

Rental Housing in Bogotá, Colombia: Challenges and opportunities for creating more multifamily properties



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INTRODUCTION

This article examines the rental housing market in Bogotá, Colombia and the challenges in developing multifamily rental properties. A description of the factors that affect the development of this asset class is followed by recommendations to overcome the existing problems. Even though more than half of the population live in rental housing, there is almost no supply of rental housing projects at a large scale in Bogotá. Four reasons explain why this type of property has not been developed: (1) lack of financing; (2) laws that protect the tenants, making eviction a long and complex process; (3) market rents do not cover the cost of development; and (4) lack of firms capable of designing and operating rental housing projects. On the other hand, for sale housing projects have easier access to financing, can justify the high value of land, and gain the advantage of the mortgage system with governmental subsidies for mid to low-income segments.

1. REGIONAL CONTEXT

The housing deficit in Latin America is a principal challenge for social and economic development. One-third of households in the region live in inadequate houses. More importantly, the need for affordable housing has been estimated to be around 10 million new units (IDB, 2012). This issue is exacerbated because individuals are living longer, an increasing number of young people are entering the workforce, and couples are separating. The current annual supply provides just a quarter of the units needed each year to accommodate the accumulated deficit and the formation of new households (Ruprah, 2009).

Colombia has a lower rate of home ownership compared to other countries in the region. The percentage of homeowners in 2014 was 36.6%. Only Bolivia has a lower rate. Ironically, Colombia was one of the first countries to implement public granting entities successfully to provide public mortgages. The Caja de Credito Agrario and the Banco Central Hipotecario were created in 1931 and 1932, respectively, facilitating the early growth home ownership. In contrast, in other countries public granting entities didn't become prominent until the 1960's and 1970's. At present, the Colombian government is still promoting homeownership through subsidies and free housing programs. Since the election of President Juan Manuel Santos in 2010, 100,000 free units have been completed and a program, called "Mi Casa Ya," has provided subsidies for low and middle-income families to acquire homes.

2. BOGOTÁ, A CITY OF RENTERS

According to The National Administrative Department of Statistics (DANE, 2017), Bogotá has a population of eight million with stable growth of 1.5% per year over the last 20 years. Regardless of the public policy that has encouraged home ownership since the 1930's, the rental housing rate in Bogotá remains high at 52.4% (approximately four

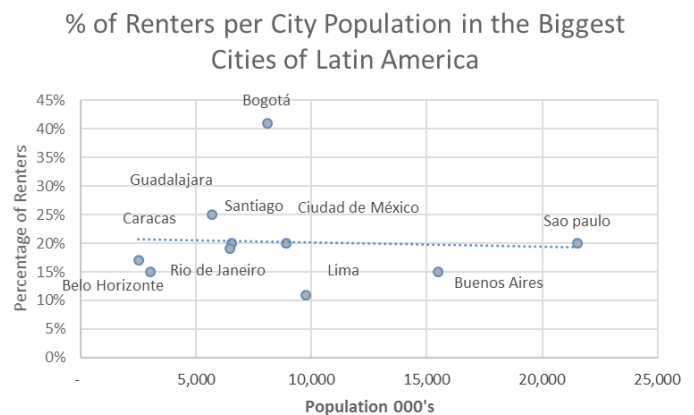


Figure 1. Renters in the Biggest Cities in Latin America. Source: IDB (2012).

million homes) with just 37.3% owning their own dwelling. (CAMACOL, 2014). The city has the highest percent of renters among the principal cities in the region (Figure 1). The rental housing small-scale is provided by individual owners, typically of the same social class as their tenants (IDB, 2014). The typical household head that rents in Bogotá is a young employee that pays an average of COP \$350,000 (around USD \$120) monthly rent. Nearly 80% of the households that rent in the city are employed, and half of the renters are between 25 and 40 years old. It is important to highlight that, even with the low number of students that rent, around 1%, several large-scale student housing projects were developed in 2017, and there are more in the pipeline. For example, a 1,800-bed project in the city center was completed in January 2017.

3. FINANCING

In developed countries, there is a strong, functioning market for construction, redevelopment, and acquisition loans for rental. The loan terms vary from 20 to 40 years, and the interest rates are usually in the single digits (IDB, 2012). Unfortunately, this is not the case in Latin America. The markets that do have these

BOGOTA- % OF HOUSEHOLD TENURE BY HOME TENURE

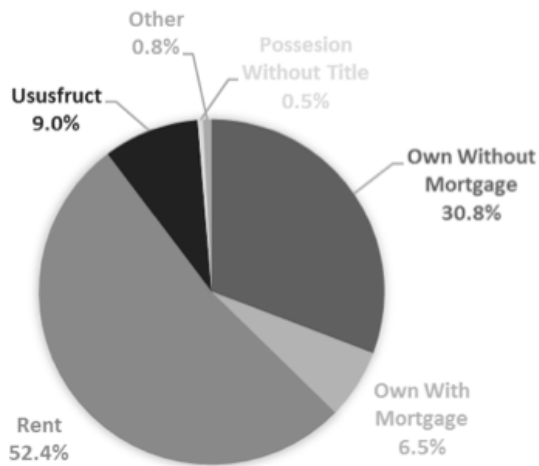


Figure 2. Household tenure. Source: CAMACOL (2014).

types of loans, and those that are available, are characterized by the short amortization periods and high interest rates.

Banks in Colombia do not have a range of products to support financing the development of rental housing. One reason may be the lack of housing projects. Banks have funded office buildings, shopping centers, and student housing facilities. Another reason might be that banks do not understand the product. The one-year lease, the lack of pre-leasing and the difficulties in evaluating tenant-credit are characteristics that raise questions when seeking financing.

Pension funds are one of the principal investors in real estate in Colombia. However, public and private pension funds in Colombia invest less than 1% of their total assets into real estate. Recently, pension funds have been allowed to allocate 10% of their portfolio to alternative assets. This will facilitate additional investments in real estate and private equity.

Regarding private equity funds, different international and local players have been operating in the country since 2005, but there are no cases where the funds have invested in rental housing developments. Most of these are opportunistic funds seeking a 25% pre-tax IRR and 2.0 equity multiple. Low and middle-income housing (for sale), office, industrial and mix-used projects are the principal investments.

In 2007, a REIT called “Patrimonio Estrategias Inmobiliarias” (PEI) was created. By June 2017, PEI had 127 properties, 8.5 million square feet of gross leasable area (GLA) and a 4.6% vacancy rate. PEI, however, does not have any

BOGOTA- % OF RENTERS BY MAIN ACTIVITY OF HOUSEHOLD HEAD

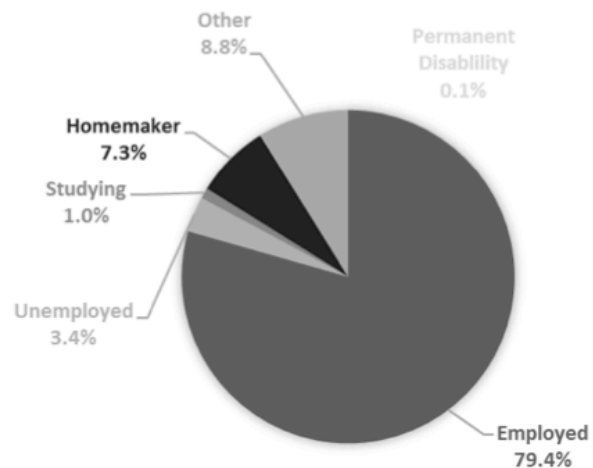


Figure 3. Main activity of households. Source: CAMACOL (2014).

residential properties. Recently, PEI purchased a 154,623 square foot student housing project—this may be the first effort to finance rental housing.

The Sociedad Hipotecaria Federal (SHF) was created in Mexico in 2014 to provide funds for rental housing. This program offers up to 20-year loan terms with a 4-year grace period and a loan-to-cost of up to 80%. As of May 2017, this project had financed 15 projects, representing 2,600 units. This program gave subsidies on the interest rate to projects that met efficiency requirements.

4. LEGAL FRAMEWORK

The legal framework has been one of the principal obstacles to the development of rental housing. Historically, the tenant’s rights have been favored over the landlord’s rights. This environment creates risky and expensive operations for rental properties. The legislation has protected the eviction and repossession of rental units as well as rent increases.

To address these concerns, in 2003 the national government approved the Law 820 which is known as the “Renter’s Law.” This law deals with affordable rental housing development subsidies and changes in the repossession process of the property. The bill has various implications that can be grouped into three primary segments: the legal framework to build affordable rental housing and incentives to spur their construction, a new process to facilitate the repossession of the property, and the establishment of the rent prices and deposit conditions.

To mitigate some tenant risk, the law created a standard and accelerated property restitution process and made

terminating the rental contract easier. One of the essential changes was the ability to terminate the agreement and evict the tenants if they stop paying their obligations. Prior to this law, landlords had to pay for these obligations after the tenant left the unit. In terms of eviction, the judicial process is faster than before, but the eviction process has not been substantially improved.

Regarding the rent and deposit, the law favors the tenant. The law states that the lease cannot be higher than 1% of the commercial value of the unit, and the increase cannot be higher than the Consumer Price Index (CPI) increase from the previous year. The law prohibits the landlord from collecting a deposit.

To mitigate these risks, landlords in Bogotá work with specialized insurance companies to reduce the risk of tenant default. These companies evaluate potential tenants based on pay stubs, personal warranties, and credit history. They require at least two cosigners to share financial responsibility. In case of late payment or default, the insurance pays up to 36 months of rent. In the extreme case of eviction, the insurance company pays legal fees for the process. The case of Gresytar in Mexico is a successful case in terms of tenant risk. The company entered into the Mexican market in 2012 and since that moment faced only one eviction process on the 2,300 units operated by the company. For Thomas Livelli Jr, managing director of the Andean Region, the tenant evaluation is key to mitigating the risk.

5. LOW RENTS

The low rents in Bogotá are one of the obstacles for rental housing. The high prices of homes are a consequence of the lack of land and the city's population growth due to the employment options that are available. The home prices in Bogotá experienced a significant appreciation during the last ten years, as shown in Figure 4. The monthly gross rental yield in the city is between 0.52% and 0.77% (around 6.2% to 9.2% annually) (Perez, 2015). With these low yields, it is difficult to develop a large-scale product with even a minimal profit above the cost of the land, the construction and the operation expenses.

Public intervention can help boost rental housing. After World War II, public pressure affected the supply and the demand for rental housing. Initially, the policies targeted the supply by creating subsidies and tax exemption programs for the developers. In the 1990s, the programs impacted the demand side through subsidies for the renters. Today,

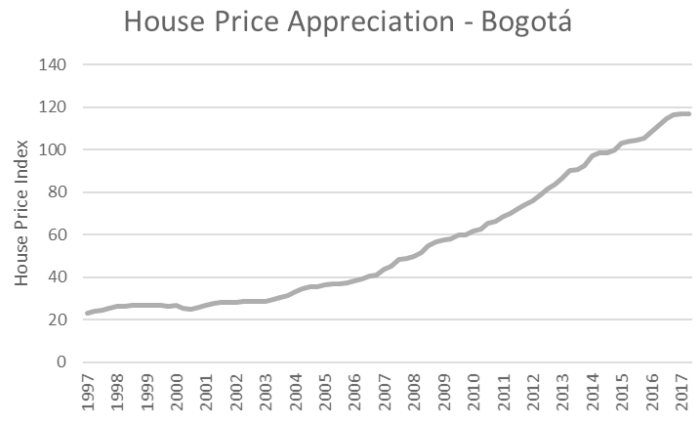


Figure 4. House Price Index. Source: DANE (2017).

there is a mix of both approaches. Chile is one country that has a subsidy program to help the medium and low-income population that cannot afford to pay rent. The program gives up to 170 Chilean Unidad de Fomento (UF), around \$7,000 USD for a maximum period of eight years.

In Colombia, one intent of Law 820 of 2003 was to encourage the development of rental housing for the low-income population. To accomplish this, it authorized a tax exemption on rental income for ten years for companies that develop and operate rental housing. Few projects of this kind were developed, however, and the tax incentive was eliminated by the Tax Reform Law 1819 in 2016.

To compensate for the low yield in the market, an efficient operation of the properties is essential to reduce operational expenses. The design plays an essential role in the operation and returns of a multifamily development. A high-rise building, with a large number of units, helps to achieve an economy of scale, reducing the impact of the fixed costs on the building's operation. The design of the units and the HVAC systems are also essential to improve the operational efficiency of the project. International companies, with experience in the development and management of rental housing, can facilitate the process. That is the case of Round Hill Capital, which manages over 100,000 units in Europe, that is looking for opportunities to operate, invest and develop multifamily in the country.

The lack of land to develop in the city is being addressed by the local government, which is adding undeveloped land through different projects around the city. One of these initiatives is the "Plan Zonal del Norte" which is adding 2,014 hectares. Just this project will have space for 132,000 new homes. With the expansion of the land supply, it can be expected that developers will find development sites at a more accessible price, being an excellent opportunity to



Figure 5. Local government's vision for PZN. Source: El Tiempo (2017).

evaluate multifamily developments.

6. DESIGN AND OPERATION

The operation of a multifamily project is very intense due to short lease terms and high turnover. Lease terms are usually one year long while office and retail have five to ten years leases. In the US, the turnover is around 50%, meaning that half of the building will be leased every year (Perez, 2015). Therefore, the role of the property manager is critical to the success of the operation. Unfortunately, in Colombia, there are few firms with experience in multifamily design and operation. The student housing projects in Bogotá operate under various models such as working with local hotel operators, creating in-house management, and partnering with an international player. A student housing project by Grupo Valor and Paladin Realty Partners, 33 DC, utilizes this last model. They partnered with Asset Campus Housing, a student housing operator with over 118,500 beds under management in the US. Perhaps this partnership will provide experience that will translate into effective management for future rental housing projects.

7. RECOMMENDATION

Despite the public policy bias to promote homeownership in the country, Bogotá has created a robust demand for rental homes. The profile of the renters in the city creates opportunities for products that target the young population. Also, the large percentage of renters who are employed decreases the tenant risk. These conditions create opportunities to increase the rental housing supply by formal investors. Bogotá presents an attractive market for investment because of the high percentage of renters, but the government must address the issues discussed in this paper to facilitate financing and decrease tenant risk.

Regarding public policy, the government should provide not only options to buy but also to rent. Saunders states that

the best strategy is to promote a tenure-neutral system in which people can choose whether to rent or buy without a confusing and contradictory system of control and subsidies affecting their decision (Saunders, 1990). Sadly, the public policy in Colombia is not aligned with Saunders' idea. Governments should create an appropriate environment for development of rental housing, attracting large-scale private investors. The case of SHF in Mexico is an attractive model to consider, facilitating the financing for rental housing projects.

The legal framework could be improved by eliminating rent controls and improving the execution of the eviction process. Fortunately, mechanisms like insurance reduce the risk of accepting a tenant that will not pay and, in case of no payment, the insurance covers the rent for an extended period.

The new student housing projects are providing a model for effectively operating rental housing. Despite the different challenges associated with this type of investment, local and international players are starting to evaluate this alternative.

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Figure 6. 33DC Mixed-use project, Asset Campus Housing. Source: Comerciales (2017).

