Box 1
The Housing Market in Colombia, recent Developments and Outlook

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Over the last two years, the real estate market in Colombia has shown a dynamism, reflected in historically high levels of housing starts, sales and launches. This has brought about an increase in housing investment, particularly as of the third quarter of 2022, which contributed to the recovery of overall investment in the Colombian economy after the Covid-19 crisis. This was generated, in part, by the expansionary fiscal and monetary policy measures implemented to stimulate the recovery of economic activity in the country.

However, in recent months the housing market has been registering signs that forewarn a change in housing investment trends going forward in light of a significant drop in sales and indications of a slowdown in future supply. The above, against a backdrop of moderating factors that drove the positive market performance of previous years, lower confidence levels and greater household debt, a steep increase of construction costs, higher financing costs and, in general, a macroeconomic adjustment process that the Colombian economy requires for inflation to return to its target and for the product and the external balance to reach sustainable levels.

1. The Housing Market, 2020-2022

From the second half of 2020 to mid-2022, the market for new homes showed significant increases in sales, driven by factors related to the recovery of economic activity after the pandemic. Consequently, influences such as the ample supply of subsidies, loose financial conditions, and the availability of household savings that at yearend 2020 and during 2021 helped finance pent-up demand, would explain a significant part of the high housing market dynamic. In 2021, sales reached an all-time high of 238,000 units, which exceeded 2019 figures by approximately 37%. This result was driven by both the social interest housing (VIS) and non-social interest housing segments (non-VIS).

Subsidies for housing purchases have been one of the most significant influences on positive sales performance. Under the *2020 Compromiso por Colombia* (Commitment for Colombia) reactivation plan, the *Mi Casa Ya* (My House Now) program was expanded so that low-income households could purchase housing. As a result of this policy, 2021 and 2022 saw a significant upsurge in the number of subsidies allocated,[1] from around 30,000 in 2019 to more than 65,000 in said period. In the case of the non-VIS segment, the subsidies from the Mortgage Portfolio Reserve Stabilization Fund (FRECH)[2] program, provided until 2022, would have been the main accelerant that buoyed the increase in the number of finished home sales. This was compounded by loose financial conditions, with interest rates for home purchases that reached a historic low in mid-2021,

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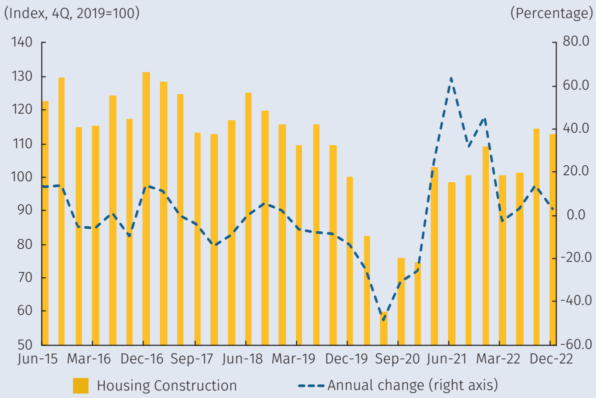
1 On May 2020, within the economic reactivation plan, the availability of 200,000 subsidies was announced for 2020 and 2022: 100,000 for VIS and 100,000 for non-VIS. According to figures from the Ministry of Housing, City and Territory (MinVivienda), in 2020 and 2021 the number of subsidies allocated through the Mi Casa Ya program increased by over 100% versus the number provided in 2019.

2 This subsidy was granted to buyers of new housing with a pre-approved mortgage loan or housing lease. The subsidy provides coverage over the agreed interest rate for homes whose price does not exceed 500 monthly minimum wages in force (SMMLV).

reflecting an expansive monetary policy and wide availability of credit for this mechanism.

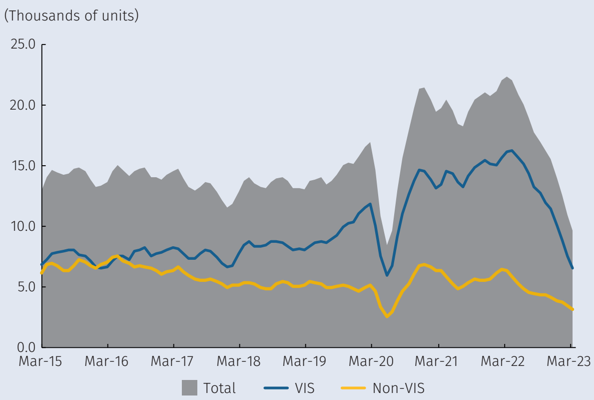
The housing supply would have responded to the improved sales scenario, both in the VIS segment through the greater supply of new homes, as well as in the non-VIS segment from inventory buildup over the previous years and the boost in new project launches. The growth in the new VIS supply was observed in the historic high starts and launches seen during the first half of 2022, which recorded levels of up to 30% above those seen before the pandemic. Furthermore, in the non-VIS segment, inventory buildup recorded since 2015,[3] together with the recovery of launches and project initiations, supported the increase in sales during 2021. It is worth noting that the supply response occurred in an environment of rising construction costs. According to residential figures in the DANE's building construction cost index (ICOCED), costs showed notable adjustments, from annual increases of 5.3% in April 2021 to values nearing 10% by mid-2022.

Graph R1.1
Value-added housing construction[a/]



a/ Seasonally adjusted and corrected for calendar effects.
Sources: DANE, calculations by the authors.

Graph R1.2
Home sales by segment [a/]



a/ Quarterly average of the units in projects that were sold in the 13 regionals.
Sources: Camacol, calculations by the authors.

The housing market's positive performance would have enabled housing investment levels, in 2022, to exceed pre-pandemic levels. In particular, in the fourth quarter of that year, this component of demand registered annual growth of 12.8% and 3.6% versus the same period in 2019 and 2021, respectively (Graph R1.1). Besides, housing sales and supply behavior would have found a relative market equilibrium, which was reflected by an absence of significant increases during 2021[4] in the real prices of new[5] and existing[6] housing. This was compounded by the regulatory limit imposed on sales prices of the VIS[7] segment, which recorded the greatest sales volumes.

2. Recent Slowdown in the Housing Market

From the second half of 2022, certain real estate market indicators began pointing to a possible cooling of housing investment going forward. Indeed, since August 2022, sales recorded annual reductions which have accentuated in recent months (Graph R1.2) in both the VIS and non-VIS segments. The latter has occurred against a backdrop of increased household financial burden and debt, lower confidence levels and higher levels of country and exchange rate risk. This along with upward adjustments in the monetary policy interest rate in an environment of high inflation, an increase in construction costs that may have been passed on to selling prices, and strong aggregate demand dynamics primarily in goods and services consumption.

The downward trend in sales would be related to a downturn in the factors that propelled the market between 2021 and mid-2022.

3 The housing construction sector recorded a healthy activity during the beginning of the last decade, leveraged on high international oil prices and the increase in national income. When the price of crude dropped in 2013, sales of this asset contracted significantly and the sector, particularly the non-VIS segment, showed high inventory buildup rates through the following years. The latter would also have led to a significant decline of new supply indicators.

4 The DANE's new housing price index (IPVN for its Spanish acronym) is used as benchmark.

5 *Banco de la República's* used housing price index (IPVU for its Spanish acronym) is used as a benchmark.

6 See "Box 1: Recent Housing Market Performance" in the April 2022 Monetary Policy Report by *Banco de la República*.

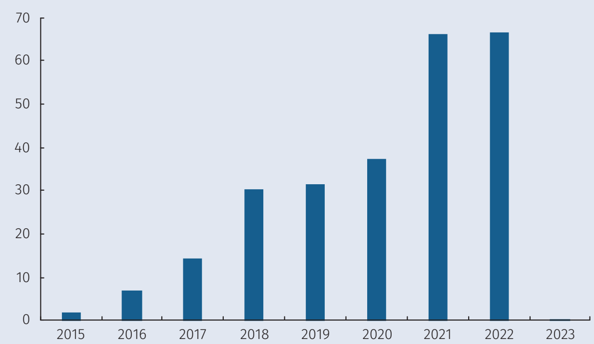
7 The sales price of a VIS unit can range between 130 and 150 minimum monthly wages in force (SMMLV).

Primarily, uncertainty surrounding the continuity of some of the housing subsidy programs coupled with the termination of others would have dampened the households' purchase intent. Particularly in the case of the VIS segment, the anticipated depletion of the *Mi Casa Ya* program subsidies by 2022[8] and changes announced in the requirements for access[9] would explain, to a large extent, the drop in sales.[10] (Graph R1.3, panel A). In the non-VIS segment, the end of the FRECH program in 2022 would have reduced their incentives to purchase housing. In addition, with the Colombian economy facing an environment of high inflation and excess demand, monetary policy adjustments have involved interest rate increases[11] to guarantee the convergence of inflation to its target in the medium term. In turn, this necessary correction of the monetary policy interest rate has been reflected in higher borrowing costs for home purchases,[12] which could have affected households' home purchase decisions, resulting in the consequent delay thereof (Graph R1.3, panel B). Likewise, higher borrowing costs would imply an increase in the financial burden of households, limiting their borrowing capacity for home purchases.

Sales in the non-VIS segment could also be affected by the recent increase in the preference for foreign assets by residents and non-residents [13], in an environment of greater perception of country risk, which has been echoed in an increase in the risk premium for Colombia (measured through the five-year CDS). This is a result of the perception of housing as an investment asset that may affect portfolio reallocation decisions in the face of changing market conditions. Furthermore, the approved tax reform would result in fewer incentives to purchase housing, by reducing the tax deduction ceiling for housing interest payments and tax benefits for voluntary contributions to pension plans and AFC accounts (savings accounts to encourage housing investments).[14] This was compounded by more restrictive financial conditions in loans for home purchases, amidst an increase in the loan quality

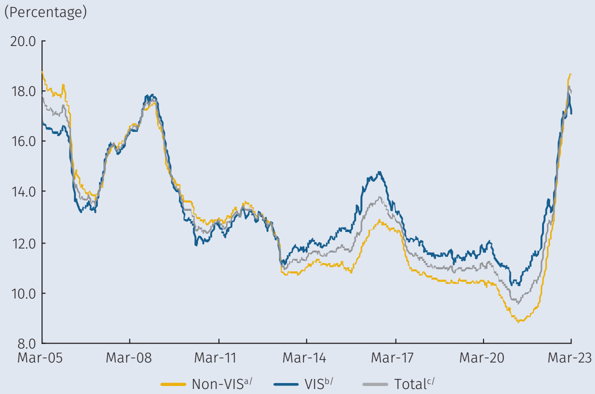
Graph R1.3
Factors affecting housing demand

A. Number of subsidies assigned through the Mi Casa Ya program



Note: Data to the first week in April 2023.
Sources: Ministry of Housing, City and Territory, calculations by the authors.

B. Interest rate for home purchases by segment



Note: Information to March 31, 2023
a/ The weighted average by interest rate value of the disbursements in pesos and in UVR to purchase non-VIS homes. Additionally, the data are smoothed over a 4-week rolling average.
b/ The weighted average by interest rate value of the disbursements in pesos and in UVR to purchase VIS homes. Additionally, the data are smoothed over a 4-week rolling average.
c/ The simple average between VIS and non-VIS purchase interest rates.
Sources: Office of the Financial Superintendent of Colombia, calculations by the authors.

8 According to the Ministry of Housing, as of September 2022, 65,000 subsidies were allocated: 41,800 were funded within the current year and 23,000 additional subsidies had to be supported with the 2023 budget. See: https://minvivienda.gov.co/sala-de-prensa/comunicado-mi- casa-ya

9 Under the new government, the Mi Casa Ya program would focus on the most vulnerable households in rural areas of the country. According to Decree 490 of April 4, 2023, those seeking a subsidy for the down payment of up to thirty SMMLV and the interest rate of up to 5 pts, must meet the following requirements: 1) they must not be homeowners in the national territory; 2)they must not have been beneficiaries of any subsidy to acquire housing; and 3) their Sisbén IV classification musts be A1 to D20. The above conditions would result in altering the allocation of demand, prioritizing the country's rural areas of the country, which would give rise to a transition period as supply for the new beneficiaries is generated.

10 In the second week of April 2023, the MinVivienda enabled the first disbursement of new subsidies for 2023, in contrast with 2022, when close to 19,000 subsidies had already been allocated by March of that year.

11 Since September 2021, the Board of Directors of Banco de la República has increased the monetary policy rate from an all-time low of 1.75% to 13.25% by April 2023.

12 Borrowing costs have reached 18-year record highs.

13 In 2022 and so far in 2023 to March, Colombian investment (both direct and through securities) in foreign assets has increased significantly, while in 2018 and 2019, by contrast, capital inflows were the norm.

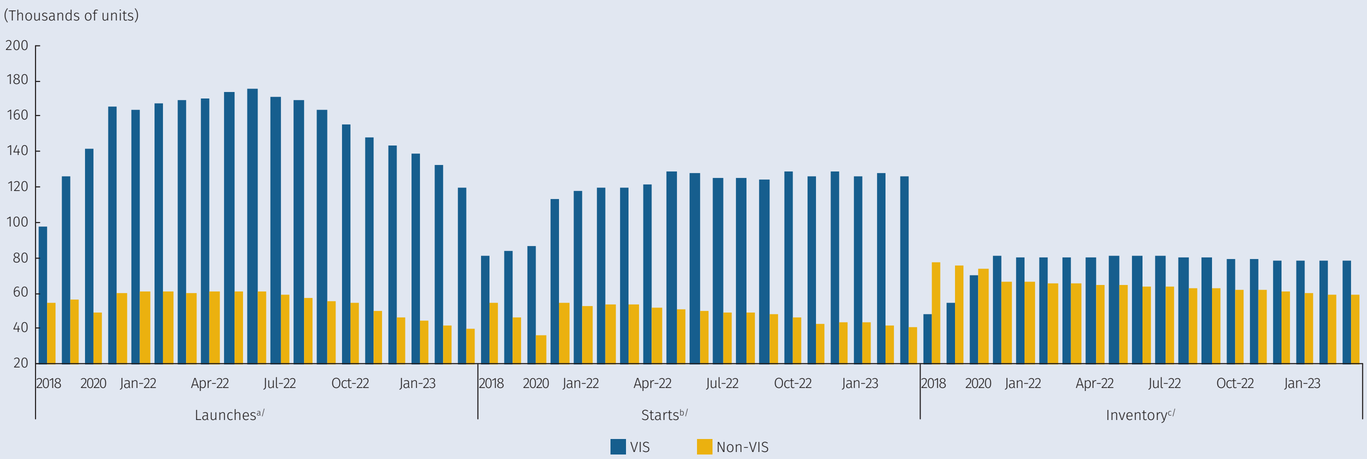
14 The tax reform reduced the deduction ceiling from 5,040 UVT (tax value units) to 1,210 UVT for interest payments on housing, AFC and AVC contributions and dependents, among others.

delinquency indicator.[15] In addition, the possible influence of the recent emigration phenomenon on housing demand cannot be ruled out.[16]

Along with lower sales of new homes, indicators of future supply are also on the decline. Figures up to March 2023, show that housing launches presented significant annual contractions versus their mid-2022 historical highs. Regarding housing starts, the non-VIS segment registered negative annual variations since mid-2022, which explains the total market decline (Graph R1.4), while the VIS segment has remained stable, registering high levels supported by previous years' sales. This has taken place in a scenario wherein construction costs remain high, with annual increases of close to 14% in recent months according to the residential ICOCED (Graph R1.5, panel A). This could have led some builders to halt construction or postpone delivery dates. In addition, the increase in housing construction interest rates, which reached levels of around 18% in March 2023, would also be curbing the pace of future supply in the sector (Chart R1.5, panel B) within a scenario of falling sales and little room for passing on construction costs to housing prices.

The market contraction has been evident in the longer placement times of the available supply. Both in the VIS and non-VIS segments, the rotation pace exceeds the levels observed throughout 2019, despite a slowdown in the production of new supply at the margin. In the case of VIS, the above is exacerbated by the increase in rescissions,[17] which would be contributing to a buildup of inventories in said segment and could lead to a rethinking of investment plans for future supply production (postponement and/or partial cancellation of projects). In this context of lesser housing demand pressures, marginal supply adjustments and high inflation, annual increases in real new and used housing prices slowed in early 2022 and moved into negative territory by yearend (Graph R1.6). Specifically, in the fourth quarter of 2022, new house prices fell in annual terms by 1.1%[18] and existing house prices by 3.0%.

Graph R1.4
Home supply launches, starts and inventory by segment



a/ Cumulative twelve-month of project units that began sales in 13 regions.
b/ Cumulative twelve-months of project units that began construction in 13 regions.
c/ Twelve-month average of project units or stages available on the market to be sold in 13 regions.
Sources: Camacol, calculations by the authors.

15 The delinquency quality indicator (DQI) is the percentage of past-due loans (loans more than 30 days past due) in the total loan portfolio, indicative of loan quality.

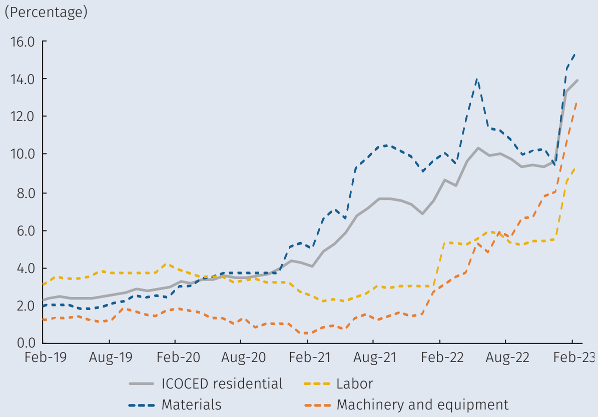
16 In 2022, there was a net population outflow of more than 500,000 Colombians from the national territory.

17 According to figures from La Galería Inmobiliaria, housing rescissions accounted for more than 20% and 25% of gross home sales in 2022 and so far in 2023 through March, respectively. In 2019 and 2020 this indicator measured between 15% and 18%. On the supply side, the rescissions could originate from loan portfolio purging or cost issues and, on the demand side, from difficulties in financial closings due to lack of loan repayment capacity or access to subsidies. Demand factors are more prevalent in recent months.

18 According to DANE's IPVN (Price Index of New Homes), deflated by CPI excluding food.

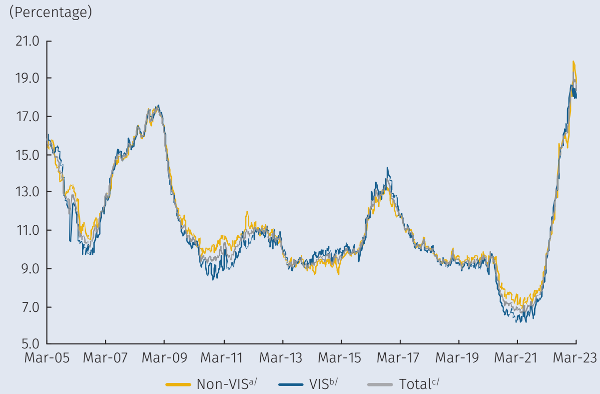
Graph R1.5
Factors affecting housing supply

A. Residential construction costs index (ICOCED) and select components (annual changes)



Note: The residential ICOCED was spliced with DANE's housing construction cost index (ICCV).
Source: DANE; calculations by the authors.

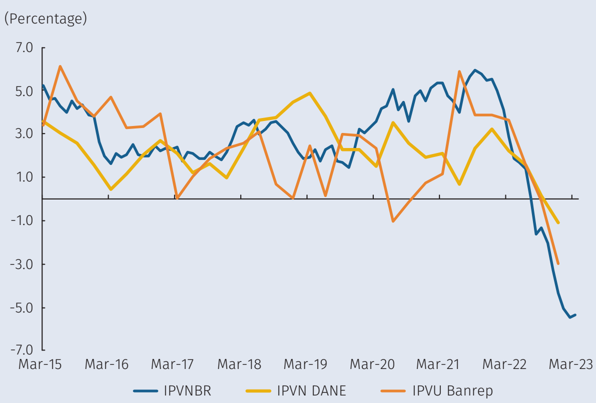
B. Interest rate for housing construction by segment



Note: Information to March 31, 2023
a/ The weighted average by interest rate value of the disbursements in pesos and in UVR to purchase non-VIS homes. Additionally, the data are smoothed over a 4-week rolling average.
b/ The weighted average by interest rate value of the disbursements in pesos and in UVR to purchase VIS homes. Additionally, the data are smoothed over a 4-week rolling average.
c/ The simple average between VIS and non-VIS purchase interest rates.
Sources: Office of the Financial Superintendent of Colombia, calculations by the authors.

In summary, the sector's recent weakening could be explained by multiple factors, such as lower public incentives and subsidies, higher levels of country risk, low confidence indices, tighter financial conditions, and higher financing and construction costs, among others. Going forward, the recovery in housing sales would be partly determined by the forthcoming definition of housing subsidy policies, particularly the resources allocated to the *Mi Casa Ya* program and their targeting. In addition, future dynamics of inflation and financial conditions for housing acquisition, as well as economic activity and employment, would also play a role. To the extent that inflation diminishes and financial conditions become more favorable for home buyers, demand for this asset would show more promising circumstances to support its recovery. The improvement of the macroeconomic imbalances facing the country (high inflation, excess demand, and high public debt and external deficit) would contribute to reducing the country's risk levels, improve confidence levels, lower long-term credit interest rates and, in general, provide better financing conditions for the construction and purchase of housing.

Graph R1.6
Real home prices in Colombia
(Annual changes)



Note: Real prices of new homes are measured through DANE's IPVN (Price Index of New Homes) which covers 53 municipalities and *Banco de la República's* IPVNBR for Bogota, Medellin, Cali and the municipalities surrounding Bogota. Real prices of used housing are measured through the IPVU (Price Index for Used home) of *Banco de la República* for Bogotá, Medellín, Cali, and municipalities surrounding the first two. All are deflated by CPI excluding food.
Sources: *Banco de la República*, DANE, calculations by the authors.