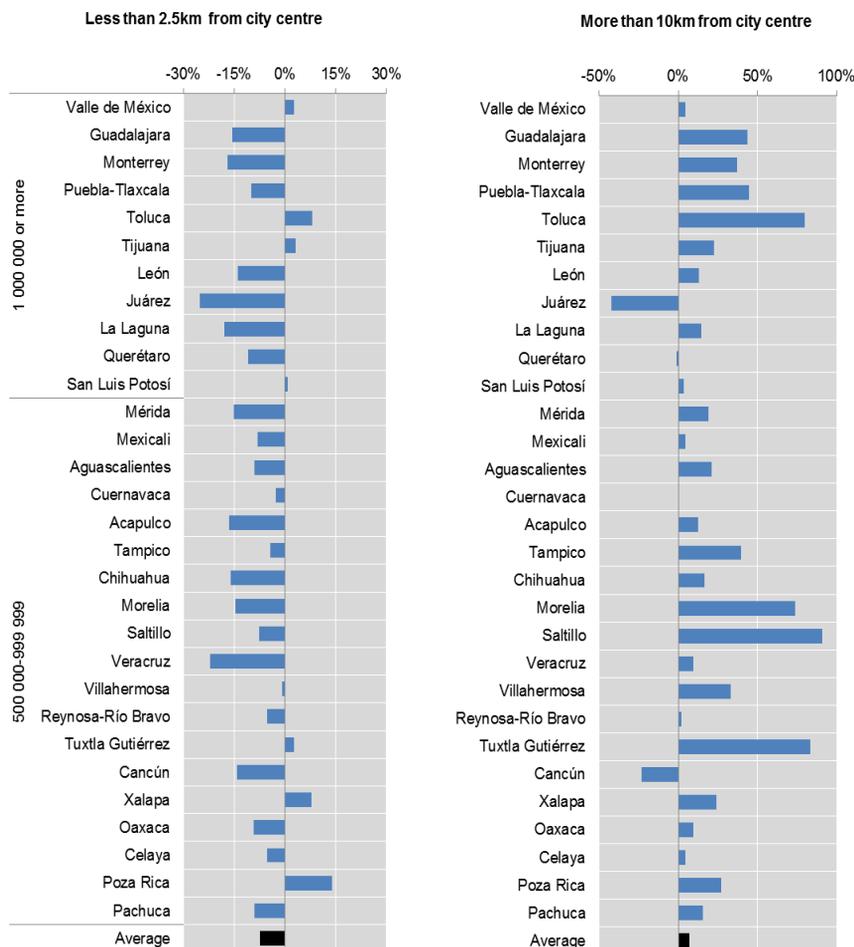


Figure 7. Peripheral areas have become denser, while centre cities depopulate
 Change in population density in Mexican metro zones with over 500,000 inhabitants, based on distance from city centre

Source: OECD calculations, based on data from INEGI (2000 and 2010)

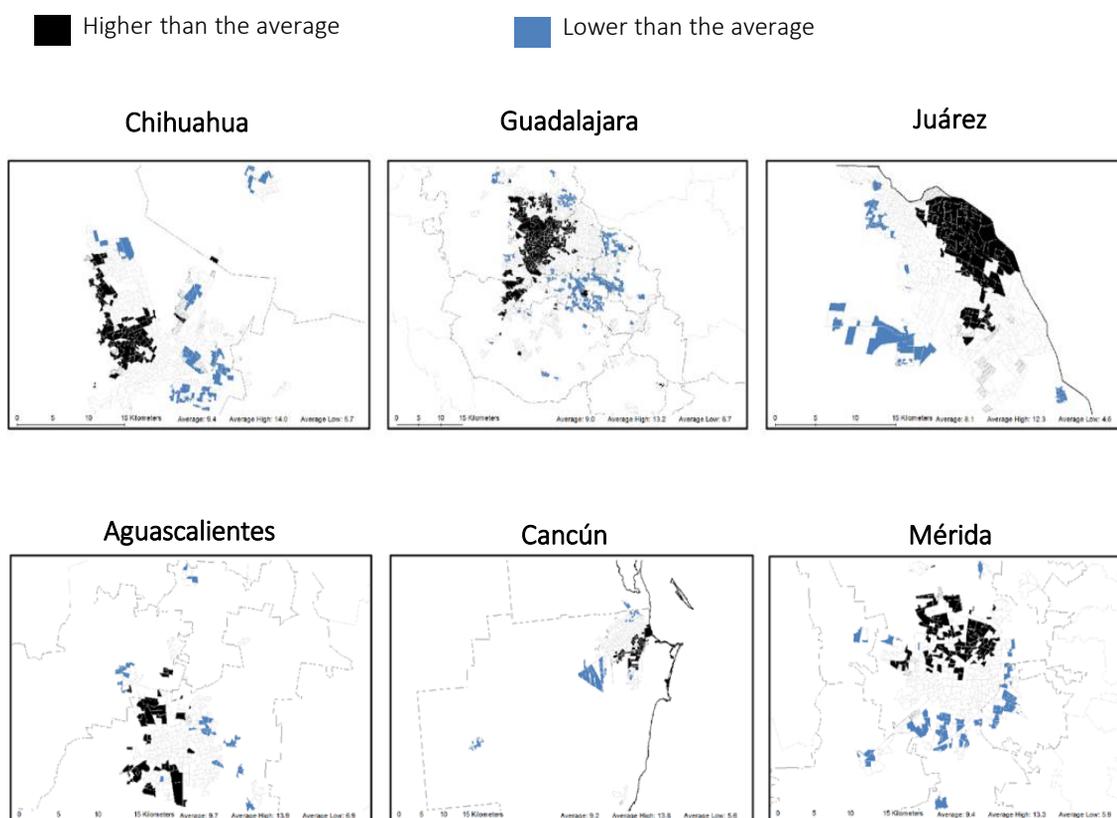
Municipal planning and permitting practices need to be improved to avoid development in risk zones and social segregation

Poor land-use planning and permitting practices – as well as the absence of adequate land available to low-income populations – result in the location of many settlements in risk-prone areas, such as river banks and unstable hills, with devastating social and economic costs when disaster strikes. These challenges are all the more relevant given that, globally, Mexico is one of the areas with the most frequent occurrence of severe earthquakes and tropical storms (OECD, 2013b). There has been a four-fold increase over the past 40 years in the average annual occurrence of disasters (OECD, 2013c). In late 2013, for instance, Hurricane Manuel left over 10 000

households in severe crisis in Acapulco, where many developments had been approved by local governments in flood zones (Fierro, 2013).

Socio-economic segregation – in terms of income and education levels, as well as access to basic services like electricity, water and drainage – is also present, albeit different, across metro zones. In some cities, low-income groups tend to be located on the outskirts, a trend that is fostered by lower land prices in peripheral areas. In other cases, there is a clear geographical divide (north/south; east/west) within the metro zone (Figure 8).

Figure 8. Spatial segregation is present, albeit different, across metro zones
Average years of schooling



Source: OECD calculations, based on data from INEGI (2012b).

Increasing motorisation and inadequate public transport are major urban challenges

At the same time, urban sprawl has consequences for mobility, contributing to rising motorisation rates and making the provision of efficient, quality public transport alternatives more challenging and costly. Mexico's motorisation rate doubled over the past decade, reaching 20 vehicles per 100 people, and in 2011 over 70% of the country's 22.4 million cars were registered in metro zones (INEGI, 2014). Two primary externalities of rising motorisation – congestion and pollution – generate important economic and social costs and reduce the quality of life for residents.

One estimate of the total cost of pollution, congestion, accidents and noise in

Mexico's five biggest metro zones – which together account for around 40% of the country's urban population and private vehicle fleet – amounted to MXN 173 billion in 2009, about 4% of the GDP of these metro zones (Medina, 2012).

Public transport service, moreover, which consists primarily of buses, can be unreliable, expensive and time-consuming, and the fleet is often of poor quality. The development of bus rapid transit (BRT) networks in some cities is promising, yet too often remains divorced from broader urban planning efforts.

One-seventh of the housing stock is uninhabited – one of the highest shares in the OECD

The Mexican authorities have made impressive progress in addressing the country's quantitative housing gap. The quantitative focus of housing development is one of several factors that have contributed to Mexico having one of the highest vacancy rates in the OECD (14.2%)³, even surpassing those of countries that have recently emerged from a major housing bubble – such as, Ireland (13.8%), Spain (13.7%) and Portugal (12.5%) (Figure 9).

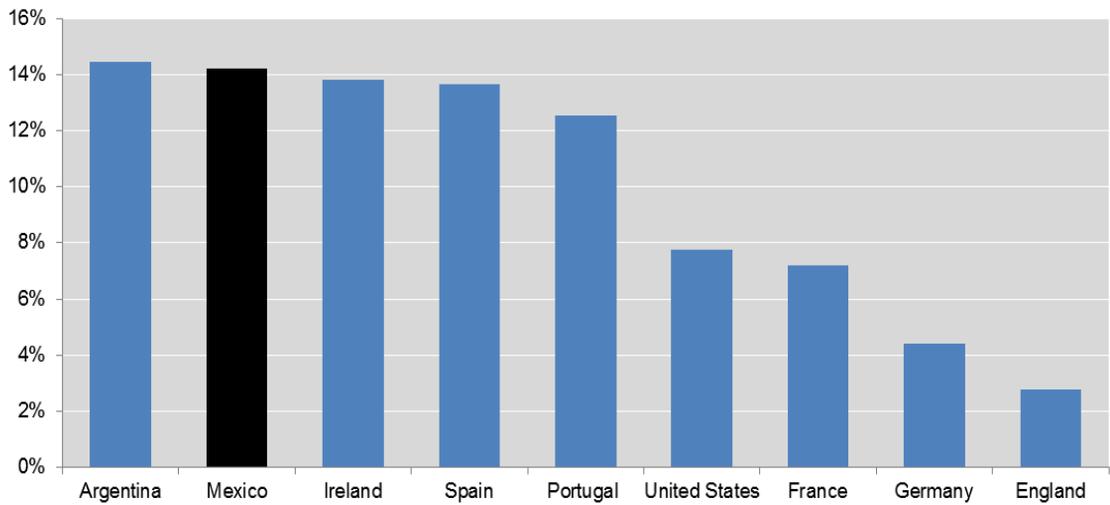
Indeed, Mexico's housing vacancy problem appears to be more structural than cyclical. In addition to the suboptimal location of much new housing development, migration, insecurity and the global crisis

have been important contributors to this high vacancy rate (Figure 10) (see Sánchez and Salazar, 2011; Monkkonen, 2014).

A large share of uninhabited homes – equivalent to one-seventh of the total housing stock (INEGI, 2010) – are located in cities, although there is considerable variation in the location of vacant housing within metropolitan areas. High vacancy rates can be found in both peripheral and centre-city locations (Monkkonen, 2014).

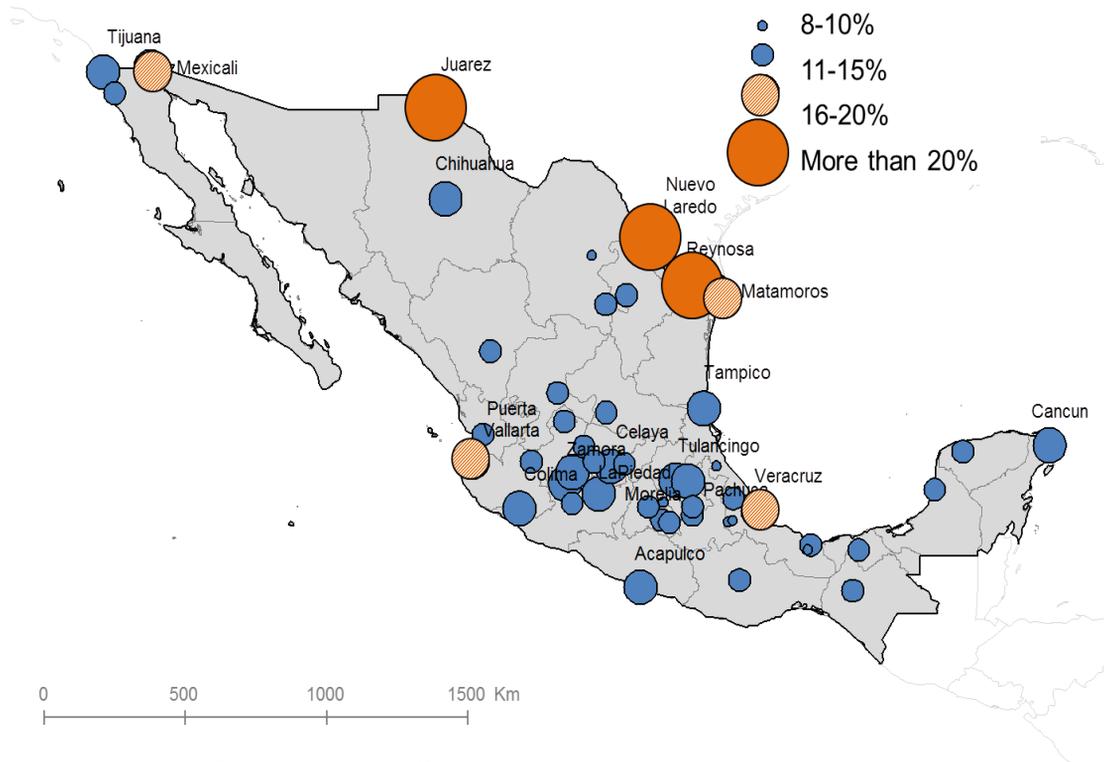
Nevertheless, in recent years, more attention is being paid to the quality of housing and its surrounding urban environment.

Figure 9. Mexico has a high vacancy rate relative to other OECD and non-OECD countries
Share of uninhabited units in the total housing stock⁴



Source: Housing data from LEA collated by the Empty Houses Campaign (England); 2011 Census (Spain, Germany, Portugal, Ireland); INSEE Government Research Bureau (France); INEGI 2010 Population and Housing Census, Mexico; INE 2010 Population and Housing Census, Argentina.

Figure 10. Uninhabited housing by urban area (2010)
Uninhabited units as a share of the total housing stock



Source: Based on data from INEGI (2012b).

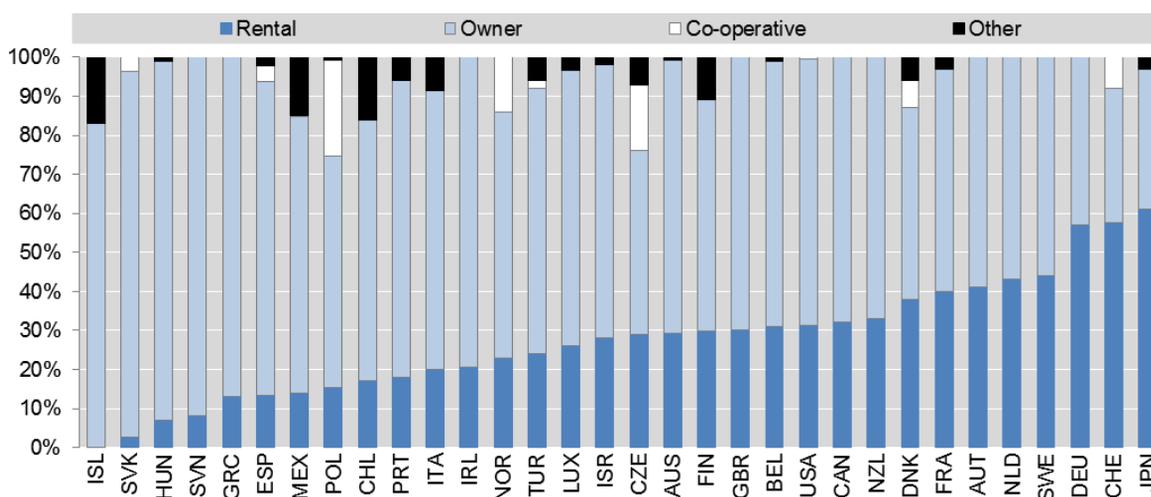
Most of the housing stock is owner-occupied, an obstacle to greater labour mobility

Home ownership is by far the dominant form of tenure in Mexico, with 76.4% of housing owner-occupied (INEGI, 2010). This has contributed to urban expansion in peripheral areas (allowing for individual homes to be built where land is cheaper) and limits labour mobility. As elsewhere in Latin America, Mexico's rental housing market remains shallow and underdeveloped relative to many OECD countries (see OECD 2013d; 2012). Mexico's share of formal rental housing (14%) is just behind Poland (15%) and Chile (17%), surpassing only a handful of OECD countries (**Figure 11**). However, to the official estimates of the formal rental housing stock should be added the informal rental stock (see INFONAVIT, 2013),

which brings the share of rental housing closer to 23% for 2012, comparable to Norway and Turkey.

The policy bias in favour of home ownership has had two important consequences: first, it has helped to facilitate the development of a low-income housing model in distant areas disconnected from employment opportunities and services. Second, it may unintentionally constrain residents' economic opportunities: home owners are typically less mobile than renters, even after taking into account household characteristics such as age, income, and marital, migrant and employment status (Henley et al., 1994; Andrews et al., 2011).

Figure 11. Mexico's rental housing market is small relative to many OECD countries
Tenure structure across OECD countries, as a percent of the total dwelling stock (2009)



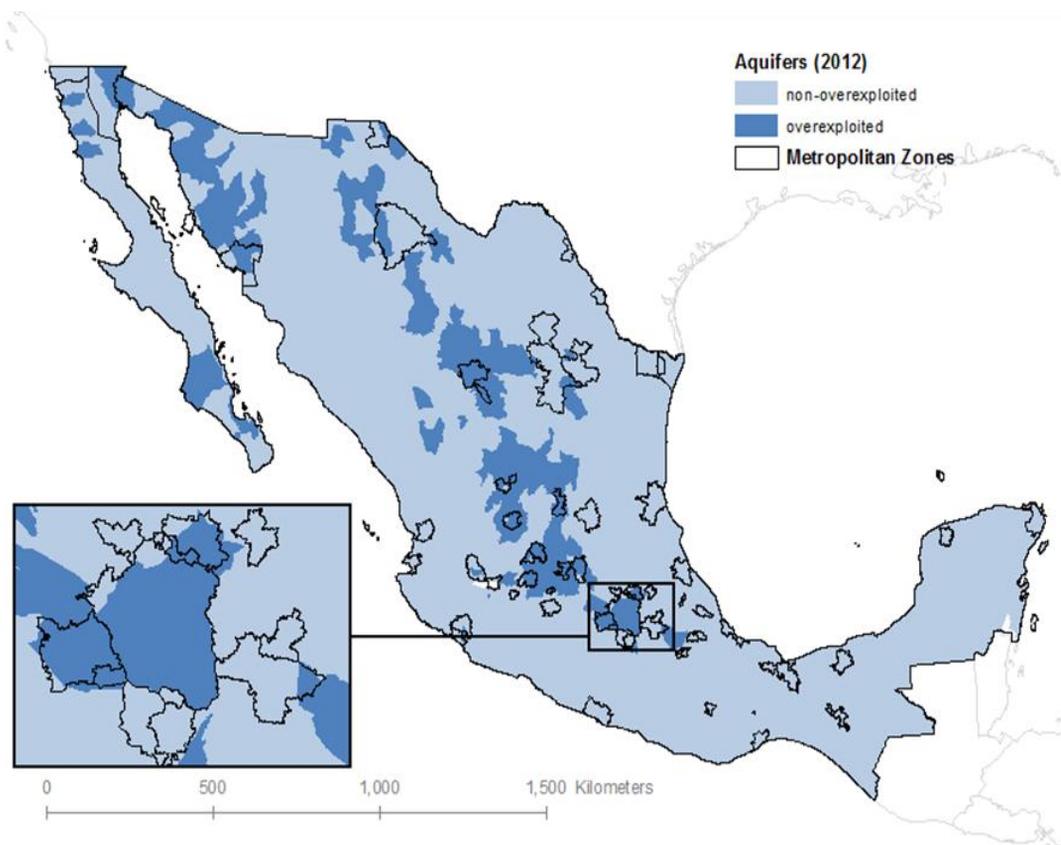
Source: OECD Housing Market questionnaire, in OECD (2012), OECD Economic Surveys: Chile 2012, OECD Publishing. doi: 10.1787/eco_surveys-chl-2012-en.

Challenges to security, air quality and water stress affect city-dwellers' well-being

Many metropolitan areas are characterised by high levels of insecurity and air pollution, as well as poor water quality and inadequate waste-water treatment. These security and environmental issues add to the economic costs of inefficient urbanisation and directly affect the quality of life in cities. Compared to its OECD peers, Mexico faces significant challenges with respect to several indicators related to insecurity, and it ranks among the bottom five with respect to the environmental indicators of water quality and air pollution included in the OECD's Better Life Index (OECD, 2014e).

Despite important progress in reducing air pollution levels across metro zones in recent years, about 14 000 deaths were attributable to air pollution in Mexico in 2008 and pollution levels still exceed WHO guidelines (Clean Air Institute, 2013). Moreover, Mexico is currently under severe water stress: over the past 60 years, the amount of water available for each person has declined drastically due to population growth (Figure 12) (OECD, 2013f). Only 68% of Mexicans surveyed are satisfied with water quality, well below an OECD average of 84% (OECD, 2014e).

Figure 12. Mexico is under severe water stress
Overexploitation of aquifers across Mexican metro zones



Source: CONAGUA (2012), CONAGUA Atlas 2012, www.conagua.gob.mx/atlas/ciclo21.html

The recent development of a national policy framework aims to generate more effective urban management

Despite its rapid urbanisation and current high urbanisation levels, Mexico has until very recently lacked a clear urban policy to guide urban development. This is now changing. The creation in 2013 of a single ministry tasked with housing and urban policy (the Ministry of Agrarian, Territorial and Urban Development, SEDATU) signalled an important step toward a more co-ordinated response to the country's urban challenges. The magnitude of SEDATU's task should not be under-estimated: in recent decades, the sheer number of actors involved in the development process has impeded

effective, co-ordinated responses to the country's urban challenges. There are various ministries and agencies involved in housing, transport and urban-related services at federal level, as well as across the different levels of government. Not only are participating actors numerous; they also are extremely heterogeneous in terms of both their ability to influence policy and practice, and their technical, fiscal and human capacities. The unprecedented focus on housing and urban policy in the current reform agenda is thus a welcome development.



Investing in cities and housing can contribute to better living conditions over the long term

Just as policy makers must contend with a legacy of complex urban challenges, they must also keep an eye on impending demographic changes, such as an ageing population, which will have important implications for Mexico's labour force and productivity levels, the adequacy of its social security regime and its investment choices (see **Special Focus on Pensions on page 29**). As the country continues to urbanise (albeit at a slower pace) through 2050, urban planning and infrastructure investment decisions made today can improve the living conditions of a large share of its population over the long term. By getting housing *and* cities right, Mexico has an important opportunity to improve the well-being of a large and ever-increasing share of the population. The reform agenda undertaken by the federal government is a critical step toward these ambitions.

PART 2 |

INFONAVIT's role in improving housing policy for Mexico

Reform of the housing finance system is needed to change urbanisation patterns

Given the role of housing finance in shaping Mexican cities over the past four decades, changing the way cities are developed will require fundamental changes to the housing finance system. Federal policies – federal housing finance in particular – have facilitated the development of higher quality houses, yet

have often failed to contribute to the development of better cities. Reforms to INFONAVIT's practices thus form the basis upon which a more competitive, sustainable housing and urban development model can be built.

Policy-makers must tackle the many peculiarities of housing trends and past policies

Housing trends and previous housing policies in Mexico are unusual in several respects compared to many other OECD countries. First, Mexico has managed to address, to a large extent and with remarkable speed, the country's quantitative housing gap and transition to more permanent housing for an increasing share of the population. Such a rapid expansion of the housing stock has been seen in only a few OECD countries. Secondly, like many Latin American countries, Mexico has a long history of informal or irregular housing development, and a large share of the housing stock continues to be self-built, lacking legal titles, or constructed outside the formal development process. Nearly one-quarter of urban households live in informal settlements

(IMCO, 2011; UN-Habitat, 2011). Thirdly, land tenure arrangements and the urbanisation of agricultural or collectively-owned land (*ejidos*) have left a complex legacy for modern-day housing and urban development. Fourthly, while public policy in other OECD countries has also tended, to varying extents, to favour home ownership in recent decades, Mexico, along with Italy and Spain, is unusual in focusing its social housing policies on home ownership (Andrews, et al., 2011). Finally, Mexico is now beginning to transition out of a long period in which housing policy has been indirectly set by an implementing body (INFONAVIT); housing and urban policy is now in the hands of an explicit policy-making body, SEDATU.

Mexico's transition from primarily informal to formal housing addressed the housing gap

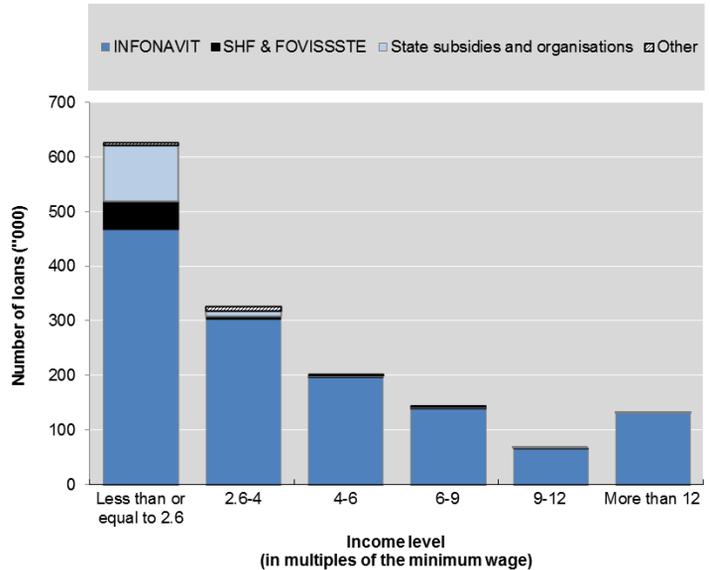
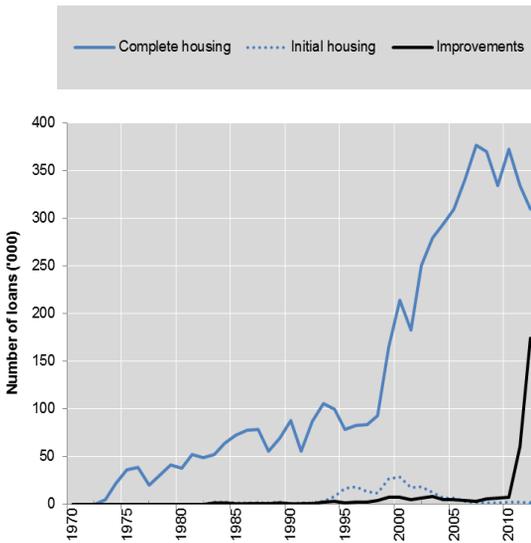
Prior to the creation of INFONAVIT, most homes were built through an incremental, informal process using household resources to acquire the land and construct the house. By 2005, however, a majority of Mexican households bought homes built by private developers with mortgages financed – for the majority, and at least in part – by government agencies with tight restrictions on both the borrower and the type of housing eligible to receive financing (Figure 13). Mexico's housing transition also hinged on the complete transformation of the country's construction

industry: prior to the 1990s, most construction companies were small-scale operations, but by 2004, nine of the country's largest developers controlled a quarter of the market share (Monkkonen, 2009). INFONAVIT, for its part, played a pivotal role in the country's housing transition, thanks to its market dominance in mortgage lending and, in the early years, a close relationship with large-scale developers (INFONAVIT, 2013).

Figure 13. Most lending has financed new homes for lower-income households

a. Number of loans (in thousands) financed by INFONAVIT, 1973-2012⁵

b. Number of loans (in thousands) financed by various lenders, 2010-2012



Source: CONAVI (2014), Históricos de vivienda, www.conavi.gob.mx/php/mapa_interactivo/busqueda_avanzada/historicos_viviendas/mapa_interactivo.php

Note: Aggregate numbers for the years 2010 to 2012. Loans without information regarding the municipality to which they were distributed are not considered. All values are 2010 prices. Source: CONAVI (2014), Históricos de vivienda, www.conavi.gob.mx/php/mapa_interactivo/busqueda_avanzada/historicos_viviendas/mapa_interactivo.php

The legacies of the previous development model include sprawl, inadequate infrastructure and high vacancies

Several features of INFONAVIT's past lending practices have contributed to the challenges now facing cities. By concentrating lending on lower-income segments of the formally employed population, favouring home ownership over other housing alternatives and relying on a business model of formal, mass-produced homes, INFONAVIT financed homes that were often developed where land was least expensive: in large land reserves far from city centres and disconnected from urban services and infrastructure. In the most egregious cases, contractual obligations with developers to build water pipelines and other services were never fulfilled, while promised

transport infrastructure connecting the developments to urban centres was never built. A large share of uninhabited homes has resulted in part from the suboptimal location of some housing developments and a lending model that provides affiliates with strong incentives to take out a loan. INFONAVIT has in recent years made important efforts to change its model by expanding housing options for affiliates (to include used [existing] homes, as well as rental housing) and by encouraging more multi-family, centrally-located housing and prioritising equity values and quality of life.

Policy-makers are working towards a more sustainable housing policy for Mexico

A more sustainable housing model in Mexico is unlikely to occur without reforms to INFONAVIT, which continues to drive the flow of funding for housing development. To improve housing and urban development outcomes, INFONAVIT could continue to advance strategies to develop the right incentives for both INFONAVIT affiliates to exercise a wider range of housing solutions and for developers to transition toward a housing model of multi-family, centrally-located developments.

These opportunities include:

- redesigning the allocation criteria through a better screening of mortgage applicants or a system that rewards the most reliable

borrowers; these efforts could help ensure a higher level of credit-worthiness of prospective borrowers and a greater probability that affiliates' could continue to afford mortgage payments over the medium to long term;

- allowing affiliates more flexibility and choice about their housing options;
- contributing to better links between housing and infrastructure development; and
- improving the quality of information offered to INFONAVIT affiliates about housing and pensions (see **Special Focus on Pensions**).

PART 3 |

Getting Mexican cities right: five priorities for more competitive, sustainable cities

Reforms to housing finance are fundamental – but insufficient

Reforms to the housing finance system are critical to change the shape of urban development – but they will not be sufficient. Moreover, their success will depend to a great extent on the ability of other public and private actors (especially home-builders) to adapt their practices and implement other fundamental reforms involving taxation, regulation, land-use policies and property rights, to name but a few. As such, Mexico is rapidly moving towards a more encompassing understanding of urban policy, a shift that is in line with an increasingly

transversal conception of urban policy across some OECD countries. The National Urban Development Programme 2014-18 outlines six core objectives for urban policy: controlling urban sprawl, boosting well-being and sustainability, promoting sustainable mobility, avoiding irregular settlements and development in risk zones, boosting local economic development, and developing instruments to improve land management.

Policy-makers could focus on five strategies to “get Mexican cities right”

Building on the proposals of the National Urban Development Programme 2014-18, this report identifies five strategies to help “get cities right” – that is, five priorities for urban policy that could have a significant impact on the competitiveness and sustainability of cities.

These strategies, mentioned below, should be viewed as complements to the suggested reforms to the housing finance system.

- ① Overcome the barriers to infill development
- ② Link housing and transport planning and investment
- ③ Tackle the vacancy problem
- ④ Remove the barriers to the rental housing market
- ⑤ Improve institutional capacity for urban planning and development



Strategy ① Overcome the barriers to infill development

Tackling urban sprawl will require policy tools that promote more intensive use of land within the existing boundaries of a city (infill development). Generally speaking, this can be achieved by encouraging within-city development activity and/or discouraging construction outside the existing city limits.

To that end, policy makers could **make infill and redevelopment cheaper** by reducing regulations and streamlining permits and other administrative procedures. These impose higher relative costs on smaller projects (they are pretty much the same regardless of project size) and thus encourage developers to favour big greenfield sites over smaller infill locations. Possible tools include: expedited review for projects that meet certain sustainability criteria; removal or reduction of parking requirements – provided that access to adequate public transport is available – which can limit urban densities and be a major barrier to redevelopment; land value capture initiatives; or the establishment of priority

funding areas.

It may also be worthwhile to **make land assembly easier** through land assembly districts, graduated density zoning or partial plans. Indeed, it is often not the higher cost of land within central parts of cities that limits the attractiveness of urban redevelopment but the challenge of assembling a parcel of land large enough to develop large projects and reap economies of scale.

Finally, policy makers can also **make urban expansion more difficult**, particularly through the creation of urban growth boundaries and greenbelts. These measures are not without their limitations, however, which should be well understood before their adoption. The impact of growth boundaries and the like also depends on how they interact with other strands of policy affecting urban growth.

Strategy ② Link housing and transport planning and investment

Ensuring sustainable, accessible modes of urban transport is a core objective of the National Urban Development Programme 2014-18. A governance mismatch makes it difficult to link urban and infrastructure investments, as housing development (typically financed at federal or state level by one set of agencies and/or administrations, and approved at municipal level) is by and large disconnected from strategies for urban transport (typically planned and financed at federal or state level by another set of agencies and/or administrations, often without the involvement of local government).

In particular, greater co-operation is needed between SEDATU and BANOBRAS, the state-owned infrastructure bank, in investment decisions for urban mobility. In this respect, reforms to the functioning of the Federal Infrastructure Fund (FONADIN), the primary vehicle for federal funding for urban transport, would be welcome. The share of funding for sustainable urban transport projects (e.g. mass transit, pedestrian and cyclist improvements)

could be increased. Yet it is also clear that local governments are in need of more than just financing to transition toward more sustainable urban mobility: they also need to build institutional capacity to plan, design and implement successful projects. Federal support in this regard will be essential.

In addition, the federal Metropolitan Fund (*fondo metropolitano*) provides another potential avenue of support for sustainable mobility projects, but the financing should be better linked to clear metropolitan investment plans and involve local actors in the decision-making process. A broader range of actors (BANOBRAS, municipal planning institutes and state land banks, in addition to states and municipalities) should be included in the planning of urban mobility projects. Finally, in their efforts to develop tools to link the costs and benefits of transport investment, policy makers could put greater emphasis on accessibility and performance measures.



Strategy ③ Tackle the vacancy problem

In addition to the strategies that could be considered by INFONAVIT to tackle the issue of vacant homes within its own housing stock, efforts from other institutional actors are needed to address the broader challenge of vacant housing. Three general strategies could help: (i) address the issue of absentee owners and underutilised property; (ii) invest in distressed neighbourhoods; and (iii) further develop land banks to deal with existing vacant homes.

Among the possible avenues for intervention, property tax reform should be a priority. Low property tax rates and low collection are not only problems for local fiscal health; they also contribute to property vacancy and the under-utilisation of space. Two alternative reforms could be considered –

a land value tax, which taxes only the land (not the structures), or a two-rate (or split-rate) tax system, which imposes a higher tax rate on the land than on the structures. A land-value tax may be a preferred option in many cities due to its potentially simpler implementation.

Finally, publicly operated land banks have in some OECD countries proven to be an effective strategy to deal with vacant houses, especially for properties that have been foreclosed. There is variation across states in their institutional structure, but those that have been more successful have clear statutory authority to acquire property, reliable revenue sources (often through bond issuance), and clear guidelines in terms of the property that they can acquire and the uses to which they can convert it.



Strategy ④

Remove the barriers to development of the rental housing market

While there are a number of possible strategies to boost the rental housing market, it will be important for Mexico to begin with broad measures targeting the fiscal, regulatory and legal framework to ensure more balanced treatment between rental housing and home ownership. These efforts should be prioritised in a coherent national policy for rental housing in Mexico.

The development of a more robust rental market will be more effectively achieved through coherent policy, rather than disparate programmes; this is the risk associated with the nascent rental housing programmes initiated recently. A piecemeal, programmatic approach to rental housing – rather a conception of rental housing as part of a broader housing agenda – has been seen as a limit to greater expansion of the rental supply in other OECD countries, such as the United States (Landis and McClure, 2010).

Reforms to the legal and regulatory framework for rental housing should ensure that both owners of rental properties and tenants are treated fairly and that rental housing meets certain quality standards. In terms of the fiscal framework, the Mexican authorities – the finance ministry in particular – could aim to ensure a greater balance between rental and owner-occupied housing by reducing the tax burden on rental properties, thereby encouraging owners to put vacant properties in the formal rental market.

There will still be a place for rental assistance programmes for individuals – such as INFONAVIT’s *Arrendavit* and CONAVI’s rental subsidy programmes. Yet these types of targeted initiatives will be most successful once broader fiscal, legislative and regulatory reforms are in place.

Strategy ⑤

Improve institutional capacity for urban planning and development

While many of Mexico’s urban challenges are well understood by policy-makers, capacity gaps – particularly at municipal level – have nevertheless made them difficult to overcome. While municipalities retain significant and critical control over urban development, the capacities of many local administrations tend not to be commensurate with their responsibilities. A majority of municipalities lack a professional workforce in charge of urban planning, property registration, valuation, cadastre management, risk management, and other related fields. Efforts to address these challenges are compounded by the policy discontinuities that result from a change in

most municipal administrations every three years at the election of a new mayor, though recent federal legislation enables states to determine whether or not to allow for re-election in the future.

Boosting the institutional capacity for planning at municipal level and, increasingly, in some areas, at metropolitan-level will be critical to more sustainable urban outcomes. Specifically, the authorities could consider (i) leveraging planning institutes to strengthen capacity for urban planning; and (ii) strengthening data collection and policy-making at metropolitan scale.

PART 4 |

Reforming urban governance for better housing and urban development outcomes

For the housing and urban policy agenda to succeed, it will be necessary to reform the urban governance structure and improve the management of urban areas. Although Mexico has developed a National Urban Development Programme, it will be necessary to build a longer-term strategy that looks beyond the six year term.

Additionally, it will be important to improve capacity for conducting and implementing urban planning by professionalising the public-sector workforce: too often, urban development projects have been characterised by an improvised, trial-and-error approach that responds to short-term political priorities, rather than the national long-term interests.

Policy fragmentation for housing and urban policy at federal level must be reduced

While the establishment of SEDATU is an important step towards better inter-institutional co-ordination, current institutional arrangements for housing and urban development remain fragmented. Such fragmentation results in policy incoherence, a lack of systemic co-ordination among actors, and duplicity in functions across federal and sub-national actors. The large number of actors reflects the importance of the housing sector for the national economy on the one hand; yet it is also the source of considerable duplication of functions and resources.

First, to help overcome policy fragmentation for housing and urban development, SEDATU should be consolidated as the centre for decision-making on these issues at national level.

Secondly, Mexican authorities could consider strategies to streamline the institutional landscape of the housing sector. The paradox of the Mexican institutional structure is the existence of a large number of housing organisms, which serve specific geographies (urban vs. rural) or segments of the population, but which, taken together, still do not adequately reach the entire population. Some institutional mergers could be considered over the longer term.

Thirdly, authorities could look to strengthen urban development through better cross-sectoral planning: establishing network-based arrangements for urban development or a national co-ordination council for urban development could be considered.

Collaboration for urban planning and development should be strengthened across levels of government

Urban planning and development are, by their nature, transversal with respect to both sectoral policies and the actors implicated in the development process. To strengthen collaboration for urban planning and development across levels of government, a more concentrated effort in strategic planning could help the Mexican authorities identify and maintain focus on priorities and global outcomes.

Additionally, while it may be difficult to establish a clear-cut allocation of competencies across levels of government (as many policy areas require shared interventions from

different levels of government), co-ordination mechanisms should aim to reduce transaction costs and information asymmetries across levels of government. By extension, co-financing and conditionality mechanisms could be useful tools to bolster fiscal relations across levels of government. Finally, there are opportunities to give a more strategic role for the existing fora for sharing information, good practices and analysis on urban challenges in Mexico; SEDATU could follow up on the outcomes of these discussions.

Modernising the municipal administration could improve urban planning and development

Mexican municipalities are short-term institutions with long-term responsibilities. Modernising the municipal administration and, where appropriate, developing metropolitan governance arrangements, will be central to better urban planning and management.

Reforms to municipal administration are all the more important in Mexico in light of the short duration of municipal presidents' terms and, in some cases, the technical complexity of the services provided. Measures could include enabling municipal re-election and/or longer terms in office for mayors (recent federal legislation has already paved the way for this change, to be determined at state level), in addition to creating incentives for urban planning and introducing city managers (professional civil servants to guide the day-to-

day administration within municipal administrations).

Reforms could also build on past efforts toward metropolitan governance in different metro zones. Metropolitan reforms have been challenging, though León and Guadalajara may be considered leaders. Such structures may be tasked with co-ordinating public service delivery (transport, water, waste management) and/or urban planning. Experience in Mexico and across the OECD suggests that involvement from federal and state governments can be instrumental in fostering more formalised co-operation among municipalities. The government of the state of Jalisco, for instance, has had a very active role in metropolitan reforms in Guadalajara.

Cities need incentives to ensure sufficient financial resources for urban development

Although federal countries tend to have larger revenue decentralisation than unitary countries, Mexico is the exception, as sub-central governments represent only 9% of total government revenues (less than 1% of GDP) (Piñero and Vammalle, 2011). States and municipal governments in particular are highly dependent on transfers, and their debt levels are soaring. Moreover, inter-governmental fiscal relations are not fully fit to allow a healthy development of metropolitan areas. Mexican urban areas struggle to finance new and growing expenditure needs and to deliver services in a cost-effective way.

Reforms to fiscal relations across governments could help ensure the availability of resources to pay for public service delivery. Strategies to bolster municipal finances include: expand own-source revenues of subnational governments (particularly through property tax reform and user fees [Figure 14]), improve the equity of the transfer system, control subnational government borrowing and municipal spending, and engage in public-private partnerships.

Figure 14. Increase in property tax revenue after modernising the municipal cadastre, 2014



Source: BANOBRAS (2014), www.banobras.gob.mx/productosyservicios/productos/asistenciatecnicaayfinanciera/Documents/Documentos%20Productos%20Asistencia%20Técnica%202013/Presentación%20Programa%20de%20Modernización%20Catastral%202013.pdf

Professionalising the public workforce can help build capacity for housing and urban policy

In Mexico, a major constraint for the implementation of investment projects, and a reason for the weak efficiency and low quality of public service delivery, is the inadequacy of the civil service system. The current system accords sub-national government officials a lower status (in particular, municipal public servants), including lower salaries and fewer chances for advancement. Recommendations to strengthen the technical and human capacities at municipal level include:

- taking the legislative and strategic steps to professionalise the local public workforce; and
- institutionalising collaboration for professionalisation across levels of government.

Strategies to professionalise the local public workforce

- ✓ Develop a merit-based recruitment process
- ✓ Improve forward-looking management and planning
- ✓ Focus on competencies
- ✓ Make training more strategic
- ✓ Offer certification of competencies
- ✓ Improve the ethical conduct of public servants at all levels of government



PART 5 |

An opportunity to change the future of housing and urban development in Mexico

Unlocking the potential of Mexican urban areas could help boost the country's productivity and, ultimately, its overall competitiveness. To this end, reforms to housing and urban policy could be instrumental in making cities more attractive to skilled workers and firms, more healthy and liveable for residents, and more inclusive for all segments of the population. This will require reforms to the fiscal, regulatory and legal frameworks that govern housing, transport and urban development.

These broad measures should meanwhile be supported by changes to the housing finance

system – to offer more flexibility and more choice with respect to housing – and further bolstered by reforms to the governance frameworks for transport and urban development.

Building better cities throughout Mexico will ultimately require efforts from all levels of government and across multiple policy domains. INFONAVIT, in close partnership with SEDATU, the finance ministry and other federal bodies, as well as states, municipalities, private developers and other key actors in the development process, can play a leading role in “getting cities right”.



Special focus | Pensions

The role of INFONAVIT in contributing to an adequate retirement income

INFONAVIT must be part of the development of a stronger pensions system in Mexico

In 1992, a retirement savings function was added to INFONAVIT's mandate. For a long period, it remained very much a secondary activity, but its salience is rising and INFONAVIT has in recent years begun to devote increasing attention to its development. The task is an especially pressing one at present, as Mexico faces a serious long-term challenge in assuring that its citizens will have adequate income during their retirement.

INFONAVIT cannot resolve these problems by itself, but it is clearly well positioned to improve workers' prospects for retirement income. Most importantly, INFONAVIT has an established relationship with formal-sector workers through the mandatory 5% employer contribution that is held in individual accounts that currently can be used to finance diverse housing solutions and to supplement pension income.

The pending social security law would have profound effects on INFONAVIT

As of this writing, the Mexican Senate is considering approval of major changes to the Social Security Law, which would imply a significant realignment of the functions of INFONAVIT.

The proposed changes include:

- the introduction of both a universal pension for those who fail to qualify for a recognised pension and unemployment insurance, such that Mexico would join the rest of OECD countries with a national system of unemployment insurance;
- measures to increase competition among suppliers of pension services; and
- additional provisions that will significantly affect the role of INFONAVIT in providing

pensions and give the Institute new functions in the country's unemployment insurance regime.

Under the new scheme, the present 5% employer contribution to the individual housing account managed by INFONAVIT would be divided into two parts: (i) a housing account, which would continue to function as under the present system, but with the amount of contribution reduced from 5% to 2% of earnings; and (ii) a new mixed account, in which the remaining 3% of the employer contribution would be placed; this mixed account could be used for unemployment benefits, mortgage down payments and/or retirement income.

Most of the changes envisaged in the Social Security Law governing the pension management regime are designed to make the regime more flexible and competitive while enhancing protection of IMSS affiliates through greater transparency and more competition. Most importantly, this new

measure should help alleviate the country's pension gap. Those who would like to increase their future retirement income can either leave the funds in their accounts with INFONAVIT, or obtain better returns elsewhere.

What future for INFONAVIT with respect to its pensions mandate?

The changes in the Social Security Law that are currently under consideration would have a profound impact on the organisational structure of INFONAVIT and thus constitute an important opportunity for INFONAVIT to reassess its options for the future. The most significant result of projected changes in the law is that INFONAVIT, which previously functioned as a housing bank with privileged access to funding, would be split along functional lines:

- a housing finance function with somewhat reduced access to low-cost funding through the individual housing accounts, which will be responsible for satisfying the demands for low-cost housing finance while retaining the double mandate for housing and pensions; and
- an asset management function with responsibilities for helping its affiliates use their new mixed accounts for housing and pensions, with the additional responsibility for unemployment insurance. Each of these functions would be carried out by a separate corporate entity, although there would be some linkages between the two.

Under the new scheme, INFONAVIT could consider different opportunities to adapt to its new role under the revised social security law, as a provider of housing finance and an asset management institution.

As a provider of housing finance, the two most promising ways in which INFONAVIT can remain active as a supplier of low-income housing finance in the face of reduced access to low cost funds would be to focus on lowering targets for prudential ratios and to increase the use of alternative finance techniques (e.g. through the capital and private markets, etc.).

As an asset management institution, the changes in the law that are now under consideration would oblige INFONAVIT to reconsider its role in the entire Mexican social safety net and the financial system. Given this fundamental change in the institutional and regulatory framework, INFONAVIT could follow one of two approaches:

- focus narrowly on the management of the mixed funds and support INFONAVIT's housing finance activities, or
- seek to become a bigger player in the market for asset management by competing throughout the range of savings instruments. To that end, possible strategies worth considering include providing high-quality financial education to workers and, in a second phase, individual counselling; developing a full range of savings investment products throughout the life cycle of the worker; and, finally, competing with other asset managers to become a market leader with respect to costs.

Notes

1/ The RUV obtains information from the construction companies on planned new housing and follows the property through the construction process, capturing information such as location, size and price of the home.

2/ Spatial de-concentration is measured through an entropy index where higher values suggest a low degree of clustering (higher dispersion) of people in space. On the horizontal axis, the ADC index measures the extent to which population is located far from the main urban centre. Higher values indicate higher distances, on average, from the centre (higher decentralisation). Country values are obtained as averages of values for functional urban areas. See reference for details.

3/ Data for Mexico and Argentina correspond to 2010; data for Ireland, Spain, Portugal and Germany correspond to 2011; data for France corresponds to 2012;; data for England corresponds to 2013; data for the United States correspond to 2014 (Q1 for vacant housing statistics). A vacant home is defined as dwelling that is offered for sale or rent, rented or sold awaiting occupancy, or held off market for other reasons. Additionally, numbers for Argentina exclude vacancy due to commercial use, use for holiday, weekend or other temporal home. Numbers for Mexico exclude housing for temporal use. Numbers for Spain and Portugal exclude secondary homes. For Ireland, numbers exclude vacant holiday homes, England defines empty homes as those dwellings that are unoccupied and substantially unfurnished. Numbers for Germany exclude vacant holiday homes, commercially used homes, homes inhabited by diplomats or foreign armed forces.

4/ Data collected for the 2010 INEGI Census report a housing stock of over 35 million homes.

5/ Loans for complete housing are exercised as one continuous and single process for new or used housing. Loans for initial housing are used for homes purchased that are subject to gradual developments/improvements that are carried out in stages based on the borrowers' economic resources and needs. Loans for co-financing are complementary to loans granted by other institutions for the acquisition or construction of a dwelling. Loans for physical improvements provide funding for repair, renovation and expansion of the property owned by the recipient. Loans for financing improvements are for the case of interest rate/terms/index reference changes that may require adjustments to the benefit of the debtor with respect to the initial conditions of funding.

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