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Report No: 78760-NG

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 199.5 MILLION

(USD300 MILLION EQUIVALENT)

TO THE

FEDERAL REPUBLIC OF NIGERIA

FOR A

HOUSING FINANCE PROJECT

August 30, 2013

Financial and Private Sector Development
Africa Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective June 30, 2013)

Currency Unit	=	Nigerian Naira (NGN)
NGN157.75	=	US$1
US$0.66491130	=	SDR 1

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS

ALM	Asset and Liability Management
AMCON	Asset Management Company of Nigeria
BPP	Bureau of Public Procurement (Nigeria)
BRC	Board Risk Management Committee
CAR	Capital Adequacy Ratio
CBN	Central Bank of Nigeria
CFAA	Country Financial Accountability Assessment
CIF	Construction Ideas Fund
CPAR	Country Procurement Assessment Review
DA	Designated Account
DFID	Department for International Development
DMB	Deposit Money Bank
EDL	Estate Development Loan
EIU-NGN	Economist Intelligence Unit/Next-Generation Network
ESMS	Environmental and Social Management System
ESOM	Environmental and Social Risk Management Operations Manual
FD	Financial Department
FIL	Financial Intermediary Loan
FM	Financial Management
FMBN	Federal Mortgage Bank of Nigeria
FMoF	Federal Ministry of Finance
FMOJ	Federal Ministry of Justice
FMoLHUD	Federal Ministry of Lands, Housing and Urban Development
FPFMD	Federal Project Financial Management Division
FSAP	Financial Sector Assessment Program
GEMS	Growth and Employment in States (DFID)
GIZ	Deutsche Gesellschaft fuer Internationale Zusammenarbeit (German International Cooperation)
HMF	Housing Microfinance
IBRD	International Bank for Reconstruction and Development
ICB	International Competitive Bidding
IDA	International Development Association

IFC	International Finance Corporation
IFR	Interim Financial Report
IFRS	International Financial Reporting Standards
ISR	Implementation Status Report
LGD	Loss Given Default
NGN	Nigerian Naira
NHF	National Housing Fund
NMRC	Nigeria Mortgage Refinance Company
NMRC	Nigeria Mortgage Refinance Company
NPL	Non-Performing Loan
OFISD	Other Financial Institutions Supervision Department
ORAF	Operational Risk Assessment Framework
PAT	Project Administration Team
PD	Probability of Default
PDO	Project Development Objective
PEFA	Public Expenditure and Financial Account
PEMFAR	Public Expenditure Management and Financial, Accounts and Reporting
PENCOM	Pension Commission
PFA	Pension Fund Administrator
PFI	Participating financial institution
PFM	Public Financial Management
PFMU	Project Financial Management Unit
PMB	Primary Mortgage Bank
POM	Project Operations Manual
P-RAMS	Procurement Risk Assessment and Management System
PRIMA	Portfolio and Risk Management
PSC	Project Steering Committee
PSSD	Procurement Supervision Service Department
ROA	Return on Assets
ROE	Return on Equity
SDR	Special Drawing Rights
SEC	Securities and Exchange Commission
SEDIN	Pro-Poor Growth and Promotion of Employment Program (GIZ)
SON	Standards Organization of Nigeria
SSC	Secretariat of Steering Committee
TA	Technical Assistance
WBG	World Bank Group

Regional Vice President:	Makhtar Diop
Country Director:	Marie Francoise Marie-Nelly
Sector Director:	Gaiv Tata
Sector Manager:	Paul Noumba Um
Task Team Leader:	Michael Wong

NIGERIA
HOUSING FINANCE PROJECT

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PAD DATA SHEET

Nigeria

Housing Finance Project (P131973)

PROJECT APPRAISAL DOCUMENT

AFRICA

AFTFW

Report No.: PAD632

Basic Information			
Project ID	Lending Instrument	EA Category	Team Leader
P131973	Financial Intermediary Loan	FI-2	Michael D. Wong
Project Implementation Start Date		Project Implementation End Date	
26-Sep-2013		29-June-2018	
Expected Effectiveness Date		Expected Closing Date	
October 29, 2013		31-Dec-2018	
Joint IFC	Joint Level		
Yes	Complementary or Interdependent project requiring active coordination		
Sector Manager	Sector Director	Country Director	Regional Vice President
Paul Noumba Um	Gaiv M. Tata	Marie Francoise Marie-Nelly	Makhtar Diop

Borrower: Federal Republic of Nigeria (Federal Ministry of Finance)			
Responsible Agency: Central Bank of Nigeria			
Contact:	Olufemi Fabamwo	Title:	Head of Other Financial Inst. Dept
Telephone	234-9-61638053	Email:	oafabamwo@cbn.gov.ng

Project Financing Data (in US$Million)					
[ ]	Loan	[ ]	Grant	[ ]	Other
[X]	Credit	[ ]	Guarantee		

Total Project Cost:	300.00	Total Bank Financing:	300.00
Total Co-financing:		Financing Gap:	0.00

Financing Source	**Amount**
Borrower/Recipient	0.00
International Development Association (IDA)	300.00
Total	300.00

Expected Disbursements (in US$ Million)									
Fiscal Year	2014	2015	2016	2017	2018	2019			
Annual	120.5	100	37	21.5	20.5	0.5			
Cumulative	120.5	220.5	257.5	279	299.5	300			

Proposed Development Objective(s)

The project development objective is to increase access to housing finance by deepening primary and secondary mortgage markets in the Federal Republic of Nigeria.

Components

Component Name	Cost (US$)
1) Nigeria Mortgage Refinance Company	250,000,000
2) Mortgage Guarantee Product	25,000,000
3) Housing Microfinance	15,000,000
4) Technical Assistance and Capacity Building	10,000,000

Institutional Data

Sector Board

Capital Markets Practice

Sectors / Climate Change

Sector (Maximum 5 and total percent must equal 100)

Major Sector	Sector	%	Adaptation Co-benefits percent	Mitigation Co-benefits percent
Finance	Housing finance	85		
Industry and trade	Housing construction	5		
Finance	Capital markets	5		
Education	Vocational training	5		
Total		100		

☑ I certify that there is no Adaptation and Mitigation Climate Change Co-benefits information applicable to this project.

Themes

Theme (Maximum 5 and total percent must equal 100)

Major theme	Theme	percent
Financial and private sector development	Other Financial Sector Development	85
Financial and private sector development	Financial Consumer Protection and Financial Literacy	5

Financial and private sector development	Micro, Small and Medium Enterprise support	5
Environment and natural resources management	Land administration and management	5
Total		100

Compliance

Policy	
Does the project depart from the CAS in content or in other significant respects?	Yes [ ] No [**X**]
Does the project require any waivers of Bank policies?	Yes [ ] No [X]
Have these been approved by Bank management?	Yes [ ] No [ ]
Is approval for any policy waiver sought from the Board?	Yes [ ] No [**X**]
Does the project meet the Regional criteria for readiness for implementation?	Yes [**X**] No [ ]

Performance Standards Applied to the Project	**Yes**	**No**
PS 1: Assessment and Management of Environmental and Risks and Impacts	**X**	
PS 2: Labor and working Conditions	**X**	
PS 3: Resource Efficiency and Pollution Prevention		**X**
PS 4: Community Health, Safety and Security		**X**
PS 5: Land Acquisition and Involuntary Resettlement	**X**	
PS 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources		**X**
PS 7: Indigenous Peoples		**X**
PS 8: Cultural Heritage		**X**
Legal Policies		
Projects on International Waterways OP/BP 7.50		**X**
Projects in Disputed Areas OP/BP 7.60		**X**

Key Non-Standard Conditions and Covenants

Name	**Recurrent**	**Due Date**	**Frequency**
Credit Effectiveness	No	October 29, 2013 (Anticipated)	Once

(a)Execution of subsidiary agreement by the Recipient and the Project Implementing Entity
(b)Adoption by the Recipient of the Project Operations Manual
(c) Adoption by the Recipient of the Environmental and Social Risk Management Operations Manual
(d) Duly authorization of the NMRC to issue securities under the Investments and Securities Act of 2007
(e) Appointment of the NMRC chief executive officer; and constitution of the NMRC Board of directors by Recipient, through the NMRC shareholders
(f) Execution of subordinated loan agreement by the Project Implementing Entity and the NMRC

Name	Recurrent	Due Date	Frequency
Procurement	No	No later than 90 days after Effective Date	Once

Description of Covenant

The Recipient shall cause the Project Implementing Entity to establish a procurement complaint mechanism comprising of an online database or a complaint hotline, in form and substance satisfactory to the Association

Name	Recurrent	Due Date	Frequency
Disbursement	See below	No later than 3 months after Effective Date	See below

Description of Condition

No withdrawal shall be made in respect of any payment under:
(a)Category (1), unless evidence satisfactory to the Association is furnished confirming that NMRC has met the DLI(s) for the tranche for which payment is requested as set forth in Schedule 4 to this Agreement; [Recurrent]
(b) Category (2), unless the Guarantee Agent Service Agreement has been executed, in form and substance satisfactory to the Association; [Not recurrent]
(d) Category (3), unless the Project Implementing Entity has adopted the HMF Manual in form and substance satisfactory to the Association. [Not recurrent]

Name	Recurrent	Due Date	Frequency
Mortgage Guarantee Manual	No	No later than 24 months after Effective Date	Once

Description of Covenant

Project Implementing Entity shall develop and adopt a Mortgage Guarantee Manual

Name	Recurrent	Due Date	Frequency
HMF Manual	No	No later than 6 months after Effective Date	Once

Description of Covenant

Project Implementing Entity shall adopt HMF Manual

Team Composition

Bank Staff

Name	Title	Specialization	Unit
Michael D. Wong	Lead Private Sector Development Spec.	Team Leader	AFTFW
Simon Walley	Program Coordinator	Housing Finance	FCMNB
Robin Hofmeister	Financial Sector Specialist	Financial Sector	AFTFW
Andrej Popovic	Financial Sector Specialist	Financial Sector	FFIMS
Frederick Yankey	Senior Financial Management Specialist	Financial Management	AFTMW
Paula F. Lytle	Senior Social Development Specialist	Social Development	AFTCS
Piotr Mazurkiewicz	Safeguards Specialist	Safeguards	IFC

Evarist F. Baimu	Senior Counsel	Senior Counsel	LEGEM
Luis M. Schwarz	Senior Financial Management Specialist	Financial Management	CTRLA
Mary Asanato-Adiwu	Senior Procurement Specialist	Procurement	AFTPW
Joseph Ese Akpokodje	Senior Environmental Institutions Specialist	Environmental Institutions	AFTN1
Johanne Buba	JP Professional Officer	Economics	AFTFP
Collins S. Umunnah	Team Assistant	Team Assistant	AFCW2
Magalie Pradel	Program Assistant	Program Assistant	AFTFW
Non Bank Staff			
Moustapha Doukoure	Consultant	Consultant	AFTFW
Halima Zarma	Consultant	Consultant	AFTFW
R. Moses Thompson	Consultant	Consultant	OPSOR
Kenneth M. Green	Consultant	Consultant	AES
Fatoumata Den Lamari Fadika	Consultant	Consultant	FCMNB

I. **STRATEGIC CONTEXT**

A. Country Context

1. **The Federal Republic of Nigeria has experienced stable economic growth averaging 8 percent over the past decade and 6.58 percent in 2012.**[1] In the context of high economic growth, Nigeria's key challenge is to make its growth more inclusive. Despite the rapid growth as measured by official statistics, direct indicators of social welfare for the broader population, such as poverty levels, have shown little improvement. Furthermore, the country is experiencing a youth employment crisis. Each year 4.5 million Nigerians are estimated to enter the labor market, but only 10 percent are able to find formal jobs. As a result from 2009–11, (formal) unemployment grew from 19.7 percent to 23.9 percent. It affected principally the young (15–24 age group). The formal unemployment rate rose from 25.0 percent in 2009 to 37.7 percent in 2011.[2] Nigeria's stability critically depends on accelerating the creation of wage jobs.

2. **Macroeconomic management in Nigeria has been addressing the challenge of high oil dependency.** With oil accounting for over 80 percent of imports and over 70 percent of consolidated budgetary revenues, Nigeria faces major macroeconomic risks from volatility in oil prices. Since 2004, the country has alleviated these risks through the management of a fiscal reserve fund and the pursuit of countercyclical fiscal policy. Nigeria built up a fiscal reserve of US$22 billion by September 2008, and used much of this reserve to insulate the country from the severe decline in oil prices in late 2008 and 2009. While there was some slippage in countercyclical fiscal policy in 2010, the Government put Nigeria back on the track of fiscal consolidation and reserve accumulation in 2011–13. The General Government budget deficit was reduced from an estimated 5.7 percent in 2010 to 2.2 percent in 2011, and to an estimated 1.9 percent in 2012. The balance of payments has been primarily in surplus since the fourth quarter of 2011, enabling authorities to build gross monetary foreign reserves from US$32 billion to US$48 billion between September 2011 and May 2013.

3. **Inflation has been stubbornly high in Nigeria, but the tightening of macroeconomic policy is finally beginning to reduce it.** Annual inflation (Consumer Price Index) has been in double digits in recent years in Nigeria. Despite a substantial tightening of macroeconomic policy in 2011 and 2012, year on year inflation (December 2011–December 2012) registered at 12 percent in 2012, In fact, inflationary pressures likely would have subsided in 2012 if not for a number of nonmonetary factors. These were the partial removal of the fuel subsidy, increases in electricity tariffs, unusually severe flooding that reduced the supply and transportation of some goods and services, and growing security risks in certain parts of the country. In 2013, year on year inflation has fallen to single digits, at close to 9 percent.

4. **Macroeconomic risks remain significant, but the short- and medium-term outlook is generally positive.** The pace of GDP growth is expected to pick up somewhat in 2013, the inflation rate should continue to decline, and the balance of payments should remain strong, at least in the short term. However, the risks from an oil price shock are still substantial, because the fiscal reserve (Excess Crude Account) is under US$6 billion as of mid-2013. An unexpected decline in crude oil output has tightened the budgetary situation and increased the medium term

[1] National Bureau of Statistics, GDP Report 4th Quarter and Full Year 2012 (Washington, DC).
[2] National Bureau of Statistics, Socio-Economic Survey: Unemployment 2011 Report (Washington, DC).

balance of payments risks. Investments that could have ensured strong medium term growth in the oil sector have been delayed, pending the passing of a Petroleum Industry Bill which has been debated in the National Assembly for a number of years.

5. **The Nigerian financial system, which is growing fast and becoming increasingly integrated into the regional and global financial systems, can underpin growth.** As of end–2011, gross financial system assets amounted to the equivalent of 61 percent of GDP. At the core of the system are banks, followed by pension funds (79 percent and 12 percent of the total financial system's assets respectively). The recent Financial Sector Assessment Program (FSAP) confirmed that the Nigerian banking system is well capitalized, liquid, and profitable. The capital adequacy ratio (CAR) grew from less than 2 percent in 2010 to an average of 18 percent in June 2012. Tier 1 is almost 100 percent of total qualifying capital, while the leverage ratio is approximately 11 percent of net assets. The Non-Performing Loans (NPL) ratio fell to approximately 5 percent of gross loans by end–June 2012, mainly due to the transfer of bad assets to the Asset Management Company of Nigeria (AMCON). At end–2011, liquid assets were approximately 40 percent of total assets, and demand deposits constituted 30 percent of the total liabilities. Loans and advances are approximately 36 percent of total assets. Earnings were relatively low in the first half of 2012, but most banks were profitable after recording negative earnings in 2011. By end–June 2012, return on assets (ROA) for the industry rose to 1.2 percent, while return on equity (ROE) rose to 8.9 percent.

6. **Despite these improvements in further deepening the financial sector, through access to long-term financing is essential to unlocking nascent markets in Nigeria.** Currently, the financial sector is dominated by the banking sector, whereas longer-term finance is largely absent. Although the sector remains dominated by domestic institutions, the consolidation of the banking sector in 2005–06 generated capacity for several Nigerian banks to expand internationally, establishing subsidiaries, particularly in Africa. While the banking system is relatively deep by comparison with other countries in Sub-Saharan Africa, bank lending is heavily concentrated on the larger corporations and their supplier value-chains. Moreover, Nigeria faces an enormous long-term financing gap, which is significantly hampering its economic growth potential. This gap relates particularly to the financing of infrastructure, including housing. Mobilization of private sources of funds through such instruments as the proposed liquidity facility for housing and public private partnerships (PPPs), as well as pure private arrangements, is critical to meeting these needs.

7. **Housing finance is limited in Nigeria due to an existing maturity mismatch.** Nigeria has 84 Primary Mortgage Banks (PMBs) and 20 Deposit Money Banks (DMBs). Lending by the DMBs for mortgage loans accounts for less than 1 percent[3] of their total assets. Oil and gas is the main lending sector, representing approximately 22 percent[4] of total credit to the private sector. Looking at the whole banking sector, data for the 10 largest banks[5] in Nigeria show that an average of 84 percent of overall liabilities are (short term) customer deposits. The remaining funding is primarily equity. Other sources of long-term funds are extremely limited, representing on average just 11 percent of the balance sheet[6].

[3] Calculations made from various data from CBN 2011.
[4] Financial Sectoral Assessment Program (FSAP) Note 2012.
[5] Compiled from publicly available bank reports.
[6] Detailed analysis is summarized in Annex 8.

8. **Unlocking the residential housing market through the development of the housing finance market can provide a wide range of income opportunities through the construction sector and related industries, as evidenced in Colombia and India**. Research from Colombia indicates that 5 additional jobs are added for every US$10,000 spent on housing construction. In India, for each housing unit, 1.5 direct and 8 indirect jobs are created and in South Africa, 5.62 jobs for every housing unit, with a further 2.48 indirect jobs created.[7] As a result of current urbanization trends Nigeria's housing demand is expanding rapidly. It is estimated that up to 700,000 house units in different market segments are needed annually to keep up with demand. Currently production is below 100,000, resulting in an overall accumulated deficit of approximately 17 million units, as of 2013[8]. There are also many social benefits associated with improved housing and home-ownership, not least of which is giving homeowners a true stake in their community.

B. Sectoral and Institutional Context

9. **The Nigerian mortgage market remains under-developed despite strong growth over the last six years.** From 2006 to 2009, the market grew from NGN54 billion (US$342 million) to NGN226 billion (US$1.43 billion) at an average rate of 61 percent. In 2010, due to the banking crisis, outstanding mortgage loans experienced a decline of 7 percent, before starting to grow again. In 2011, the market stood at NGN224 billion (US$1.42 billion). Despite this rapid increase, the ratio of mortgage loans to GDP stood at 0.6 percent as at end 2011. This compares with outstanding mortgage loan to GDP ratios in Botswana (2 percent), China (13 percent), India (6 percent) and South Africa (31 percent) and a European average of 50 percent.

10. **Unlocking the potential in the housing market requires multiple and interrelated market functions to work effectively**: (a) conducive macro policies that provide for stable and low inflation, (b) access to long-term finance, (c) reduced cost to business transactions in land registration and foreclosure, and (d) good quality and efficient building and construction.

11. **Current market penetration is limited at all income levels.** The average loan size in Nigeria is approximately NGN5 million (US$32,000), although this does not reflect the high variance between high income luxury properties and those at the bottom of the market. Exact data remain difficult to obtain, because loans to cooperatives are treated as a single loan, despite having multiple end recipients. However, based on an average loan size of NGN5 million there were 44,000 individual mortgage loans outstanding in 2011.

12. **Access to long-term funding is reported as the key constraint to accessing housing finance in Nigeria.** A mortgage market survey of financial institutions implemented by the Central Bank of Nigeria (CBN) confirmed anecdotal reports that access to long-term funds was their major constraint to mortgage growth. Other obstacles highlighted included difficulties with property registration. Titling and the cost and time of foreclosing were ranked as the second and third obstacles, respectively.

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[7] Viruly, "Think about the Social Housing Market", Presentation at the 2011 affordable housing Conference; Tibaijuka, "Building Prosperity: The Centrality of Housing in Economic Development" (2009); McKinsey Presentation at the 5th Global Housing Finance Conference, 2012

[8] Ministry of Lands, Housing and Urban Development (Lagos).

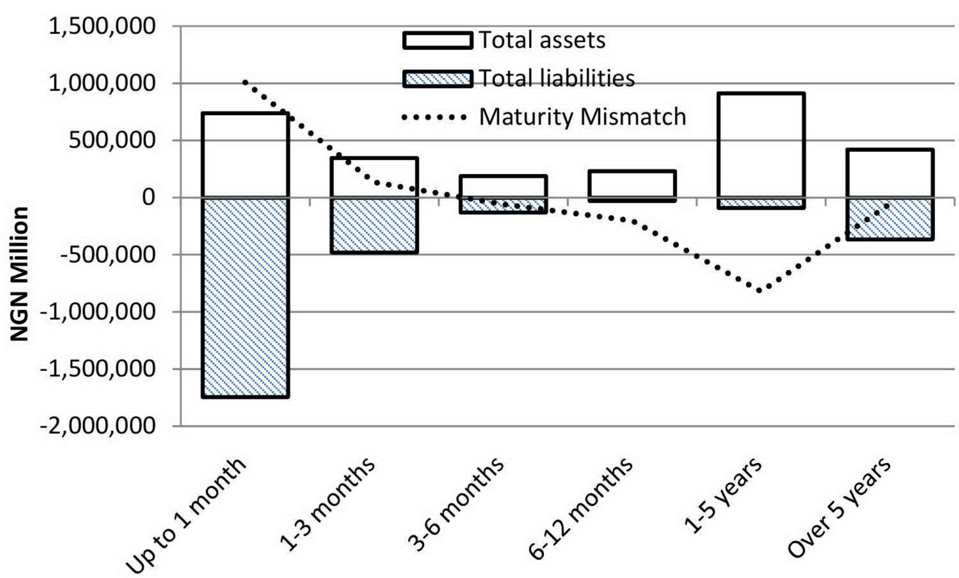
Table 1. Mortgage Market Obstacles Survey, 2012

Mortgage Market Obstacles	Frequency of Response
Access to long-term funds	**55**
Difficulties with property registration/titling	**21**
Cost and time of foreclosing on a property	**18**
High interest Rate	**14**
Lack of housing supply - new construction	11
Burden of regulation (provisioning, capital requirements, liquidity rules)	9
Credit risk (lack of credit histories, documented income)	7
Low level of incomes/informality	5
Lack of understanding of mortgage product by consumer - lack of financial literacy	3

Note: Respondents were asked to rank their top 5 obstacles to market development. Many respondents ranked several obstacles as number 1, so overall frequency is higher than the number of survey participants.

13. **A full maturity breakdown for a large Nigerian Deposit Money Bank which is representative of the sector as a whole, further confirms the maturity mismatch.** The position would be even more accentuated for other financial institutions, particularly the Primary Mortgage Banks, which have access to very limited sources of funding including deposits. Reporting typically would be done using behavioral maturity of the depositor, so the analysis has been adapted to show the contractual maturity of deposits. This is a very conservative approach but does serve the purpose of showing the maturity gaps in the balance sheet. It is clear that a mismatch of over NGN800 billion (US$5 billion), or one third of the balance sheet, exists in the 1-5 year maturity bucket. Beyond 5 years, the bank's equity provides some comfort, although using equity to fund lending activities may not be economical.

Figure 1 - Maturity Analysis of Bank X Using Contractual Deposit Maturity



Source: Publicly available annual reports and accounts.

14. **The absence of long-term finance also has contributed to the lack of innovation in financial products to reach lower income segments.** A financing mismatch in financial institutions, particularly in Microfinance Banks (MFBs), has limited their ability to respond to market demand. Anecdotal evidence from microfinance banks suggests that home improvement loans often are disguised as productive loans because they latter are more easily available. Following consultations with the industry it is suggested that these loans could be as much as 25 percent of the micro finance portfolio. Smaller loans often are needed for home improvements, expansion, upgrading roofing, water supply or connection to the power grid. Only recently, in connection with this project design, have microfinance banks been allowed to provide loans of up to 24 months.

15. **The high cost of doing business for financial institutions, which is reflected in the interest rates they charge, prevents access to low income markets.** The credit risk is calculated using the Probability of Default (PD) and the Loss Given Default (LGD). The PD in Nigeria is high due to the difficulties in underwriting a loan without reliable credit scoring information to assess borrowers and to know with certainty whether the borrower already has additional loans. The LGD will be high, due to the difficulties in foreclosing on properties, lack of reliable property valuations, and lack of a liquid property market on which to resell foreclosed properties.

16. **A sound legal framework for foreclosure is in place. However in practice, its implementation encourages informal practice.** Power of sale (non-judicial foreclosure and sale of property used as mortgage collateral) is available under the laws of Nigeria. However, lenders regularly forego their right to "perfect"[9] mortgages by registration in the property records due to the lengthy process, making it difficult to foreclose in the case of a default. The State of Lagos has adopted fast track court procedures for mortgage cases under a specialized commercial division of the High Court. The fast track procedures have reduced the time to resolve a mortgage enforcement case to approximately eight months down from several years. Other states can adopt similar procedures to make mortgage enforcement more efficient.

17. **The housing sector suffers from high construction costs which limit the development of affordable housing**. It is estimated that the construction of a 3-bedroom house in Nigeria costs US$50,000, compared to US$36,000 in South Africa and US$26,000 in India. Limited, often absent, public infrastructure frequently is priced into residential housing. Skilled labor is in short supply, and larger construction companies resort to training their staff. All of these costs make housing construction in Nigeria expensive so limit its affordability.

Strategic approach

18. **A programmatic approach that addresses the core constraints identified above will enable the sector to reach its full potential.** The building blocks for developing the housing market are: sound macro-economic policies; access to long-term funding; improved land and legal systems, and improved housing construction. A Presidential Task Force, consisting of all relevant ministries and agencies is coordinating technical working groups and is chaired by the Coordinating Minister of the Economy to ensure that policies are conducive to the sector. In

[9] The completion of the formal registration of claims on the property.

addition to the macro policies outlined above, several regulatory reforms are underway: the CBN passed microfinance regulations in January 2013, which enable MFBs to develop 24 month lending products; CBN's draft regulations for the Mortgage Liquidity Facility, which were published for comments in March 2013; and the draft Land Use Act regulations, which cover land registration, foreclosure and mortgages and were presented to the National Economic Council in May 2013.

19. **Other building blocks related to land registration and housing construction, that are beyond the scope of the project, will be addressed by TA operations funded by Department for International Development (DFID) and also supported by Gesellschaft fuer Internationale Zusammenarbeit (GIZ).** The land registration related project will assist four states to improve their land registration processes and stream-line approval processes to reduce the overall cost of registration. This project also will support the implementation of the new Land Use Act regulations, including an improved fore-closure system. The DFID and the World Bank funded Growth and Employment (GEM) project are working to improve the housing construction value chain. The project will support skills upgrading, capacity improvements for developers, and development of standards to improve the quality of buildings.

20. **The IFC and the World Bank are cooperating closely in developing the housing market.** The World Bank Group (WBG), in collaboration with DFID, will support the project in developing common underwriting standards and building the capacity of mortgage lenders to originate loans following international standards.

21. **The complimentary DFID and GIZ funded projects are addressing land, legal and construction issues**: Technical assistance is being made available to selected states (including Ogun and Kaduna) to: (a) land registries, by taking steps to improve transparency in the provision of services; (b) streamline and computerize registration procedures; and (c) develop standards for key registration activities (mainly concerning the time and cost required) along with clear and transparent service targets; and systems will be established for customers to lodge complaints in the registries and to authorities outside the agencies. Training will be provided to registry staff. DFID supported project covering permits and land certificates comprises an estimated 7 million pounds for implementation until 2015. DFID and GIZ supported construction projects will build the capacity in the housing value chain to respond to housing demand. These projects will provide technical assistance (TA) on skills training and improve the quality and standards of housing units and housing developers.

22. **The housing finance projects will reach across Nigeria, but first mover states with better operating environments will benefit first.** As mortgages are given based on the location of the property or the house improvement, there likely will be more mortgages in States whose financial institutions find it easier to issue mortgages. The TA provided by DFID and GIZ will put the first mover states, such as Lagos, Anambra, Ogun, Ondo, Kano, Kaduna and Rivers in a better position to develop their local markets.

C. Higher Level Objectives to Which the Project Contributes

23. **The project will contribute to the objectives of Nigeria's development strategy "Vision 20:2020" and the national "Transformation Agenda" to meet the housing demand**

of Nigerian citizens and develop the construction sector.[10] The Transformation Agenda assigns priority to supporting non-oil sectors that have strong job creation and multiplier potential, such as housing and agriculture. The project will contribute to these objectives by building a secondary mortgage market that addresses the maturity mismatch and access to long-term funding. The increased availability of funds will stimulate the housing market value chain and to create jobs resulting from house improvements and housing-related expenditure.

24. **The project will support the Country Partnership Strategy (CPS) for Nigeria 2010–2013, which aims at maintaining non-oil growth through diversifying financial markets**.[11] Developing housing finance system will deepen the banking system and promote non-oil growth. This development also is fully aligned with the proposed growth and competitiveness pillar of the Country Partnership Strategy (CPS) under discussion with the Government of Nigeria.

II. PROJECT DEVELOPMENT OBJECTIVE

A. Project Development Objective

25. The Project Development Objective (PDO) is to increase access to housing finance by deepening the primary and secondary mortgage markets in the Federal Republic of Nigeria.

B. Project Beneficiaries

26. **The project will benefit new mortgagors in existing market segments in the first 2 years; and in lower income market segments, including the self-employed in the microfinance market segment, in the following 2 years**. Secondary beneficiaries of the project will be those employed directly or indirectly in the housing sector. They will benefit through increased activity as housing production is scaled up. A third tier of beneficiaries will be the institutions in the financial sector that will benefit from the growth of mortgage assets. This growth will include commercial banks, MFBs and institutional investors such as Pension Fund Administrators (PFAs). PFAs will have a new investment outlet in the form of Nigeria Mortgage Refinance Company (NMRC) bonds which will match their need for long-term investments.

C. PDO Level Results Indicators

- **Indicator 1.** Number of new mortgage loans provided
- **Indicator 2.** Number of new mortgages below NGN5 million
- **Indicator 3.** Proportion of mortgage debt outstanding refinanced by NMRC

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[10] Nigeria Vision 20:2020 (2010) The First National Implementation Plan (2010–2013), Volume II: Sectoral Plans and Programmes, 44 and 46; Nigeria Transformation Agenda (2011) Priority Policies, Programmes and Projects of the Federal Government of Nigeria (2011 –2015), 99.

[11] AfDB, USAID, and World Bank, Country Partnership Strategy (2009) for Nigeria 2010–2013, vi.

III. PROJECT DESCRIPTION

A. Project Components

Component 1. Establishment of the Mortgage Refinance Company (US$250 million)

27. **Support a mortgage liquidity facility, the Nigeria Mortgage Refinance Company (NMRC), for mortgage refinancing.** The project will support the establishment and operation of NMRC, created in partnership between private financial institutions, development finance institutions and the Ministry of Finance. The NMRC will be registered as a non-bank under publicly listed limited liability company rules and regulation with majority ownership coming from the financial institutions and will act as a bridge between mortgage lenders and the capital markets. It will issue standard corporate bonds into the capital markets and subsequently issue loans (refinance and prefinance) to mortgage lending institutions. These loans will be backed up by collateral in the form of an assignment of rights over part of the lenders' mortgage portfolio. This collateral protects NMRC's loans and minimizes the amount of credit risk it is taking which in turn helps the mortgage refinance company (MRC) to achieve the lowest possible rates in raising its bond financing. A key distinction of this model compared to securitization is that the underlying loans offered as collateral stay on the balance sheet of the lender, and should they go into default will need to be replaced by performing loans. Thus, unlike Mortgage-Backed Securities (MBS), the MRC model does not take direct credit risk on mortgage borrowers.

28. **A line of credit of US$250 million equivalent will be disbursed in 6 tranches to NMRC as Tier 2 capital.** The role of the IDA line of credit will be twofold: (a) Strengthen the balance sheet. The credit line will engender confidence in the credit standing of NMRC as a bond issuing entity. This confidence is critical in ensuring its ability to raise bond financing at just above sovereign debt levels. In addition, the initial bond issuances will benefit from a sovereign guarantee, this is for the initial issues only, with an amount capped at NGN50 billion and will gradually be phased out during course of the project. (b) Ensure sustainability of the model. The IDA funds will be invested in Government securities to generate sufficient return to cover administrative expenses and generate sufficient income to grow the capital base in line with the growth in the balance sheet. Investing the IDA funds is a departure from previous models in which World Bank loans were used to provide funding directly for on-lending, One of the consequences is that NMRC will have to issue bonds soon after creation, and before it can begin refinancing or prefinancing operations.

Box 1. How Does a Mortgage Refinance Company Operate?

Long-Term Funds for Long-Term Investments in Housing

A mortgage refinance company, also known as a mortgage liquidity facility, channels long-term funds from pensions funds and insurance companies into housing investment by making long-term funds available to mortgage lenders. It effectively takes on the role of an intermediary between capital markets and the primary mortgage markets. Such facilities have helped develop and catalyse markets in Malaysia, Egypt and Jordan. They also play an important role in the mortgage systems in the US, France and Mexico.

Connecting Mortgage and Capital Markets

The mortgage refinance company funds itself by raising funds through the issue of simple corporate bonds into the capital markets and then makes loans to mortgage lenders. These loans are secured by the mortgage lenders pledging part of their mortgage assets as collateral for the loans. This allows the mortgage refinance company to operate with minimal levels of risk and to raise funds cheaply. Because the mortgages remain with the lender, the same risks faced in a securitization process do not arise here.

Main Benefits

The main value added of a mortgage refinance company is the provision of long-term funds to lenders who, especially in emerging markets, struggle with a maturity mismatch on their balance sheet where short term deposits often dominate their funding.

The second key value added is the 'liquidity facility' function, which effectively allows lenders to turn an illiquid asset – a mortgage loan – into cash by obtaining a refinance loan. This liquidity function can help support long-term lending and strengthen the overall financial system.

A final benefit, especially in emerging markets, is that it acts as a catalyst for market development by encouraging standardization of mortgage underwriting and by bringing lenders together with a shared objective of developing the market. This can help to put pressure on reform in areas such as property registration and land rights.

Component 2. Establishment of a Mortgage Guarantee Product, Targeted at Lower Income Borrowers (US$25 million)

29. **To further support the reach of mortgages down the income distribution, US$25 million equivalent will be used to develop a guarantee product to bear some of the credit risk for lower income lenders.** The guarantee will provide credit default loss protection to mortgage lenders. It will be established in year 2 of the project and will be subject to detailed pricing and market analysis. The project will fund the product development including testing and financial modeling, and then launch a competitive process, among private or public owned non-bank financial institutions to select a mortgage guarantee agent to implement the project. Criteria will include that: (a) the guarantee product must be financially sound and solvent as confirmed by CBN; (b) matching contribution by the service provider to the proposed product; and (c) the guarantee product has a business plan based on increasing the scope and outreach to lower

income groups. In addition, a detailed section will be added to the Project Operation Manual (POM) describing pricing and operations of the guarantee product and how the relationship with the implementing firm will be managed. The project will also provide a line of credit to the Project Implementing Entity on account of the Mortgage Guarantee Agent for the issuance of Mortgage Guarantee Products to Eligible Lenders.

Component 3. Housing Microfinance (US$15Million)

30. **The aims are to support the development and piloting of new and/or emerging formal HMF products and to demonstrate a sustainable business case for these activities.** To jump start the development of HMF in Nigeria, the project will be rolled out in three phases: (a) tailored TA to select MFBs to develop new and/or improve emerging HMF products (to be funded by component 4 of the project); (b) risk capital provided to MFBs as limited soft loans to test the new HMF products; and (c) a line of credit to MFBs to roll out the tested HMF products.

Component 4. Technical Assistance and Capacity Building (US$10 million)

31. **The TA will be provided to support components 1, 2, and 3**. Specifically, the TA will include provision of operational support to NMRC including assistance for bond issuance, mortgage lender training, mortgage consumer protections and financial literacy, housing market information, and impact evaluation of the mortgage market. Furthermore, this component will fund a two-part process to create a mortgage guarantee facility. The funding will include the feasibility study that will provide the analytical underpinning for developing a mortgage guarantee, and the implementation stage. TA also will be provided for housing microfinance (HMF) product development and piloting, Microfinance banks MFBs staff training, consumer protection, impact evaluation, and related ancillary support services necessary for establishing sustainable HMF operations. In support of strengthening the legal and regulatory environment underpinning the housing finance sector, training for CBN banking supervisors on supervision of NMRC and of mortgage lenders is envisaged, as well as capacity building of the Federal Ministry of Finance (FMoF), the Federal Ministry of Land Housing and Urban Development (FMoLHUD), and the Federal Minsitry of Justice (FMoJ) to supervise the activities of the project. Finally, an exchange program for judges and lawyers is envisaged to improve contract enforcement and foreclosure. The project also will support the strategic review of FMBN and NHF, and the implementation of a restructuring plan for the FMBN.

B. Project Financing

32. **The proposed lending instrument is the Financial Intermediary Loan (FIL).** The project will be funded through an International Development Association (IDA) credit in an amount of US$300 million equivalent. The loan would be denominated in Special Drawing Rights (SDR) for a 40-year period with a 10-year grace period. The loan will be disbursed over the 5 years of the project and be allocated to 4 project components as follows:

Project Cost and Financing

Table 2. Project Financing (US$Million)

Project Components	Total Project Cost	IDA Financing	Government	Financing (%)
1. Funding for NMRC	250	250		100
2. Mortgage guarantee product	25	25		100
3. Line of credit for HMF	15	15		100
4. TA for the housing finance sector		10		100
5. PAT operating cost (covered by CBN, staff, and office space)	2		2	0
6. Private and public investment	37		37	0
Total costs	339	300	39	88.5
Total financing required	339			

C. Lessons Learned and Reflected in the Project Design

33. **The project design has been informed by the experiences and lessons learned in a number of similar previous World Bank operations including the Housing Finance Projects in Egypt, Jordan, and Tanzania.** Lessons also can be drawn and applied to the project from the sub-prime crisis[12]. The key lesson from the sub-prime crisis was the need for "responsible" lending, taking into account more fully the capacity for repayment rather than relying on collateral alone. A second important lesson from the sub-prime crisis and, especially important in developing economies, is the need for adequate consumer protection and financial literacy standards. The lesson learned from Jordan and other similar operations such as Egypt, has been the importance of creating linkage with the capital market to ensure sustainability. Project design needs to balance the incentives given to different stakeholders to ensure that the mortgage refinance company raises its own bond financing at an early stage of the project. In addition, while there are limited lessons learned on housing microfinance from World Bank operations, lessons learned from other donor-funded housing finance projects follow.

34. **Increasing access to housing finance through Nigeria's National Housing Fund (NHF) has not worked for most contributors.** The scheme requires workers, including civil servants, earning over the minimum wage of NGN18,000 per month to make a mandatory contribution of 2.5 percent of their salary to the NHF. Their contribution then should be matched by the employer. In August 2012, only 12,031 of a total number of 3.8 million contributors had received mortgage loans from NHF. The majority of funds had been lent out to poorly performing Estate Development Loans (EDLs) for housing developments.

35. **Access to long-term funds is the major impediment to the growth of mortgage finance in Nigeria.** Without access to long-term funds, lenders are either unwilling or unable to further extend maturity mismatches on their balance sheets. This lack of access also prevents

[12] Global financial crisis.

lenders from making the necessary investments in staff and systems to establish large-scale mortgage lending operations. The planned NMRC is a mortgage liquidity facility that will be a source of both liquidity and long-term funds. The NMRC will allow lenders to present illiquid mortgage assets for refinancing and receive cash in return. This is a key benefit for lenders relying on deposits for their main funding because it will enable them to use the facility as part of their asset/liability management process. The second benefit is that the funding received from NMRC will be of a long-term nature, typically 5 years–7 years, matching the typical duration of an amortizing mortgage loan.

36. **Reforms in the financial sector are not a standalone solution to develop the housing market, but need to be accompanied by reforms in the construction and land sectors and the legal environment.** While developing the mortgage market will increase the demand for houses, to increase the supply of houses, reforms in the other sectors need to be implemented. To increase the chances of a supply response, the proposed project will follow a coordinated approach with International Finance Corporation (IFC), DFID, and GIZ. The combination of these projects will support states in Nigeria to implement land and legal reforms, and develop the construction industry. This coordination will enable a project, in combination with other projects, to directly and indirectly address all parts of the value chain.

37. **Globally, if a market approach is not followed, programs targeted at low-income households often are captured by higher income groups.** Targeted programs for lower-income households often are captured by high level income groups that should have no access, as was the Moroccan "Cities without Slums" program" (*Villes sans Bidonvilles*, or VSB). Higher income groups often capture subsidies intended for poor households through market dynamics. The current project aims to establish a first building block in the housing market by addressing access to long-term finance. Once this access has been established through the creation of NMRC, the project will systematically tackle other market failures to increase consumer surplus and reach lower income segments.

38. **There is a demonstrable demand for HMF in Nigeria that has not been met by Nigerian microfinance banks.** MFBs have voiced a strong interest to tap into HMF based on reported client interest in the various forms of HMF. That the demand for HMF is estimated 25 percent– 30 percent of all microfinance loans. MFBs experience funding or capitalization pressures, making it hard for MFBs that want to move to HMF to tap the resources that would enable them to do so. Furthermore, MFBs often lack the capacity to address the distinct characteristics of HMF, including with regard to products, eligibility, and risk mitigation. The project aims to jumpstart the development of HMF in Nigeria by providing TA, soft loans and lines of credit for pilot MFBs.

39. **Learning from other projects, corporate bond issuance will be immediate.** The solutions used in both Egypt and Tanzania had weaknesses that did not always create the right incentives to tap the bond market. To reflect these lessons, the IDA loan to NMRC will be disbursed in phases as subordinated debt financing. As noted above the funds will not be on-lent, but invested in securities to cover NMRCs operational costs and grow its capital base. This approach will ensure a strong capital base and will force NMRC to issue bonds from year 1.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

40. **The overall governance and steering of the project will be carried out by a Project Steering Committee (PSC), chaired by the Federal Ministry of Finance (FMoF) and representing the involved private and public stakeholders.** The day-to-day operations will be managed by a Project Administration Team (PAT) hosted in the CBN, which will report to the PSC on a quarterly basis. The Project Steering Committee will be supported by a Secretariat based in the FMoF. The detailed institutional and implementation roles are outlined below.

41. **Project Steering Committee (PSC):** The PSC will be established to provide policy oversight and strategic direction to the implementation of the project. The PSC will be chaired by the FMoF and will consist of senior representatives (Director level) from the FMoF, the Federal Ministry of Lands, Housing and Urban Development (FMoLHUD), the CBN, the Securities and Exchange Commission (SEC), selected States[13] and the banking sector. The PSC will convene as required, but at a minimum of twice a year during the life of the project. The FMOF has constituted the PSC for this project.

42. **Secretariat of the Steering Committee (SSC):** The SSC will be established to support the work of the PSC, coordinate activities across different institutions and coordinate activities that are highly relevant to the success of the project but not included as a funded component, i.e. land registration; coordinate with the State level agencies that are willing to reform land and foreclosure process; coordinate with other agencies i.e. FHA, prepare the PSC meetings and follow up on all decisions of the PSC, including reports and approval of annual plans. Next Steps: The FMoF have appointed an interim SSC led by the Senior Advisor to the Minister. The full time staff will be recruited after project effectiveness.

43. **Project Administration Team (PAT):** The PAT will be established in and fully funded by the CBN. It will be responsible for the day-to-day and overall project management, monitoring and reporting, including the implementation of the Environmental and Social Risk Management Operations Manual (ESOM). The PAT will consist of a project director and a deputy director. It will be supported on a needs basis by a procurement specialist of CBN's procurement department and a financial management specialist of CBN's financial management unit. In addition, a sustainability specialist will be staffed to oversee all ESOM requirements across the participating financial institutions (PFIs).

B. Results Monitoring and Evaluation

44. **The counterparts and the World Bank will evaluate progress on the proposed indicators through regular reporting by the PAT and implementation support missions**. The PAT will collect and present data on project indicators and core sector indicators. Data will be collected to assess performance on the demand and supply side as well as to measure the overall impact of the program. Also to be collected are detailed construction cost data for

[13] A number of States will be selected based on their willingness to engage in meaningful reform to improve the enabling environment. Included are improvements in property registration process and costs, in creditor rights such as establishment of specialized courts, and measures to assist the supply of affordable housing.

different categories of housing, as well as data of new mortgagees to assess the income and social profile of new beneficiaries gaining access through the project. A sample of mortgages being refinanced and those not being re-financed will be compared. The same methods will apply to Housing Microfinance clients. By the end of the first year a base line will be established. In year two, a second round of data collection will inform a mid-term review of the project. Mid-term review is planned for 2016.

C. Sustainability

45. **The project design integrates mechanisms aimed at ensuring sustainable housing finance solutions extending beyond the completion of IDA funded activities**. The design of the project expressly targets a goal of sustainability for the mortgage refinance company which itself aims to support the long-term development of Nigeria's mortgage market. The key pillars of this project in terms of sustainability are:

- **Market Pricing.** Mortgage refinancing will be done at market rates from day one.
- **Private Ownership.** NMRC will be majority owned by its users. This will ensure that its objectives are aligned with those of the market. It also ensures that interest rates are kept low to pass on maximum advantage to lenders and households.
- **Linkage with Capital Market**. Moving NMRC toward a bond issuance is a critical step toward ensuring its long-term viability. It creates a fully functioning housing finance system in which long-term funds can be channeled from institutional investors toward housing. An initial Government guarantee of the bonds will help establish NMRC with investors but will be removed by end of the project to create a fully sustainable model.

46. The project design integrates mechanisms aimed at ensuring sustainable housing finance solutions extending beyond the completion of IDA funded activities. These include: (a) partnership with the private sector to implement the project; (b) operational self-sufficiency of the mortgage facility from the outset; (c) ability of the mortgage facility to raise its own funding at market rates; and (d) piloting the business case for housing microfinance.

47. The mortgage facility will be required to access the bond market to raise its own funding at market rates by project mid-term. This is one of the key features aimed at ensuring sustainability of the mortgage facility. Access to the bond market will be ensured with a disbursement condition, whereby the last three tranches, out of a total of six, will be subject to issuance of a corporate bond. Despite the fact that the disbursements will be front loaded with approximately US$165 million provided in the first three tranches, each of the remaining three tranches (i.e. a total of US$110 million) will be subject to this condition. This approach will ensure a gradual reliance on the market to meet the funding needs prior to full utilization of the IDA loan.

48. **The microfinance pilot will rely largely on a gradual design-test-roll out model to make the business case for housing microfinance.** Due to the absence of established housing microfinance products, and with only emerging initiatives, the project aims to support selected microfinance banks in developing and piloting sustainable products at market rates, and establishing initial HMF portfolios. In addition, the project may support an emerging private

HMF wholesale facility. Such private sector initiatives already illustrate the potential for sustainable commercially based HMF in Nigeria. Following the demonstration effect supported by the project, it is expected that the microfinance sector will be willing and able to raise commercial funds to expand their housing loan books.

V. KEY RISKS AND MITIGATION MEASURES

A. Risk Ratings Summary Table

Table 3. Housing Finance Risk Ratings

Stakeholder Risk	**Low**
Implementing Agency Risk	**Substantial**
- Capacity	**High**
- Governance	**Low**
Project Risk	**Substantial**
- Design	**Moderate**
- Social and Environmental	**Low**
- Program and Donor	**Low**
- Delivery Monitoring and Sustainability	**Low**
Overall Implementation Risk	**High**

B. Overall Risk Rating Explanation

49. **Macroeconomic policy must remain conducive to long-term lending.** The most critical risk to the overall sector and to the project achieving its objective is the Government's policy consistency. Keeping inflation and interest rates low, despite external and internal treats, such as falling oil prices and pressure to raise the Government's deficit, is the main challenge for Government's macro policy.

50. **Capital markets must respond favorably to NMRC corporate bonds.** The objective is for NMRC to raise its own financing from the capital market. IDA funds and some Government support in the form of a minority shareholding and a guarantee of the initial bond issuances will put NMRC in a strong starting position. Nevertheless, NMRC must build trust, with a strong balance sheet to will encourage capital at a rate at par with Government bonds.

51. **Financial institutions must increase their capacity to maintain high levels of performing loans in this market segment.** Financial institutions must be able and willing to issue loans, and "perfect" these loans as required in a formal financial system. Loans must be properly documented, registered and administered for NMRC to be considered.

52. **Governance risk.** The housing industry and the project intervention areas are being supervised by several agencies and ministries. The most critical are the Central Bank of Nigeria and the Securities Exchange Commission (SEC). In Nigeria, the CBN is recognized as the premier financial institution. Given the small size or nonexistence of a significant market, the project has the opportunity to build the knowledge and the tools to supervise this sector adequately.

53. **Supply response from the housing sector to growth in effective demand.** The project scope means that it is unable to work fully on both the demand and supply sides. However, significant efforts are being undertaken in parallel by DFID and the Nigerian Government to develop the capacity of the housing supply chain and property titling. One of the unknowns in the project is the degree to which housing developers and artisans have the capacity to respond to the expansion of mortgage availability. Using DFID and World Bank funded Growth and Employment Project, capacity development will be applied to the housing value chain to mitigate this risk.

54. **Operational risks with project execution.** The project requires managers who have sound financial knowledge and legal capacity. High-quality NMRC management will be the critical centerpiece of the project because managers must maintain a high level of trust in both international and national financial markets. Alongside them, the CBN must maintain a high level of capacity to supervise the sector, and develop and maintain market information systems that is, create a construction price index.

VI. APPRAISAL SUMMARY

A. Economic and Financial Analysis

55. **The Nigerian Mortgage Refinancing Company (NMRC) is expected to gradually refinance 5 percent to 20 percent of total mortgage loans over the amortization period of 5 years.** In addition the project will promote a stable lending environment, introduce standardization, and provide liquidity safety nets, thereby leveraging additional funds to finance mortgage lending beyond NMRC's initial equity (*Scenario Reference*). The economic analysis of this project has been structured to capture the impact of the project at a micro level (job creation and households). The costs and benefits that are expected to accrue from the impact of NMRC have been estimated, and the net present value (NPV) and the economic rate of return (ERR) for the investments in the main project component were calculated. Detailed assumptions, results, and non-quantifiable benefits are presented in annexes 6 and 7.

56. **This economic analysis focuses on the impact of NMRC on the mortgage market compared to a counterfactual, which assumes that current market conditions are sustained.** The project will generate at least 180,000 additional mortgages in line with the assumption that the project will have a broader impact on the mortgage market. This number is 130,000 mortgage loans more than the counterfactual scenario, which expected 80,000 loans.

57. **This increase in mortgage volumes also will energize the construction sector (residential housing) and increase the number of full-time workers employed in it.** The literature shows that unskilled workers can benefit from additional activity in the construction industries. The value added to the construction sector as a result of the project will be the volume of loans discounted by the new housing construction factor.[14] The impact on the construction

[14] The new construction factor is the share of the property financed through mortgage loans (75%) times share of mortgages value that will go into new construction (75%). The proportion of the new mortgages that is met through new housing construction is estimated at 75%. Given the housing deficit, it is likely that most of the loans will be used (directly or indirectly) to increase the housing stock because evidence indicates that the formal sector is producing only a fraction of the total number of urban units needed each year.

sector is estimated to increase GDP over 5 years on a cumulative basis by 0.4 percent above the counterfactual. Under the counterfactual, approximately 300,000 jobs would be created over 5 years. Under the project, new jobs are expected to increase by approximately 490,000 to 790,000. These additional jobs will generate additional income estimated at NGN60 billion (US$380 million) above the counterfactual over 5 years.

58. **Beyond the impact on jobs and income, the project will generate a net surplus to households**. This surplus is estimated as the difference between the Net Present Value (NPV) of the mortgage loan and the NPV of the amount needed to be saved by a household that is renting its dwelling and is willing to pay upfront for a property 15 years from now. The net gain for households is estimated at NGN5 billion (US$32 million).

59. **The economic rate of return was estimated at 38.9 percent using a 14 percent discount rate.** The NPV for the Scenario Reference assuming leverage of the financial sector is largely positive (over NGN11.6 billion or US$73.4 million) with an ERR of 38.9 percent (see annex 7 for sensitivity analysis).

B. Technical

60. **The NMRC has legally been registered and written commitments from financial institutions received.** Regulations to supervise a mortgage liquidity facility were discussed and published. The business plan and model have been completed and the general principles agreed. A law firm has been appointed by the promoters, the Ministry of Finance and the Commercial Banks, to represent NMRC, sign agreements on its behalf, and recruit a CEO. The PAT has been established within the CBN and procurement and financial assessment completed. The business plan and details of NMRC are given under Annex 12.

C. Financial Management

61. **Responsibility for establishing and maintaining acceptable financial management (FM) arrangements will be vested in the Finance Department (FD) of the CBN.** FD/CBN has an acceptable financial management system that is capable and will be used to process the financial accounting, recording and reporting for the project. The FD has adequate accounting staff to support the project activities. The computerized accounting system of the CBN also will be modified to enable it to be used to record the financial activities under the project. It also has been agreed that FD/CBN will appoint a seasoned accounts officer to carry out the day to day activities for the project and liaise with CBN's Other Financial Institution Supervision Department (OFISD) to ensure project financial accounting requirements are treated on a timely basis. The CBN internal control systems will be applied to the project including oversight by Internal Audit over project activities. The project unit located within OFISD will work with the FD to request approval from CBN management to appoint a separate and independent external auditor for the project. Given the assessment conducted and the few recommended actions agreed and being implemented as per the agreed time frame, the financial management arrangements will meet the minimum FM requirement in accordance with OP/BP 10.00. Annex 3 provides additional information on FM and flow of funds.

D. Procurement

62. **Procurement under this project can be classified as upstream, which pertains to the procurement activities in the PAT located in the CBN, and downstream procurement which will occur at the beneficiary (NMRC) level.** An assessment of the capacity of the PAT to implement project procurement activities was carried out in accordance with the Procurement Risk Assessment and Management System (P-RAMS) which was developed to align with the Bank's risk based approach in 2011. While upstream procurement will include technical assistance (TA) consultancies, in case of downstream procurement (Procurement in Loans to Financial Intermediaries) the Guidelines on Procurement of Goods, Works and Non-Consulting Services, January 2011 edition, will apply.

63. **The assessment reviewed the organizational structures of CBN that will function as the PAT.** The detailed assessment is in the P-RAMS. The assessment notes that the CBN has a very large department (Procurement Support and Services Department --PSSD) that handles the procurement implementation of the organization. The procurement activities of CBN are guided by the Nigeria Public Procurement Law of 2007. CBN has assigned one of the staff of PSSD as the Procurement Specialist for the PAT.

64. **This is the first time that a World Bank funded project shall be located in CBN.** However, under this project, the bulk of the funds will pass through CBN to NMRC and a relatively small percentage (from Component 2, 3 and 4) will be retained for the selection of consultants that will be engaged for the TAs, a few goods procurement activities and operational expenses. The goods procurement activities will be limited to office and ICT equipment.

65. **During the assessment of the procurement risk at CBN, a few lapses observed in the current procurement implementation include:** (a) lack of experience in World Bank procurement procedures; (b) lack of procurement plan; (c) lack of appropriate management information system (MIS) for tracking procurement records; and (d) undue interference in the procurement process.

66. **To mitigate these risks and considering the relatively small volume of procurement transactions, the procurement specialist will have access to internal and external training**. A short term procurement consultant will be hired and the Bank will hold continuous dialogue with Government to address issues of potential political interference.

67. **Downstream–implementation of component 1 by NMRC.** Appropriate procurement arrangement will be put in place, and NMRC is expected to comply with agreed project arrangements.

68. **The applicable World Bank guidelines are:**

- "Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants," dated October 15, 2006 and revised in January 2011.
- "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits and Grants by World Bank Borrowers." dated January 2011.

- "Guidelines: Procurement of Goods, Works and Non-consulting Services under IBRD Loans and IDA Credits and Grants by World Bank Borrowers." dated January 2011.

Considering the risks and proposed mitigation measures, and progress made in reforming Federal and procurement systems in Nigeria, the procurement risk is **Substantial.**

E. Social (including Safeguards)

69. **It is anticipated that the majority of transactions covered by NMRC and HMF will be in services or investments that will have little environmental or social risks associated with them.** However, it is recognized that there may be some business activities in which the environmental and social risks and impacts are moderate and require commensurate assessment and management, such as land acquisition, labor and working standards, inappropriate disposal of wastes, or unhealthy or hazardous working conditions.

70. **In June 2012, Bank Management adopted the IFC Performance Standards as the World Bank Performance Standards for Private Sector Projects (World Bank Performance Standards) and the application of such World Bank Performance Standards to Bank financing or support which is destined to projects (or components thereof) that are owned, constructed and/or operated by the private sector, in place of the World Bank environmental and social safeguard policies.** In May 2013, these new approaches were codified as OP/BP 4.03, **Performance Standards for Private Sector Activities**. Consequently, following discussions among the task team and safeguards specialists in the World Bank Group this project is FI–2. This is based on the anticipated knowledge that the proposed project (Component 3 in particular) is comprised of, or is expected to be comprised of, subprojects that have potential limited adverse environmental or social risks or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures; or includes a very limited number of subprojects with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented. Component 4 does not involve environmental and social impacts.

71. **With regards to the mortgage financing activities in Component 1, one of the prerequisites of the WBG support for NMRC is that the PFIs integrate into their lending operations the requirements of environmentally and socially sound and sustainable development as identified in laws and regulations of the Government of Nigeria and in the sustainability policies and frameworks of the participating WBG entities.** Accordingly, the WBG and the CBN will collaborate to produce an Environmental and Social Risk Management Operational Manual (ESOM) for the PAT reflecting all the requirements of environmentally and socially sound and sustainable development as identified in laws and regulations of Nigeria and the sustainability policies and frameworks of the participating WBG entities. These measures will ensure that appropriate risk management measures have been identified for implementation by the loan applicants in each of the Project PFIs.

72. **Participating financial institutions are required to establish or arrange for proper capacities to duly implement their Environment and Social Management Systems (ESMS) in a manner consistent with the guidance that will be provided in the Environmental and Social Risk Management Operations Manual (ESOM).** The ESMS describes key features such as: social and environment policies and procedures; current organization structure and

staffing for managing environmental and social risk; skills and competencies in social and environmental areas; training and awareness of the institution's investment, legal, and credit officers on the organization's ESMS; reporting systems to managers; and performance monitoring procedures. Additionally, the Project Implementing Entity shall collect, compile and submit to the Association, each calendar year (or at such other frequency as may be agreed with the World Bank), consolidated reports on the status of compliance with the ESOM. This process also follows along the lines of current IFC capacity building across the Nigerian Banking industry with their Environmental Performance and Market Development Program. It also is in alignment with the IFC sustainability requirements for their financing of NMRC.

73. **In supporting the development of the housing microfinance market, the proposed activities also will attempt to address gender issues.** Gender specific constraints to HMF access will be analyzed and proposed solutions will be integrated in the TA provided to MFBs, such as through gender specific products.

74. **Since there is no direct investment in land purchase or acquisition under this project, no involuntary resettlement is expected.** However, as part of the PFI ESMS, there will be a review process to assess if transactions do lead to specific land acquisition for any sub loan action and the proper Performance Standards will be followed.

F. Environment (including Safeguards)

75. **No long-term or large-scale negative environmental impacts are anticipated.** The potential environmental risk will be managed by applying the ESOM across all participating institutions. Details on this process are included in annex 10.

Table 4. Applicable Performance Standards

Performance Standards	Yes	No	TBD
PS 1: Assessment and Management of Environmental and Social Risks and Impacts	x		
PS 2: Labor and Working Conditions	x		
PS 3: Resource Efficiency and Pollution Prevention		x	
PS 4: Community Health, Safety, and Security		x	
PS 5: Land Acquisition and Involuntary Resettlement	x		
PS 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources		x	
PS 7: Indigenous Peoples		x	
PS 8: Cultural Heritage		x	

Annex 1. Results Framework and Monitoring

NIGERIA: HOUSING FINANCE PROJECT

<u>Project Development Objective (PDO)</u>: Increase access to housing finance by developing primary and secondary mortgage markets in Nigeria.

PDO Level Results Indicators*	**Core**	**Unit of Measure**	**Baseline**	**Target Values****					**Frequency**	**Data Source/ Methodology**	**Responsibility for Data Collection**	**Description (indicator definition)**
				YR 1	**YR 2**	**YR3**	**YR 4**	**YR5**				
Indicator One: # of new mortgage loans provided	x ☐	# loans	0	20,000	35,000	35,000	40,000	50,000	6 months	Supervision reports	CBN	Indicator of outreach
Indicator Two[15] # of new mortgages below NGN5 million		# loans <NGN5 million	N/A	2,000	5,250	5,250	6,000	7,500	6 months	Supervision reports	CBN	Indicator for outreach
Indicator Three: Proportion of mortgage debt outstanding refinanced by NMRC	☐	% of the market	0%	5%	10%	15%	20%	20%	6 months	Supervision reports	CBN	Leverage indicator
INTERMEDIATE RESULTS												
Intermediate Result (Component One): Mortgage Market Expanded with secondary lender												
Intermediate Result Indicator One: MRC Efficiency Indicator – Cost-to-income ratio	☐	%	0	< 50%	**48%**	**46%**	**44%**	42%	6 months	NRMC reports	PIU	Indicator of NMRC's operational efficiency
Intermediate Result Indicator Two: *MRC New Bond issuance volume (years 3–5 are without sovereign guarantee)* [16]		Billion Nigerian Naira	0	**20**	**30**	**50**	**70**	**50**	6 months	NRMC reports	PIU	Bonds issued with sovereign guarantee for first 2 years , up to a maximum of NGN50 billion
Intermediate Result (Component Two) *Indicator One* # of guarantees		Annual number of guarantees	**0**	**0**	**300**	**500**	800	900	6 months	NRMC reports	PIU	Guarantee product in operation for lower middle income levels
Intermediate Result (Component Three): Housing Microfinance model piloted, evaluated, and ready for going to scale												
Intermediate Result Indicator One: 3–5 pilot MFBs *develop/adapt/adopt housing* microfinance loan products, access project credit line, and establish first cycle of microfinancing lending	☐	MFBs with operational programs	0 MFBs	0 MFBs	3 MBF	4MFBs	5 MFBs	5 MFBs	6 months	MFI Reporting	PIU	Housing microfinance lending program operational

[15] Non-cumulative indicator
[16] Non-cumulative indicator

programs												
Intermediate Result Indicator Two: Number of HMF loans disbursed	☐	**# loans**	**0**	**0**	1,070	1,430	2,140	2,860	6 months	MFI Reporting	PIU	Scale of HMF
Intermediate Result Indicator Two: *Volume (US$) of HMF loans disbursed*		**US$ million loans**	**0**	**0**	**3**	**4**	6	8	6 months	MFI reporting	PIU	Scale of HMF
Intermediate Result Indicator Three: *Portfolio at risk*		PAR@30 days	0		5%	**4%**	3.5%	2.5%	6 months	MFI reporting	PIU	Loan performance

Note: *Target values should be entered for the years that data will be available, not necessarily annually.

Annex 2. Detailed Project Description

NIGERIA: HOUSING FINANCE PROJECT

Component 1. Establishment of the Nigeria Mortgage Refinance Company (US$250 million)

1. **The Project will assist in the development of Nigeria's mortgage finance market through providing long-term funds to finance mortgages**. The line of credit of US$250 million will be made available to the Central Bank of Nigeria for on-lending to the Nigeria Mortgage Refinance Company (NMRC) in 6 installments during the lifetime of the project. Components 1 and 2 of the loan will be disbursed according to the schedule in table A2.1.

Table A2.1 IDA Loan Disbursement Schedule for Components 1 and 2 (US$Million)

	Year 1	Year 2	Year 3	Year 4	Year 5
NMRC funding	120	70	20	20	20
Mortgage Guarantee Product	0	25	0	0	0
Cumulative disbursement	120	215	235	245	275

2. **The credit will be lent to the Federal Republic of Nigeria on IDA terms with a maximum commitment fee of 0.5% on the unwithdrawn credit balance and a service charge of 0.75 percent on the withdrawn credit balance. The tenure of the credit will be 40 years, with a 10 years grace period.** The funds then will be on-lent to NMRC in Naira at a rate and terms that match the amortization schedule of the IDA funds with the addition of an interest rate to cover the cost of the foreign exchange risk. This cost has been estimated at 4.25 percent per annum. Given that the loan would be offered over such a long period, the line of credit amounts to quasi-capital and may be classified as Tier 2 capital by CBN.

3. **The key element of Component 1 and the entire project is the establishment of a mortgage liquidity facility, the Nigeria Mortgage Refinance Company (NMRC).** This entity has been established as a private sector institution with majority ownership coming from the financial institutions that also will be using it to refinance their loans. NMRC will act as a bridge between mortgage lenders and the capital markets. It will issue standard corporate bonds in the capital markets and use this funding to make loans to mortgage lending institutions. These loans will be backed by collateral in the form of an assignment of rights over part of the lenders' mortgage portfolio. This collateral will protect NMRC's loans and minimize the amount of credit risk that the agency will take. The minimized risk, in turn, will help to achieve the lowest possible rate in raising its bond financing.

4. A key distinction of this model compared to securitization is that the underlying loans offered as collateral stay on the balance sheet of the lender, and, should they go into default, would need to be replaced by performing loans. Thus, unlike mortgage-backed securities (MBS), this model does not take direct credit risk on mortgage borrowers.

5. **A total of US$250 million equivalent will be disbursed in 6 tranches to NMRC and sit on the balance sheet as Tier 2 capital.**

6. The role of the IDA funds will be twofold: (a) **Strengthen Balance Sheet.** They will provide confidence in the credit standing of NMRC as a bond-issuing entity that critical in ensuring its ability to raise bond financing at just above sovereign debt levels; (b) **Ensure Sustainability of Model.** The IDA funds will be invested in Government securities to generate sufficient return, to cover administrative expenses, and to generate sufficient income to grow the capital base in line with growth in the balance sheet. This model is a departure from previous models in which World Bank loans were used to directly fund on-lending. One of the consequences of this new model is that NMRC will have to issue bonds from the outset before it can begin refinancing operations.

7. **Pricing from NMRC to mortgage lenders will depend on the marginal cost of funds raised by NMRC in the bond market together with an operating margin of 1 percent to cover costs and return on equity.** Initially, to give confidence to bond holders in the new entity, IDA funds will represent a large proportion of the balance sheet. As the balance sheet grows and NMRC generates its own capital resources through accruing reserves, the IDA funds will become less significant, although they still will be critical in creating sustainability.

8. **The Federal Government of Nigeria will provide limited support to NMRC in its initial phase through a guarantee of its bond issuance.** The guarantee will be both time limited and amount limited, but, in the context of the Nigerian market, is seen as a necessary credit enhancement. Institutional investors will not be familiar with NMRC and will require some initial reassurance to support their investments. Alongside its initial support, the Government will seek a number of regulatory concessions for NMRC bonds to ensure that they become attractive and liquid capital market assets.

9. **The project will help expand the reach of mortgage finance down the income distribution by setting targets for the refinancing of smaller loans.** As part of the project design and to encourage greater access to mortgage finance, there will be a requirement that the portfolios of mortgage loans presented as collateral in a refinance operation must contain a specified minimum proportion of smaller loans. A starting target could be in the range of 30 percent of loans being below NGN5 million (US$32,000). This requirement would be subject to review and regular update through the Project Operations Manual (POM).

Component 2. Establishment of a mortgage guarantee product targeted at lower income borrowers (US$25 million)

10. **To further support reach of mortgages down the income distribution, US$25 million equivalent will be used to develop a guarantee product to bear some of the credit risk for lower income lenders.** The guarantee will provide credit default loss protection to mortgage lenders. It will be established in year 2 of the project and will be subject to detailed pricing and market analysis. The project will fund product development including testing and financial modeling and then will launch a competitive process among private or publicly owned non-bank financial institutions to implement the project. Criteria will include: (a) being financially sound and solvent as confirmed by the CBN; (b) providing a matching contribution to the proposed product; and (c) submitting a business plan based on scope and outreach to lower income groups.

11. In addition, a detailed section will be added to the POM that will describe pricing and operations of the guarantee product and how the relationship with the implementing firm is to be managed.

12. The project will finance the TA required to design the guarantee product, the development of the detailed operation manual, the bidding criteria, and the consultations events; and will support the implementation and monitoring. The TA financing is allocated under Component 4. Furthermore, the project will make available a line of credit to cover the issuances of guarantees. The guarantee line of credit allocation will be made available upon the signing of the agreement with the service provider. The selected service provider will issue a quarterly report with the list of issued guarantees and the guarantee terms, including social income data and GPS location of the mortgagor.

13. **Mortgage insurance has long been a feature of mortgage markets in Australia, Canada, the UK, and the US.**[17] More recently, insurance and guarantee products have spread to other EU countries and some emerging markets. Most notably, Morocco has successfully launched a guarantee product covering informal and seasonal workers. India is implementing a guarantee scheme for low income borrowers.

14. The potential benefits to Nigeria from such a product are:

- Helping otherwise qualified borrowers who have not accumulated sufficient cash to meet current down payment requirements.
- Expanding access to housing finance by helping bankable households with variable or self-employed income to apply successfully for mortgage loans.
- In the medium term, spurring the ability of lenders to sell their own mortgage-backed bonds to pension funds and life insurance firms.
- In the longer term, the credit enhancement may serve a useful role in creating a sound foundation for mortgage-backed securities as a fixed-rate funding vehicle to buttress the primary mortgage market.

15. **For mortgage insurance to be attractive to lenders, real risk would need to be transferred.** Such action would indicate that the amount of capital lenders must hold against the risks associated with their loans had been be reduced. To enable risk transfer and the recognition of it by both lender and the insurer requires that regulations be put in place. Implementation of regulations potentially requires the involvement of both the banking and insurance regulators. Overall, based on conservative capital ratios, the IDA funds could achieve a modest leverage ratio. The full extent of any leverage would be calculated in the feasibility analysis to be done ahead of product launch.

[17] For more information on MI in emerging markets, see Urban Institute, *Development of Mortgage Default Insurance in Kenya: Assessment Report* (Washington, DC, 2006).

16. The key design features of the guarantee will be:

- **First loss position to stay with originator.** It is important not to create moral hazard whereby the originator does not operate under the right incentives for prudent underwriting.
- **Partial guarantee to be provided after first loss.** The depth of the guarantee (that is, the proportion of loss coverage) will be determined through analysis carried out by sector specialists in conjunction with lenders.
- **Premiums for coverage.** To make the guarantee sustainable, some level of premium will be charged that will be determined based on detailed analysis.
- **Outreach to lower income groups.** The product will be especially important in expanding access to housing finance, particularly among those who may struggle to raise both the necessary equity for a house and all the transaction fees. The product also could benefit potential borrowers working in the informal sector, in which lenders may require additional guarantees before lending.

17. **Implementation of the product would be done through a competitive tender held for a financial institution to initially run the guarantee product and earn fee income for doing so.** The institution would be selected based on a review of proposals that would take into account a number of factors around the proposed implementation of the scheme and the operational capacity of the institution. Another requirement would be that the institution offering such a product would not itself be able to benefit from the coverage. The three key criteria on which evaluation will be based are that the firm must (a) be of good standing, financially sound, and solvent as confirmed by the CBN; (b) provide some matching contribution to the capitalization of the proposed product; and (c) provide a business plan based on scope and outreach to lower income groups.

18. **A possible long-term option for locating the guarantee product could be to capitalize the guarantee with National Housing Fund (NHF) funds.** Reforms at Federal Mortgage Bank of Nigeria (FMBN) and NHF may allow a long-term solution in which the guarantee can be run for the benefit of NHF contributors backed by NHF capital. Such a solution would require some corporate governance reforms at the FMBN, which currently administers NHF funds. In particular, a ring-fencing of NHF contributions, possibly into a new National Housing Trust Fund, could help achieve the necessary degree of accountability and transparency.

Component 3: Housing Microfinance (US$15Million)

Objective of the Component

19. **The proposed objective is to support the development and piloting of new and/or emerging formal Housing Microfinance (HMF) products and to demonstrate a sustainable business case for this activity.** The activities under this component will include (a) tailored TA to select microfinance banks (MFBs) to test the new HMF products, develop new and/or improve emerging HMF products (to be funded from component 4; (b) provision of risk capital to MFBs,

in form of limited soft loans; and (c) a line of credit to MFBs to roll out the tested HMF products.[18]

Context

20. **The existing 889 MFBs are not offering formal housing microfinance products.** Their portfolios primarily consist of small loans for microenterprises ranging from below US$100 to approximately US$1,500 with maturities of 3 months–9 months. The development of a HMF market from scratch is a complex task. MFBs understandably are cautious about venturing into a new line of business that extends beyond their current business model. Despite the existing market potential, without initial external support, it is unlikely that MFBs will expand significantly to HMF in the near term.

21. **At the same time, and based on initial engagement with MFB sector,[19] the MFBs have a strong interest to tap into housing microfinance given the reported client interest in various forms of it.** As a result, several MFBs are considering specific housing products, largely related to home improvement and incremental construction. Furthermore, all MFBs indicated the necessity to better understand the market potential, the need for TA to develop tailored HMF products, and to understand the funding constraints of venturing into this market segment. Based on this input, and in line with the current regulations, table A2.2 illustrates potential housing microfinance products and sample product uses identified by respondents.

Table A2.2 Illustration of Potential HMF Products and Their Use

Potential HMF Products	Potential Use
Loan amount: NGN100–NGN800,000* (US$620–US$5,000). **Tenor:** 12–24** months. **Interest rates:** 1.5–4.0 percent per month. **Customer profile:** Clients who own their property, regardless of whether they have title; existing MF customers with repayment history; new clients. __________ *Maximum loan size set to NGN500,000 by CBN or obligor limit of 1 percent of shareholders' funds for individual lending. **Maximum maturity currently allowed by CBN.	**Incremental housing construction** via series of HMF loans. **Home improvement** (such as repairing the roof, connecting to public utilities, adding lavatory facilities, plumbing, tiling a floor). **Relocating business activities** outside of the living area (for example, adding a separate room).

22. **Although the sector has not yet developed and tested formal HMF products, three emerging initiatives could be considered for project support.** They are: (a) MFBs that intend to create a HMF business unit that have products in conceptualization or initial design stage; (b) partnerships between construction materials producers and MFBs offering HMF loans combined with construction TA; and (c) wholesale facilities that intend to focus on HMF market.

[18] The project will not fund developers.
[19] Based on responses from 18 MFBs via short survey and/or meetings.

Proposed Activities

23. **To jump start the development of HMF in Nigeria, the project will be rolled out in three phases: TA for HMF product development, testing, and roll-out.** The proposed allocation of resources and specific activities are presented in table A2.3.

Table A2.3 Housing Microfinance: Allocation of Resources and Specific Activities

Phases	Estimated IDA Allocation	Proposed Activities
Phase 1	Up to **US$0.5 million**	**Tailored TA to MFBs** as needed (such as for product design, piloting, training, strategy development, risk management, financial consumer protection, management information systems, or MIS)
Phase 2	Up to **US$1 million**	**Pilot HMF product testing** via limited soft loans
Phase 3	Approx. **US$143 million**	**Line of credit** to roll out tested HMF products
M&E	Up to **US$0.5 million**	**Impact assessment/evaluation** following Phases 2 and 3; ongoing monitoring

Note: TA under Phase 1, and M&E and impact assessments will be funded from component 4 of the project.

24. **In supporting the development of a housing microfinance market, the proposed activities also will attempt to address gender issues.** This will be achieved primarily by sensitizing the MFBs to gender issues during the provision of TA and exploring the feasibility of products that could be targeted sustainably to women borrowers. Furthermore, the project will closely monitor the gender coverage under the pilots and the credit line and will attempt to respond to any opportunities which could increase outreach to women.

25. **Phase 1: This stage will include the selection of 3–5 pilot MFBs and provision of tailored technical assistance to develop HMF products and implementation capacities; Phase 1 is estimated to take up to 6 months.** To be considered for project support, the MFBs will have to meet a set of eligibility criteria (such as financial performance, governance) (Box A.2.4). In addition, the selected MFBs ideally should have presence in different areas of the country to ensure that the products are piloted in different settings. The process of selecting the MFBs will be agreed with the World Bank at the time of implementation. The TA will focus on developing and testing pilot products and related support (e.g. regarding risk management, training, MIS) or assessment and/or improvement of HMF products and processes that may have emerged prior to the commencement of project activities.

26. **Phase 2: Prior to roll-out, the pilot products would be subject to the market test, supported by risk capital in the form of limited soft loans for initial lending; this phase is estimated to take up to 12 months.** Each of the selected MFBs would be offered a soft loan of up to US$200,000, depending on its absorption capacity, aimed at testing the new products developed in phase 1. The soft loans would be passed to MFBs at cost to the government (0.75 percent) plus the cost of foreign currency interest rate swap, with a maturity of up to 24 months (matching the maximum allowed loan maturity prescribed by regulations). There would be no interest rate capping on loans to final recipients, and they would be priced in line with the market conditions. The total amount of soft loans disbursed in this phase would be capped to US$1 million, representing approximately 6.6 percent of total loans envisaged under the project (that

is, in both phases 2 and 3). This volume level is expected to be sufficient for testing the new products, including market take-up, pricing, and performance. Subject to successful testing, which would be evaluated under the project, the selected MFBs would be able to access a line of credit to roll out the market-tested HMF products.

27. **Phase 3: Eligible MFBs would access a line of credit to roll out the tested HMF products.** The line of credit would amount to approximately US$14 million, following utilization of up to US$1 million in the piloting phase. In case some of the participating MFBs have developed and tested HMF products on their own and prior to the project support, they would be considered for accessing the credit line in phase 3 directly, subject to viability of their HMF portfolio as assessed under the project and/or additional TA to improve their products/practices. In addition to MFBs, and subject to eligibility, a portion of the funds may be channeled to HMF wholesalers (such as specialized funds and/or private firms, commercial banks) for on-lending to MFBs. All participating financial institutions accessing the line of credit also would have to adhere to minimum standards of financial consumer protection that will be developed under the project and for which TA can be made available (such as to develop a key facts statement for HMF products). More details on the line of credit design including its key terms and eligibility criteria are included in Box A2.4.

28. **Monitoring and Evaluation: Under the project, the development of the HMF market would be measured with a set of key performance indicators, while the impact assessment/evaluation will be conducted after the testing/piloting exercise and at the end of the project.** In addition to key indicators aimed at measuring the performance of the line of credit (listed in Box A2.4) additional performance indicators may be developed during the first and second phases of the project (TA and pilot product testing, respectively) to monitor HMF market development. Such indicators could measure the number of HMF products, entrants in the HMF marketplace, nonperforming loans, write-off ratios, and renewal rates.

29. The project will provide a line of credit to qualifying MFBs and/or the wholesale institutions. The disbursements will be based on the MFBs' withdrawal applications, which will include the details (e.g. loan purpose, amount, maturity, client) about their HMF portfolios. For wholesalers, the funds from the line of credit would be available periodically against a wholesale demand schedule, and upon the project administration team (PAT) and the World Bank review of the appraisal of the client MFBs.

30. **The operational details of the Housing Microfinance Component will be summarized in the POM, which will be prepared by the PAT.**

Box A2.4 Proposed Line of Credit Design

Line of Credit Amount: Approximately US$14 million to roll out the tested HMF products and expand the volume of the housing microfinance portfolios of participating MFBs. The MFBs would be required to continue to reinvest the funds from the credit line in their HMF portfolios during the entire duration of the project.

Loan Currency: The loan would be extended to the Federal Government of Nigeria in US$ and passed on to the MFBs in Nigerian Naira. The foreign exchange risks would rest with the government and be managed by the Central Bank of Nigeria (CBN). The cost of foreign currency interest rate swap would be integrated in the on-lending rate to MFBs.

Loan Terms to MFBs: Loan maturity of up to seven years, with a consideration for an appropriate grace period upon principal repayment. The on-lending rate to MFBs would be set to reflect the cost of the World Bank funds to the Government of Nigeria, including the cost of foreign currency interest rate swap, administrative/operational costs, and credit risk. The rate could be based on a T-bill rate plus a spread reflecting administrative costs and credit risk. This rate would be in line with the common practice whereby commercial lines of credit for MFBs are priced using the T-bill rate as the basis for setting the final interest rate. The exact loan terms would be determined at the time of implementation to reflect the market conditions at that time.

Allocation of the Loan Amount to MFBs: Each MFB selected would receive an initial credit allocation based on the estimated absorptive capacity. However, in case an MFB could not utilize its allocation over a specified time, this allocation could be offered to better performing MFBs. Overall, the maximum withdrawn amount should not exceed 30 percent of the MFB's capital.

Availability of Funds to MFBs: The funds from the line of credit would be available to MFBs on a monthly basis against previously lent funds for HMF loans disbursed in accordance with the agreed project criteria.

Loan Terms between MFBs and Final Borrowers: Loan size, maturity, and interest rate would not be capped. They would be based on the product design, CBN's regulations, and market conditions. The MFBs would take the full credit risk of introducing new HMF products and would price the loans in line with market conditions to ensure the sustainability of their HMF portfolios.

Performance Indicators: The performance of MFBs would be monitored based on eight indicators of their HMF portfolios: (1) volume of disbursed loans, (2) number of disbursed loans, (3) number of active loans, (4) percentage of disbursed and active loans to women, (5) portfolio at risk at 30 days, (6) total outstanding portfolio, (7) average loan size and maturity, and (8) loan losses. Additional relevant indicators may be developed during the product design and piloting phases.

Reporting: During the piloting/testing stage and the draw-down period, MFBs would be expected to report monthly on their HMF portfolios and key financial and performance indicators, and to report quarterly thereafter.

Supervision: The product administration team (PAT) established within the CBN would be responsible for implementing and supervising the credit line. These actions would include assessing and monitoring MFB compliance with eligibility criteria, supervision of withdrawal applications, and reporting on the credit line implementation progress. Supervision also would include an annual review of audited financial statements, review of loan books, and interaction with MFB management. During the supervision process, the World Bank also would have access to participating MFBs' loan books, and financial and operational information. The PAT would report quarterly to the Bank on implementation progress.

Eligible Activities: The line of credit would be used to fund microfinance activities solely related to housing purposes, such as home improvement loans and incremental housing construction. The MFBs would be responsible for providing basic information about their HMF portfolios in the withdrawal applications (such as loan purpose, amount, maturity, and client). The goods and works on the IFC Exclusion List would not be eligible for financing*.

HMF Wholesale Facility: In the case of a non-bank wholesaler (such as a private equity firm), the line of credit would be priced to match the commitments that the wholesaler already has secured in the market (such as from specialized funds) to ensure the sustainability of the emerging wholesale scheme. In the case of commercial banks intending to serve as HMF wholesalers, the pricing would be set to reflect the cost of funding, administrative costs, and credit risk. The funds from the line of credit would be available periodically against a wholesale demand schedule, and upon the PAT and the WB review of the appraisal of the client MFBs. The exact loan terms would be agreed at the time of implementation to reflect the market conditions at that time.

Eligibility Criteria for MFBs: To qualify for access to the credit line and become a participating financial institution under the project, MFBs would be appraised against the eligibility criteria listed below prior to entering in the loan agreement with the CBN. The responsibility for ensuring appraisals of MFBs would be with the PAT, located in the CBN. The PAT would monitor the compliance with eligibility criteria on a regular basis during the project implementation. Formal review would be conducted annually, including preparation of a compliance report for each MFB accessing the credit line. The World Bank would review the eligibility reports for each institution as prepared by the PAT, and would conduct additional appraisal as needed. In addition, the selected MFBs would be required to establish and maintain an Environmental and Social Management System (ESMS).

The following criteria would be applied to determine eligibility of MFBs to participate in the project and access the line of credit:

- Licensed MFB (state or national license) and at least three years in operation
- Full compliance with microfinance laws and regulations, and all required and recommended prudential and supervisory standards (such as satisfactory capital adequacy, liquidity, portfolio at risk, loan loss provisions, nonperforming loans, loan write-offs, minimum required capital, operational and financial self-sufficiency)
- Minimum "sound" rating under CAMEL criteria and overall good standing with CBN
- Fully sustainable and covering its operating costs and costs of capital on an adjusted basis
- Positive net income for the current year and the one immediately preceding the project
- Clean unqualified audits for two years preceding participation in the project, and continuously thereafter
- Well-defined policies and written procedures for management of all relevant financial risks and acceptable risk profile
- Fit and proper owners and board of directors, qualified and experienced management, adequate organization, oversight, internal audits and controls, and institutional capacity
- Adequate management information systems (MIS)
- Capacity to mobilize domestic resources
- Demonstrated commitment to engage in housing microfinance.

Eligibility Criteria for HMF Wholesale Institutions: In the case of a specialized fund and/or private equity firm, appraisal of the potential institution would be based on the criteria established by IFC in conducting due diligence of private equity firms. In addition, such private wholesaler would have to secure a portion of the resources for the on-lending facility in the market. In the case of a commercial bank, the eligibility criteria largely would resemble those stated above, adjusted to respond to banking sector requirements (such as licensed banks, compliance with banking regulations) and would be confirmed during an appraisal process. Subject to satisfactory compliance with those criteria, the wholesalers would be considered to participate in the project.

Note: The final arrangements for the line of credit design will be specified in the POM.

*The IFC's exclusion list is found in the following link:
http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Sustainability+Framework/IFC+Exclusion+List/

Component 4. Technical Assistance and Capacity Building (US$10 million)

Mortgage Market

31. **MRC Operational Support Including Assistance for Bond Issuance.** Right from the start of the project, NMRC will need to establish itself. To do so, it will need large amounts of support in preparing its key policy and process manuals covering issues such as financial management, operating policies, credit risk management, asset and liability management (ALM), and HR issues. Alongside this operational support, NMRC also will require expert advisory services when it is in a position to start issuing bonds. Support could be provided to help prepare issuance documentation, and advice on the structure of bonds or issuance process.

32. **Mortgage Lender Training.** Mortgage lenders also need to be supported. Accompanying IFC's roll-out of the Mortgage Toolkit, the project will support training and capacity building with lenders by running training programs. Subjects could include loan underwriting, collateral valuation, mortgage risk management, housing finance policy, management of delinquent loans, and other areas in which training gaps are identified. An additional objective would be to partner with a local institution to build up local expertise and training capacity to ensure sustainability of the program.

33. **Mortgage Consumer Protection and Financial Literacy.** The lessons from the sub-prime crisis are still fresh and are all the more important in an emerging market with little previous experience in mortgage lending. An awareness and literacy campaign can deepen understanding and familiarity with the mortgage product, while work on consumer protection can help underpin confidence in the market.

34. **Housing Market Information.** Having reliable and up-to-date market information is critical both for policymakers as the mortgage market develops, and for lenders looking to position themselves in the market. Good data on house prices can be a valuable credit risk management tool in valuing real estate collateral. This TA component will start with the inception of NMRC. The TA provides funds to develop (a) a house price index system and (b) mortgage market data covering volumes, numbers, and rates. The data collection will involve providing support to a number of organizations including CBN, FMBN, and the Ministry of Housing. It also may involve working directly with State governments in data collection exercises.

35. **Impact Evaluation of Mortgage Market.** Using the housing market information system, this TA intervention will assess the impact of the project on the development of the mortgage market. The impact evaluation will be carried out toward the end of the project. Key performance indicators could include number, volume, and quality of mortgage loans in the participating mortgage institutions and the overall market.

Housing Microfinance

36. **Technical Assistance to Develop and Pilot Housing Microfinance Products.** The project will support provision of tailored TA to select microfinance providers to develop, test, and roll out housing microfinance products. The TA will include support with activities and topics required to set up sustainable housing microfinance operations, including HMF product design, piloting, and assessment; training; strategy development; risk management; responsible finance; and management information systems (MIS).

Evaluation of Housing Microfinance Pilot. Component 4 also will fund impact assessments and/or additional evaluation work following the piloting and roll-out stages.

Guarantee Instrument

37. **Guarantee Instrument.** This component will fund a two-part process toward the creation of a mortgage guarantee facility. Phase 1 will fund a feasibility study that will provide the analytical underpinning for developing a mortgage guarantee. This study should include a full risk analysis based on current trends in the mortgage market with an actuarial calculation of the potential costs of providing such coverage and premium levels. An operational business plan also should be developed on how the product could be implemented. The regulatory framework also would be examined from the perspective of mortgage lenders and their capital requirements, and from the perspective of an insurance provider and the possible requirements set by that sector's regulator. Phase 2 will support implementation of the product. Resources will be made available to the winning bidder to provide the service to put it into operation. This support could include preparing an operational manual, product design, and staff training.

Legal and Regulatory Environment

38. **Training for CBN Banking Supervisors on Supervision of NMRC and of Mortgage Lenders.** Following the recommendations of the Financial Sector Assessment (FSAP), the regulatory oversight for the mortgage and microfinance sector needs strengthening. To build CBN's capacities, this component will involve consultancies of international experts and exchange programs with foreign regulators. These interventions will commence early in project implementation to keep pace with project activities.

39. **Capacity Building of FMoF, FMoLHUD, and FMoJ.** The involved ministries will need capacity building to supervise the activities of the project and to implement the needed changes in the legal and regulatory framework, for instance, in land regulations and foreclosure. The ministries will have access to consultants and trainings throughout the lifetime of the project.

40. **Exchange Program for Judges.** To improve contract enforcement and foreclosure, the capacity of judges and lawyers to manage mortgage caseloads and promote strict enforcement of deposit requirements in injunction cases needs to be increased. An approved method is an exchange program for judges. The exchanges should start in the early project stages.

FMBN Reform

41. **FMBN and NHF Strategic Review.** The project will provide support for a review of FMBN's current strategy, structure, and products. The establishment of NMRC will put pressure on FMBN to make itself more relevant in taking a public sector role in developing Nigeria's mortgage market and expanding access. In particular, the review will look at the options for the National Housing Fund regarding collections, targeting benefits, corporate governance, and long-term outlook. Specifically, the potential role of FMBN and NHF in providing solutions for lower income borrowers will be explored, including establishing a guarantee facility.

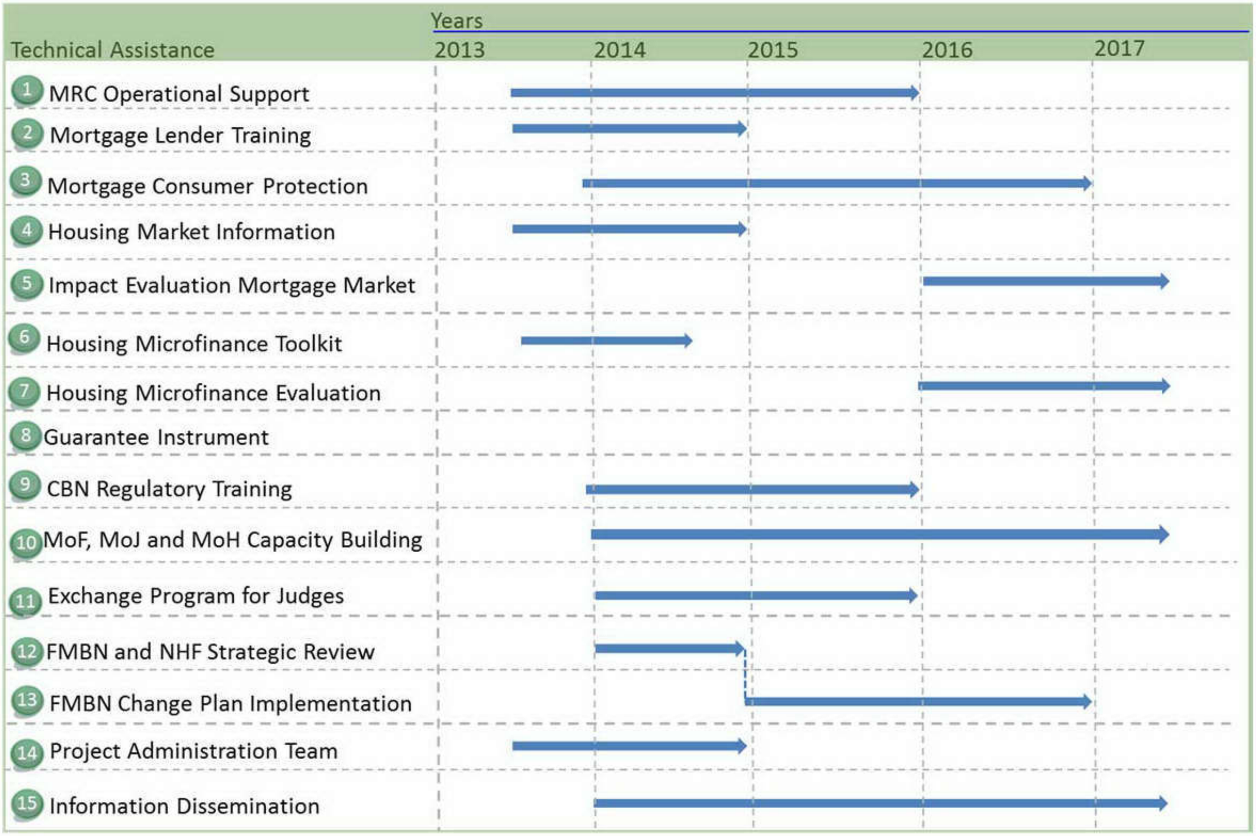
42. **FMBN Change Program Implementation.** Following the strategic review, the developed restructuring plan will need to be implemented. Support to the restructuring process will come in the form of short- and long-term consultancies.

Support Mechanisms

43. **Project Administration Team.** Full-time staff from the CBN will be assigned to a project administration team (PAT), which will have responsibility for overseeing project implementation tasks ranging from financial management, procurement, and M&E framework to safeguards and ongoing liaison among the implementation partners and the donor community. The PAT in CBN will be responsible for implementation of all project components.

44. **Information Dissemination.** It is important for the wide range of stakeholders across the housing value chain to be kept informed and involved with the project as it develops. Various dissemination methods could be employed, ranging from the use of social media to conferences or workshops. The aim is to document the progress of the project and to maintain an active dialogue on mortgage market development with key stakeholders.

Figure A2.1. Technical Assistance and Capacity Building



Annex 3. Implementation Arrangements

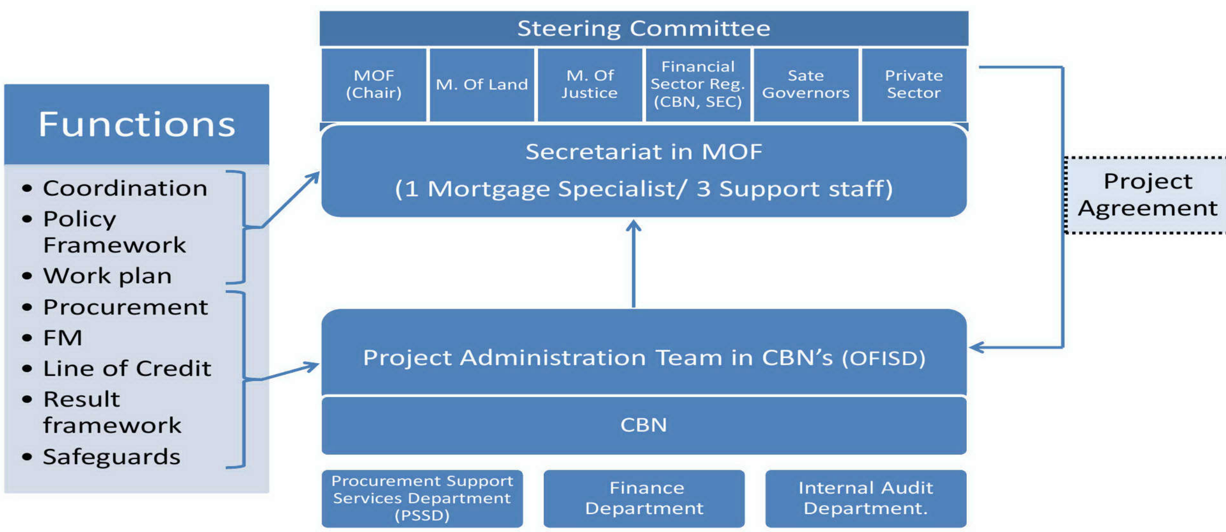
NIGERIA: HOUSING FINANCE PROJECT

Project Institutional and Implementation Arrangements

1. **A Project Steering Committee (PSC), chaired by the Federal Ministry of Finance will supervise project implementation**. The involved ministries, regulators, states, and the banking sector will be represented in the PSC through senior level representatives of at least director level. The PSC will be supported by the Secretariat of the Steering Committee (SSC) based in the Ministry of Finance. The SSC will report directly to the PSC and support the PSC in its supervisory role. The day-to-day operations will be managed by a Project Administration Team (PAT) hosted and funded by the CBN, which will report quarterly to the PSC.

2. The Secretariat will be in charge of drafting the policy framework as well as the annual work plan in close collaboration with the PAT and the coordination among donors.
The implementation framework will be structured as follows:

Figure A2.1 Implementation Structure



3. **Project Steering Committee (PSC).** A PSC will be established to provide policy oversight and strategic direction to the implementation of the project. The PSC will be chaired by the Ministry of Finance (minister or designated representative) and will consist of representatives from the Ministry of Finance and the Ministry of Lands, Housing and Urban Development, the Ministry of Justice, the CBN, the Securities and Exchange Commission (SEC), the priority States, and the banking sector (all designated representatives of the Minister, Governor, or Director General no lower than directorate level). The primary responsibilities of the PSC will be to:

- Provide overall leadership to the project.

- Ensure that respective government and private sector institutions and donor partners are informed, provide inputs, and contribute to project implementation. Of particular importance is that the PSC ensures that the reforms in the land and construction sector are coordinated with the activities of the Housing Finance Project.
- Assist in the resolution of constraints that cannot be resolved at a technical level by the PAT.
- Discuss and resolve any project complaints from stakeholders or beneficiaries.
- Approve the annual work plan.
- Discuss progress and impact of the project.

4. **Secretariat of the Steering Committee (SSC).** The SSC will be established in the Ministry of Finance. It will be staffed with at least one Housing Finance Specialist and support staff. The role of the Secretariat will be to facilitate and assist the Project Steering Committee in completing its missions.

The primary responsibilities of the SSC are to:

- Draft policy and strategic planning documents for consideration by the PSC.
- Draft the annual work plan in close collaboration with the PAT for consideration by the PSC.
- Ensure coordination between the different agencies and the donor community, as well as support the reforms in the land, legal, and construction sectors and ensure that they are coordinated with the activities of the Housing Finance Project.
- Report any project complaints from stakeholders or beneficiaries as well as any constraints that cannot be resolved at a technical level by the PAT.
- Prepare the PSC meetings and follow up all decisions of the PSC, including reports and approval of annual plans.

5. **Project Administration Team (PAT).** A PAT will be established in the Other Financial Institutions Department (OFISD) of the CBN and be funded by the CBN. The OFISD also is responsible for the regulation and supervision of PMBs, MFBs, and NMRC and therefore is the optimal location for the PAT. The PAT will be led by a project director and a deputy director. The project director will work closely with the SSC. Other members of the PAT will include a procurement specialist, project accountant, M&E specialist, and sustainability specialist. The PAT will be supported on a needs basis by a procurement specialist of CBN's procurement department and a financial management specialist of CBN's financial management unit. The PAT will be fully embedded in the CBN; therefore, contracts, and reports will be approved by the governance structure of the CBN. The PAT and the secretariat will be the main contacts with the World Bank project team. The PAT in close collaboration with the Secretariat will develop a full operational plan before the project becomes effective.

The primary responsibilities of the Project Administration Team are to:

- Provide overall project management of the project.

- Collect data together with OFISD and CBN's statistical department of NMRC's operations and assess their impact.
- Supervise NMRC's compliance with the Environmental and Social Risk Management Operations Manual (ESOM).
- Procure consultants for a market analysis and TA for the MFBs.
- Consolidate reports to the World Bank, including quarterly financial reports and half-yearly and annual implementation progress reports aligned to agreed project indicators and synchronized with half-yearly Bank review missions.
- Contract and coordinate with a consulting firm to conduct the annual technical audits.

The main implementation modalities, and the institutional arrangements to support them, will be detailed in the POM.

The NMRC is organized as follows:

Shareholders

6. **The NMRC is majority owned by private sector institution, and is registered as a publicly listed company owned by Deposit Money Banks, Primary Mortgage Banks, International Financial Institutions and a 20 percent share owned by the Ministry of Finance.** The NMRC falls under the supervisory authority of the Securities Exchange Commission (SEC) and the Central Bank of Nigeria. NMRC will provide liquidity only to those mortgage lenders that also are shareholders in NMRC. Because the NMRC is a private sector company with a public mission, the shareholding structure is intended to reflect the public-private partnership. The NMRC should be: (a) majority privately owned; and (b) any public stake limited. The proposed shareholder mix will comprise the Ministry of Finance Incorporated (MOFI) and 3 groups of investors, namely: (a) Banks and PMBs; (b) International Finance Institutions such as the IFC, Shelter Afrique, ADB, (FMO), and KFW; and (c) Private Investors such as Pension Funds, Investment Funds, Private Equity, and Insurance Companies. The FMoF will hold up to 20 percent preference shares, valued at 1.2 billion Naira (US$7.6 million). The remaining shareholders will hold up to 90 percent ordinary shares, valued at 4.6 billion Naira (US$29 million).

7. The shareholdings of MOFI and Sovereign Wealth Fund will be diluted gradually over time as other private shareholders participate in the equity. Government support is envisaged as a temporary measure to facilitate the establishment of NMRC.

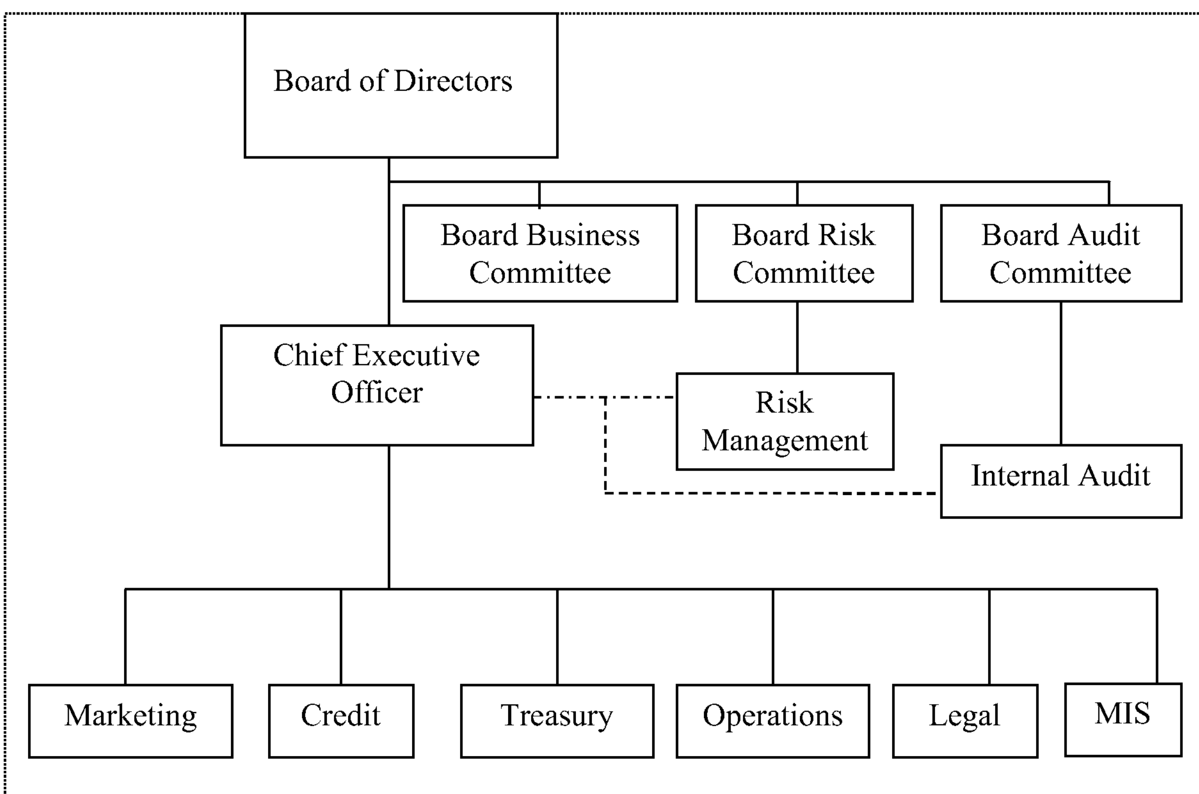
Board

8. **There could be 7–10 members of the Board of Directors who are the Chief Executive Officers (CEOs) of the participating financial institutions.** The Board will be responsible for the formulation of policies and strategies of the Company.

9. **More detailed and technical issues will be handled by Board Committees, which would receive delegated authority to decide on certain issues and to recommend the more important issues to the Board for approval.** The following Board Committees and organization structure are suggested:

a. Board Audit Committee – Reviews the audit of the Company's operations as well as the effectiveness of the financial and internal controls. The Internal Auditor and External Auditors will report directly to the Board Audit Committee.
b. Board Business Committee – Responsible for overseeing the business operations of the Company, both the refinancing and the funding.
c. Board Risk Management Committee (BRC). Overall responsibility to ensure there is proper oversight of risks of the Company. The Board sets the risk appetite and tolerance level that are consistent with the Company's overall business objectives and risk principles. The BRC assists the Board by ensuring that there are effective oversight and development of strategies, policies, and procedures to manage risks.
d. Organizational Structure.

Figure A3.2 NMRC Organizational Chart



10. **The Chief Executive Officer (CEO) should have an entrepreneurial flair with good knowledge of risk management and the bond market**. Knowledge in housing finance will be a critical advantage. The CEO preferably should be an experienced banker/investment banker who is well respected within the banking community and by all the authorities.

Charter

11. **The NMRC will be a licensed non-deposit-taking institution authorized by the CBN to conduct its business, and by the Securities and Exchange Commission (SEC) to issue bonds.** The Charter of NMRC reflects its unique role in being a single-purpose vehicle. The charter restricts the Company from undertaking any other activities (such as taking deposits, commercial loan refinancing, or lending directly) apart from the ones for which the Company is established. The restrictive charter is to ensure that the Company focuses on supporting the growth of the mortgage market and the bond market by limiting its activities to the refinancing and prefinancing of mortgage loans and the issuance of bonds in support of these activities. IDA's Financing Agreement will include a negative covenant/remedy that the NMRC Charter will not be amended without IDA's prior written approval.

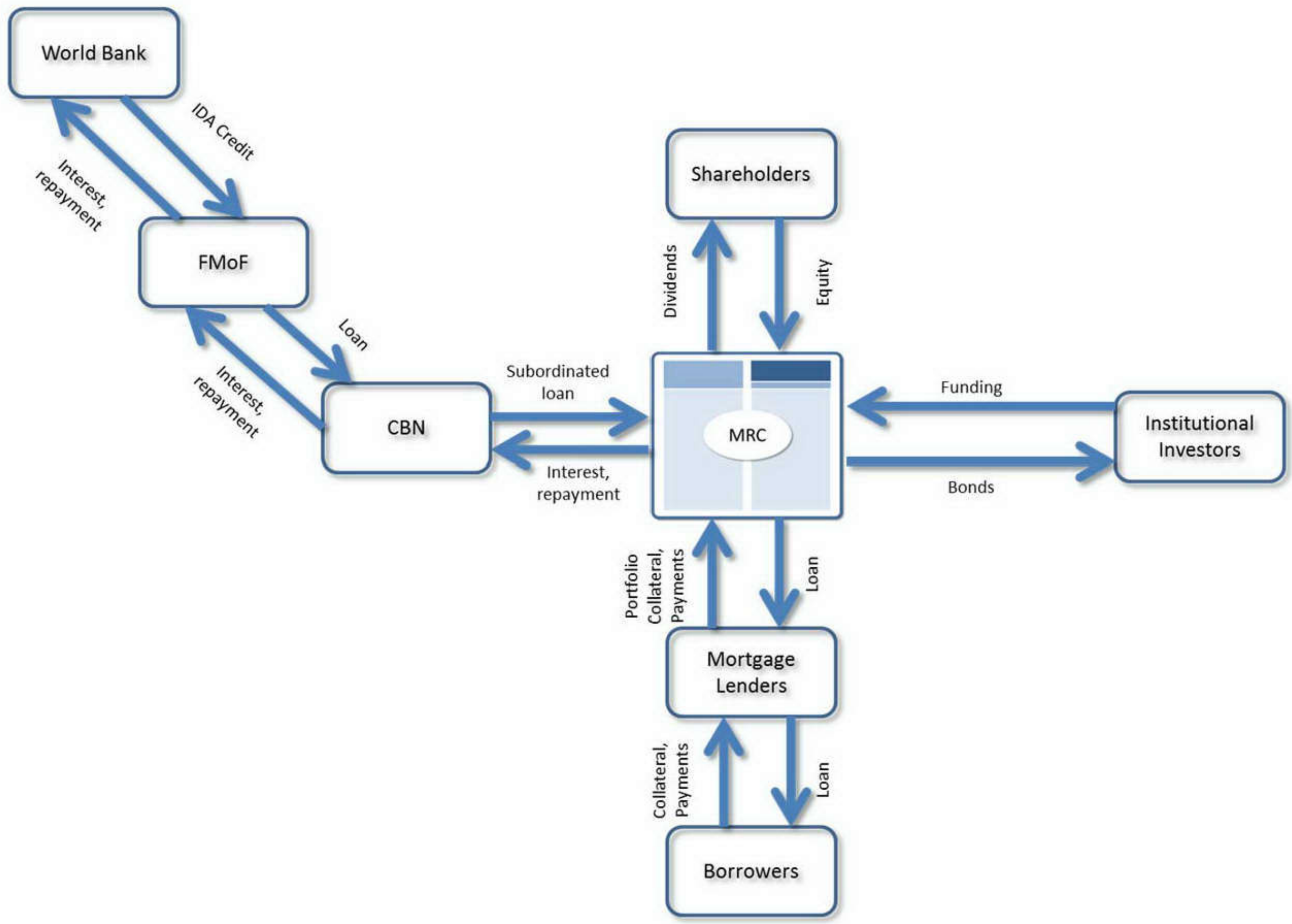
Regulation

12. **The main regulator for NMRC is the CBN**. NMRC will be licensed as a non-depository financial institution with clear limitations on its scope of business limiting it to its core activity of refinancing mortgages. As NMRC seeks to fund itself in the bond market, it also will have to be licensed and regulated by the SEC as a bond issuer.

Flow of Funds

13. IDA funds will flow from the World Bank to the Ministry of Finance, then through to the CBN, which will assume the currency risk and pass on the IDA funds to NMRC in Naira (figure A3.3). Funds then are provided through to NMRC in the form of Tier 2 Capital which, together with equity from shareholders, will help give it the financial strength to raise bond financing and fund loans to mortgage lenders. The lenders then will provide the long-term funds to then be passed on to the mortgage borrowers. There are limitations in the loan agreement and in the subordinated loan agreement on the use of IDA funds. In the eventuality of NMRC model not delivering, both the regulator and the WB supervision team would intervene. If NMRC still failed to deliver, the institutions would be wound down, with IDA being repaid in line with the creditor agreements for different investors. Any reflows arising from the repayment of funds ahead of the IDA schedule would be at the disposal of the FMoF for recycling under the project or as a contribution to the general budget.

Figure A3.3 Flow of Funds



Financial Management and Disbursements

Financial Management

14. **A financial management assessment of the implementing entity in line with the Financial Management Manual (March 1, 2010) and the AFTFM Financial Management Assessment and Risk Rating Principles (October 2010) was conducted in February 2013.** The objective was to determine whether the implementing entity has acceptable financial management arrangements, which will ensure (a) that all financial transactions and balances relating to the project activities are correctly and completely recorded; (b) the preparation of regular, timely, and reliable financial reports/statements; (c) safeguard of the entity's assets; and (d) existence of auditing arrangements acceptable to the Bank.

15. **The entity responsible for project implementation is assessed to have acceptable FM systems,** robust risk-based internal audit functions in place, acceptable qualified staff, and satisfactory auditing arrangement to support this project.

16. **The Bank has extensive knowledge of the country's public financial management (PFM) system.** A review of implementation of the recommendations of the Country Financial Accountability Assessment (CFAA 2000) was carried out in January 2005. The Public Expenditure Management and Financial Accountability Review (PEMFAR) was done in 2006. More recently, a Public Expenditure and Financial Accountability (PEFA) was done, and the report is being discussed with government for finalization. These reviews indicate that the FGN has made significant efforts to advance reform of the PFM system since 2003. However, the system remains weak. PFM initiatives and reforms are included in the Government's Poverty Reduction Strategy Paper (*PRSP):* National Economic Empowerment Development Strategy *(NEEDS)*, and elaborated in the *7-Point Agenda*. The latter sets out policy priorities to further strengthen the reforms and support economic growth, ensuring that the impact of the reforms is felt widely. If all ongoing reforms are implemented successfully, it is envisaged that Nigeria's PFM systems will improve significantly.

17. **Some achievements so far include:** (a) adopting an oil-based fiscal rule that has greatly improved the quality of macroeconomic management; (b) launching significant steps to increase budget transparency;, (c) ensuring more efficient cash management with the introduction of the Treasury Single Account (TSA);, (d) undertaking procurement reforms; (e) updating PFM legislative framework; (f) reallocating budget resources in support of Millennium Development Goal (MDG)-related government functions;, (g) strengthening M&E; and (h) introducing a more strategic longer term budget management focus. Continuing challenges include overcoming weaknesses in audit efficiency and budget monitoring. The Bank has supported the government's PFM initiatives through Bank-assisted projects including Economic Management Capacity Building, State Governance and Capacity Building, and the Economic Reforms and Governance.

Risk Information Summary

18. **Based on the overall country PFM knowledge and assessment of the FM systems of the implementing entity, the control risk elements identified for the project and the mitigation measures have been summarized in table A3.1.**

Table A3.1 Control Risk Elements

No.	Risk	Preliminary Risk Rating	Risk-Mitigating Measures	Residual Risk Rating
1	**Budgeting** – Delays in timely preparation of a comprehensive budget and effective monitoring of same.	Moderate	CBN Budget Committee to be made responsible for project budget. Obtain Committee's agreement on time to ensure project budgeting is synchronized with CBN's own budget preparatory timeline, using work plan as point of reference. Budget execution to be monitored through quarterly interim financial reports (IFRs).	Low
2	**Accounting** – Delays in providing, and failure to account for, timely project funds and in providing full documentation to support same.	Substantial	Adequate capacity building regarding Bank requirements re: fund usage and retirement, as documented under accounting and internal control procedures in Financial Procedures Manual (FPM).	Moderate
3	**Financial Reporting** – Delays in preparing timely Interim	Moderate	Project reporting guidelines and timelines included in FPM. Simple IFR reporting format shared with FD of	Low

No.	Risk	Preliminary Risk Rating	Risk-Mitigating Measures	Residual Risk Rating
	Financial Report in an acceptable format and in timely submission of required reports to Bank.		CBN. CBN chart of accounts to be modified to ensure that its system is capable of producing required report by effectiveness.	
4	**Internal Control/Internal Audit** – CBN internal control policies not being fully applied to project operations.	Moderate	Agreement has been reached with CBN Director of Internal Audit Department (IAD) to include project in its program and ensure project is covered as part of IAD's work program. IAD also uses risk-based approach to its audit work, consistent with new WB approach. Where needed, Bank will dialogue with IAD to address emerging issues to strengthen its oversight.	Low
5	**External Audit** - Failure to prepare timely Audited Financial Statement in an acceptable format	Substantial	Required FM actions include ensuring that TOR for auditors is ready by negotiation and selection concluded 60 days after effectiveness. Timely appointment of an external auditor following Bank guidelines.	Moderate
6	**Funds Flow** – Delayed funds flow to MFBs.	Substantial	Qualified and competent Finance Officer dedicated to project activities with disbursement trainings to augment officer's knowledge. MFBs to open project accounts in CBN to facilitate transactions. Specific criteria and streamlined procedures have been outlined for disbursement to NMRC and for each component.	Moderate
	Sub-overall Control Risk	Substantial		Moderate
	Overall FM Risk Rating	Moderate		

19. **Strengths.** The CBN has a robust fiduciary management system in place with competent staff. It has adequate capacity in its Finance, Internal Audit and Procurement Departments, to support the operation of the PAT in the effective management of this project. Consequently, the CBN's internal control systems would be used to manage the project funds. The Internal Audit Department (IAD) prepares annual work programs and is effectively using the risk-based approach in discharging its functions. The IAD is committed to including this project in its annual audit program once effective. In addition, the CBN has procedures in place to effect payments to Microfinance bank*s* (MFBs) and other service providers in both local and foreign currencies should the need arise. Finally, for effective accounting purposes, CBN's chart of account is designed facilitate addition of special projects.

20. **Weaknesses.** Of note is the fact that the CBN has not had previous experience in directly implementing a Bank-assisted project. However, this lack is compensated by CBN's robust fiduciary system and IDA's strategy of implementation support and effective capacity building.

21. **Implementing Entity.** The Credit will be managed by a PAT within the CBN. Within CBN, the Other Financial Institutions Supervision Department (OFISD) will be the coordinating department that hosts the PAT. The project activities will be supported by the fiduciary service providers within the CBN, namely the (a) Procurement Support Services Department (PSSD), (b) Finance Department, and (c) Internal Audit Department.

22. **A finance officer, who would serve as the Project Accountant, would be assigned by the Finance Department of CBN to support the Project Manager within the PAT.** The activities of these supporting departments would be facilitated by the existing service level agreement presently operational within the CBN. To ensure that the project is implemented smoothly, the World Bank will provide capacity building support to the PAT on the financial management and disbursement procedures applicable to Bank-financed projects.

23. **Planning and Budgeting.** Budget preparation will follow the CBN budgeting procedures. During this period, the project management team will prepare the project-specific budget based on the agreed work program, to be reviewed by the CBN's Budget Committee for internal approval. The budget will be submitted to the TTL at least two months before the beginning of the client's fiscal year. Detailed procedures for planning and budgeting will be documented in the FM section of the PIM.

24. **Accounting.** IDA funds will be accounted for by the Project on a cash basis. These transactions will be augmented with appropriate records and procedures to safeguard assets and track commitments. The accounting records will be maintained in dual currencies (Naira and US$). A computerized accounting system will use the Oracle flexible accounting software being used for similar projects in the CBN.

25. **The chart of accounts** will be modified and be used to facilitate the preparation of relevant monthly, quarterly, and annual financial statements, including, but not limited to, the following information:

- Total project expenditures
- Total expenditure on each project component/activity
- Analysis of total expenditures for all categories, such as trainings and consultancies, for

  Component 1: Mortgage Refinance Company
  Component 2: Mortgage Guarantee Product
  Component 3: Housing Microfinance
  Component 4: Technical Assistance and Capacity Building.

26. All accounting and control procedures are documented in the FPM, updated regularly by the Project Accountant, approved by the Project Management Team, and shared with IDA and the Government.

27. **Financial Reporting.** The project will be required to submit quarterly unaudited interim financial reports (IFRs) on the project activities. The IFRs will be required to reach the World Bank not later than 45 days after the end of the quarter to which they relate. The formats of IFRs were developed at appraisal and agreed at negotiation stage. The quarterly financial reports will consist of (a) sources and uses of funds, which will provide information on all planned and actual IDA resources and any other funds received for the period and cumulative to date; (b) uses of funds by project components and activities, also showing the planned and actual amounts with narrative explanations of any significant variances; and (c) support documents such as bank reconciliation statements and copies of bank statements.

28. **Internal Control and Internal Audit.** Adequate internal controls are in place at CBN to support the project. The finance directorate of the CBN will apply its internal approval procedures to the project. Internal service standards exist that specify how long each unit should take to review and approve activities for payment processing. The CBN applies these same processes to other ongoing projects in which these processes have been found acceptable and project implementation has not suffered. The arrangements enable effective segregation of functions and timely processing of payment for project implementation. CBN has an effective internal audit directorate, which uses the risk-based approach for its work. The project will be covered as part of the CBN's program, and copies of its report on the project, including any required actions and management responses, will be shared with the Bank.

External Audit. The CBN will be responsible for ensuring that an audit of the project is carried out at the end of each fiscal year during the life of the project. The audit will conform with the World Bank's audit requirements and accord with internationally recognized auditing standards. The auditor will express an opinion on the Financial Statements that are in compliance with International Standards on Auditing (ISA). The external auditors also will prepare a Management Letter giving observations and comments, and providing recommendations for improvements in accounting records, systems, controls, and compliance with financial covenants in the Development Financing Agreement. The CBN will ensure that the audited project annual financial statements together with auditors' management letter on the project will be submitted to the Bank within six months after the end of the financial year.

Disbursements and Flow of Funds

29. Proceeds of the financing will follow the standard Bank procedure for investment lending: for use by the Borrower for eligible expenditures as defined in the project financing agreement.

30. Issues of inadequate documentation for incurred expenditures and poor quality IFRs have been flagged in the FM and external audit reports of some ongoing projects in Nigeria's Federal Project Financial Management Division (FPFMD) and Project Financial Management Units (PFMUs). Therefore, since this is the first Bank-financed project to be managed by the CBN, the project will use the transaction-based disbursement procedures under the project. Details of the disbursement arrangement will be in the Disbursement Letter.

31. Disbursement arrangements have been designed in consultation with the Borrower taking cognizance of assessments of the Borrower's Financial Management and Procurement arrangements, the Procurement Plan, cash flow needs of the operation, and prior disbursement experience with respect to IDA. Additional instructions for disbursement are contained in the Disbursement Letter for the project. IDA will disburse the credit through a US$-denominated designated account, which will be managed by CBN. Given the different requirements of the components, the following paragraphs detail some of the requirements for each component and how funds will flow to support these activities.

Flow of Funds

32. The disbursement under the Technical Assistance category/component will follow the normal transaction-based disbursement. To facilitate this procedure, the project will open a Designated Account (DA) in US$ at the CBN into which proceeds from IDA will be paid. The proceeds will be used by the project to make payments for eligible expenditures. The project will be required to submit withdrawal applications on monthly basis to replenish the DA. There are limitations on the use of IDA funds in the loan agreement and the subordinated loan agreement. In the eventuality of NMRC model not delivering, both the regulator and the WB supervision team would intervene. If NMRC still failed to deliver, the institutions would be wound down, with IDA being repaid in line with creditor agreements for different investors. Any reflows arising from the repayment of funds ahead of the IDA schedule would be at the disposal of the FMoF for recycling under the project or as a contribution to the general budget.

33. The disbursement to NMRC will be in 6 tranches (US$20 million, US$100 million, US$70 million, US$20 million, US$20 million, and US$20 million) and will follow unique and different steps as per agreed requirements. When NMRC is fully set up and operational in line with the technical requirements, including fulfillment of its legal license and other obligations to operate, and as confirmed by IDA, IDA will disburse the initial sum of US$20 million to it. An additional US$100 million will be approved for payment to NMRC when the Bank's mission has been able to confirm that performance indicators specified under the first supervision mission have been met. These indicators include that NMRC has set up adequate systems and controls; and set up its credit policy, its asset and liability management policies, and its financial management and operations policies. In respect of the payments to NMRC, the foreign currency payment will be made directly to the CBN, which will pay NMRC the Naira equivalent. Subsequent disbursements will be based on meeting specified performance indicators (annex 5), under the implementation support plan of the PAD and summarized as follows:

a. NMRC will be required to use the funds received to invest in government bonds and securities. It also will be required to meet a certain volume of transactions.
b. On submission of evidence that the funds have been duly invested and that NMRC has met the relevant performance indicators required, NMRC will be entitled to receive the third tranche of US$70 million.
c. The fourth, fifth, and sixth tranches of US$20 million each also will be paid when specific performance indicators have been met, as set out in implementation support plan. A disbursement condition therefore will apply to this component category.

Table A3.2 Disbursement-Linked Indicators

Tranche	Maximum Amount Allocated (US$ equivalent)	Disbursement Linked Indicators
I	**20,000,000**	Compliance with Conditions of Effectiveness under Section 5.01 of the Financing Agreement
II	**100,000,000**	Evidence that NMRC has carried out due diligence[20] for refinance or prefinancing transactions of mortgage loans of Participating Mortgage Lenders
III	**70,000,000**	Evidence that since Tranche II disbursement, NMRC has (a) issued new bonds to fund the refinance or prefinancing of eligible mortgages with a minimum volume of bonds outstanding equivalent to US$120 million and (b) new refinancing or prefinancing of eligible mortgage loans at a minimum volume of US$120 million equivalent
IV	**20,000,000**	Evidence that since Tranche III disbursement, NMRC has (a) issued new bonds to fund the refinance or prefinancing of eligible mortgages with a minimum volume of bonds outstanding equivalent to US$100 million and (b) new refinancing or prefinancing of eligible mortgage loans at a minimum volume of US$100 million equivalent
V	**20,000,000**	Evidence that since Tranche IV disbursement, NMRC has (a) issued new bonds to fund the refinance or prefinancing of eligible mortgages with a minimum volume of bonds outstanding equivalent to US$50 million and (b) new refinancing or prefinancing of eligible mortgage loans at a minimum volume of US$50 million equivalent
VI	**20,000,000**	Evidence that since Tranche V disbursement, NMRC has (a) issued new bonds to fund the refinance or prefinancing of eligible mortgages with a minimum volume of bonds outstanding equivalent to US$50 million and (b) new refinancing or prefinancing of eligible mortgage loans at a minimum volume of US$50 million equivalent

34. The **Mortgage Guarantee component** will support the development of a guarantee product to bear some credit risk for lower income borrowers. The guarantee will be made on the basis of partial mortgage payments for losses incurred by lenders in this regard. Prior to receiving any payment, the lender will be required to meet set criteria as specified in the guarantee product developed and deemed acceptable to IDA.

35. The project will finance the TA required to design the guarantee product, the development of the detailed operation manual, the bidding criteria, and the consultations events;

[20] Due diligence means a pre-selection of an eligible pool of mortgages from PMLs to be pre-financed or refinanced by the NMRC in accordance with the criteria set out in the *Regulatory and Supervisory Framework for the Operations of a Mortgage Refinance Company* and the provisions of a master refinance and servicing agreement (or such other applicable agreement satisfactory to the Association) to be entered into between PMLs and the NMRC – See Financing Agreement.

and will support the implementation and monitoring. The financing for TA is allocated under Component 4 of this project. Furthermore, the project will make available a line of credit to cover the issuances of guarantees. The guarantee line of credit allocation will be made available upon the signing of the agreement with the service provider. The selected service provider will issue a quarterly report with the list of issued guarantees and the guarantee terms, including social income data and GPS location of the mortgagor.

36. Under the **Housing Microfinance component**, the project expects to make lines of credit available to HMF institutions first to pilot on a small scale, and then to roll out, tested housing microfinance products. For this line of credit to be eligible, this component will first have to complete the development and testing of the required product. Testing will be done with support from the TA component. The MFBs that qualify will be eligible to receive the line of credit. Where MFBs may have successfully piloted the HMF products prior to project engagements, as evaluated under the project, they may be allowed to access the line of credit in phase 3 directly. The project will provide a line of credit to qualifying MFBs and/or the wholesale institutions. The disbursements will be based on the MFBs' withdrawal applications, which will include the details (loan purpose, amount, maturity, client) about their HMF portfolios. In the case of a wholesaler, the funds from the line of credit would be available periodically against a wholesale demand schedule, and upon the PAT and the WB review of the appraisal of the client MFBs.

37. **Disbursement Categories**

Table A3.3 sets out the expenditure components/categories and percentages to be financed from the credit proceeds.

Table A3.3. Allocation of Credit Proceeds to be financed by Component.

Financial Management Action Plan

Components	Amount of Credit Allocated (US$ million)	Expenditures to be Financed (Inclusive of Taxes) (%)
Expanding the Mortgage Market - NMRC	250	100
Mortgage Guarantee Facility	25	100
Housing Microfinance	15	100
Technical Assistance	10	100
TOTAL AMOUNT	300	100

38. Actions to be taken for the project to further strengthen its financial management system are listed in table A3.4.

Table A3.4. Financial Management Action Plan

No.	Action	Date due	Responsible
1	Agreement of format of Interim Financial Report (IFR), Annual Financial Statement, and External Auditors Terms of Reference	Agreed at negotiations	OFISD/FD/IDA
2	Design FM procedures and Disbursement instructions	Agreed at negotiations	OFISD/FD
3	Appoint external auditor	Within 90 days after effectiveness	OFISD/PSSD/FD
4	Update computerized accounting systems to incorporate project activities	Within 60 days after effectiveness	OFISD/FD of (CBN)
5	Designate focal person as scheduled accounting officer for project	At negotiations	OFISD/FD
6	Open a Designated Dollar Account and a Draw- Down Account in Naira; advise IDA of the Authorized Signatories through the Federal Ministry of Finance	After effectiveness	OFISD/FD

Financial Management Implementation Support Plan

39. **FM supervision will be consistent with a risk-based approach, and will involve collaboration with the Bank's project team, loan department and procurement**. The supervision intensity is based initially on the assessed FM risk rating and subsequently on the updated FM risk rating during implementation. Given the Substantial residual risk rating, on-site supervision will be carried out at least twice a year. On-site review will cover all aspects of FM, including internal control systems, overall fiduciary control environment, tracing transactions from the bidding process to disbursements, and statement of expenditure (SOE) review. Additional supervision activities will include desk review of semester IFRs, quarterly internal audit reports, audited Annual Financial Statements and management letters, timely follow-up of issues that arise, and updating the FM rating in the Implementation Status Report (ISR) and the Portfolio and Risk Management (PRIMA) system. Additional target reviews may be conducted depending on emerging risks. The Bank's project team will support in monitoring the timely implementation of the action plan.

Conclusion

40. The Financial Management Assessment conclusion is that, subject to the mitigation measures and the action plan being implemented per the agreed timeframe, the project has met the minimum FM requirement in accordance with OP/BP 10.00. Furthermore, this objective will be sustained by ensuring that strong and robust financial management arrangements are maintained for the project throughout its duration. Detailed financial management reviews also will be carried out regularly, either within the regular proposed supervision plan, or on a more frequent schedule if needed, to ensure that expenditures incurred by the project remain eligible.

Procurement

General

41. **Country Environment: Nigeria has been implementing a procurement reform program based on the recommendations of the 2000 Country Procurement Assessment Review (CPAR).** A review of the progress made on the 2000 CPAR recommendations as reflected in 2007 PEMFAR shows that implementation of the procurement reform program has brought about substantial improvements in obtaining value for money in the public sector expenditure. The reform has introduced some level of transparency into the country's procurement process, which has led to substantial reduction of contract prices. The Public Procurement Act was promulgated in Nigeria in June 2007 to further sanitize the public procurement system, which often has been the subject of abuse and corruption. The regulatory agency, the Bureau of Public Procurement (BPP), was established, and the procurement professionals' cadre was created at the federal level in 2006. These measures have significantly improved the procurement system in the public service and enhanced transparency. The Act adheres to the principles of the United Nations Commission on International Trade Law (UNCITRAL) model law. The Act outlines the principles of open competition, transparent procurement procedures, clear evaluation criteria, award of contract to the lowest evaluated tender, and contract signature. The legal framework is applicable to all procurement categories (suppliers, contractors, consultants) and must be applied to all public funds regardless of value. The Act has provisions for exceptions to competitive tendering. Government has already prepared relevant implementation Regulations, Standard Bidding Documents (SBD), and Manuals for the Procurement of Goods, Works and Consulting Services, which describe the minimum contents of the tender and proposal documents. The essential elements are in line with internationally acceptable procurement standards. The Procurement Act provides for a complaints and appeals mechanism to be established to enhance accountability. The Bank, with the support of DFID, is conducting a value chain analysis of government procurement activities to identify bottlenecks in implementation and disbursement of allocated resources to procurement activities.

42. **Procurement Risk at Country Level.** With the substantial progress in procurement reforms described, procurement risk such as capacity, fraud and corruption are being addressed. The BPP has organized series of trainings and awareness workshops to build the capacity of the professional cadre and the capacity of bidders respectively. Currently, the Governance Reform Program is being supported by an IDA Credit- Economic Reform and Governance Project (ERGP) with a substantial component focusing on procurement reforms. There have also been three IDF Grants, to assist federal address the weak procurement capacity in the public sector and to build appropriate partnership with the private sector. These vehicles have been used by the government to prepare the relevant procurement tools mentioned above.

43. **Procurement Risk at Project Level.** Although the Central Bank of Nigeria (CBN) is a government agency, there is no annual budgetary provision for it by the federal government. CBN's procurement also is not subjected to the oversight of the Bureau of Public Procurement (BPP) even though CBN claimed its procurement is based on the Federal Public Procurement Act. CBN's procurement activities have different approval thresholds; the highest approval level

is by the Board of Directors. The procurement of goods is mostly based on direct procurement from the manufacturers or major distributors of the items.

44. **Other than the yearly budget, procurement plans for contracts are not prepared by CBN.** However, under the project, a procurement plan for the few activities shall be prepared using the Bank's template and approved by the Bank for implementation. The procurement activities will include TA consultancies. Therefore, the Bank's procurement policies and procedures shall be used, while allowing the use of the national bidding documents for National Competitive Bidding (NCB) when the need arises.

45. **Procurement Arrangements.** As stated earlier, procurement activities upstream in the project are few because most of the funds shall be directed toward NMRC. Therefore, the few procurement activities shall be handled by PAT in the CBN. The CBN shall prepare the work plans and procurement plan, which will include all TAs. CBN will handle the bidding and supervision processes in an effective, efficient, and transparent manner to ensure value for money. Downstream – Component 1, at NMRC level; Clause 3.13 (Procurement in Loans to Financial Intermediaries) of the Guidelines on Procurement of Goods, Works and Non-Consulting Services, January 2011 edition, will apply.

Guidelines

46. Procurement under the proposed project will be carried out in accordance with the World Bank's "Guidelines: Procurement of Goods, Works, and Non Consulting Services under IBRD Loans and IDA Credits and Grants by World Bank Borrowers," dated January 2011; "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits and Grants by World Bank Borrowers," dated January 2011; Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants," dated October 15, 2006 and revised in January 2011; and the provisions stipulated in the Legal Agreements. The various items under different expenditure categories are described in general below. For each contract to be financed by the credit, the different procurement methods or consultant selection methods, estimated costs, prior review requirements, and time frame are agreed between the Recipient and the World Bank in the Procurement Plan. The Procurement Plan will be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

47. **Procurement of Goods and Non-consultancy Services.** Procurement of goods will be carried out using the National Standard Bidding Documents (SBD) agreed with the Bank for NCB and shopping. Procurement for readily available off-the-shelf goods that cannot be grouped, or standard-specification commodities for individual contracts of less than US$100,000 equivalent, may be procured under shopping procedures as detailed in paragraph 3.5 of the "Guidelines: Procurement under IBRD Loans and IDA Credits," dated January 2011; and the Guidance on Shopping Memorandum" issued by IDA on June 9, 2000.

48. **Selection of Consultants.** Consultancy services will be provided under the project and include the following categories: TA, financial audit, and M&E. These consultants shall be selected using Request for Expressions of Interest, short-list, and the National Standard Request

for Proposal. Short-lists of consultants for services estimated to cost less than US$200,000 equivalent per contract may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7– 2.8 of the Consultant Guidelines.

Procurement in Loans to Financial Intermediaries

49. The line of credit of US$275 million equivalent to be made available to CBN for on-lending to NMRC would be advanced to the mortgage lenders by NMRC. Therefore, the procurement of works, goods, and nonconsulting services will be undertaken by the respective beneficiaries in accordance with well-established private sector procurement methods or commercial practices that shall be acceptable to the Bank.

50. **Operating Costs**. The operating costs will include equipment, fuel, office supplies, bank charges, advertising expenses, travels, and per diems. Operating costs financed by the project will be procured using the implementing agency's administrative procedures that shall be acceptable to the bank.

Assessment of the Agency's Capacity to Implement Procurement

51. **Procurement risk assessment of CBN was conducted and reported under Section IV (Appraisal Summary).** The assessment reviewed the organizational structure for implementing the project and the roles of the key actors in project implementation. The key issues and risks concerning procurement in the implementation of the project and action plan to address them were discussed with the government. The corrective measures that will be put in place to address the issues and risks are reflected in tables A3.5 and A3.6.

52. **The CBN has assigned one of the staff of the Procurement Services Support Department (PSSD) as a Procurement Specialist for the project.** He has relevant qualification and experience working in different units of CBN but with no experience in World Bank procurement. Since the procurement activities at the PAT shall be small, he will be able to handle the process with initial training on Bank procurement. A short-term consultant may be hired to support the process of selecting the TAs when the need arises.

Table A3.5 Procurement Action Plan

	Action	Responsibility	Due Date	Remarks
1	Train procurement specialist	CBN		Continuous
2	Set up procurement tracking system	CBN	By effectiveness	
3	Establish procurement complaint online database and/or hotline	CBN	3 months after effectiveness	

Procurement Plan

53. **The 18-month procurement plan for project implementation provided the basis for the procurement methods during appraisal, which was finalized and agreed upon during**

negotiations. The plan also will be available in the project's database and in the Bank's external website. The Procurement Plan will be updated in agreement with the Project Team annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

Procurement Reviews and Thresholds

Table A3.6 Thresholds for Procurement Methods and Prior Review

Note: *These thresholds are for the purposes of the initial procurement plan. The thresholds will be revised periodically based on reassessment of risks.

N/O	Expenditure Category	Contract Value Threshold* (US$)	Procurement Method	Contracts Subject to Prior Review (US$)
1	Works	C>=5,000,000	ICB	All contracts
		5,000,000 <C < 5,000,000	NCB	Specified contracts as will be indicated in the Procurement Plans
		C<100,000	Shopping	First contract only
		All values	Direct Contracting	All contracts
2	Goods, and Services (other than Non-Consulting Services	C>=750,000	ICB	All contracts
		100,000= <C < 750,000 C=<750,000	NCB	Specified contracts as will be indicated in the Procurement Plans
		C<100,000	Shopping	First contract only
		All values	Direct Contracting	All contracts
3	Consulting Services	C>= 300,000 firms	Quality- and Cost-Based Selection (QCBS) (International)	All contracts. For TAs that may require the engagement of a firm
		200,000 =<C<300,000 firms	QCBS (National)	All contracts (For TAs that may require the engagement of a firm)
		C<200,000	Consultants' Qualifications (CQS)	Only TORs
		C>=100,000 individuals	Individual consultant (IC)	All contracts
		C < 50,000 individuals	IC	TOR
		All values	Single Source Selection	All contracts

Frequency of Procurement Supervision

54. **In addition to the prior review supervision to be carried out from Bank offices, the capacity assessment of the Implementing Agency has recommended at least one supervision mission a year to carry out post-review of procurement actions.** The Procurement Plan shall set forth those contracts which shall be subject to the Association's Prior Review. All other contracts shall be subject to Post Review by the Association. The procurement post-reviews should cover at least 10 percent of contracts subject to post-review.

Table A3.7 Details of the Procurement Arrangements Involving International Competition

Ref no.	Description of TA	Selection Method	Review by Bank. (Prior/post)	Expected Proposals Submission Date
	Guarantee Product Development	QCBS	Prior	3 months after effectiveness
	HMF TA	QCBS	Prior	3 months after effectiveness
	NMRC TA	QCBS	Prior	3 months after effectiveness

Note: These are key procurement contracts under the project.

Publication of Results and Debriefing

55. On-line (DG Market, UN Development Business, and/or Client Connection) publication of contract awards will be required for all, NCB, Direct Contracting, and the Selection of Consultants for contracts that exceed a value of US$200,000. With regard to large value consulting contracts, the Recipient will be required to ensure publication of contract awards as soon as IDA has issued its "no objection" notice to the recommended award. With regard to Direct Contracting and NCB, publication of contract awards can be in aggregate form on a quarterly basis and in local newspapers.

Environmental and Social (Including Safeguards)

56. **A number of proactive considerations are being planned to ensure improved sustainability across the program activities.** They include the creation of an Environmental and Social Risk Management Operations Manual (ESOM): a review of land administration and land tenure issues and approaches to improve green building incentives across the housing industry.

Environmental and Social Risk Management Operations Manual

57. **One of the prerequisites of the WBG support for the project is that the financial institutions integrate into their lending operations the requirements of environmentally and socially sound and sustainable development as identified in laws and regulations of FGN and the sustainability policies and frameworks of the participating WBG entities.** Accordingly, the CBN and/or the FMoF will produce the ESOM for the participating financial institutions (PFIs) to use as guidance in screening loan applications for environmental and social risks and to ensure that appropriate risk management measures have been identified for implementation by the loan applicant.

58. **The ESOM, along with an Environmental and Social Management System (ESMS) that will establish by each PFI, meets the WBG requirement that a financial intermediary has established an appropriate ESMS.** The WBG shall review the ESOM from the CBN and Ministry of Finance as well as each FI's ESMS. In reviewing the adequacy of the ESOM and each FI's ESMS, the WBG shall determine whether the FI's ESMS is appropriate to the FI's risk profile. Upon determination that the ESOM from the CBN and each FI ESMS is appropriate to the risk profile of the FI's portfolio, the Bank approves the ESOM and each ESMS in a written memorandum.

59. **It is anticipated that the majority of transactions covered by NMRC, the mortgage guarantee product, and HMF will be in services or investments that will have few or no associated environmental or social risks.** However, it is recognized that there may be some business activities in which the environmental and social risks and impacts are moderate and require commensurate assessment and management. Examples include land acquisition, labor and working standards, inappropriate disposal of wastes, or unhealthy or hazardous working conditions.

60. **In agreeing to participate, each PFI effectively accepts responsibility to the PAT and the WBG for mandatory screening, assessment, and management of the environmental and social risks and impacts of proposed transactions it takes in a manner consistent with WBG Performance Standards.** To effectively adapt the principals of the ESOM as guidance to staff for managing environmental and social risk, each financial institution will develop an internal ESMS. The ESMS should describe key features such as social and environment policies and procedures; current organizational structure and staffing for managing environmental and social risk; skills and competencies in social and environmental areas; training the awareness of the institution's investment, legal, and credit officers on the organization's ESMS; reporting systems to managers; and performance monitoring procedures.

Land Administration and Tenure

61. **An overview of the policy, legal, and institutional framework was completed.** The principal legislation in relation to the ownership of land in Nigeria is the Land Use Act (the Act). By virtue of section 315 (1) d of the Constitution, the Act was incorporated in the Constitution; hence the difficulty that has attended the propositions for its amendment. The Act converts the old forms of estate into right of occupancy by vesting all lands within the state in the Governor of each State, to be held in trust and administered for the use and common benefit of all Nigerians in accordance with the provisions of the Act.

62. **Perhaps the most debated provision of the Act is the restriction placed on holders of rights of occupancy from transferring such rights or any part of them (by assignment, mortgage, transfer of possession, sublease, or any other way) without the consent of the Governor or Local Government.** Failure to do to obtain this consent would render the transaction null and void. The Act also empowers the Governor to revoke rights of occupancy issued under the Act for "overriding public purposes." Such a situation would entitle the holder of the right of occupancy and the occupier of the premises to compensation for the value of the

property at the date of revocation. It is interesting to note that the Act precludes the Courts from interfering in the adequacy or otherwise of the compensation paid under the Act.

63. **Available Land Ownership Rights.** The enactment of the Land Use Act created limitations on the rights that otherwise had been available to Nigerians for ownership and use of land. The available rights are:

- Statutory Right of Occupancy granted by the Governor
- Customary Right of Occupancy granted by the local government
- Deemed grant of Statutory Right of Occupancy
- Deemed grant of Customary Right of Occupancy.

64. **More important, efforts can begin immediately to improve procedures by which the Act is implemented; these procedures can make a substantial difference in the growth of the mortgage market.** Provisions in the current Act enable states to overcome some of the most vexing problems embedded in the Act, so long as governors and state courts are willing to do so. In recent years, Lagos State has adopted and implemented a series of reform-oriented administrative and judicial procedures that demonstrate how progress can be made even within the framework of the Land Use Act in its current form. Using Lagos State as a model for mortgage legal reform is discussed in detail in Section III of this report.[21] Despite the potential risks, the PAT and PSC will work closely with the sponsors and state/local governments to ensure that the project complies with applicable Bank policies.

Building Green Options in the Nigerian Housing Sector

65. **Both the World Bank and IFC have promoted Green Growth across their operations over the past several years.** Several housing and construction initiatives in Nigeria have begun to explore the opportunities and costs associated with green building in the housing sector. This project will create a window to explore these options as well as create a mix of incentives to encourage scaling up these activities. Green approaches to housing construction are being developed through the Growth and Employment in States (GEMS) operation funded by DFID, and any lessons learned will be applicable to this project.

66. **Overall, the project will be structuring incentives to promote not only affordable housing but also how to make such program and projects "greener."** This work also needs to create a logical and practical platform for looking at the various themes for energy efficiency, water conservation, waste minimization, and the concepts of using environmentally friendly construction techniques. This discussion needs to be grounded in the context of the Nigerian urban housing market.

[21] For detailed information on the legal environment, refer to Carol Rabenhorst and Olubukola Thomas, "The Legal Framework for Housing Finance in Nigeria: Current Constraints and Proposed Reforms."

Role of Partners

67. **The housing finance project will draw substantially on the support of 2 DFID projects and 1 GIZ project in the area of lands and construction.** Broad principles of cooperation have been agreed, and specific work-streams in support of the Housing Finance project will be developed. The projects and their contributions to the Housing Finance project are summarized below.

68. The DFID and GIZ interventions in the construction sector will contribute to the outcomes of the Housing Finance project in five ways:

a. Lower cost of housing.
b. Better quality housing construction.
c. Improved transparency of housing market.
d. Increased employment of Nigerian artisans in construction.
e. Improved regulatory systems for housing: permits, standards, building codes.

GEMS2 Construction Project (DFID, GBP13.5 million, running 2010–2015)

69. GEMS is a parallel co-financed project of the World Bank and DFID. DFID funds the "GEMS2" component, which is focused on supporting the construction sector in four Nigerian states (Lagos, Kano, Kaduna, and Abuja). Existing GEMS2 interventions target the above five outcomes in the following ways:

- *Improved construction inputs:* GEMS2 uses TA to support firms that supply inputs such as bricks, concrete blocks, roofing, and wood to introduce improved products and processes. In addition, the GEMS2 Construction Ideas Fund (CIF)—a competitive matching grant scheme—has a special window for input supplies. Proposals recently submitted through this window include requests to develop/commercialize hydraform building techniques, new concepts for roofing structures, and new technology for roofing sheets.
- *Construction skills systems:* GEMS2 is supporting both public and private sector delivery of vocational training. It includes basic training that targets out-of-school youth and specialized training for existing artisans. GEMS2 is supporting the Lagos State Technical and Vocational Education and Training (TVET) Board and the private sector in the delivery of a high quality apprenticeship scheme in which 500 students are enrolled, with the expectation of 2000 students per year in the future. A second scheme is due to be launched in Kano State.
- *Advocacy and capacity building:* GEMS2 works with the Lagos State Ministry of Housing in developing capacity in public and private partners toward establishing affordable housing schemes. Additionally, GEMS2 cooperates with a range of membership organizations including engineers, artisans, and a group of activists pursuing improved access to low-cost housing.

70. **DFID has agreed that GEMS2 can develop new activities to further support the needs of the Housing Finance project.** In addition to the ongoing activities, GEMS2 plans to provide support to state governments and the construction sector to improve building codes,

standards, and building permits at the state level. GEMS2 can engage specialized consultants to develop these codes and standards and to coach officials during roll-out.

GIZ Pro-Poor Growth and Promotion of Employment Program (SEDIN) (April 2011–March 2014 (first phase; possibly followed by a second phase):

71. **SEDIN's objective is to increase employment and income generation in micro, small and medium enterprises (MSMEs).** The promotion of the construction value chain in Plateau, Niger, and Ogun States is a core activity within SEDIN's Business Environment Component.

72. To date, baseline studies on the construction sector have been conducted in all three focal states. Building on these studies, SEDIN plans to provide skills training for construction workers and partner with the Standards Organization of Nigeria (SON) on dissemination of norms and standards for construction material to reduce use of substandard material.

73. The DFID and GIZ interventions in lands will contribute to the outcomes of the Housing Finance project in two important ways:

a. Reduce cost, time, and uncertainty in land registration processes

b. Increase number of property owners who obtain recognized certificates of occupancy/ownership.

GEMS3: Land Administration Reform (DFID, approx. GBP9 million, August 2010–2015)

74. **GEMS3 is the Business Environment Component of the GEMS project, also funded by DFID.** One of its core components is land administration reform—crucially important to the effective roll-out of a functional mortgage system.

75. Activities focus on the development of land registration pilots run in conjunction with the Presidential Technical Committee for Land Reform and participating state governments. Participating states include Kano and Ondo, with additional pilots expected to be launched in Kaduna. An estimated five thousand to 10,000 people will benefit directly from pilots in each of these states, with further roll-out, upon completion within those states, to other states. TA also is provided to streamline land registration procedures Kano and Ondo, and in Lagos and Cross River.

GIZ SEDIN:

76. **The support of land reforms is another core activity of SEDIN's Business Environment Component.** GIZ is supporting land reform in four ways:

a. Supporting advocacy groups that have identified land registration as an issue that impedes business growth.
b. Conducting research for advocacy on land and property registration and acquisition in Niger and Plateau States.
c. Supporting public-private dialogue (PPD) on the issue of land registration in Niger and Plateau.

d. Setting up one-stop-shops to reduce the need for multiple contact points and reduce time and possibilities of corruption in the process.

GIZ plans to continue and increase these activities and to start a closer cooperation with the Ministries of Lands in all three partner states – Ogun, Plateau, and Niger – to implement reforms.

Coordinating DFID and GIZ Projects with the Housing Finance Project

77. The World Bank, DFID, and GIZ are drawing up a work plan that will spell out the activities of the single agencies and how the activities can be coordinated; and to meet regularly to coordinate. DFID's GEMS2 and 3 projects and GIZ's SEDIN currently work in a limited number of states, although overlap with Housing Finance target states is very likely. However, GEMS2 and 3 have sufficient flexibility to offer a package of support, based on the activities outlined above, in the states identified as priority for the Housing Finance work. Although the GEMS2 and 3 projects are contracted to run until 2015, project extensions are considered likely.

78. **Other DFID projects may provide ad hoc support as required.** The Justice for All project may be well positioned to support work on foreclosure law. The DFID-funded Nigeria Infrastructure Advisory Facility (NIAF) has a work stream on urban planning.

Annex 4. Operational Risk Assessment Framework (ORAF)

NIGERIA: Housing Finance Development Program (P131973)

Risks				
1. Project Stakeholder Risks	**Rating**	**Low**		
Description: Weak policy coordination between ministries and agencies that includes **policy coordination between lands and legal; and policy coordination between Federal and State.**	**Risk Management:** A steering committee has already been set up by the Coordinating Minister of the Economy that includes all relevant private and public stakeholders involved in housing. WBG, DFID, and GIZ are also key members during implementation and supervision.			
	Resp: Borrower	**Stage: Implementation**	**Due Date: Throughout**	**Status: In Progress**
2. Implementing Agency Risks (including fiduciary)				
2.1 Capacity	**Rating:**		**High**	
Description: The CBN lacks the experience in coordinating such type of project and may not staff the PAT adequately.	**Risk Management:** The project team will continue providing TA to the CBN in the supervision of the Housing Finance sector. The CBN was fully involved in the development of the project. The Other Financial Institutions Supervision Department (OFISD) designated two staff to a PAT within the department reporting to the director. Further, housing finance will remain a high priority, particularly as market matures thereby developing further interest within the CBN.			
	Resp: TT	**Stage: Implementation**	**Due Date: Continuous**	**Status: In Progress**
2.2 Governance	**Rating:**		**Moderate**	
Description: Notwithstanding the Directors of the OFISD and NMRC's resolve to maintain the capacity and make informed decisions; and the Board of NMRC intent to adhere to good private sector governance standards as a private-sector-led company, there is still a need for improving governance.	**Risk Management:** The project will make available continuous governance training to the Board			
	Resp: TT	**Stage: Implementation**	**Due Date: Continuous**	**Status: In Progress**
3. Project Risks				
3.1. Design	**Rating:**	**Moderate**		
Description: *(i) Complexity in Design:* The main component of the project, the NMRC, may appear complex since it is new to Nigeria. (ii) Capital markets may not respond favorably to NMRC corporate bonds. (iii) The HMF component, which is an experimental Adaptive R&D project design that tests and validates a model to be scaled up after the end of project may not garner sufficient interest.	**Risk Management:** (i) Although new to Nigeria, NMRC was initiated by the Mortgage Finance Institutions in Nigeria. The institutions involved have been exposed to several such companies across Africa and in other Regions. (ii) The NMRC will build confidence in the market place, by fully complying with the SEC, regulations, obtaining necessary guarantees, but most importantly build awareness in the market place through the focused results-based Capacity Building/TA component. The objective is for NMRC to raise its own financing from the capital market. IDA funds and some government support in the form of a minority shareholding and a guarantee of the initial bond issuances will put NMRC in a strong starting position. After that, NMRC must build the trust with a strong balance sheet that will encourage capital at a rate on par with government bonds. (iii) The HMF will be closely managed during implementation and monitored for learning and improvements. The design has flexibility built in to take advantage of opportunities.			
	Resp: TT/Partner	**Stage: Implementation**	**Due Date: Continuous**	**Status: In Progress**

3.2. Social and Environmental	**Rating:**	**Low**		
Description: There are no significant and/or irreversible adverse environmental and social issues, particularly regarding subprojects and/or community infrastructure financed under the Project. However, since the subprojects could potentially entail negative impacts, the Project safeguard category is FI-2 (or B equivalent).	**Risk Management:** Project is rated FI-2. It will provide TA and financial support to Financial Intermediaries (PML) so that it can fully comply with the World Bank's Group Performance Standards. The ESOM also stated that the private sector financial intermediary, or commercially operated entity, will be responsible for *identifying, assessing and managing environmental and social risks and impacts associated with the project, consistent with the Performance Standards*. Furthermore, Primary Mortgage Lenders (PML), the financial intermediaries, will have to develop an acceptable ESMS that guides the intermediary in assessing and managing environmental and social risks in its Bank-financed lending portfolio of subprojects.			
	Resp: TT	**Stage: Implementation**	**Due Date: Continuous**	**Status: In Progress**
3.3. Program and Donor	**Rating:**	**Low**		
Description: Continued donor commitment may not be available for related areas and other project interventions that support the Housing Finance sector, that is, in construction, land, and property registration.	**Risk Management:** Development partners will be included in project supervision and implementation support. We will work closely to assure close coordination among their project interventions directly related, causally, to the achievement of the PDO. In addition, the PSC with work closely with States to allocate their own budgets towards improvements in the related business environment.			
	Resp: TT/Partner	**Stage: Implementation**	**Due Date: Continuous**	**Status: In Progress**
4. Overall Risk Following Review				
4.1 Implementation Risk Rating:	**High**			
Comments: The team and implementing partners have agreed upon a detailed Governance Implementation framework of the project.	**Comments: This risk will be mitigated through interagency collaboration between supervisory regulators, close partnerships among development partners and collaboration with other ongoing projects to strengthen Governance.**			

Note: Include on average no more than 3 Risk Management Measures per Risk Category.

Annex 5. Implementation Support Plan

NIGERIA: HOUSING FINANCE PROJECT

1. **The key element of component 1 and the whole project is the establishment of a mortgage liquidity facility, the Nigeria Mortgage Refinance Company (NMRC).** A total of US$250 million equivalent will be disbursed in 6 tranches to NMRC and sit on its balance sheet as Tier 2 capital. Pricing from NMRC to mortgage lenders will depend on the marginal cost of funds raised by NMRC in the bond market together with an operating margin of 1 percent to cover costs and return on equity (ROE). Initially, to give bond holders confidence in the new entity, IDA funds will represent a large proportion of the balance sheet. As the balance sheet grows and NMRC generates its own capital resources through accruing reserves, the IDA funds will become less significant, although they still will be critical in creating sustainability.

2. **The project will help expand the reach of mortgage finance down the income distribution by setting targets for the refinancing of smaller loans.** As part of the project design and to encourage greater access to mortgage finance, there will be a requirement that the portfolios of mortgage loans presented as collateral in a refinance operation should contain a certain minimum proportion of smaller loans. A starting target may be in the range of 30 percent of loans being below NGN5 million. This target would be subject to review and regular update through the Project Operations Manual (POM).

Component 2. Establishment of a mortgage guarantee product, targeted at lower income borrowers (US$25 million)

3. **To further support the reach of mortgages down the income distribution, the project will capitalize a guarantee product to bear some of the credit risk for lower income lenders.** The guarantee will provide credit default loss protection to mortgage lenders. It will be established in year 2 of the project and will be subject to detailed pricing and market analysis.

4. **The proposed aim of the housing finance component is to support developing and piloting new and/or emerging formal HMF products and to demonstrate a sustainable business case for this activity.** The activities proposed under this component include (a) tailored TA to select MFBs to develop and/or improve emerging HMF products (to be funded from component 4 of the project); (b) provision of risk capital to MFBs in the form of limited soft loans to test the new HMF products; and (c) a line of credit to establish initial HMF portfolios.

Table A5.1

I. Focus of Support during Each Phase of Implementation

Time	Focus	Skills Needed	Resource Estimate	Partner Role
First 12 months	Full operation of NMRC and issuance of first corporate Bond	Senior Financial Expert	50,000	DFID and IFC will provide support to supervision with TA
12–48 months	Development of guarantee product and the housing microfinance	Senior Financial Expert and Microfinance Expert	50,000	DFID will support with TA
Housing Construction	Improved housing Value chain	TTL	20,000	DFID and GIZ TA in GEMs construction
Land and Legal	Coordination of Land and Legal policy reforms	TTL	20,000	DFID TA

II. Skills Mix Required

Skills Needed	Number of Staff Weeks	Number of Trips	Comments
Private Sector	32	8	Task-management
Finance	32	8	Special expertise in different areas
Legal, Land	10	10	Special expertise in different areas

III. Partners

Name	Institution/Country	Role
IFC	IFC	Joint supervision
DFID	UK	TA support
GIZ	Germany	TA support

5. **Establishment of NMRC is governed by a series of steps, regulations, and processes to ensure that the company meets high levels of transparency and governance.** The regulations covering the supervision and prudential requirements for mortgage liquidity facilities have been issued by the Central Bank of Nigeria under the Banking and Other Financial Institutions Act (BOFIA). These powers give CBN a mandate to regulate and enforce a prudential supervision framework on NMRC including setting capital requirements for NMRC. Alongside this, NMRC is registered under the Companies and Allied Matters Act as a Public Limited Company. Furthermore, the Articles of Association and the Shareholder Agreement incorporate a number of provisions ensuring transparency such as appointment of external auditors, implementation of a code of ethics, and adequate control and risk framework. Last, the following documents have been prepared and will be improved and updated ongoing by NMRC and its Board (a) Articles of Incorporation, (b) Code of Ethics, (c) Asset/Liability Management (ALM) Policy, (d) Credit Policy, (e) Business Plan, (f) Financial Management Policy, and (g) Risk Policy.

6. **To ensure compliance with corporate governance standards, a detailed Governance Supervision Matrix has been prepared setting out key requirements that WB supervision missions will assess during the course of project implementation.** In addition, where possible, corporate governance requirements have been included in documents such as the Subordinated Loan Agreement between CBN and NMRC, the Articles of Association establishing NMRC, and the Shareholder Agreement for NMRC, all of which reinforce the strong requirements already

present in the CBN regulations. The corporate governance requirements address disclosure of Directors' interests, suspension of bonuses and dividends in the case of not achieving business volumes, effective implementation of systems and controls to manage risks, appointment of an external auditor, and establishment of a Code of Ethics and Business Conduct.

7. **An additional measure incorporated in the subordinated loan agreement between CBN and NMRC is a set of triggers governing disbursement against business performance.** The triggers effectively require NMRC to meet certain levels of lending volumes in refinancing or prefinancing, as well as moving toward sustainability by raising its own bond funding. The triggers that NMRC must meet are US$120 million equivalent of refinance or prefinance contracts in year 1 together with a corresponding issuance of bonds; of US$100 million equivalent in year 2; and of US$50 million equivalent in years 3–5, respectively. If the business volumes for refinancing and bond issuance set out above are not achieved in the prescribed period, the follow-on tranche of the IDA credit will not be disbursed to NMRC. In addition, unless agreed by IDA, any bonuses to NMRC employees or consultants, as well as any dividends payable to shareholders, will be suspended.

Table A5.2 Governance Supervision Plan

Event	Performance Indicator
First Supervision Mission	Evidence that no complaint, claim, or suit has been brought against NMRC alleging failure to comply with any of the following: 1. Shareholders' effective participation and voting in general shareholder meetings 2. Equal treatment of all shareholders of same class 3. Prohibition of insider trading and self-dealing by Directors and key executives 4. Disclosure by Directors and key executives of any material interest in any transaction or matter directly affecting NMRC 5. Disclosure by Directors, key executives, and shareholders of material information on company objectives, major share ownership and voting rights, remuneration policy, issues regarding employees and other stakeholders, and governance structure 6. Evidence in place of adequate systems and controls including but not limited to evidence of a credit policy, asset and liability management policy, financial management policy, and operations manual 7. Establishment of a Code of Ethics and Business Conduct, which (a) specifies high standards of honesty, integrity, and impartiality for NMRC Directors, Senior Management, Officers, and Employees; and (b) provides guidance on the avoidance of conflicts of interest, self-dealing, and other types of impropriety as specified in the Banks and Other Financial Institutions Act (BOFIA) or by the CBN. 8. Appointment of external independent auditor approved by CBN who meets the qualifications and has the duties, responsibilities, and authorities of approved bank auditors as specified in BOFIA or by CBN (pursuant to the CBN Regulations, section 4.3.2) 9. Director's duties to act on a fully informed basis, with due diligence and care, and in the best interest of NMRC and its shareholders, including by ensuring the integrity of NMRC's accounting and financial reporting systems; and by monitoring and managing potential conflicts of interest, misuse of corporate assets, and abuse in related party transactions by management, board members, and shareholders.

Second Supervision Mission	Submission by every shareholder, member of the Board of Directors, and Senior Management, to be updated annually, of: 1. Statement of their net worth comprising assets at current values and total liabilities as at the date of appointment, accompanied by a sworn affidavit 2. Declaration of any relationship they have with the institution 3. Declaration of whether any member of their families has any relationship with the institution 4. Declaration of the percentage of the institution's shares that they own, directly and indirectly.
	Submission by NMRC—within the deadlines established in the *Regulatory and Supervisory Framework for the Operations of NMRC* issued by CBN, December 2012 (the "CBN Regulations"), section 6.2—of the following financial information: 1. Monthly Returns including statements of financial condition, income, and capital compliance and leverage 2. Quarterly Returns including statements of cash flow, capital, investments, outstanding advances and commitments, outstanding liabilities, and shareholders' stock holdings 3. Annual (Audited) Financial Statements produced in accordance with IFRS standards, including auditor's management letter and statement on the effectiveness of internal controls signed by NMRC's Board of Directors. Housing Microfinance 1. Up to 5 pilot MFBs selected and subject to due diligence process to confirm compliance with eligibility criteria (with arrangements for annual appraisal of participating MFBs) 2. Procurement process for HMF TA provider initiated.
Third Supervision Mission	Evidence that NMRC has (a) issued bonds to fund the refinance or prefinancing of eligible mortgages with a minimum volume of bonds outstanding equivalent to 1st disbursement tranche of US$120 million and (b) refinancing or prefinancing of eligible mortgage loans at a minimum volume of US$120 million equivalent; and (c) first tranche of IDA is invested in assets compliant with eligible investments for NMRC as defined in CBN regulations. Housing Microfinance 1. HMF TA provider selected and TA delivery underway 2. Loan agreements with MFBs signed.
Fourth Supervision Mission	Evidence that during the period since previous IDA disbursement, NMRC has (a) issued new bonds to fund the refinance or prefinancing of eligible mortgages with a minimum volume of bonds outstanding equivalent to US$100 million and (b) new refinancing or prefinancing of eligible mortgage loans at a minimum volume of US$100 million equivalent; and (c) second tranche of IDA is invested in assets compliant with eligible investments for NMRC as defined in CBN regulations. Housing Microfinance: 1. Testing of HMF products underway, along with monthly reporting on key indicators 2. Evaluation of pilot HMF portfolio completed.
Fifth Supervision Mission	Evidence that during the period since previous IDA disbursement, NMRC has (a) issued new bonds to fund the refinance or prefinancing of eligible mortgages with a minimum volume of bonds outstanding equivalent to US$50 million and (b) new refinancing or prefinancing of eligible mortgage loans at a minimum volume of US$50 million equivalent; and (c) third tranche of IDA is invested in assets compliant with eligible investments for NMRC as defined in CBN regulations. Housing Microfinance: 1. MFBs access a line of credit to roll out the tested HMF products, following confirmation of their compliance with eligibility criteria.

All additional Supervision Missions	Evidence that during the period since previous IDA disbursement, NMRC has (a) issued new bonds to fund the refinance or prefinancing of eligible mortgages with a minimum volume of bonds outstanding equivalent to US$50 million and (b) new refinancing or prefinancing of eligible mortgage loans at a minimum volume of US$50 million equivalent; and (c) fourth tranche of IDA is invested in assets compliant with eligible investments for NMRC as defined in CBN regulations. Housing Microfinance: 1. Supervision and reporting on the progress with implementation of the line of credit in line with the fiduciary, environmental, and social standards; and ensuring continued MFB compliance with stated eligibility criteria.

Annex 6. Financial Analysis

Financial Analysis

1. **The overall objective of the Government is to achieve a mortgage market in excess of 200,000 mortgage loans outstanding during the project period**. Financial modeling has been used to help project what is required in terms of funding and growth levels to meet this target. The target does imply rapid growth in the mortgage market, averaging 30 percent annually and would require mean a significant increase in industry capacity to handle additional lending volumes. NMRC also would have to grow at a significant pace building up its balance sheet at an annual compound growth rate of 60 percent over the project period. However, both the mortgage market and NMRC are starting from low and zero bases, respectively. Thus, these assumptions, although challenging, are feasible.

2. **Based on current interest rates, the currency risk inherent in an IDA loan denominated in SDR and disbursed in Naira is calculated to add an additional 3.5 percent to the cost of the IDA credit.** The estimate is based on examining the largest shifts in the Naira over the past 40 years. We assume with a 90 percent confidence level that NMRC has to cover a risk amounting to an annual 6.0 percent devaluation in the Naira. By further assuming a discount rate of 10.0 percent and modeling the cash flows of the project, the CBN requires an extra 3.5 percent interest to cover the currency risk against this worst case scenario. The resulting overall cost of financing to NMRC is set at 4.25 percent.

3. **The IDA loan would be disbursed gradually over the project in a series of tranches and sit on the balance sheet of NMRC as Tier 2 capital.** The role of the IDA funds will be twofold: (a) **Strengthen Balance Sheet.** To do so, the IDA loan will provide confidence in the credit standing of NMRC as bond-issuing entity that is critical in ensuring its ability to raise bond financing at just above sovereign debt levels; and (b) **Ensure Sustainability of Model.** The IDA funds will be invested in government securities to generate sufficient return to cover administrative expenses and generate sufficient income to grow the capital base in line with growth in the balance sheet. This model departs from previous ones in which World Bank loans were used directly to provide funding for on-lending. One of the consequences is that NMRC will have to issue bonds from the outset before it can begin refinancing operations.

4. **Full market-based pricing is used to set the interest rates of NMRC refinance and prefinance operations.** The pricing will be based on the marginal cost of funding, in other words, the rate at which NMRC is able to raise bond financing. This methodology means that there is no need to create an artificial pricing mechanism that never can match full market conditions. NMRC then will take a 1 percent margin above the marginal cost of funds to generate income and a return on equity (ROE). Pricing by mortgage lenders to their borrowers will be determined by the lenders themselves. Table A6.1 sets out some assumptions on the pricing with mortgage lender spreads falling gradually as the market grows.

Table A6.1 Balance Sheet, Years 1–5

(NGN millions)	2012	year 1	year 2	year 3	year 4	year 5
Assets						
Value of Refinanced Loans	-	20,125	52,250	102,375	170,000	220,000
Investments	-	24,960	37,366	42,835	48,663	55,050
Total Assets		45,085	89,616	145,210	218,663	275,050
Liabilities						
Capital	-	24,960	37,366	42,835	48,663	55,050
Tier 1 Capital	-	6,000	7,346	9,655	12,323	15,550
Share Capital	-	*6,000*	*6,000*	*6,000*	*6,000*	*6,000*
Reserves	-	-	*1,346*	*3,655*	*6,323*	*9,550*
Tier 2 Capital - IDA Loan	-	18,960	30,020	33,180	36,340	39,500
Bonds	-	20,125	52,250	102,375	170,000	220,000
Total Liabilities		45,085	89,616	145,210	218,663	275,050

Table A6.2 NMRC Income Statement, Years 1–5

(NGN millions)	2012	year 1	year 2	year 3	year 4	year 5
Profit and Loss Account						
Interest Income		2,365	6,126	11,466	18,998	24,530
Interest Expenses		2,163	5,604	10,442	17,298	22,330
MRC Net Interest Income	-	201	523	1,024	1,700	2,200
Operating Expenses	-	500	550	605	666	732
Bond Issuance Expenses	-	352	653	1,177	1,700	1,540
Profit before Tax	-	(651)	(681)	(759)	(666)	(72)
Tax @32.0%	-	-	-	-	-	-
Profit from Non-Taxable Income*		1,997	2,989	3,427	3,893	4,404
Total Profit after Tax	-	1,346	2,309	2,668	3,228	4,332
Proposed Dividend @20.0%		-	-	-	-	(94)
Transfer to Reserves		1,346	2,309	2,668	3,228	4,238

Note: *Investments in FGN Bonds.

5. **The financial analysis clearly shows that, based on the business volumes and pricing assumptions, NMRC generates sufficient profit to be sustainable.** The ROE ranges from 20 percent to 30 percent, which is in line with typical returns available in Nigeria. The IDA funds enable NMRC to have a very strong capital ratio in the initial years of the project and to remain well above minimum regulatory capital requirements, as set down by the Central Bank of

Nigeria in regulations applying to mortgage liquidity facilities. Likewise, the Tier 1 leverage ratio reaches 15 only by the end of the project, which level remains conservative, especially in view of the overall leverage ratio when Tier 2 capital is included.

6. **MRC is expected to refinance approximately 20 percent of the total mortgage market.** This assumption is in line with international experience. Experience in the US by the Federal Home Loan Banks and in Malaysia with Cagamas Berhad shows that lenders are able to raise their own funding, supplemented by a mortgage liquidity facility, which often is used as a backstop. Many of the larger Deposit Money Banks may simply use NMRC as a standby line, compared to the Primary Mortgage Banks, which, given their more limited access to the deposit market, are more likely to use the facility.

7. **Stress-testing of NMRC business model carried out for low-growth, base-case, and high-growth scenarios.** Three scenarios were established with three key variables changing in each case. The scenarios were built around (a) different levels of growth in the overall mortgage market, (b) different assumptions on the overall level of interest rates, and (c) different assumptions on the market share of mortgage lending that NMRC would refinance. These three scenarios were modeled to show the impact on pricing, the capital position of NMRC, its profitability, and loans outstanding.

8. **Results of the stress tests demonstrate the resilience of NMRC business model and its ability to adapt to different market conditions.** Because of the simple nature of NMRC's model whereby it is essentially simply intermediating funds from the bond market to lenders and taking a 1 percent spread, the overall business model is reasonably isolated from market risk. The two areas that may cause difficulties, especially over the longer 10-year period covered by the modeling, are the capital adequacy for the high-growth scenario and the mortgage market size for the low-growth scenario. If the market were to grow much more rapidly than 30 percent per annum, and the market share of refinancing were higher than projected, NMRC would hit a capital constraint that would limit its ability to grow its balance sheet. In this case, NMRC could either look for equity injections from existing shareholders or raise Tier 2 capital in the market. Any growth rate below the projected base scenario would see the overall mortgage market shrink in relative terms. This shrinkage would be attributable to the high level of growth forecast for the Nigerian economy over the coming years. Thus, while mortgage debt/GDP is approximately 0.80 percent, even in the base case, during the project period, it rises slowly to only just over 1 percent.

Table A6.3 NMRC Ratio Analysis, Years 1–5

	2012	year 1	year 2	year 3	year 4	year 5
Key Ratios						
Tier 1/Assets	-	29.8%	14.1%	9.4%	7.2%	7.1%
Capital Ratio		55.4%	41.7%	29.5%	22.3%	20.0%
Leverage Ratio (Assets/Tier 1)		3.4	7.1	10.6	13.8	14.1
Return on Equity	-	22.4%	31.4%	27.6%	26.2%	27.9%
Return on Assets	-	6.7%	4.4%	2.6%	1.9%	2.0%
Cost:Income Ratio	-	38.8%	34.3%	40.0%	42.3%	34.4%
Growth in Assets	-	-	159.6%	95.9%	66.1%	29.4%

Table A6.4 Mortgage Market Projections, Years 1–5

(NGN millions)	2012	year 1	year 2	year 3	year 4	year 5
Mortgage Market						
Number of Mortgage Loans	50,000	70,000	95,000	130,000	170,000	220,000
Mortgage Debt Outstanding	300,000	402,500	522,500	682,500	850,000	1,100,000
Nominal GDP Forecast*	42,622	48,005	56,539	67,203	82,832	104,492
Mortgage Debt/GDP	0.70%	0.84%	0.92%	1.02%	1.03%	1.05%
Average Mortgage Size	6.00	5.75	5.50	5.25	5.00	5.00
Refinancing						
Proportion of Loans Refinanced	-	5.0%	10.0%	15.0%	20.0%	20.0%
Value of Refinanced Loans	-	20,125	52,250	102,375	170,000	220,000
Number of Loans Refinanced	-	3,500	9,500	19,500	34,000	44,000

Note: * Economist intelligence unit/Next-generation network (EIU – NGN) billion.

Table A6.5 Pricing and Key Assumptions, Years 1–5

	2012	year 1	year 2	year 3	year 4	year 5
Key Rates						
Rate of Return on Investments	-	12.3%	12.3%	12.3%	12.3%	12.3%
FX Risk	-	3.5%	3.5%	3.5%	3.5%	3.5%
IDA Loan Cost	-	0.75%	0.75%	0.75%	0.75%	0.75%
Net Investment Income	-	1,997	2,989	3,427	3,893	4,404
10-Year Govt Bond (June 2023)		10.50%	10.50%	10.00%	10.00%	10.00%
Market Liquidity Risk Premium		0.25%	0.23%	0.20%	0.18%	0.15%
Average Bond Interest/Coupon Rate		10.8%	10.7%	10.2%	10.2%	10.2%
Bond Issuance Costs		1.75%	1.25%	1.15%	1.00%	0.70%
Pricing of Refinance Loan						
Marginal Cost of Funds	-	10.8%	10.7%	10.2%	10.2%	10.2%
MRC Spread	-	1.00%	1.00%	1.00%	1.00%	1.00%
Total	-	11.8%	11.7%	11.2%	11.2%	11.2%
Pricing of Mortgage loan						
Mortgage Lender Spread	6%	4.0%	3.0%	2.5%	2.5%	2.0%
Final Price to Borrower	16.0%	15.8%	14.7%	13.7%	13.7%	13.2%
Assumptions						
Tax Rate		32%				
Dividend Rate (based on share capital)		20%				

Table A6.6 Stress-Testing Scenario Analysis

(NGN millions)	2012	year 1	year 2	year 3	year 4	year 5
High Market Growth, Low Interest Rates, and high uptake of MRC Facility						
Mortgage Loans Outstanding	50,000	80,000	122,857	190,752	278,791	401,787
10 year Govt bond(June 2023)		10.00%	9.50%	9.00%	8.50%	8.00%
% of loans refinanced		7.5%	15.0%	20.0%	25.0%	27.5%
Mortgage Debt to GDP	0.70%	0.96%	1.20%	1.49%	1.68%	1.92%
Refinanced Loans - value	-	34,500	101,357	200,289	348,489	552,458
Refinanced Loans - number	-	6,000	18,429	38,150	69,698	110,492
MRC Profit after tax	-	1,238	2,177	2,502	3,195	5,294
MRC Capital Adequacy	0.0%	42.0%	26.9%	17.5%	12.2%	9.0%
Mortgage Interest Rate	16.0%	15.3%	13.7%	12.7%	12.2%	11.2%
Central Case						
Mortgage Loans Outstanding	50,000	70,000	95,000	130,000	170,000	220,000
10 year Govt bond(June 2023)		10.50%	10.50%	10.00%	10.00%	10.00%
% of loans refinanced		5.0%	10.0%	15.0%	20.0%	20.0%
Mortgage Debt to GDP	0.70%	0.84%	0.92%	1.02%	1.03%	1.05%
Refinanced Loans - value	-	20,125	52,250	102,375	170,000	220,000
Refinanced Loans - number	-	3,500	9,500	19,500	34,000	44,000
MRC Profit after tax	-	1,346	2,309	2,668	3,228	4,332
MRC Capital Adequacy	0.0%	55.4%	41.7%	29.5%	22.3%	20.0%
Mortgage Interest Rate	16.0%	15.8%	14.7%	13.7%	13.7%	13.2%
Low Market Growth, High Interest Rates and low uptake of MRC Facility						
Mortgage Loans Outstanding	50,000	60,000	70,714	83,741	96,624	110,833
10 year Govt bond(June 2023)		11.0%	11.5%	12.0%	12.5%	13.0%
% of loans refinanced		2.50%	5.00%	7.50%	10.00%	12.50%
Mortgage Debt to GDP	0.70%	0.72%	0.69%	0.65%	0.58%	0.53%
Refinanced Loans - value	-	8,625	19,446	32,973	48,312	69,271
Refinanced Loans - number	-	1,500	3,536	6,281	9,662	13,854
MRC Profit after tax	-	1,432	2,398	2,786	3,251	3,905
MRC Capital Adequacy	0.0%	74.3%	65.8%	56.6%	50.3%	44.4%
Mortgage Interest Rate	16.0%	16.3%	15.7%	15.7%	16.2%	16.2%

* (EIU - NGN billion)

Annex 7. Economic Analysis

1. **This economic analysis will focus on the impacts of an increased availability of long-term and affordable funds for mortgage lending to the real sector. The project will address the critical issue of long-term financing faced by financial institutions.** In a September 2012 survey, liquidity constraint was ranked first by mortgage lenders such as Deposit Money Banks and Primary Mortgage Institutions (table A7.1). This constraint implies that, given their limited access to long-term funds, mortgage lenders choose to lend to the most creditworthy households. In Nigeria, in addition to the lien on the property, lenders commonly require personal guarantees as collateral for mortgage loans. Of the lenders surveyed, 55 of 76 require personal guarantee for mortgage loans. Only 10 lenders require both a lien and personal guarantees as collateral. Personal guarantees provided by family members and cooperatives often are a second-best choice since, in the case of default, foreclosure procedures are difficult to implement. As a consequence, in 2011 only 0.06 percent of households had outstanding loans from formal financial institutions to purchase homes.[22] This share represented 20,833 households of a total of approximately 33 million[23] households.

Table A7.1 Major Obstacles to Mortgage Market Expansion

Mortgage Market Obstacles	Frequency of Response
Access to long-term funds	55
Difficulties with property registration/titling	22
Cost and time of foreclosing on a property	18
High interest rate	14
Lack of housing supply and new construction	12

2. **On the demand side, the interest rates are high, at 17 percent–22 percent, made more onerous because the maturity offered by lenders is relatively low, between 5 and 15 years, resulting in households facing large monthly repayments.**[24] Mortgage lenders are using primarily savings and deposits to finance long-term lending, creating a maturity mismatch that limits the number of mortgages.

3. **The objective of the Nigerian Mortgage Refinancing Company (NMRC) is to support mortgage lenders in increasing mortgage lending by refinancing their mortgage loan portfolios.** The company will be the intermediary between mortgage lenders and capital market investors who typically are looking for long-dated, high-quality securities. The project will energize the mortgage market by making available a larger number of mortgage loans. It also will create a guarantee fund, thereby decreasing the risks perceived by commercial banks. The project also will propose a TA component (component 4) to promote financial sector reforms and institutional capacity building, enhancing a favorable lending environment.

[22] Findex database.
[23] EIU database.
[24] CBN Survey 2012.

4. **The economic analysis of this project has been structured to capture its impacts at the micro level: in job creation and households.** The costs and benefits expected to accrue from the impact of NMRC have been estimated compared to a counterfactual, and used to derive the net present value (NPV) and the economic rate of return (ERR) of this investment. The main benefits captured are the increased number of households having access to mortgage loans to buy properties. This increase in mortgage volumes will stimulate the construction sector (residential housing) and increase the number of jobs in the sector as well as the incomes of new entrants in the construction sector. The total investment under components 1 and 4, with an amortization period of 5 years, at a discount rate of 14 percent, results in a NPV of NGN11.6 billion (US$73.4 million) and an ERR of 38.9 percent.

Assumptions

5. **The assumptions used in the economic analysis are in line with those used in the financial analysis, which focuses on the profitability of NMRC.** The economic analysis assesses the impacts of NMRC from society's point of view. These impacts are considered over five years, the period corresponding to the project's lifetime.

6. **This analysis will focus on the US$285 million invested in the NRMC, Guarantee product and the Technical Assistance component**. The impact of the microfinance component (US$15 million) will be discussed qualitatively in subsequent sections.

7. **Impacts considered in the calculation.** The facility is expected to gradually refinance 5 percent–20 percent of total mortgage loans over the amortization period. However, the project will promote a stable lending environment, introduce standardization, and provide liquidity safety nets, thereby leveraging additional funds to finance mortgage lending beyond NMRC's initial equity (*Scenario Reference*). The quantifiable benefits of this project, which are discussed in more detail in this section, are (a) additional income for the new employees in the construction sector, and (b) consumer surplus for households.

8. **In 2012 the mortgage market was estimated at NGN300 billion (approximately 0.70 percent of GDP). The *Scenario Reference* assumes that, after implementation of the project, the mortgage market will grow steadily to represent 1.05 percent of GDP in year 5 of the project's lifetime.** To capture the net impact of the project, the team built a counterfactual that assumed that, everything remaining equal, under current market conditions, the mortgage market would shrink to 0.58 percent of GDP as the nominal GDP is expected to grow faster than the annual growth of the mortgage market (estimated at 15 percent[25]). The team assumed that, under current market conditions, mortgage loans would have a maturity of 15 years, an interest rate of 18 percent, and a required down payment of 20 percent (*Scenario Reference*).

[25] This represents the average growth of the Mortgage market outstanding between 2008 and 2011. Source CBN Survey – 2011.

Inflow 1: Additional income for new entrants in the construction sector

9. **In line with the above, the team assumed that the additional volume of mortgages would benefit the economy first mainly through increased output in the construction sector.** The team confined the benefits from the construction sector to the generation of *additional jobs* leading to *increased income* for these new entrants (compared to the counterfactual).

10. **The housing construction creates jobs directly through on-site employment and indirectly through backward linkages with industries that produce building materials and related products.**[26] In Nigeria, the import content of construction materials is relatively high. Nevertheless, given the labour intensive technologies in use in the industry as well as the current industry development level, promoting residential housing could have a large employment impact. The team estimates that the residential construction sector currently employs 1 million people.[27] This number includes those employed in the construction subsectors and input supply sectors. This number enables us to calculate the employment intensity (jobs per US$) and to link it to the additional economic activity generated by the project in the construction sector.

11. **The literature indicates that the construction industries—of which housing represents 35 percent to 75 percent[28]—historically have played a major role in creating employment not only for skilled labor but also for the unskilled and the landless. These industries constitute ports of entry to urban labor markets.** Any investment in construction has a multiplier effect on the national output and employment of a country that goes beyond the direct investment itself. Examples exist in Philippines,[29] Colombia, Korea, Pakistan, India, Argentina, and Mexico.[30] Thus, by stimulating construction sector output, NMRC will promote job creation.We assume in the Scenarios Reference that most of these jobs will be generated within population decile 4. The net impact of the project is presented as the difference between the average income of a worker within the sector[31] and the current average household income within this decile.[32] These additional jobs thus will generate *additional income* for the new entrants in the construction sectors.

Inflow 2: Surplus for households

12. **Beyond the impact on jobs and income, the project will generate a *net surplus to households*.** This surplus is estimated as the difference between the NPV of the mortgage loan

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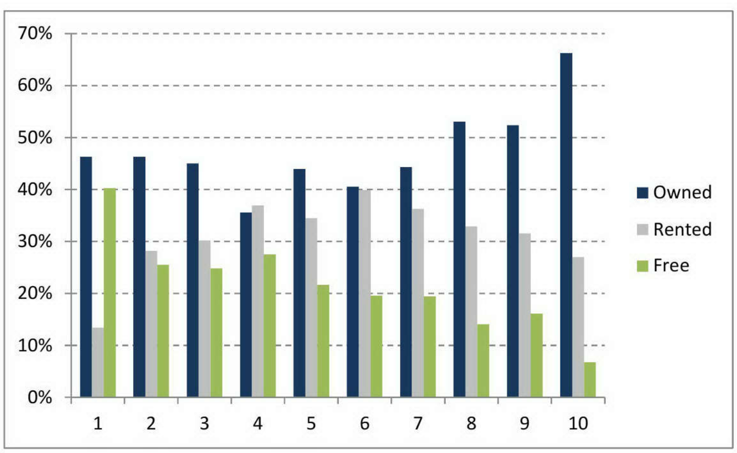
[26] Dubel (2006), "Does Housing Finance Promote Economic and Social Development in Emerging Markets?"
[27] Source GEM II.
[28] Sources: "The Construction Industry in the Twenty-First Century: Its Image, Employment Prospects and Skill Requirements", ILO, 2001; "Greenhouse Gas Emission Baselines and Reduction Potentials from Buildings in South Africa" (2007).
[29] Input-output multiplier analysis for major industries in Philippines.
30 Grimes, Orville F., 1976, Housing for low income urban families (Johns Hopkins Press, Baltimore, MD); Wegelin,1978, Urban low-income housing and development: A case study in Peninsular Malaysia,(Leyden and Boston); Uy, Willie, 2006, Medium-Rise Housing: The Philippine Experience, Presentation Paper for the 5th Asian Forum; Freire, Mila, M. Gautier and O. Hassler, 2006, Review of Argentina's Housing Sector: Options for Affordable Housing Policy, World Bank Working Paper.
[31] Household Survey 2010–11: at US$2,100 per year (or US$5.7 per day).
[32] The average income in the construction sector is estimated at NGN36,000 per month (DFID GEMS II, UK).

and the NPV of the amount needed to be saved[33] by a household that is renting its dwelling and is willing to pay upfront for a property 15 years from now. Anecdotal evidence indicates that this is a relatively current practice. Similarly, we assume that a proportion of current owners would be willing to get a mortgage to possibly build a bigger house. In this case, the NPV of the mortgage will be compared to the NPV of saving over 15 years. In both cases, we compare a case in which households are saving to buy a house (counterfactual) to a case in which households borrow money from the financial institutions to buy a house under the project.

13. **First, not all Nigerian households could afford a mortgage.** Where a household is unable to meet its most basic needs, obtaining formally financed shelter is not likely to be a priority.[34] We thus assume that households in the highest decile will be served first but that the larger the mortgage market, the more households in the lower decile will benefit from the project. Besides, it is likely that poorer households would not purchase a home but would rather improve their dwellings incrementally with smaller loans. This assumption provides the rationale for the microfinance component of the project (annex 8, Affordability section).

14. **Second, not all households that are within reach of the market (in terms of monthly income) will choose to get a mortgage.** Owners are not likely to be the main beneficiaries of the project. The 2010 Household Survey indicates that most households own their dwellings and that the middle class rents. We assume that approximately 85 percent of tenant households in the highest deciles are saving to buy their own residences. We also assume that approximately 20 percent of the owners are likely to ask for mortgages to move into larger properties.

Figure 3 Type of Dwelling in Urban Areas from the Poorest (1) to Richest Decile (10), 2010



Source: Household Survey 2010.

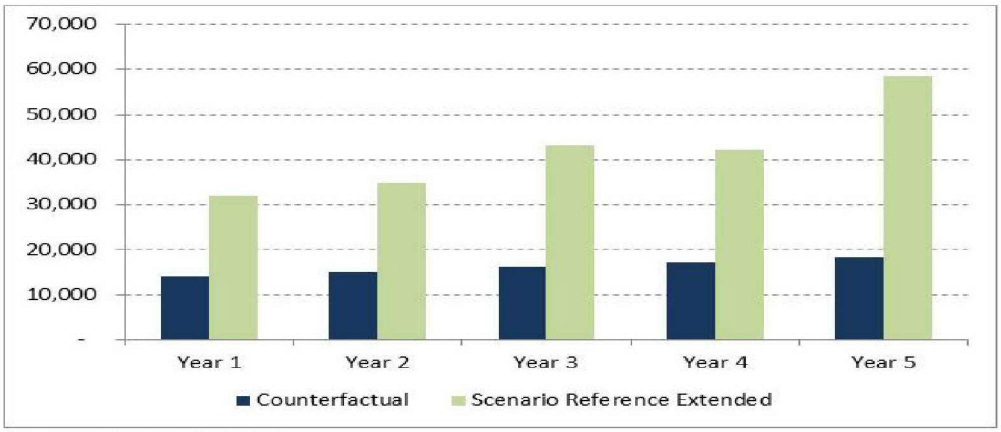
15. **Starting from the highest, the deciles that could access a mortgage would depend on the** (a) average loan size (related to a percentage of the monthly income of the household[35]), (b) total amount of available long-term funds as presented in the financial projections, and (c) number of households in the preceding deciles that are actually getting loans.

[33] Saving rates taken equal to 5%; yearly wage increase is estimated at 7.5%; and house price increase of 8%.
[34] Melzer, D. (2003) 'Inequalities in mental health: A systematic review.' The Research Findings Register, Summary No. 1063. London: Department of Health.
[35] The repayment-to-income ratio is assumed to be 30% for households in the lowest deciles, 40% for those in the highest.

Results

16. **Number of Mortgages.** Taking into account the broader impact of the project on the mortgage market (compared to the counterfactual), the project will generate close to 130,000 additional mortgage loans. In year 5, the cumulative number of loans is projected at 81,000 for the counterfactual, and at 210,000 for the Scenario Reference Extended. The assumption that NMRC will have an impact on the overall mortgage market is the cornerstone of the project (figure **A7.2).**

Figure A7.2 Number of New Mortgages, per Annum (Compared to Year 0)



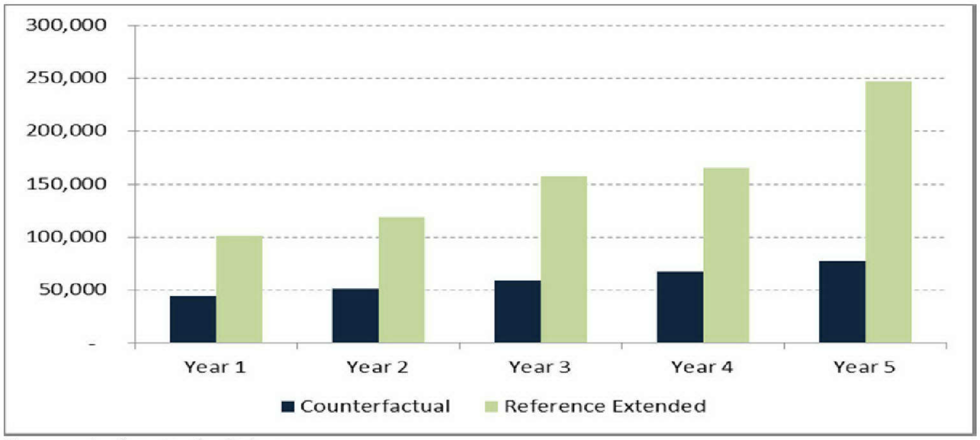
Source: Authors' calculation.

17. **Workers Employed in the Construction Sector.**[36] The value added to the construction sector as a result of the project will be the volume of loans discounted by the new housing construction factor.[37] The projected growth of the mortgage market will result in the construction of approximately 130,000 units (Scenario Reference) above the counterfactual over 5 years. The impact on the construction sector is estimated to increase GDP over 5 years on a cumulative basis by 0.4 percent above our counterfactual. The number of full-time workers is proportional to the additional activity generated in the construction sector. Under the counterfactual, approximately 300,000 jobs would be created over five years. In comparison, the project was expected to increase jobs to 790,000, a net addition of approximately 490,000 jobs. These additional jobs will generate additional income estimated at NGN60 billion (US$380 million) above the counterfactual over the 5 years.

[36] The analysis does not deconstruct this impact per sector due to a lack of data. However, jobs created in subsectors and the input sector are accounted for. The team acknowledges that the impact on jobs potentially is larger as a result of possible induced job creation. The increased output in the financial sector is unlikely to result in a significant increase in labor demand because the marginal value added of an additional worker in a PMI/DMB's mortgage unit will be relatively low.

[37] The new construction factor is the share of the property financed through mortgage loans (75%) x share of mortgages value that will go into new construction (75%). The proportion of the new mortgages that is met through new housing construction is estimated at 75%. Given the housing deficit, it is likely that most of the loans will be used (directly or indirectly) to increase the housing stock because evidence indicates that the formal sector is producing only a fraction of the total number of urban units needed each year.

Figure A7.3 Additional Full-time Workers Employed by the Construction Sector per Annum (Compared to Year 0)

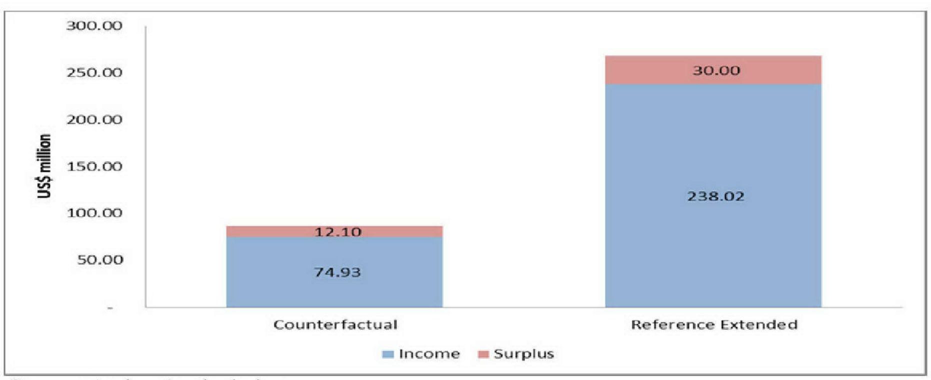


Source: Authors' calculation.

18. **Households' Surplus.** The project will generate a *net surplus to households* estimated at NGN5 billion (US$31.8 million) above the counterfactual.

19. **Benefits.** Among the two inflows presented above, job creation is the impact that drives the profitability of the project (figure A7.4). From an equity angle, it is obvious that in the absence of a microfinance component, only the households of the top decile would have access to a mortgage (15 percent of the households in the Scenario Reference, compared to 5.6 percent in the counterfactual). However, the main effect relates to higher salaries accrued to the workers employed in the construction sector through additional activities generated in this sector (figure A7.4).

Figure A7.4 Benefits in Year 5 (US$ mil)



Source: Authors' calculation.

20. **Economic Rates of Return.** At a discount rate of 14 percent, the net present value for the Scenario Reference is largely positive, thereby highlighting the importance of enhancing the conditions for the overall mortgage market. In the table A7.2, we present the results for different assumptions regarding the leverage effect.

Table A7.2 Economic Rates of Return and Net Present Values for Different Leverage Effects

Scenarios (%)	ERR (%)	NPV (US$mil)
Reference Extended (Mortgage/GDP: 1.05)	38.90	73
Mortgage/GDP: 1.0	21.02	28
Mortgage/GDP: 0.9	5.50	-32
Mortgage/GDP: 0.8	-12.10	-92
Mortgage/GDP: 0.7	-34.44	-152

Source: Authors' calculation.

Other Non-quantifiable Benefits

21. **Under current market conditions, mortgage lenders' spread between the loan rate and the source of funds is relatively high (above 10 percent) because the spread includes a premium reflecting the difficult lending environment.** The financial sector will benefit from the project in several ways: (a) access to long-term funds, (b) improved lending environment as a result of joint efforts from the donor community to improve the lending environment and foreclosure processes, and (c) increased number of loans. Under our assumption, the spread to banks is expected to be lower, but the impact is expected to be offset by the increased volume of mortgages. The additional volume of mortgages will stimulate *the financial sector,* but the net impact on GDP is expected to be marginal. The literature indicates that this net increase could spill over to other sectors of the economy, thus providing input to the financial sector. This impact is partially captured with the leverage assumption.

22. **In addition to the impacts presented, the project will have a larger developmental impact.** This impact will include the benefits of deeper financial markets, which are difficult to quantify and estimate. The literature indicates that employment-intensive growth in secondary sectors (manufacturing, construction, mining, and utilities) correlates with poverty reduction.[38] By extension, because it will stimulate growth in auxiliary sectors such as manufacturing, construction, mining, and other utilities, housing finance will reduce poverty by generating income and jobs as presented above.

23. **Poverty reduction also will result from the microfinance component (component 3), which will have a positive impact on the economy.**[39] The literature finds that low-income housing has a lower import component and is more labor intensive than middle- or high-income housing.[40] Thus, benefits to the economy tend to be inversely proportional to housing cost,

[38] Gutierrez, C., et. al., 2007, Does Employment Generation Really Matter for Poverty Reduction?, World Bank Policy Research Working Paper No. 4432, World Bank, Washington, DC.

[39] Most of the impact discussed in the section will be applicable to the microfinance component. The intervention will impact the microfinance sector by laying down the foundation for future upward expansion of MFBs or potential downscaling of other financial institutions (such as building societies). However, the macroeconomic impact will be difficult to evaluate. Similarly, given the fragmented market and the lack of relevant data, the microeconomic impact also will be difficult to determine.

[40] Erbas, S. and F. Nothaft, 2002, The Role of Affordable Mortgages in Improving Living Standards and Stimulating Growth: A Survey of Selected MENA Countries, IMF Working Paper.

meaning that low cost housing is more beneficial. Similarly, home improvement entails the sale of building materials and the employment of low-skilled and medium-skilled workers. In Kenya, for example, the labor-to-materials ratio for low-income housing is 45:55 whereas, for high-income housing, the ratio is 30:70.[41] In most developing countries, the informal sector is largely responsible for the provision of shelter in low-income houses. However, because very little hard data exist, it is difficult to estimate the informal sector's contribution to the construction sector and to economic development. Research has shown that housing construction in low-income neighborhoods in the developing world stimulates the creation of small businesses because much housing construction is done by small firms, largely in the informal sector.[42]

24. **Another study found that 10 percent to 25 percent of dwellings in developing country cities have an enterprise on the premises.**[43] As premises are either free, or accounted as such in the business, overheads are kept very low, and the householder faces a lower marginal capital investment in setting up operations at home than in setting up externally. However, most of these activities are likely to yield the lowest incomes because of easiest entry, least skills, and lowest capital intensity. Through the microfinance project, improvement to the houses could impact the living conditions and incomes of low-income households. The microfinance component also has a gender aspect. The majority of HMF borrowers and households are female-headed or have women as the principal income earners. Therefore, improving their homes expands the hours in the day that women can work, their ability to mind children, and their health (clean water, safe toilets).

25. **To the extent that housing improves homeowners' borrowing capacity, housing finance could lead to more investment in human capital.** Investment in human capital may require an individual to borrow money, and borrowing money is costly. Consequently, to the extent that housing finance lowers the cost of borrowing, it should lead to larger investments in human capital. Many authors have studied the link between investment in human capital and wealth distribution and found that income inequality will decrease as access to finance improves.[44] Jacoby and Skoufias (1997)[45] find that income shocks cause poor families who lack access to finance to discontinue schooling for children. Housing provides an asset that can be used to smooth income shocks.

26. **Housing, Financial Deepening, and Poverty.** One segment of this housing finance project is to further develop the secondary mortgage market and the creation of mortgage instruments or bonds. While there has not been research specifically on the development of mortgage markets and poverty, the development of these markets can be viewed as part of an overall financial deepening of the capital markets in developing countries. Analyzing data from Sub-Saharan Africa between 1992 and 2006, Singh and Huang (2011) find that financial deepening (as measured in part by credit to the private sector as a percent of GDP) is associated

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[41] Syagga, P.M. and E.M Aligula (1999), Management and Agency in the Urban Real Property Market in Kenya. Shaker Verlag, Aachen, Germany.
[42] A.K. Tibaijuka, *Building Prosperity: Housing and Economic Development* (London: Earthscan, 2009).
[43] Strassmann, W. P. (1986). "Types of Neighbourhood and Home-Based Enterprises: Evidence from Lima, Peru". Urban Studies, 23: 485-500.
[44] Starting with Becker, G. S., 1975, Human Capital, NBER and Columbia University Press, New York. and Atkinson, A. B., 1974, The Economics of Inequality (Oxford: Clarendon Press).
[45] Jacoby, Hanan and E. Skoufias, 1997, Risk, Financial Markets, and Human Capital, Review of Economic Studies, Vol 64, 311-335.

with less poverty and income disparities in SSA countries and that these findings are amplified in early stages of financial development.[46] Beck, Demirguc-Kunt, and Levine (2004) find that financial development (as measured by the ratio of financial intermediation to the private sector to GDP) reduces income inequality by disproportionately raising the incomes of the poor.[47] In other words, in this sample of SSA countries, financial deepening reduces absolute levels of poverty but does not significantly impact income inequality.

27. **Effects on Prices.** Up to 60 percent of construction sector inputs are imported.[48] Thus, prices in Nigeria are more likely to follow international prices. However, an increase in housing demand will produce an increased demand for inputs. Experience in developing countries has shown that the supply markets may be incapable of responding quickly to increased demand, leading to short-run price increases. Locally produced building materials and components are frequently overpriced, of poor and variable quality, and subject to long delays in delivery owing to the inadequacy of the transport system, monopoly, hoarding, and lack of essential inputs.[49] This experience implies that a strategy to alleviate supply deficiencies must be implemented simultaneously with the joint action of the donor community in the Housing Finance project. In the short run, NMRC will add pressure on prices. However, in the medium to long term, through the effort of GEMS and other donor programs, the bottlenecks in the housing supply chain will be removed, driving down prices.

28. **The technologies in use in the industry also matter because approximately 60 percent of materials used in the building and construction industries are imported.**[50] Importation limits employment generation and potential linkages with other sectors within the economy. Thus, at present, there is a trade-off between firms' productivity and employment opportunities (that is, less-capital-intensive firms use more unskilled labor). Currently, the Nigerian construction sector is labor intensive and dominated by small and medium-size enterprises.[51] Consequently, as presented above, the project is expected to support job creation. These companies use greater proportions of locally produced materials, higher labor-to-capital ratios, smaller amounts of imported machinery, more unskilled and semi-skilled labor, and less hard currency. In many countries, there is considerable scope for encouraging the substitution of imported materials by local ones. For example, many countries have locally established industries to make materials, such as cement. Substitution will reduce not only the direct import costs but also the energy (usually a high foreign-exchange user) required to produce the materials.

29. **Government Revenue.** Revenue sources during the construction phase include VAT on building materials, corporate taxes on builders' profits, income taxes on construction workers, inspections, and increased customs revenue on imported inputs. Challenges in obtaining appropriate data limit our analysis, but the project undeniably will improve the government's balance sheet through its positive impacts on both the construction and financial sectors.

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[46] Nigeria is included in the sample used for this study Singh, Raju and Y. Huang, 2011, Financial Deepening and Property Rights: Evidence from Sub-Saharan Africa, IMF Working Paper No. 11/196.
[47] Beck, Thorsten & Demirguc-Kunt, Asli & Levine, Ross, 2004. "Finance, inequality, and poverty: cross-country evidence," Policy Research Working Paper Series 3338, The World Bank.
[48] DFID, GEM II Construction Sector Overview (UK).
[49] UNCHS/ILO, "Shelter Provision and Employment Generation" (Geneva: ILO Office, 1995).
[50] UNCHS/ILO, "Shelter Provision and Employment Generation" (Geneva: ILO Office, 1995).
[51] DFID, GEM II (UK)," The Construction Sector in Nigeria", unpublished.

Annex 8. Sectoral Description

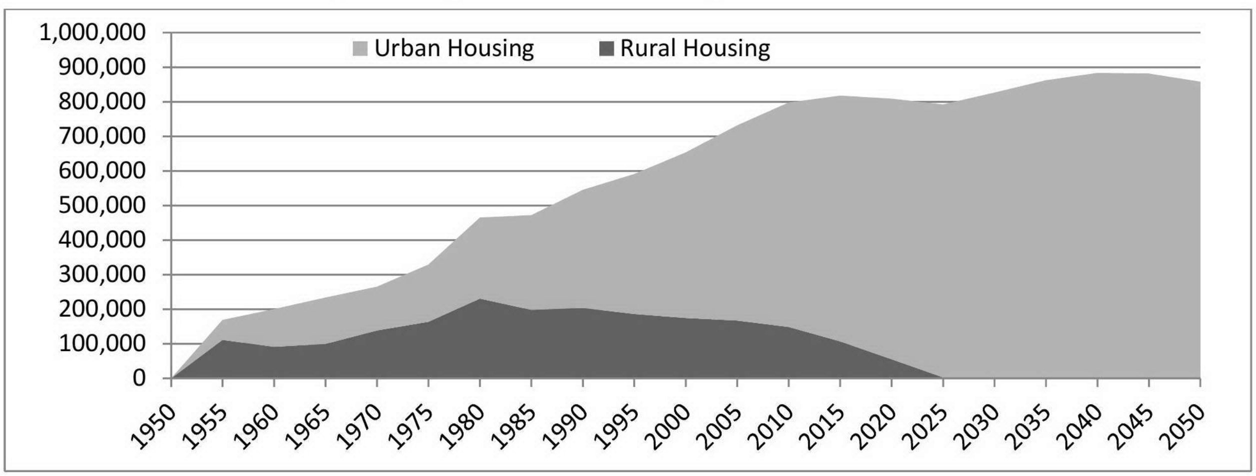
I. Housing Sector

(a) Population and Housing Needs

1. **Nigeria is the most populous country in Africa, more than 162.5 million people, approximately 50 percent of whom are concentrated in urban areas.** The rapid growth of the country's metropolitan population is exerting tremendous pressure on the housing sector. In 2003, an estimated 70 percent of the urban population was living in inadequate settlements.

2. **The housing deficit has been estimated to be as high as 16 million units. In Lagos, Ibadan, Kano, and Abuja, where urbanization is accentuated, the need for housing rises 20 percent annually.** Current total annual output in the formal housing sector is estimated at no more than 100,000 units. Clearly, the formal sector is producing only a fraction of the total number of urban units needed each year. By 2050, the UN estimates that 75 percent of Nigeria's population will be living in cities. This share translates into an annual housing requirement over the coming decades of at least 700,000 units just to keep up with growing population and urban migration.

Figure 4 Nigeria Annual Housing Needs, 1950–2050



Source: UN Population Division; World Bank calculations.

(b) Housing Tenure

3. **A majority of Nigerian households own their dwellings, whereas rental housing is more prominent in urban areas.** More than two-thirds of households in Nigeria own the houses in which they live. Owning a house is more common in rural areas (81 percent) than in urban areas (44 percent). Conversely, renting houses and rooms is more common in urban areas (35 percent) than in rural areas (4 percent). Living in a rent-free house is rather common in both urban and rural areas at 17 percent and 13 percent, respectively.

4. **Using the income distribution, we note that, as total expenditure increases, the ownership rates increases.** In addition, we note that large numbers of rural households (81 percent) own their housing. This kind of ownership often is informal and may be held

collectively, rather than individually. While some farmers rent land, very few rent a home. Figure A8.2 underlines that, whether rich or poor, most rural dwellers have some kind of access to "ownership." The situation is different in the cities, where a higher percentage rent.

5. **International experience indicates that most variations in home ownership in poorer cities can be explained in terms of access to cheap or free land. In cities, in which land invasion or clandestine subdivision has been permitted, thousands and even millions have taken advantage of them, pushing up rates of home ownership.** By contrast, where the authorities have been stricter, rates of home ownership tend to be lower.

Figure 5 Tenure by Income Band

Source: General Household Survey, Nigeria 2011, www.nigerianstat.gov.ng

(c) Share of Expenditure on Housing

6. **The General Household Survey (GHS) indicates that the share of rent in total household expenditures is fairly constant across regions.** Also noted is that urban households spend more on rent in absolute terms than do their rural counterparts.

Table A8.1 Share of Expenditure on Rent

Income Brackets	Share of Rent (%)			Share of Rent (N)		
	Total	Urban	Rural	Total	Urban	Rural
Above N1.8m ($12,000)	9.1%	10.1%	2.3%	205,098	225,612	60,000
between N1.1m & N1.8m ($4,000 & $12,000)	9.6%	9.9%	6.4%	132,275	136,662	83,568
between 600,000 & 1.1m ($4,000 & $7333)	6.9%	6.7%	8.0%	54,774	53,347	63,195
between 340,000 & 600,000 ($2260 & $4000)	7.3%	7.3%	7.7%	33,881	33,549	35,920
below 340,000 ($2260)	7.5%	7.6%	7.1%	18,086	18,634	15,580
Total	7.4%	7.4%	7.5%	40,801	41,663	35,937

Source: General Household Survey, Nigeria, 2011, www.nigerianstat.gov.ng

7. **Similarly to the above trends, house-related expenditures (rent, water, electricity, and repairs) are more costly in urban areas than rural areas.** However, these expenditures also represent a larger share of urban household total consumption.

Table 5.2 Share of Expenditure on Housing-Related Expenditure

Income Brackets	Share of House Related Expenditure (%)			Share ofHouse related Expenditure (N)		
	Total	Urban	Rural	Total	Urban	Rural
Above N1.8m ($12,000)	19.3%	21.4%	4.2%	409,517	452,076	108,500
between N1.1m & N1.8m ($4,000 & $12,000)	13.8%	14.2%	8.7%	194,580	202,021	111,966
between 600,000 & 1.1m ($4,000 & $7333)	10.9%	10.8%	11.7%	86,610	85,919	90,694
between 340,000 & 600,000 ($2260 & $4000)	12.0%	12.4%	9.7%	55,242	56,925	44,924
below 340,000 ($2260)	12.1%	12.8%	8.9%	29,774	31,956	19,809
Total	12.0%	12.3%	9.8%	65,699	68,802	48,194

Source: General Household Survey, Nigeria, 2011, www.nigerianstat.gov.ng

The share of expenditure allocated to house-related items is higher than households' average expenditure on education and health.

(d) Construction Materials for Dwelling

8. **The main materials used by households for the construction of walls are mud (32 percent) and concrete (50 percent).** In the urban areas, 73 percent of households live in dwellings constructed with concrete. In contrast, more than 45 percent of rural households live in dwellings constructed mainly with mud. Moreover, households in the highest income brackets are more likely to live in concrete dwelling whereas lower income brackets are more likely to live in mud dwellings. Owned dwelling are more likely to be made of mud, whereas 80 percent of rented dwellings are made of concrete.

(e) Land and Property Registration

9. **Land tenure and property registration have been identified as major obstacles to the development of Nigeria's housing sector.** Under the Land Use Act of 1978, there is no private ownership of land in Nigeria. The maximum interest a person may hold in land is the right of use and occupancy. This statutory right of occupancy of urban land is given to any person by the state governor's consent and a written certificate of occupancy (C of O). The process has proved time consuming, and very costly. The registration process takes approximately 82 days, as measured by the Doing Business Report, but, can take 6 months to 2 years and costs 20.8 percent of the value of the property (table A8.3). These costs in time and money are very high compared to peer countries in Sub-Saharan Africa. In the World Bank Doing Business 2012, Nigeria ranked 180 (of 183) in terms of registering property because of its too long and costly process.

Table A8.3 Registering Property

Country	Ranking	Number of Steps	Number of Days	Cost as % of Property
Nigeria	180	13	82	20.8
Ghana	*36*	*5*	*34*	*0.7*
Senegal	171	6	122	20.3
South Africa	76	6	23	5.6
India	97	5	44	7.3
Brazil	114	13	39	2.3
Egypt	93	7	72	0.8
OECD		5	31	4.4
SSA		6	6.5	9.5

Source: Doing Business 2012, World Bank.

10. **Certain states are making some efforts to tackle these issues. Lagos started the upgrading and computerization of its title registration system.** Lagos also implemented a much shorter process for land registration and instituted also fast-track court procedures to shorten claims involving a mortgage transaction. The cost and length of registration vary from state to state but, in the major states, they remain high. Table A8.4 compares registration costs in Nigeria's 20 most populous states.

Table A8.4 Costs in Time and Money to Register Property in Nigeria, by State

Country	Procedures (number)	Time (days)	Cost (% of property value)
Akwa Ibom	12	55	15.6
Anambra	13	212	15.4
Bauchi	10	77	11.1
Benue	9	98	8.1
Borno	8	14	14.1
Delta	13	76	25.7
Imo	9	147	21.3
Jigawa	11	28	11.1
Kaduna	12	130	13.6
Kano	11	31	10.8
Katsina	11	33	11.0
Lagos	13	82	20.9
Niger	11	86	15.4
Ogun	15	101	16.2
Ondo	16	62	33.6
Osun	14	93	22.2
Oyo	17	65	24.0
Rivers	13	201	23.2
Sokoto	12	86	15.0

Source: Doing Business 2012, World Bank.

11. **The entire title registration process is so cumbersome that homeowners do not show any interest in registering their properties.** As a result, the records are inaccurate and incomplete. Other characteristics of the land tenure and property registration process in Nigeria include the weak collateral system and the unreliable system of mortgage enforcement.

12. **The major impacts of this dysfunctional process are the large proliferation of informal settlements and slums and the growing trend of urban land-squatting.**

II. Mortgage Market

13. **Nigeria has 84 Primary Mortgage Banks (PMBs) and 20 Deposit Money Banks (DMBs). Lending by the DMBs for mortgage loans accounts for less than 1 percent of their total assets.**[52] The oil and gas sector is the main sector banks lend to, representing approximately 22 percent of total credit to the private sector.[53]

[52] Calculations made from various CBN data (2011).
[53] Financial Sectoral Assessment Program (FSAP) Note 2012.

14. **The main initiative of the government to increase access to housing finance was the implementation of the National Housing Fund.** The scheme provides that workers making over minimum wage NGN18,000, including civil servants, shall contribute 2.5 percent of wages to the NHF. Contributions plus interest at 2 percent are to go to the employee at age 60. After contributing for 6 months, employees are supposed to be entitled to receive a mortgage loan worth up to 90 percent of the value of the property, up to a maximum amount of NGN5 million[54] (approx. US$43,000) at a rate of 6 percent for 30 years under the current rules. Results achieved by the FMBN, the administrator of this fund, are unsatisfactory. In August 2012, only 12,031 had received mortgage loans from NHF on a total number of 3.8 million contributors.[55] The reason for this under-lending was that a large proportion of the funds had been lent to real estate development companies.

15. **In 2011 CBN issued new guidelines relating to PMBs to strengthen the overall sector through a recapitalization.** The main points of these guidelines include new capital requirements: NGN5 billion (approximately US$43 million) (for a national license), or NGN2.5 billion approx. (US$21.5 million) (for a State license) by a deadline of December 2013. It is expected that no more than 30 PMBs will survive this recapitalization. Other measures adopted by the CBN include restricting PMBs' business to mortgage loans, adopting the International Financial Reporting Standards (IFRS) by the financial system, and the introduction of the Financial Report Council (FRC) of Nigeria with regards to the reporting framework.

16. **In September 2012, the CBN conducted a survey of the mortgage lenders, deposit money banks (DMBs), and primary mortgage banks (PMBs) operating in Nigeria.** To identify the key factors that would encourage lenders to provide housing finance to their clients, lenders were asked to rank the obstacles against deciding to expand their housing finance businesses. Of 68 respondents, 55 (80 percent) reported that access to long-term funds was the major obstacle to growing their businesses. Difficulties with property registration and titling, and cost and time of foreclosing were listed as second and third, respectively (table A8.5).

Table A8.5 CBN Mortgage Market Obstacles Survey, 2012

Mortgage Market Obstacles	Frequency of Response
Access to long-term funds	55
Difficulties with property registration/titling	21
Cost and time of foreclosing on a property	18
High interest rate	14
Lack of housing supply/new construction	11
Burden of regulation (provisioning, capital requirements, liquidity rules)	9
Credit risk (lack of credit histories, documented income)	7
Low level of incomes/informality	5
Lack of understanding of mortgage product by consumer/lack of financial literacy	3

Source: Central Bank of Nigeria 2012.

Note: Respondents were asked to rank their top 5 obstacles to market development. However, many respondents ranked several obstacles as number one, so overall frequency is higher than the number survey participants.

[54] Discussions to raise this amount to NGN15 million have been underway; it is not clear whether the new ceiling is in effect.

[55] FMBN financial statements.

17. **The shortage of affordable housing also constrains the development of the mortgage market**. The cheapest house built by a private developer costs approximately US$31,250 (NGN4.6 million) in Lagos, and US$15,600 (NGN2.3 million) outside Lagos.[56] A large part of the housing supply is concentrated in luxury homes that the middle-income population cannot afford. The high prices of houses derive primarily from the high cost of construction. In most cases, construction companies and developers must carry the cost of implementation of rudimentary infrastructure such as sewage, water, and power. These costs add 30 percent to the construction costs of the houses.[57]

III. Liquidity Analysis

18. **Access to long-term funds is a major impediment to the growth of mortgage finance in Nigeria.** A 2012 CBN survey showed overwhelmingly that lack of access to long-term funds was the top obstacle to growth named by financial institutions in the mortgage market. Costly and lengthy foreclosure processes, tight housing supply, and costly and lengthy title registration also were cited as major obstacles (table A8.6). Without access to long-term funds, lenders are either unwilling or unable to further extend maturity mismatches on their balance sheets. The unavailability of long-term funds also prevents lenders from making the necessary investments in staff and systems to establish large-scale mortgage lending operations. The regulatory framework is relatively lax regarding maturity mismatches, thus allowing banks to operate with significant levels of contractual maturity mismatches on their balance sheets. However, regulation likely will change in the coming years because the Basel III international framework's new standards on liquidity management are being implemented globally.

Table A8.6 Constraints Ranked by Lenders in Growing Their Mortgage Portfolios

Mortgage Market Obstacles	Frequency of Response
Access to long-term funds	55
Difficulties with property registration/titling	22
Cost and time of foreclosing on a property	18
Lack of housing supply/new construction	12
High interest rate	14
Burden of regulation (provisioning, capital requirements, liquidity rules)	9
Credit risk (lack of credit histories, documented income)	7
Low income levels/high informality	5
Lack of understanding of mortgage product by consumer/financial literacy	3

Source: Report on mortgage market, CBN (2013)

19. **The Nigeria Mortgage Refinance Company (NMRC) is an institution known as a mortgage liquidity facility, which provides a source of both liquidity and long-term funds.** The facility enables lenders to present illiquid mortgage assets for refinancing and receive cash in return. Essentially, the facility enables lending institutions to transform illiquid assets on their balance sheets into liquid assets. This benefit is key for lenders that rely on deposits for their main funding source because it enables them to use the facility as part of their asset/liability management (ALM) process. The second benefit is that the funding received from NMRC will be long term, typically 5–7 years, thus matching the typical duration of an amortizing mortgage loan. The key then is the pricing of the funding, which is the reason that NMRC needs to be

[56] Africa Yearbook 2010.
[57] Staff interviews with construction and real estate development companies.

established as a low-risk, efficient market intermediary linking capital markets to the housing market at a reasonable price. Together with its funding role described above, NMRC also acts as a market catalyst for other reforms such as market standardization.

Why are maturity mismatches an issue?

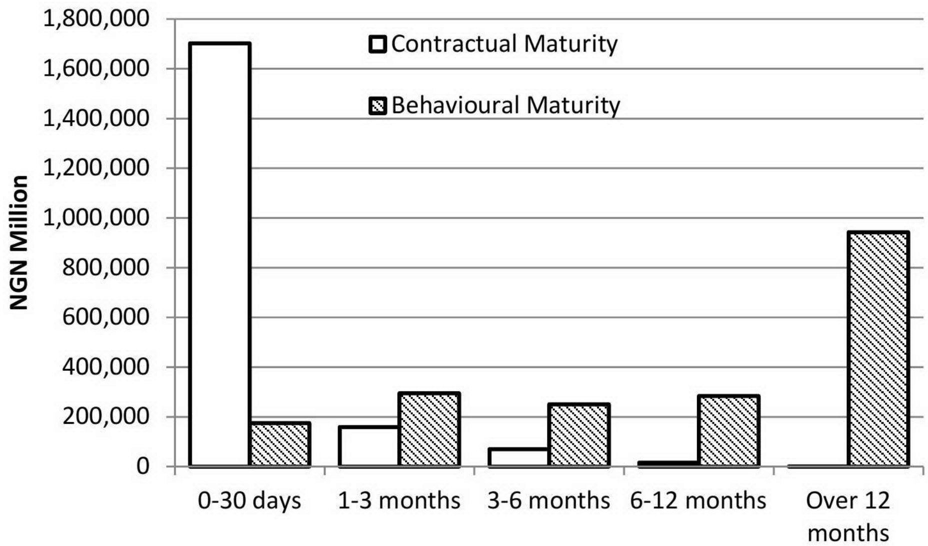
20. **Bank failures typically result from reaching a position of illiquidity, often preceded by a drop in confidence brought on by falling profits or bad loans**. Banks reach a position in which they are unable to meet their obligations to creditors such as depositors. Ending in this position often is precipitated by a fall in public confidence in the institution or the sector. Savers withdraw their deposits from the institution and credit lines that had been available, even as standby facilities are no longer open. A classic example is a run on a bank such as happened during the 2008 global financial crisis to the Northern Rock Bank in the UK.

21. **Nigerian banks adopt the practice of distinguishing between the contractual maturity and the behavioral maturity of their deposit base**. Essentially, this distinction means that, although, legally, a large part of the deposit base could be withdrawn at very short notice; in practice the "behavior" of the deposit base is to stay put and take the form of quasi long-term funds. This "stickiness" of the deposit base is especially prevalent when large deposits are held by the public sector, which can be more reliable than large deposits held by individuals. Another source of "stickiness" may come from depositors such as small and medium enterprises (SMEs) or Corporates, which will maintain minimum credit balances on their transaction accounts. Their stickiness can be enhanced by offering bonuses to depositors for maintaining higher balances, for making only a certain number of withdrawals over a given period, or for having some short-term contractual notice obligations. Around the world, many regulators accept some behavioral long-term deposit base as part of an institution's liquidity requirements.

22. **Figure gives the example of a large Nigerian Deposit Money Bank (DMB) with a substantial variation in the maturity profile of its deposit base in contractual terms versus behavioral terms.**[58] A standard tool for understanding liquidity risk is the "liquidity ladder," which categorizes an institution's assets and liabilities by maturity "buckets." These range from very short-term 1-day buckets to 7-day, 1-month, 3-month, 6-month, and 12-month buckets and beyond. The shorter the maturity, the greater the level of matching expected, because there is greater urgency in ensuring that funds are available before claims fall due. Although Nigerian banks currently are relatively liquid, this liquidity reflects their holdings of short-term tradable assets, largely government securities. In practice, in terms of the maturity profiles on their balance sheets, they are heavily mismatched. These banks have almost no long-term funding to match their long-term assets, and the vast majority of their funding is in the form of deposits. Figure A8.3 assumes that demand and sight deposits have a maturity of 0–30 days, which is a conservative approach.

[58] Data were obtained from this bank's annual reports and are fully available in the public domain. However, full sectoral data on this basis are not available. Situations will differ across institutions depending on their funding sources and strategy. Overall, given the lack of alternative and long-term sources of funding, mismatch analysis largely still would apply across all mortgage lenders.

Figure A8.3 Analysis of Nigerian Bank X Deposit Base by Behavioral and Contractual Maturity



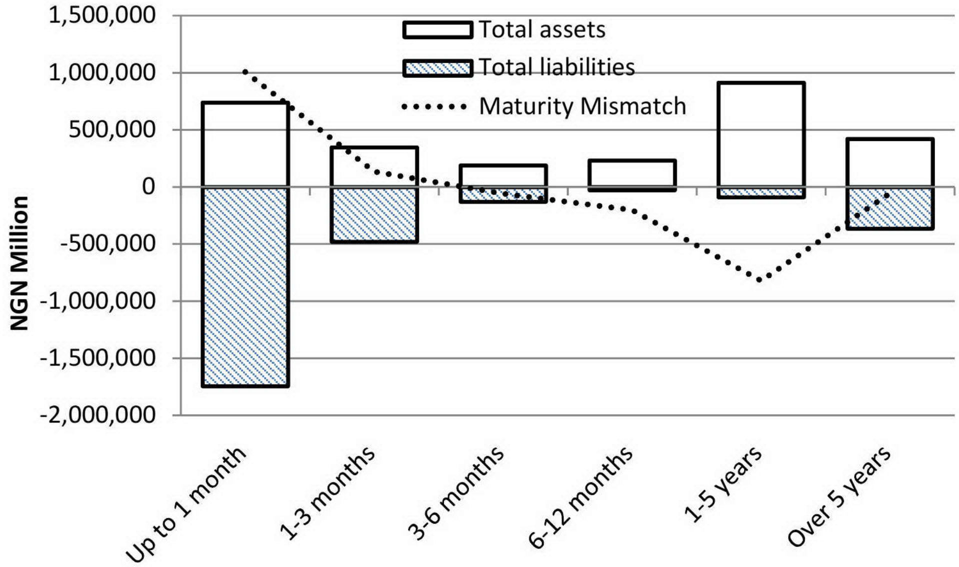
Source: Data drawn from publicly available annual reports and accounts, 2012.

23. **Figure A8.3 provides a full maturity breakdown for a large, typical Nigerian Deposit Money Bank.** Reporting typically would be done using behavioral maturity so the analysis has been adapted to show contractual maturity of deposits. Clearly, a mismatch of over NGN800 billion, or 33 percent of the balance sheet, exists in the 1–5 year bucket. Beyond 5 years, the bank's equity provides some comfort, although it may not be very economical to use equity to fund lending activities.

24. **Looking at the whole Nigerian banking sector, data for the 10 largest banks[59] show that an average of 84 percent of overall liabilities comprise (short-term) customer deposits.** The majority of the remainder of funding is equity. Other sources of long-term funds are extremely limited, averaging just 11 percent of the balance sheet.

[59] Compiled from publicly available bank reports.

Figure A8.4 Maturity Analysis of Nigerian Bank X Balance Sheet Using Contractual Deposit Maturity



25. **Current regulations applying to both DMBs and PMBs focus on ensuring that the short-term liquidity position is covered.** The CBN requirement is that 30 percent of deposit liabilities are held as liquid assets. Satisfying this requirement means investing in government securities or holding funds as cash or short-term placements. Nigeria has limited options in the types of liquid assets that financial markets are still developing. This liquidity requirement provides great strength to the Nigerian banking system but ignores larger, more structural, issues in its funding make-up. For instance, the UK's regulatory rules limit clearly the amount of maturity transformation in which banks can engage. Mismatches in each of the time buckets are capped at a certain level. Moreover, using short-terms funds for long-term funding is capped at 15 percent.

26. **Liquidity constraints will tighten when the Basel Committee's proposals (Basel III) are adopted.** Basel III strengthens the liquidity framework by developing 2 minimum standards for funding and liquidity, initially published in 2010:

a. *Liquidity Coverage Ratio* (LCR) to promote short-term resilience of a bank's liquidity profile by ensuring that it has sufficient High Quality Liquid Assets (HQLA) to survive a significant stress scenario lasting for 1 month. The stock of HQLA must be equal to or greater than the expected net cash outflows over a 30-day stress scenario.

b. *Net Stable Funding Ratio* (NSFR), to promote resilience over a longer time horizon (one year) by creating additional incentives for banks to fund their business with more stable sources of funding on an ongoing basis. Thus, the amount of available stable funding must be greater than the required stable funding. These amounts are determined using weighting factors designed to reflect the stability of the funding and the duration of the assets.

27. **Best Practice as set out under Basel II and Basel III makes several additional recommendations.** "Liquidity monitoring tools" should be developed together with the LCR and the NFSR ratios to ensure a stable and prudent liquidity management. Specifically, it is recommended to develop the following three analyses:

a. *Contractual maturity mismatch:* Cash flows from on- and off-balance-sheet items must be assigned to defined time bands based on their maturity.

b. *Concentration of funding:* In counterparties, product/instruments, and currency.

c. *Available unencumbered assets*: Marketable as collateral in secondary markets and eligible for central banks' standing facilities.

Strengthening System Resilience

28. **Several steps can be taken by both lenders and regulators to protect and strengthen banking system liquidity. Some of these measures are detailed below. As the Nigerian financial system matures, a greater range of instruments and products will facilitate liquidity management.**

a. Strengthen the resilience of the deposit base by instilling greater confidence through deposit guarantee mechanisms.
b. Limit and regulate the amount of maturity transformation (long-term lending funded by short-term deposits) allowed.
c. Avoid systemic effects in which too much reliance is placed on stand-by lines of credit that likely would be withdrawn when most needed in a crisis. In particular, avoid situations in which banks' inter
d. Connected lines create a large systemic risk.
e. Diversifying funding sources is key to reduce reliance on a single particular liability class. This means complementing deposits with wholesale funds, interbank resources, corporate bonds, and commercial paper programs. In emerging markets, opportunities for such funding are more limited, hence the value of tools such as NMRC.
f. Lengthen deposit maturities: Product design and innovation can help by providing better interest rates for longer term deposits and providing products such as Certificates of Deposit (CDs), which may be more secure.
g. Macrostability: Improving the long-term outlook naturally would encourage depositors to invest their funds in longer term products. For example, stability would give depositors greater confidence in locking in their funding with fixed interest rates.
h. Under Pillar II of the Basel II framework, regulators have some discretionary powers to perform reviews of such things as liquidity policies and to stress test liquidity positions based on scenarios covering both endogenous and exogenous factors. Basel III will further strengthen the liquidity requirements applied to financial institutions with LCR and NSFR.

Role of Mortgage Liquidity Facility in Bridging Maturity Mismatch

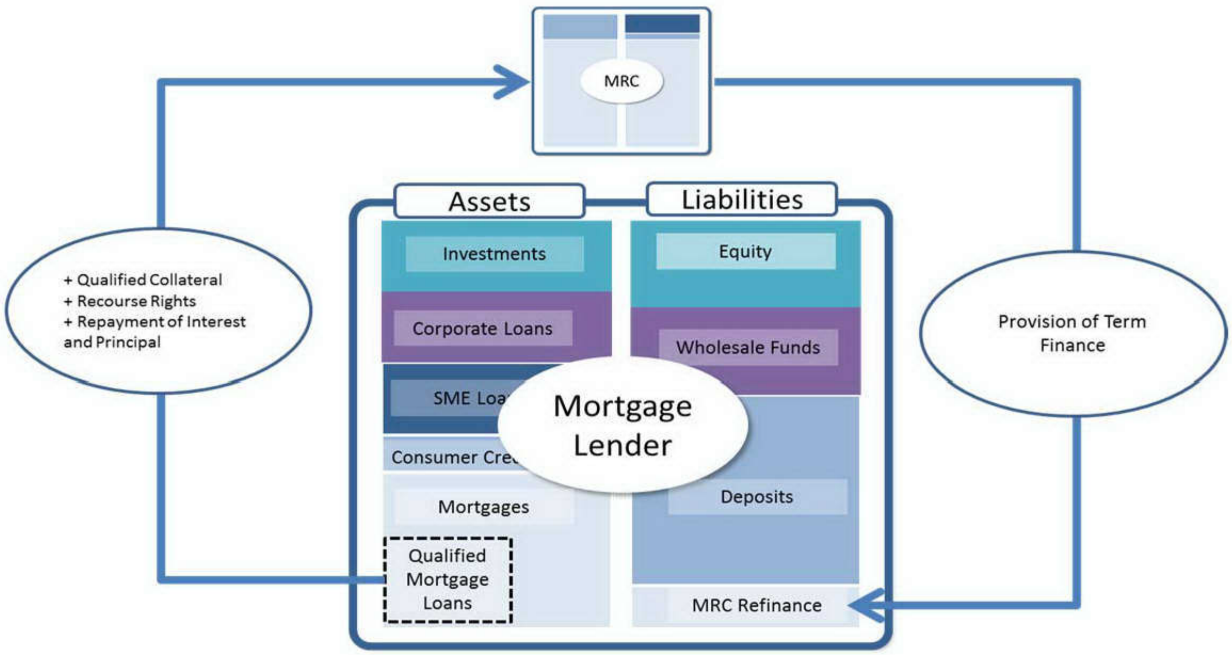
29. **The Nigeria Mortgage Refinance Company will fulfill two key roles in the Nigerian financial system**:

a. Provide mortgage lenders with access to medium-/long-term funding enabling them to match the weighted maturity of the mortgage assets they are originating.
b. Provide a liquidity window, in which mortgage lenders can trade mortgages loans that otherwise are relatively illiquid into cash. The government's overall objective is to achieve a mortgage market in excess of 200,000 mortgage loans outstanding during the project period. Financial modeling has been used to help project what funding and growth levels are necessary to meet this target. The target implies rapid growth in the mortgage market averaging 30 percent per annum, and would mean a significant increase in capacity in the industry to handle additional lending volumes. NMRC also would have to grow at a significant pace by building up its balance sheet at a compound growth rate of 60 percent per annum over the project period. However, both the mortgage market and NMRC are starting from low and zero bases respectively, so these assumptions, although challenging, are feasible.

30. **An additional role that NMRC will play is to provide a deep and liquid supply of corporate bonds to the market for institutional investors.** These bonds are expected to be treated as eligible liquid assets from the CBN's point of view and therefore will offer a better return to banks than banks can obtain currently from government securities. The bonds also will provide an alternative investment option for the pension fund administrators as well as other institutional investors.

31. **Figure A8.5 provides a schematic view of how a refinance operation takes place**. NMRC provides long-term refinance to a typical bank that, in return, pledges part of its mortgage portfolio, equivalent to 125 percent of the loan amount, as security for the loan. In the case of bankruptcy, this pledge effectively ring-fences these assets on the bank's balance sheet, meaning that, should the bank go into liquidation, NMRC has a priority ranking above the bank's other creditors. In addition, these mortgages are termed Qualified Mortgage Loans, because they meet a set of stringent criteria for quality standards and underwriting rules to be eligible as pledge collateral. An additional safeguard protecting NMRC is that if any or all of these mortgage loans go into default, the lender must replace each mortgage loan with a performing loan or other eligible asset. The combination of all of these safeguards means that NMRC faces minimal credit risk and is able to raise bond financing at the lowest possible rate in the market.

Figure A8.5 Structure of an NMRC Refinance Operation



* Note: Over-Collateralization - Qualified Mortgage Loans = 125 % of MRC Refinance

Source: Authors

32. **Growth in the mortgage market will especially impact the Primary Mortgage Banks, but Deposit Money Banks also will need extra resources.** Based on the expected growth in the mortgage market from NGN300 billion to NGN1.1 trillion over the project period, there will be a clear need for additional funding resources to become available to prevent a further deepening in the maturity mismatch. As a proportion of total lending, the growth in the mortgage market would represent a relatively modest 11 percent rise in the loan portfolio of the top 10 banks. In practice, this rise will be spread across the PMBs also. However, the long-term nature of the lending will cause further imbalance on the balance sheets of the DMBs, and for many of the PMBs. If they do not have access to large deposit bases, expanding at this pace simply will be impossible.

IV. Mortgage Affordability

33. **This section sets out the current situation in terms of affordability. The section then showcases examples of how improving affordability can be tackled and what other countries have done in this regard. Last, the section sets out possible solutions for Nigeria.** Table A8.7 shows the enormity of the problem facing Nigeria in expanding access but also what can be achieved with reductions in interest rates and extensions in loan maturities. At present, interest rates are approximately 20 percent per annum for mortgages with loans of approximately 10 years in maturity. Thus, only 7 percent of the urban population currently could afford a mortgage loan for a basic NGN2 million loan (US$13,000), to purchase a NGN2.4 million (US$15,000) property. The situation in rural areas is even more restricted because incomes are much lower. Thus, 93 percent of the urban population is excluded from the formal housing market.

34. **To improve affordability there are three parameters that can be tackled: maturity of loans, interest rate of loans, and cost of housing units.** The fourth variable, which is the income of the borrower, also can help bring greater numbers of households within the affordable range. However, this variable is beyond the scope of this project. Each of the three parameters contains multiple reasons explaining high interest rates, or short loan maturities, or high building costs. This project cannot tackle every issue, but will attempt to make some difference on some issues. Accumulating even small marginal changes can help lead to shifts along the affordability matrix (toward the top right of table A8.7).

Table A8.7 Mortgage Affordability Matrix (%)

Proportion of urban population able to afford repayments on a NGN2 million mortgage loan: Interest rates * Loan maturity (%)

%	5 years	10 years	15 years	20 years	25 years	30 years
5.0	7	18	30	43	51	55
7.50	6	16	22	28	34	39
10.0	5	13	18	21	23	24
12.50	5	12	15	17	18	18
15.0	4	10	12	14	14	14
17.5	3	8	10	11	11	12
20.0	2	7	8	9	9	9
22.5	1	6	7	7	7	7
25.0	1	4	5	6	6	6
27.5	0	3	4	4	4	4
30.0	0	2	3	3	3	3

Sources: Nigeria Household Expenditure Survey 2010; World Bank calculations.
Note: Assumptions: (a) Loan payments do not exceed 40% of household income; (b) regular amortizing loan; (c) based on mortgage payments only, so excluding cost of deposit or transaction costs.

35. **Housing Affordability Parameter 1: Interest Rates. The interest rate on a mortgage loan is composed of a number of different constituents. They include the overall cost of funding, administrative costs for loan servicing and underwriting, costs associated with credit risk, and a spread to allow for a return on capital. The largest cost typically is the overall cost of funding.** It will be determined in part by the benchmark cost of funds as set by the yield curve based on government debt issuance. The second largest component will be administrative costs. In particular, nascent markets face the problem that staff costs tend to be high because the necessary investments in automated systems have not been made yet. Consequently, due to low volumes of business, each mortgage carries a high level of fixed costs. Therefore, it is not unusual to require 300–400 basis points (bps)[60] to cover administration and processing costs in low-turnover, labor-intensive markets. The third largest expense built into the interest rate is the credit risk. The credit risk is calculated using the Probability of Default (PD) and the Loss Given Default (LGD). Together, they provide the overall expected loss on an asset. The PD in Nigeria is high due to the difficulties in underwriting a loan without reliable credit

[60] Mortgage insurance rates often are expressed in bps (basis points). One basis point equals one one-hundredth of 1%, that is, 50 bps = 0.5% (http://budgeting.thenest.com/mortgage-insurance-calculated-3601.html)

scoring information to assess borrowers and to know with certainty whether a borrower already has other loans. The LGD will be high due to the difficulties in foreclosing on properties, the lack of reliable property valuations, and the lack of a liquid property market to resell foreclosed properties. Last, given the overall high levels of interest rates, the return on equity (ROE) also will be high.

36. **A high interest rate environment is the corollary of a high inflation environment. Both have a markedly inflationary impact on long-term finance whereby the value of money is more rapidly eroded.** A more detailed discussion including possible solutions to this impact is set out below both in the maturity discussion and in a separate section on mortgage product indexation. The main point is that creating a more inclusive system can be accomplished much more effectively by providing a sound macroeconomic framework than by any amount of subsidization.

37. **Housing Affordability Parameter 2: Loan Maturity.** Loan terms in Nigeria tend to be 10–15 years. Although long-term funds are a constraint, the biggest obstacle to term lending is the high level of interest rates. It often is not well understood that, at rates of 15 percent or more, there is very little value in extending loan maturity beyond 10–12 years. The reason is that, beyond a certain point, the present value of a loan that is discounted at a high rate due to high interest rates is almost zero. For instance, table A8.7 clearly shows that, with rates at 15 percent, there is virtually no change in affordability whether the loan is extended for 20 years, 25 years, 30 years, or 100 years. The much more significant benefits accrue once the interest rate falls below 10 percent. The key benefit of this project is to increase the availability of long-term funds to help lenders offer loans of up to 10–12 years versus not being able to offer any loans at all owing to maturity mismatches.

38. **Housing Affordability Parameter 3: House Prices.** Nigeria's housing sector suffers from high construction costs, which limit the development of affordable housing. Causes are that the construction supply chain is dysfunctional, and locally produced building materials are not available in sufficient quantities. In addition, the cost of missing public infrastructure often is priced into residential housing. Skilled labor also is in low supply, causing the construction companies to have to train their own staff. All of these cost factors make housing construction in Nigeria highly expensive. It is estimated that the production of a 3-bedroom house in Nigeria costs US$50k, compared to US$36k in South Africa and US$26k in India.

V. International Experience

39. **Numerous countries have tackled one or several of the above parameters to expand inclusion in their housing finance sectors.** A variety of tools can be used that include a mix of private and public sector interventions. Some of the most successful cases have sought strong partnerships with the private sector to enable affordable housing finance to go to scale.

40. **Sequencing interventions is critical; international experience shows that mortgage markets tend to develop from the top down.** Top-down growth of mortgage markets makes intuitive sense, because those with higher incomes represent lower credit risks and are more likely to have savings for an equity cushion. It is natural for lenders initially to target this market. As the upper end of the market gets saturated, lenders gradually will adapt their products to reach farther down the income distribution. It is at this point that government could provide support to

help facilitate this move down-market by providing subsidies where necessary, providing guarantees to mitigate credit risk, or helping support the construction of lower income housing units.

41. **Egypt: Fixing primary market issues before moving down to lower income households.** The World Bank and United States Agency for International Development (USAID) have provided extensive support to Egypt through a series of interventions that address many of the issues facing the country's mortgage market. These interventions included rewriting the mortgage law to make foreclosure more effective; introducing a strong regulatory framework for lenders and all related professions such as mortgage brokers, and foreclosure agents; and importantly establishing a secondary mortgage market funding mechanism. The Egyptian Mortgage Refinance Company was created to provide refinancing funds to lenders and was focused on mortgage finance companies that were not eligible for deposit-taking. In addition, the project aimed to tackle issues around property registration and titling. The government embarked on an ambitious titling program that was launched with a big cut in the cost of registration to encourage home owners to formally register property transactions.

42. **During the project period, the mortgage market grew rapidly, and government focused on reaching lower income households through introducing a mortgage subsidy program.** The Egypt Affordable Mortgage Finance Project amounted to US$300 million and aimed to reach households earning less than LE 2,000 per month equivalent to a maximum of US$400 per month. In practice, the average beneficiary household income was approximately US$300 per month. The program aims to shift housing subsidies from inefficient supply side subsidies that are poorly targeted and benefit developers more than households to subsidies that go directly to households in the form of support for mortgage payments. The innovative part of the program is that the subsidies operate at regular market interest rates with regular loans. During their initial years, the loans help borrowers make a portion of their payments. As the loans amortize and borrowers' incomes gradually rise, the subsidies diminish. This added income provides the support to those who need it when they need it. Several thousand recipients already have benefited from the scheme, and it is being scaled up to reach over 50,000 beneficiaries annually.

43. **India faced a similar set of issues as Nigeria: a large informal sector, difficulties in titling and property registration, a poor/nonexistent foreclosure mechanism, and a lack of long-term funding.** The Indian government took a strategic view on the sector and helped to establish housing finance companies (HFCs) to be supported by a refinance agency, the National Housing Bank of India. Although State owned, it operates along commercial lines, is efficient, and achieves its role with fewer than 100 staff—a fraction of the number working in the Federal Mortgage Bank of Nigeria, which has not been very effective. The mortgage market in India developed gradually over the past decade with improvements in the foreclosure process, improvements in land titling in many States, and a gradual scaling up of lender capacity. The market grew gradually starting with upper income borrowers and has gradually come down market to a point at which efforts are being made to extend the mortgage sector to informal sector borrowers.

44. **A new IDA project for India is under preparation—the Low Income Housing Finance Project—which aims to push the boundaries of affordability to reach those on informal incomes who may not have full formal title.** Addressing affordability is possible only

because of the work that has been done in the primary mortgage market, which now is reasonably efficient and has gone to scale with loans outstanding exceeding US$100 billion. The new project consists of an IDA line of credit to fund a new window offered by NHB to refinance loans to those on monthly incomes of 15,000 Rupees and below (approximately US$300). Loan sizes amount to a maximum of approximately US$11,000. This is small-scale lending, but it has tremendous potential given the market size. Another enabler of this market has been the development of housing production capacity for low-cost housing through which small, well-built units are being mass produced and offered by the private sector.

VI. Indexation of Mortgage Loans

45. **A major limitation on affordability in the Nigerian market is the current high level of interest rates, which is in part due to the high level of inflation.** One possible solution advanced and raised during the concept review stage of the project would be to introduce a system of indexed mortgages that effectively would ensure that a loan is priced from both the borrowers' and lenders' points of view and is based on real interest rates, rather than on nominal rates. This proposition also is being advanced in a forthcoming 2013 World Bank publication in which Paul Collier argues in support of indexed mortgage loans as a means to improve affordability in high-inflation environments.[61]

46. **Conceptually, spreading the cost of a mortgage loan over a longer period makes sense.** By indexing the mortgage, the borrower effectively is being charged a "real" rate of interest over the lifetime of the loan, that is, payments are kept constant in real terms. In a standard mortgage product, the payments are kept constant in nominal terms, which means that over time, their real worth decreases as inflation erodes the value of money. Keeping a mortgage payment constant in real terms through indexation enables the mortgage to amortize over a longer period, thereby increasing upfront affordability.

47. **Different forms of indexation have been tried in different countries with varying success. A common issue is the reliability of the data used for the index.** Especially in emerging economies, inflation data can be unreliable and can undermine confidence in a system reliant on objective, timely data. Indices produced by government statistical departments may risk being subject to political interference.

48. **The implementation of an indexing system itself can be complex due to the different financial stocks and payment streams involved in a mortgage system.** The outstanding mortgage balance, the monthly mortgage payment, the borrower's income, the lender's source of funds, and the value of the housing collateral all are subject to different price dynamics and influences. Using a single index to capture all of them can lead to a disconnect among different flows. For instance, a borrower's income may not keep pace with a price inflation index. Alternatively, using a wage index may not accurately capture changes in prices and could result in losses for a lender. Thus, although the initial concept appears simple, practical implementation requires a degree of sophistication and reliable data.[62]

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[61] Paul Collier and Tony Venables, *Rethinking Cities*, Chapter 11, Housing and Urbanization in Africa (Oxford: Oxford University Press, forthcoming 2013).

[62] For details, see L. Chiquier, *Dual Index Mortgages: Lessons from International Practice and Conditions of Development in Poland* Housing Finance International, 1998).

49. **Overall experiences with indexation have been very mixed**. Latin America has trialed several versions of indexation. Some versions have worked for reasonable periods but have not been able to stand up to crises. Such was the case in Mexico, in which the "Tequila crisis" overwhelmed the system. Colombia had reasonable success with Price Level Adjusted mortgages (PLAMs) until a sharp deterioration in the economy, combined with a Supreme Court ruling that required a change in the index, led to high levels of default and a serious asset/liability mismatch for lenders. The most successful example is Chile, which has benefited from a very stable and decreasing level of inflation as well as a well-developed capital market and pension system able to provide the funding for inflation indexed mortgages.

50. **A final example is Ghana, in which the Home Finance Company (HFC), a nonbank financial institution, is virtually the sole lender now.** It was created in 1991 as the implementation agency for the housing finance component (US$7 million) of an IDA urban loan. The HFC was intended to become more generally a central provider of long-term funds to mortgage originators and a catalyst for the development of the market. To meet its two-fold functions, HFC developed an IDA-related product for moderate-income groups (the "Pilot Scheme"), followed by other schemes targeting more diverse populations. Practically all of the loans are based on an indexation principle to enable positive remuneration of the capital raised through bonds issues. These issues are placed with the government for one-third of the Pilot scheme, and with Ghana's Social Security and National Insurance Trust (SNITT) for almost all of the remainder of the funding needs in Cedi. Under the Pilot Scheme, mortgage payments are indexed so as not to exceed 25 percent of a borrower's income.

51. **During the surge of inflation in the mid-1990s that led to a severe fall of real wages, had its principles not been temporarily altered, the indexation mechanism would have implied unbearable rises in mortgage payments, or unsustainable negative amortization.** Instead, the appreciation of the balance of the loans in the Pilot Scheme at a floating benchmark tied to the bank's prime rate, and HFC negotiated with its investors (GoG and SNITT) a symmetrical limitation of the appreciation of its bonds.

52. **Several lessons can be drawn by examining the experience with high-inflation mortgages.**[63] First, although they can ameliorate the impact of inflation on mortgage payments by improving affordability and reducing the risk of default, high-inflation mortgages can do so only within a range of inflationary outcomes. Severe shocks like those seen in Colombia, Ghana, and Mexico will overwhelm the instrument, leading to adverse results. Second, there must be a matched funding source for the instruments. Lenders without a matching liability will not be able to manage the cash-flow risk they generate. Finally, these instruments are very complex, presenting challenges to both lenders and borrowers. It is likely that many borrowers with these loans do not really understand their dynamics. Past experience has suggested that lenders' staff may not understand them either.

53. **When looking at the current situation in Nigeria and the potential for indexed products, several preconditions would need to be assessed:** (a) quality, independence, and robustness of price inflation data and wage inflation data; (b) capacity of lenders to service and underwrite highly complex products; (c) inflationary outlook for Nigeria; (d) sources of long-

[63] This paragraph is drawn largely from *Housing Finance Policy in Emerging Markets,* ed. L. Chiquier and M. Lea, chapter 3, Mortgage Instruments (Washington, DC: World Bank, 2008).

term inflation-indexed funding; and (e) consumer protection issues around selling such products and consumer understanding. Even a cursory assessment would indicate that, at present, many of these conditions could not be met. However, a longer term program could be initiated to lay down the right conditions for such an innovation in the market with consequent benefits for overall affordability.

VII. Land and Mortgage Registration Issues and Next Steps

54. **In Nigeria, costly and lengthy procedures act as strong disincentives to land and mortgage registration.** A key issue is the requirement of the governor of each respective state to consent to each land transaction or transfer of rights, including by mortgage. Other problems are created by the incompleteness and inaccuracy of many land records due to widespread informal land occupancy and rapid urbanization, and the unwillingness of holders of rights to register them. Their unwillingness makes the records unable to serve as legal evidence of rights or to support effective research of records to identify all interests in a parcel of land. Registration in most Nigerian states is done in handwriting, with notations kept in large ledgers that note transfers from the government to an individual, and subsequent assignments of interests or rights in the land through transfer, mortgage, or easement.

55. **Efforts to improve registration systems through computerization and digitization of records and geographic information systems (GIS) have taken place with government funding in the Federal Capital Territory and the State of Lagos, and to a lesser extent in several other states in which donor assistance has been provided.** Beginning in 2005, the Lagos State Lands Bureau began an ambitious project to improve land registration by upgrading facilities, modernizing operations, and making information more accessible to customers. These reforms are leading to an increasing number of properties being brought into the formal system every year and at lower cost to the occupants.

56. **In addition to improving the physical facilities, staff capacity, and computerization of the registry, Lagos State also has implemented procedures to lessen the cost and time required for registration.** Under the new procedures, a Certificate of Occupancy on state land should be issued within 21 days of the submission of the application and appropriate documentation. The Lands Bureau is planning to lower its registration fees for anyone who buys a landed property in the state to pay the government 2 percent–5 percent of the value of the property.

57. **Significant improvements can be made without changing existing laws.** In this way, changes can be put in place and begin to improve the mortgage market more quickly than through enacting new legislation. These changes include:

- Making broader use of the state governors' powers of delegation to grant consents to land transactions, including sales and mortgages
- Improving administrative procedures, including reduction or merger of the number of steps to register a property, digitalization of land registries, introduction of electronic point of payments, and simplification of the overall process so that an individual is able to do it without the need for a lawyer

- Lowering costs of land registration through, for instance, elimination of the consent fee and the introduction of flat fees where applicable, rather than fees as a percentage of property value
- Replicate good practices, such as Lagos' fast-track registration and land regularization program, and promote replication in other states.

VIII. Foreclosure Issues and Next Steps

58. **Lengthy and expensive methods of mortgage enforcement and the failure of lenders to qualify for right to power of sale impede the growth of the mortgage market.** Power of sale—nonjudicially supervised foreclosure and sale of property used as mortgage collateral—is available under the laws of Nigeria. However, this market-oriented procedure often cannot be used because many of the major mortgage lenders routinely forego the obligation to perfect mortgages by registering them in the property records before power of sale can be used. Mortgage enforcement through the courts—whether initiated by the lender to enforce its rights to the collateral, or by the debtor to enjoin the action of the lender—can be lengthy process.

59. **Improved procedures including standardization of mortgage documentation and procedures and increased registration of mortgages are being considered through the adoption of new regulations**. In addition, the State of Lagos has adopted fast-track court procedures for mortgage cases under a specialized commercial division of the High Court. The fast-track procedures have reduced the time to resolve a mortgage enforcement case to approximately eight months. Similar procedures should be adopted by other states to make mortgage enforcement more efficient. Even with these changes, however, it is essential that lenders perfect mortgages so that they can avail themselves of nonjudicial and fast-track procedures.

The following interventions can be taken to improve contract enforcement and foreclosure:

- Create specialized court division as stipulated in the Land Use Act to deal with mortgage foreclosure issue
- Increase capacity of judges and lawyers to manage mortgage caseloads and promote strict enforcement of deposit requirements in injunction cases
- Establish licensed foreclosure administrators
- Improve High Court judicial procedures to make mortgage enforcement less expensive and more efficient and to foster strict compliance with deposit requirements in injunction cases
- Increase the capacity of lenders to manage mortgage portfolios, stressing the importance of perfection of title so that power of sale can be used, and diligent record-keeping so that good evidence of default is available when litigation is necessary
- Enactment of adequate land use regulations.

IX. Completed Background Studies

60. **The project team could refer to a wide range of existing research and materials for the design of the Nigeria Housing Finance Project.** Additional in-depth research in the areas of housing finance, housing construction, and legal framework—identified as the major impediments to housing delivery—was conducted by the team and contracted experts. The following paragraphs give an overview of the objectives and key conclusions of these studies.

61. **The 2009 study, "Housing Finance for the Poor," conducted by Simon Walley looked at options for Nigeria—particularly social housing, housing microfinance (HMF), rental housing, and construction finance—available for those further down the income distribution.** The author found that none of the studied areas was delivering solutions for the needs of poor households. The study recommended commissioning a detailed study on the rental housing market, setting up a working group on real estate development finance, clarifying and developing the HMF regulatory framework, developing the Real Estate Investment Trust framework, creating a framework for Housing Public Private Partnership Schemes, and advocating for a more coordinated and inclusive housing policy.

62. **Following a series of workshops in 2009 the Nigeria Financial System Strategy 2020 Plan (FSS2020) Mortgage Implementation Committee issued a report that identified access to land and finance and lack of housing delivery and quality as the main impediments to the development of the mortgage market**.

63. **In 2010, the Enhancing Financial Innovation & Access organization (EFinA) commissioned the report, "Overview of the Housing Finance Sector in Nigeria," to explore access to housing finance in Nigeria.**[64] In line with earlier research, the report identified limited access to finance, slow bureaucratic procedures, and the high cost of land registration and titling as major factors negatively affecting housing in Nigeria.

64. **To analyze the housing market dynamics, the World Bank team conducted a housing demand profile analysis using data from the Nigerian General Household Survey 2010/11 and commissioned a housing supply study.** The housing demand analysis contributes insights about consumers' preferences in the housing market, enabling a better match between housing supply and demand. The analysis also helps the design of housing policies to be better adapted to household demand, income level, and market gaps (that is, lack of adequate housing). The analysis indicated that more than two-thirds (66 percent) of households in Nigeria own the houses in which they live. Approximately 33 percent of the households have a different type occupancy status, including 14.4 percent who live in rent-free houses, and approximately 17 percent who live in rented premises. Owning a house is more common in rural areas (81 percent) than in urban areas (44 percent). Renting houses and rooms is more common in urban areas (35 percent) than in rural areas[65] (4 percent). The analysis also indicates that the number of persons

[64] Enhancing Financial Innovation and Access (EFInA) is a financial sector development organization that promotes financial inclusion in Nigeria. EFInA is funded by the UK Government's Department for International Development (DFID) and the Bill and Melinda Gates Foundation. EFInA focuses on four key pillars: research, innovation, advocacy, and capacity building. http://www.efina.org.ng/.

[65] The remaining fraction of the population has an occupancy status different from simply owning or renting their dwelling. This includes households living in dwellings paid by their employers or living in dwellings free of rent with or without the consent of the owner.

per household in Nigeria (5.6) is marginally higher than the Sub-Saharan average, pointing to a lack of housing. The analysis highlighted the need for better housing since only 73 percent of housing in urban areas is made of concrete, and only 83 percent of households use iron sheet for roofing.

65. **The ongoing housing supply study will determine the current supply of houses and possible supply gaps, and assess the structure of the industry and the price composition of building a house.**

66. **The CBN and the project team jointly conducted a survey of Nigerian banks providing mortgage finance. The objectives were to determine characteristics of the market and identify key factors that will encourage lenders to provide housing finance to their clients.** The analysis showed that the mortgage market increased rapidly in recent years but that access to mortgages remains very scarce, with mortgage loans only amounting to 0.6 percent of GDP. Eighty percent of mortgage lenders identified access to long-term funds as the key constraint to increasing their lending.

67. **The team and a contracted regulation expert have drafted regulations and guidelines for NMRC**. Based on the draft regulations, the CBN has developed an exposure draft, which is being reviewed by Nigeria's financial industry. The regulations are expected to be passed in September 2013.

68. **A market study on the current demand and supply of HMF was conducted by the Affordable Housing Institute**. Although there is a demonstrable demand for HMF in Nigeria, it does not yet exist as a business. Instead, a handful of Nigeria's leading innovators in microfinance are seeking to move into this business space. They are interested in this market segment and are innovating products that address the need. The report on the study recommended including HMF in the housing finance project, and dividing it in three phases: viability and TA, piloting with seed grant-equity, and scale-up of successful pioneers.

69. **As part of project preparations, an in-depth study of the legal environment for mortgage lending was conducted by an international lawyer and a local law firm.** The purpose of the report was to understand the key constraints on market growth imposed by the legal framework for mortgage lending. Certain components of the legal environment are major disincentives to land and mortgage registration and enforcement. These obstacles include costly and lengthy procedures; failure of lenders to qualify for right to power to sale; lack of standardization in mortgage origination, underwriting and servicing procedures; and lack of a legal framework for multi-unit developments. A number of significant improvements can be made without changing the existing laws.

Annex 9. Sector Policy Note from Coordinating Minister for the Economy

FEDERAL MINISTRY OF FINANCE

Office of the Co-ordinating Minister for the Economy / Hon. Minister

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NIGERIA COUNTRY OFFICE
28/05/2013
John Litwack / Michael
Khady
Coloria / Yinka Babalola
Action: for your action

CME-HMF/FMF/DP/2013 **May 22, 2013**

Ms Marie Françoise Marie-Nelly
Country Director, The World Bank
102 Yakubu Gowon Crescent
Opposite ECOWAS Secretariat, Asokoro District and
Abuja, Nigeria

Dear Madame,

LETTER OF DEVELOPMENT POLICY

Nigeria's transformational agenda and vision aim to create sustainable jobs, improved prosperity and livings standards for all Nigerians. The Government is therefore pursuing a series of sectoral policies covering the macro-economy, the financial system, business environment, trade, as well as housing and housing construction to achieve these objectives. As part of this transformation process, enabling a vibrant housing value chain will create jobs at all skill levels and strengthen the social fabric of society.

Macro policies

Nigeria's economic policy of fiscal consolidation and building of fiscal buffers is aimed at underpinning low levels of inflation. The consolidated fiscal deficit in 2010 was -7.7 per cent of GDP. In 2011, further consolidation combined with a higher oil price resulted in a consolidated surplus of 0.5 per cent. The Consolidated Government balance sheet is expected to remain in surplus in the medium term (estimated at +0.9 per cent of GDP in 2012)[1]. The Government aims to continue with these policies as reflected in the 2013 budget.

The Government of Nigeria has also established the Nigeria Sovereign Wealth Fund (SWF) in May 2011 to address external shocks, support a competitive exchange rate and address infrastructure bottle necks. The SWF which started its operations in March 2013 will address risks

[1] IMF Article IV Consultation 2012

resulting from fluctuating international oil prices. Most importantly it will create the policy space for the Central Bank to pursue a more stable interest rate policy that encourages investment in the real sector.

The Government's prudent macro policies also include a reduction in domestic borrowing. In line with Government's policies of fiscal consolidation, FGN's domestic borrowing requirements decreased by 50% between 2010 and 2013[2]. Consequently, the growth rate of domestic debt stock reduced from 23% to 16% between 2011 and 2012, beginning the process of addressing the "crowding out" effect caused by large Government borrowing in the domestic capital market. Continued fiscal consolidation has resulted in the yield on Nigerian bonds falling significantly (i.e. a drop in yield from 16.2 per cent in August, 2012 to 11.3 per cent in May, 2013 on 10 year bonds), that will release long term capital for private investment into housing and other sectors such as infrastructure in Nigeria.

The Financial Sector

The Government continues to implement policies to reform the financial sector following the banking crisis in 2009. Substantial liquidity was injected; a blanket guarantee for depositors, as well as for interbank and foreign credit lines of banks (extended for six-monthly periods until end–2011), was provided; AMCON was established to purchase banks' nonperforming loans (NPLs) in exchange for zero coupon bonds and inject funds to bring capital to zero; regulations and supervision were strengthened and corporate governance enhanced; and the universal banking model was abandoned and banks instructed to establish holding companies or to divest their non-bank activities.

The Government will continue and extend these reforms to encompass development finance in order to achieve a more inclusive and deeper financial sector. The Government aims to build market enablers to expand financial services to all Nigerians, while at the same time ensuring that development finance initiatives are designed to harness rather than replace private sector provision of financial services. One institution designed with this aim in mind will be the Nigeria Mortgage Refinance Company, established as a majority privately-owned company, to channel long term capital resources into housing investment. Consistent with best international practice this new institution will be placed under the supervision of the Central Bank of Nigeria. They will play a critical role in facilitating funding for specific gaps/needs where the private sector is unwilling to engage, such as the provision of longer term finance for mortgages, while also benefiting from strong private sector governance. As a general principle these institutions will be established or reformed to be fully financially sustainable. They will therefore be independent of Government budgetary allocations after

[2] 2013 FGN Budgeted Figure

the start-up phase, and will be managed according to specific performance criteria and at arm's length from direct Government control.

Legal and Land reforms

A successful financial sector can only be fully achieved with a business environment that creates certainty and predictability. In particular this applies to the legal/judicial environment and security whether in the form of fixed or movable property. The Government, through a Presidential Technical Land Reform Commission is addressing property rights, the transfer of property and the process for registering land/property as collateral. The Commission started and completed several registration pilots in selected States, enabling the Commission to develop the administration guidelines and templates to be rolled out to other States in Nigeria. The Commission is also drafting regulations for the Land Use Act so as to operationalize the Act consistently across Nigeria. The regulations relating to the Land Use Act also include the foreclosure process for land-related matters, including mortgages. These reforms will reduce the transaction cost and time associated with titling, transferring property, registering a mortgage and enforcing property rights. The Government will continue the process of effective implementation of a legal framework that is efficient but also fair and just, including the establishment of special claims courts, as set out in the Land Use Act to hear land related cases, such as enforcement of mortgage collateral.

Trade policy

The Government is developing trade policies that are conducive to the development of the housing market in Nigeria. Tariffs and other non-tariffs are being identified and monitored to assess their social and economic impact on housing market growth. The Government objective of provision of mass housing at affordable rates can be only achieved by ensuring that building materials are available in the market at competitive prices. The Government is particularly committed to encouraging the development of local industries in the housing construction supply chain to serve the growing market in Nigeria and support local employment generation. In developing the market for housing construction and housing supplies the Government will ensure that this is implemented in an inclusive way for the benefit of all Nigerian households.

Housing Construction

The Government is reforming the Federal Housing Authority (FHA) from a publicly owned housing construction agency, into an institution that leverages private sector resources in the building of affordable houses. The reform will enable FHA to build more affordable houses with private developers across Nigeria in a shorter time frame. This public private arrangement will focus the public involvement in acquiring land with secure titles combined with utilizing the private funding for construction.

The productivity of the construction sector must improve if it is to reach more households within Nigeria. This will require more productive human resources, the use of better building techniques, of better building materials, and environmentally friendly, safe and better standards across the industry.

The Strategic approach

The Government fully recognizes that in order to achieve its transformative goals in the Housing Industry, there must be better coordination at the Federal level between different Ministries, and better coordination between the Federal and the State level.

As the Coordinating Minister of the Economy, under the Presidential Housing Round-table, we have coordinated the activities of the Ministry of Housing and Lands, The Ministry of Justice and the Central Bank of Nigeria in reaching these goals. At the State level we are working with an initial set of States that are implementing the policy reforms outlined above.

In order to ensure that the housing sector fulfills the pivotal role that it should play in the economy, Nigeria will continue the reform process of all critical elements of the value chain.

With best personal regards

Ngozi Okonjo-Iweala

Dr. Ngozi Okonjo-Iweala
Coordinating Minister for the Economy/
Honourable Minister of Finance
Federal Republic of Nigeria

Annex 10. Environmental, Social, and Green Development

1. A number of proactive considerations are being planned to ensure improved sustainability across the program activities. These considerations include the creation of an Environmental and Social Risk Management Operations Manual (ESOM), application of ESMS across the Participating Financial Institutions (PFIs), a review of land administration and land tenure issues across World Bank projects in the country, and approaches to improve green building incentives across the housing industry.

Environmental and Social Risk Management Operations Manual

2. One of the prerequisites of the WBG support for this Housing Finance Project in Nigeria is that the PFIs (MRC, Guarantee, and housing microfinance implementing agencies) integrate in their lending operations the requirements for environmentally and socially sound and sustainable development as identified in laws and regulations of Nigeria and the sustainability policies and frameworks of the participating WBG entities. Accordingly, the WBG and the FGN have collaborated in producing this manual (ESOM) for the project and the three PFIs participating in this project. These measures will ensure that appropriate risk management measures have been identified for implementation by the loan applicant.

3. This manual, along with the Environmental and Social Management System (ESMS) established by each of the three PFIs, also meets the requirement of the WBG that a financial intermediary has established an appropriate Environmental and Social Management Framework. Participating financial institutions are required to establish or arrange for proper capacities to duly implement their ESMS in a manner consistent with the guidance provided in this manual. If a PFI does not have the capacity to implement such a framework, the WBG members reserve the right to develop an Action Plan that identifies all action necessary to meet the requirements set forth in this manual.

4. The Environmental and Social Risk Management Operations Manual (ESOM) overview also provides specific details on the contents and actions that an acceptable ESMS is required to develop to meet WBG lending requirements.

5. It is anticipated that the majority of transactions supported in this program will be in the services or investments that have few associated environmental or social risks. However, it is recognized that there may be some business activities in which the environmental and social risks and impacts are moderate and require commensurate assessment and management. Examples of such activities are land acquisition, labor and working standards, inappropriate disposal of wastes, or unhealthy or hazardous working conditions.

6. All PFIs also are exposed to some level of environmental and social (E&S) risk through the activities of their borrowers/investees. These activities can represent a financial, legal, and/or reputational risk to the PFI. The E&S risks associated with the internal operations of a PFI typically are limited to managing aspects related to labor and working conditions of employees, as well as ensuring the safety of employees and visitors within its premises. The E&S risk associated with a PFI's lending/investment activities depends on factors such as the specific E&S circumstances associated with a borrower's/investee's operations, the sector, and the geographic context.

7. A PFI needs to address these risks based on the level of perceived risk, the type of financing undertaken, and the amount of leverage that the PFI has in obtaining mitigation measures from its borrowers/investees. When a PFI provides project or long-term corporate finance, the institution is more exposed to the underlying E&S risks of the borrowers'/investees' operations but also has the opportunity to manage these risks at the transaction level. Considering E&S risk in the transaction review and using the due diligence process contributes to a PFI's overall risk management efforts. These actions require undertaking individual transaction screening and, where necessary, due diligence and monitoring, and overall E&S risk management in accordance with the resulting E&S risk profile of the portfolio. In parallel, the PFI needs to develop and maintain the requisite capacity for E&S risk management and allocate appropriate resources for this function.

Project Implementation Arrangements

8. The day-to-day operations will be managed by a Project Administration Team (PAT) hosted in the CBN and funded by the CBN. The team will consist of a project director and a deputy director. Other members of the PAT will include a Procurement Specialist, Project Accountant, M&E Specialist, and a Sustainability Specialist. The team will be supported on needs basis by a procurement specialist of CBN's procurement department and a financial management specialist of CBN's financial management unit. The PAT will be fully embedded in the CBN; therefore, all work and procurement plans, contracts, reports, will be approved by the governance structure of the CBN. The PAT will develop a full operational plan before the project becomes effective that will encompass key ingredients of the ESOM.

9. The main implementation modalities, and the institutional arrangements to support them, will be detailed in the POM. In addition, the PAT will coordinate capacity building across the PFIs for enhancing the enabling environment and build market capacity for improved E&S performance of PFIs and their clients. It is anticipated that this initiative will be part of IFC's ongoing TA activities. A number of activities shall be administered by the WBG to ensure that the ESOM meets acceptable standards and requirements including the ESOM clearance and annual review of the PAT reporting. The PAT shall be responsible for submitting PFI ESMS performance reports to the WBG.

ESMS Requirements

10. The PFI's clients are required to develop and operate their ESMS commensurate with the level of environmental and social risk in their portfolios and prospective business activities. The ESMS should incorporate relevant principles of Performance Standard 1 on Assessment and Management of Environmental and Social Risks and Impacts. The scope and complexity of the ESMS will depend on the environmental and social risk of the PFI's lending/investment activities. All PFI clients also must manage the working conditions of their workforces in accordance with the relevant aspects of Performance Standard 2 on Labor and Working Conditions, which in the case of this financial sector relates to employment practices and conditions. Finally, while land acquisition is unlikely to occur as a result of this project, and especially given the complexities of land tenure in Nigeria, it is proposed that PFIs incorporate the principles of PS 5 in their lending/investment activities (see next section).

11. Project clients must avoid supporting activities on the WBG Exclusion List (Annex 3). When the operations of borrowers/investees present E&S risks, the clients must review these operations for compliance with national E&S laws and regulations when they exist and are applicable. Because this Project is categorized as FI-2, the FIs are required to apply the Performance Standards to transactions involving project finance and long-term corporate finance. Each PFI will assess E&S risks of transactions according to Performance Standards 1–8 and will require its borrowers/investees to comply with these Performance Standards in their operations.

12. The ESMS is a management system (both formal and informal) consisting of procedures, management commitment, delineation of roles and responsibilities, and guidance that a bank/PE fund follows to review and manage the E&S issues and risks associated with its investments.

Land Administration and Tenure

13. In 2012 an overview of the policy, legal, and institutional framework on Nigeria's land administration and tenure was completed by the WB team**.** The principal land ownership legislation is the Land Use Act (the Act). By virtue of section 315 (1) d of the Constitution, the Act was incorporated in the Constitution, hence the difficulties that have attended the propositions for its amendment. The Act converts the old forms of estate into right of occupancy by vesting all lands within the State in the Governor of that State to be held in trust and administered for the use and common benefit of all Nigerians in accordance with the provisions of the Act.

14. The most debated provision of the Act is the restriction placed on holders of rights of occupancy from transferring such rights or any part of them (by assignment, mortgage, transfer of possession, sublease, or any other way) without prior consent obtained from the Governor or Local Government. Failure to obtain such consent would make the transaction null and void. The Act also empowers the Governor to revoke rights of occupancy issued under the Act for "overriding public purposes." Such situation would entitle the holder of the right of occupancy and the occupier of the premises to compensation for the value of the property at the date of revocation. It is interesting to note that the Act precludes the Courts from interfering in the adequacy or otherwise of the compensation paid under the Act.

15. Land Ownership Rights follow the enactment of the Land Use Act, which created limitations on the rights that had previously been available to Nigerians for ownership and use of land. The available rights are:

- Statutory Right of Occupancy granted by the Governor
- Customary Right of Occupancy granted by the Local Government
- Deemed grant of Statutory Right of Occupancy
- Deemed grant of Customary Right of Occupancy.

16. More important, efforts can begin immediately to improve procedures by which the Act is implemented, thus making a substantial difference in the growth of the mortgage market. Provisions in the current Act allow states to overcome some of the most vexing problems embedded in the Act so long as there is willingness to do so among governors and state courts. In

recent years, Lagos State has adopted and implemented a series of reform-oriented administrative and judicial procedures that demonstrate how progress can be made even within the existing framework of the Land Use Act. The example of Lagos State as a model for mortgage legal reform is discussed in detail in Section III of this report.[66] Despite the potential risks, management will work closely with the sponsors and state/local governments to ensure that the project complies with applicable Bank policies.

Building Green Options in Nigeria Housing Sector through DFID GEMs Project

17. Over the past several years, both the World Bank and IFC have promoted Green Growth across their operations. Several housing and construction initiatives in Nigeria have begun to explore the opportunities and costs associated with green building in the housing sector. This project will create a window to explore these options as well as create a mix of incentives to encourage scaling up these activities. Green approaches to housing construction are being developed through DFID's Growth and Employment in States (GEMS), and any lessons learned will be applicable to this project.

18. Overall, the WB project will be structuring incentives not only to promote affordable housing but also for how to make such projects "greener." This work also needs to create a logical and practical platform for looking at the various themes for energy efficiency, water conservation, waste minimization, and the concepts of using environmentally friendly construction techniques. The discussion needs to be founded on the context of the Nigerian urban housing market.

19. This approach will be built on the following activities:

- *Reviewing the status of "green building" in the housing construction sector in the urban context across donor organizations and select countries.* An overview of the salient considerations for success in a sample of projects and programs around the globe will be based on several case studies, chosen in agreement with the World Bank and IFC, to illustrate lessons learned and guide future work in Nigeria.
- *Developing policy incentives or opportunities to stimulate green building:* These incentives will identify key stakeholders whose input is critical to enhance green building. These stakeholders include players in government and the housing, and construction market; and land development sponsors and investors. This work will build on current knowledge developed by the Project Team and leverage the experience of professionals across these disciplines in parallel activities (GEMS and IFC).
- *Determining how the housing sector understands green building and review activities across stakeholders*. A solid storyline regarding the history of green building in Nigeria will be told. This storyline will be developed through clear documentation of initiatives in both the public and private sectors. A discussion of recently innovative development schemes undertaken in Nigeria will be summarized.
- *Developing an approach to encourage and support green building in the project.* A synopsis will be developed of current green housing construction in Nigeria, concepts for

[66] For detailed information on the legal environment, refer to Carol Rabenhorst and Olubukola Thomas, "The Legal Framework for Housing Finance in Nigeria: Current Constraints and Proposed Reforms", Abuja, 2012.

expanding knowledge across the sector for such opportunities in-country, likely benchmarks and/or standards to be used in the early stages in Nigeria, possible financing stimulus packages and incentives, and clear indicators of success to advance this agenda.

Annex 11. Compliance with OP/BP 10: Financial Intermediary Financing

I. GENERAL PROJECT OVERVIEW

A. Project Summary:

1. The project will support the development of Nigeria's housing finance market. Extensive diagnostic work has identified lack of long-term resources as one of the major obstacles for the development of Nigeria's mortgage market. The project aims to develop an efficient intermediation mechanism to enable long-term capital market funds to be invested in housing. In addition to difficulties in the formal mortgage market, there are also very limited solutions for lower income households. There are no established housing microfinance products. The bulk of the project resources will be directed toward establishing a private, sustainable mortgage liquidity facility. This facility will be the catalyst for wider market development and will be supported by a comprehensive package of TA to build capacity among lenders and to tackle some of the other market obstacles such as lack of standardized documentation, difficulties in foreclosure, or slow and expensive mortgage registration. The project will include the following activities divided in three components:

Component 1: Line of Credit for Mortgage Refinance Company (US$250 million)

2. **To support a mortgage liquidity facility, the Nigeria Mortgage Refinance Company (NMRC), for mortgage refinancing and prefinancing.** The project will support the operation that NMRC created in partnership among private financial institutions, development finance institutions, and the Ministry of Finance. The NMRC, registered as a non-bank, under publicly listed limited liability company rules and regulation, with majority ownership coming from the financial institutions, will be a bridge between mortgage lenders and the capital markets. NMRC will issue standard corporate bonds in the capital markets and subsequently issue loans (refinance) to mortgage lending institutions. These loans will be backed up by collateral in the form of an assignment of rights over part of the lenders mortgage portfolio. This arrangement protects NMRC's loans and minimizes the amount of credit risk it is taking. This lowered risk, in turn, helps to obtain the lowest possible rate in raising its bond financing.

3. A key distinction with this model compared to securitization is that the underlying loans offered as collateral stay on the balance sheet of the lender and, should they go into default, must be replaced by performing loans. In the case in which no eligible loans are available as replacement, alternative collateral should be provided such as cash or Government bonds. Thus, unlike Mortgage-Backed Securities (MBS), this model does not take direct credit risk on mortgage borrowers; direct credit risk firmly remains with the originating bank.

4. An alternative product offering prefinancing also would be available to help lenders build a stock of eligible mortgage loans. Such financing would be for a shorter period and would be rolled over into refinancing once all the conditions are met. The prefinancing would be subject to monitoring by the PAT to ensure that funds are used for the intended purpose. The loan agreement would stipulate the right for the funds to be recalled if they are not used for designated purpose within an agreed timeframe. Such prefinancing also would be subject to collateral requirements but in the form of Government bonds and/or cash.

Component 2: Mortgage Guarantee Product for Lower Income Borrowers (US$25 million)

5. **To further support reach of mortgages down the income distribution, US$25 million equivalent will be used to develop a guarantee product to bear some of the credit risk for lower income lenders.** The guarantee will provide credit default loss protection to mortgage lenders. It will be established in year 2 of the project and will be subject to detailed pricing and market analysis. The project will fund the product development including testing and financial modeling and then launch a competitive process among private or public owned non-bank financial institutions to implement the project. Criteria will include: (a) financially sound and solvent as confirmed by the CBN; (b) matching contribution to the proposed product, and (c) a business plan based on scope and out-reach to lower income groups.

Component 3: Line of Credit for Housing Microfinance Piloting (US$15 million)

6. The proposed objective is to support development and piloting of new and/or emerging housing microfinance (HMF) products and demonstrate a sustainable business case for this activity. The component will be rolled out in three phases: (a) tailored TA to selected microfinance banks (MFBs) to develop and/or improve emerging HMF products (to be funded from TA component), (b) provision of risk capital to MFBs in the form of limited soft loans to test the new HMF products, and (c) a line of credit to roll out the tested HMF products.

Component 4: Technical Assistance and Capacity Building (US$10 million)

7. Activities under this component will address all relevant ancillary issues related to project implementation, such as training and capacity building, support to the project administration team, support to legal and regulatory reforms and enhancement of the enabling environment, and dissemination events. Technical assistance will be provided for both the mortgage market and housing microfinance markets in support of the two lines of credit.

B. Objectives of the Project:

8. The project development objective: ***Increase access to housing finance by deepening primary and secondary mortgage markets in Nigeria***

C. Flow of Funds:

9. The funds will be extended by IDA to the Government of Nigeria. The foreign exchange risk will be managed by the Central Bank of Nigeria (CBN) and will be integrated in the on-lending rates to NMRC and microfinance banks. The funds then will be passed through the CBN, which will serve as the agent of the Government. The CBN will on-lend the resources to NMRC and eligible microfinance banks selected to participate in the project, and/or the private HMF wholesale facility, which then will lend the funds to final borrowers.

II. COORDINATION BETWEEN WORLD BANK AND IFC

10. The proposed project is a joint project between the World Bank and IFC. The role of IFC would consist of an equity investment in NMRC. IFC also would support the project by making strategic investments in key mortgage lenders in Nigeria, and is preparing a pilot affordable housing project, which the government is hoping to replicate in a number of states. IFC's investment would come with a multi-year advisory services component to be delivered in conjunction with the World Bank. In this regard, the Bank and IFC would work in close coordination.

III. POLICY FRAMEWORK FOR FINANCIAL INTERMEDIARY LOANS (FILs)

A. Macroeconomic Environment:

11. Despite sound economic growth estimated at 6.58 percent in 2012, reducing poverty, and improving welfare, Nigeria will require stronger non-oil growth and a strong focus on employment growth. Non-oil growth driven by the services sectors is estimated at 7.88 percent in 2012 but failed to translate into job creation. An estimated 4.5 million Nigerians enter the labor market each year, but only 10 percent are able to find formal jobs. As a result, unemployment grew from 19.7 percent in 2009 to 23.9 percent in 2011. Unemployment affects principally the young (ages 15–24), at a rate that rose from 25 percent in 2009 to 37.7 percent in 2011. Estimated poverty rates declined only marginally between 2003–04 and 2009–10 from 64.2 percent to 62.6 percent, implying that, given the growth in the population, the number of Nigerians living in poverty actually increased. Similarly, progress toward a number of the other Millennium Development Goals (MDGs) in Nigeria also has been disappointing.

12. Given the current global economic context, considerable fiscal consolidation is taking place to rebuild fiscal buffers as well as to tighten monetary policy to fight inflationary pressures. FGN exhibited new momentum to re-establish countercyclical fiscal policy, and Nigeria's debt profile remains sound. However, the recent rapid growth of domestic debt has prompted the Government to plan a reduction in domestic borrowing, thus reducing the crowding-out of lending to the private sector. Consequently, aggregate domestic credit (net) grew by 2 percent in December 2012, reflecting an increase in claims on the private sector and significant contraction in credit to Government. Similarly, by raising its policy rate to 12 percent, in 2011, CBN tightened monetary policy, and inflation dropped to 10.3 percent. It started trending upward again in 2012 to 12 percent as a result of adverse higher energy prices and poor weather conditions. However, in the current context of tight monetary policy, inflation is expected to trend downward. Early in 2013, inflation fell to 9 percent. During the last 12 months, yields on Treasury bills and 10-year Government bonds fell from 17 percent to 12 percent and 16 percent to 12 percent, respectively, reflecting higher demand from international investors following Nigeria's inclusion in the JP Morgan GBI-EM index.[67]

[67] Launched in 2005, the JPMorgan Government Bond Index-Emerging Markets (GBI-EM) indices are world's first comprehensive emerging market debt benchmarks that track local currency bonds issued by emerging market governments. http://en.wikipedia.org/wiki/JPMorgan_GBI-EM_Index.

B. Financial Sector Framework:

(a) Mortgage market

13. Despite strong growth over the last six years, the Nigerian mortgage market remains under-developed. From 2006 to 2009, the market grew from NGN54 billion to NGN226 billion at an average rate of 61 percent. In 2010, due to the banking crisis, outstanding mortgage loans experienced a decline of 7 percent, before starting to grow again. In 2011 the market stood at NGN224 billion, equivalent to approximately US$1.42 billion. Despite this rapid increase, access to mortgages remains limited. At end 2011, the ratio of mortgage loans to GDP stood at 0.6 percent. This ratio is low for a country with a relatively well-developed financial system such as Nigeria. Outstanding mortgage loans to GDP ratios of South Africa are 31 percent, Botswana 2 percent, India 6 percent, China 13 percent, and the average European country approximately 50 percent. In Nigeria, mortgage loans are offered by 104 mortgage lenders including 84 Primary Mortgage Banks (PMBs) and 20 Deposit Money Banks (DMBs). However, 7 lenders account for approximately 75 percent of all lending.

14. Most Nigerians remain excluded from access to housing finance. According to the World Bank's Global Findex Survey, in 2011 only 0.26 percent of adults aged over 25 had an outstanding loan to purchase a home. This percent represents approximately 90,000 households of a total of 35 million. Of households with a loan, only approximately one-third have a formal mortgage loan. Typically, housing is self-financed through accumulating equity over a long period, or financed by friends or relatives.

15. The Government's main initiative to increase access to housing finance was the implementation of the National Housing Fund (NHF). The scheme requires workers earning above the minimum wage of NGN18,000 per month, including civil servants, to make a mandatory contribution of 2.5 percent of their salaries into the NHF. Their contributions then should be matched by their employers. Contributions receive annual interest of 2 percent, and the balance of savings is payable to contributors at the age 60. Under the current rules, after contributing for 6 months, employees are entitled to receive a mortgage loan worth up to 90 percent of the value of a property to a maximum amount of NGN15 million (approximately US$95,000) at a rate of 6 percent for 30 years. Results achieved by the Federal Mortgage Bank of Nigeria (FMBN), which oversees the NHF program, are unsatisfactory. In August 2012, only 12,031 contributors had received mortgage loans from NHF of a total number of 3.8 million contributors. The majority of funds have been lent out to poorly performing Estate Development Loans (EDLs) for housing developments.

16. Access to housing finance is out of reach for most Nigerian due to difficult macroeconomic conditions and the lack of development of the sector. Loans are denominated in Naira generally at fixed rates of 17 percent–22 percent. The maturity varies from 5 years–15 years. Only the subsidized loans obtained through the NHF scheme have an interest rate of 6 percent and a maturity of 30 years. The high interest rates are related to the country's high level of inflation, approximately 12 percent in 2012, and the high cost of funding. In January 2013, risk-free Treasury bills paid 13 percent.

(b) Financial sector

17. In recent years, Nigeria's banking sector has undergone significant reform. The oil price drop and currency devaluation that accompanied the 2008 global financial crisis stressed banks with heavy concentration in the oil and gas sector. By 2009 the banking sector was in crisis. Insider abuse and inappropriate related-party lending also were identified in a number of banks. CBN intervened. Its measures to stabilize the banking sector included substantial liquidity injection; the creation of the Asset Management Corporation of Nigeria (AMCON) under the ownership of the FMoF, the purchase by CBN of banks' nonperforming loans, and the recapitalization of troubled banks. The health of the banking system has improved substantially after the implementation of this set of measures, and financial soundness indicators point to continued improvements. Growth in banks' assets increased from -3.6 percent in December 2009 to +37.0 percent in December 2011. The nonperforming loans portfolio decreased by 27.6 percent in December 2009 to 4.0 percent in June 2012. Over the same period, return on average assets increased from -8.9 percent to +1.2 percent.

18. Nigeria's financial system is growing fast and is becoming increasingly integrated in the regional and global financial systems. The banking system consists of 20 banks and is dominated by 6: 1 pan-African and 5 domestic banks. At end-2011, the 6 largest banks accounted for approximately 60 percent of total banking sector assets. Unlike in many other Sub-Saharan African countries, European banks in Nigeria held only 4 percent of total assets. Thus, spillovers from potential Eurozone banking troubles are limited.

19. Despite all these positives, the big spreads charged by Nigerian bankers indicate that competition is ineffective. The weak competition arises from the relatively high inflation rate; the high cost of funding; and the degree of concentration of the banking industry. The concentration enables the biggest banks' interest rates to become the benchmark for the other banks. The introduction of NMRC will mitigate at least in part the lack of competition. Specifically, with the increased availability of resources facilitated by NMRC, even the smallest market lenders will be become more competitive, which is expected to result in reduction of spreads and more affordable mortgages.

(c) Microfinance sector

20. Moreover, despite a large number of microfinance providers, there are no formal housing microfinance (HMF) products in the market. Nigeria is home to nearly 900 MFBs with over 31,000 branches. The MFBs serve approximately 3.2 million clients, but only approximately 1.1 million are active borrowers. At end 2011, the MFB market remained dominated by short-term investments, reflected in MFBs' asset structure. Approximately 90 percent of their loans and advances had maturities of up to 1 year.

21. In addition to MFBs, there are nearly 700 non-regulated microfinance institutions (MFIs), which serve approximately 350,000 clients. The MFIs are not allowed to take deposits and are not under the supervisory purview of the CBN. Approximately 50 percent of MFI loans were for up to only 6 months, and only approximately 22 percent were 6 months–12 months.

22. Despite the number of MFBs, the sector remains relatively small. While on the aggregate level, the sector remains well capitalized and liquid, the portfolio at risk is high. As of March

2013, the total sector assets stood at NGN238 billion (approximately US$1.5 billion) up from NGN190.7 billion at end-2011. Based on CBN's March 2013 data, the sector capital adequacy ratio (CAR) was 46.54 percent, and the liquidity ratio was 81.93 percent. At the same time, the portfolio quality remained weak, as illustrated by a portfolio at risk at 30 days of 11.64 percent. The aggregate numbers are a result of mixed performance, with some strong and well-performing MFBs and a significant number of weak performers. Overall, the sector requires close monitoring, supervision, and enforcement.

C. Interest Rates:

23. The tightening monetary policy has negatively influenced the mortgage market. The average mortgage interest rates have been 18 percent–22 percent for the last 5 years. The NMRC aims to reduce the overall cost of funds and to extend maturities within the constraints of the benchmark rates set by Government bonds. The NMRC will reduce liquidity risks for primary market lenders by providing them access to the capital market. In addition, NMRC may reduce interest rate risk by giving lenders longer term funds with rate structures different from those that they can raise on a retail basis.

24. Since there is no formal housing microfinance market (such as formal microfinance loans for housing purposes such as home improvement and incremental housing construction), there are no established rates for HMF products. There also are no accurate aggregate data for interest rates in the microfinance sector. According to the interviews with more established MFBs, reported interest rates vary from 1.5–7.0 percent per month depending on the product and customer profile. Anecdotal reports suggest that some MFBs even charge in the double digits.

D. Directed Credit:

25. Project resources will be directed to the housing finance sector, by addressing the needs of mortgage lenders and supporting the development of the HMF market. Financial constraints of the mortgage lenders have been identified as a main cause of the underdevelopment of the country's mortgage market, whereas the absence of formal HMF products is limiting the housing opportunities of the poorest citizens. By alleviating these issues, the project will help jumpstart the housing finance market and help mitigate the challenges related to Nigeria's rapid urbanization.

E. Subsidies:

26. The project does not include a subsidy program aimed at final borrowers. By design, there is no interest-rate capping. NMRC member banks and MFBs will assume the entire credit risk and will be free to set the interest rates for mortgages and MHMF loans in line with market conditions.

IV. Eligibility Criteria for Participating Financial Institutions (PFIs)

(a) Mortgage Lenders

27. NMRC's strength will come in part from the corporate model of being majority owned by its users. The greater the membership and utilization, the stronger the company will be. Its key value added for lenders will be to access capital markets at rates and terms that an individual institution could not achieve. In addition, as NMRC will be a regular and trusted issuer, its bonds will offer an attractive alternative to Government debt due to a slightly higher yield.

28. Given the cooperative model, it is important for a lender to be a member/shareholder to be able to access refinancing or prefinancing. The only restrictions to becoming a shareholder will be the financial soundness of the investing institution and its being regulated as either a Primary Mortgage Bank or a Deposit Money Bank. The exact criteria will be agreed among the private shareholders but probably will be assessed on the current profitability of the institution. There also should be no restrictions in terms of minimum shareholding, meaning that in essence NMRC is open to all and therefore would not give unfair advantage to one institution over another.

29. Access to refinancing would be dependent on credit limits and the normal loan process of any other credit institutions. It also is worth noting that pricing would be done on a flat basis with the same pricing for all institutions.

30. The funds lent to NMRC would be advanced to mortgage lenders to refinance eligible mortgage loans, or in some cases to prefinance creating a stock of eligible mortgage loans. Refinancing involves the banks' pledging mortgage assets as collateral for loans. These loans already have been created, and funded. One requirement will be that loans are performing and have been for at least six months. The refinance loan is a general obligation liability with the collateral provided as additional security. The funds provided under such an operation are at the disposal of the borrowing entity as general funding. Given that the loans are offered for longer terms than most other funding, the new assets originated are expected to be additional mortgage loans, thereby keeping the cycle going. The reason that the borrowing institution is not obligated to use the funds obtained from NMRC exclusively for new mortgages is that if conditionality were attached to these funds, the funds no longer would qualify as "liquidity," that is, they could no longer be used for general purposes but would have contingency attached to them. Aside from providing long-term funding, another key function of NMRC is to act as a "liquidity facility": essentially turning illiquid assets—mortgages—into liquid ones—cash. This function would not be possible if restrictions were placed on how the funds can be used. In short, there are no guarantees that funds would be recycled nor can there be if the model is to work. The assumption is that mortgage lending is profitable and is something banks want to do as part of their core business. PMBs in particular have no other sources of funding, so to continue to access it, they will have to keep generating new mortgage loans. Some lenders (especially the larger banks) may use NMRC as a standby facility whereas others (most PMBs) cannot operate without such funding.

31. An alternative product offering, prefinancing also would be available to help lenders build a stock of eligible mortgage loans. Such financing would be for a shorter period and would be rolled over into refinancing once all the conditions are met. The prefinancing would be subject to monitoring by the PAT to ensure that funds are used for the intended purpose. The

loan agreement would give the right for the funds to be recalled if they are not used for the designated purpose within an agreed timeframe. Prefinancing also would be subject to collateral requirements but in the form of Government bonds and/or cash.

(b) Housing Microfinance Institutions

32. Participating financial institutions under the housing microfinance pilot will include licensed microfinance banks. The PAT will ensure that each participating MFB is appraised to ensure satisfactory compliance with eligibility criteria prior to accessing the line of credit, and continuously thereafter during the project duration. The selection and appraisal of MFBs will be agreed with the World Bank at implementation. The World Bank also will review the appraisal reports for each MFB and may conduct additional supervision as needed. The following criteria will be applied to determine eligibility of MFBs to participate in the project and access the line of credit:

- Licensed MFB (state or national license) and at least three years in operation
- Full compliance with microfinance laws and regulations, and all required and recommended prudential and supervisory standards (satisfactory capital adequacy, liquidity, portfolio at risk, loan loss provisions, nonperforming loans, loan write-offs, minimum required capital, operational and financial self-sufficiency)
- Minimum "sound" rating under CAMEL criteria and overall good standing with CBN
- Fully sustainable and covering its operating costs and costs of capital on an adjusted basis
- Positive net income for the current year and the year immediately preceding the project
- Clean, unqualified audits for two years preceding participation in the project and continuously thereafter
- Well-defined policies and written procedures for management of all relevant financial risks and acceptable risk profile
- Fit and proper owners and board of directors, qualified and experienced management, adequate organization, oversight, internal audits and controls, and institutional capacity
- Adequate management information systems
- Capacity to mobilize domestic resources
- Demonstrated commitment to engage in housing microfinance.

33. In addition, the project may support eligible HMF wholesale facilities. In case of a specialized fund and/or private equity firm, appraisal of the potential institution would be based on the criteria established by IFC in conducting due diligence of private equity firms. In case of a commercial bank, the eligibility criteria would largely resemble those stated above, adjusted to respond to banking sector requirements (licensed banks, compliance with banking regulations) and would be confirmed during an appraisal process.

V. ONLENDING TERMS

34. The IDA loan will be lent to the Federal Government of Nigeria on IDA terms in SDRs with a maximum commitment fee of 0.5% on the withdrawn credit balance and service charge of 0.75 percent on withdrawn credit balance. The tenure of the credit will be 40 years with 10 years

grace period. The funds then will be passed through Central Bank of Nigeria, which will act as the conduit for lending to project beneficiaries, including NMRC, eligible MFBs, and private HMF wholesale facility.

(a) Mortgage market on-lending

35. The funds will be on-lent to NMRC in Naira at a rate and terms that match the amortization schedule of the IDA funds with the addition of an interest rate to cover the cost of the foreign exchange risk. At this time, this interest rate has been estimated at 3.5 percent per annum, setting the total cost of funds to NMRC at 4.25 percent annually.

36. The on-lending from NMRC to mortgage lenders will be done based purely on the market rate. This rate will be determined by the cost of bonds that NMRC issues in the market. Initially, these bonds will benefit from a FGN guarantee, so should be priced close to sovereign rate. NMRC then will add a 1 percent spread to cover its operating costs and a return on capital. The FGN guarantee will be limited in terms of amount and will be subject to a "sunset" clause during the lifetime of the project. Using the bond price to set the refinance rate ensures a sustainable market based system.

(b) Housing microfinance on-lending

37. The housing microfinance component will include limited soft loans to MFBs for testing the HMF products, and a line of credit to roll out the tested products. While the flow of funds will remain the same, the resources will be offered under different terms. The on-lending rates to final borrowers will not be capped and will be set by MFBs in line with market conditions.

38. The limited soft loans for testing pilot products would be passed to MFBs at cost to the Government (0.75 percent) plus the cost of foreign currency interest rate swap, and would come with a maturity of up to 24 months (matching the maximum allowed loan maturity prescribed by regulations). The total amount of soft loans will be limited to up to US$1 million. The soft loans essentially represent risk capital for testing the newly developed HMF loan products, following which the MFBs will access the line of credit to achieve volume.

39. The line of credit of at least US$14 million[68] aimed at supporting MFBs to roll out the tested HMF products will have the maturity of up to 7 years, with a consideration for an appropriate grace period on principal repayment. The on-lending rate to MFBs will be set to reflect the cost of the World Bank funds to the Government of Nigeria, the cost of foreign currency interest rate swap, administrative costs, and credit risk. The exact loan terms will be determined at implementation to reflect market conditions at that time.

40. As an illustration, the current reported cost of commercial debt from lines of credit to MFBs (for their established portfolios, which do not include HMF products) is 15 percent–20 percent (in Nigerian Naira). Some MFBs receive floating rates consisting of a T-bill rate and a spread of approximately 5 percent–6 percent; others enjoy a fixed rate of approximately 19 percent–20 percent. Most of the current reported maturities on MFB debt from commercial lines of credit stand at 2 year–5 years, with a grace period on principal repayment of 3 months–6 months and, in rarer instances, up to 1 year.

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[68] The line of credit amount could be higher in case the initially allocated US$1 million for the product testing phase is not fully utilized.

41. To ensure the sustainability of such emerging wholesale scheme, when a private HMF wholesaler qualifies to participate in the project, the line of credit would be priced to match the commitments that it already had secured in the market (such as from private equity, specialized funders). When commercial banks intend to serve as HMF wholesalers, pricing would be set to reflect the cost of funding, administrative costs, and credit risk. The exact loan terms would be determined at implementation to reflect the market conditions at that time.

VI. MONITORING

42. Progress reports to provide information on the uses of funds will be prepared by the Project Administration Team and sent regularly to the project team. The progress will be based on monitoring and financial indicators. It is expected that, as host of the PAT, CBN is capable and well positioned to effectively carry out most of the M&E. The necessary data and information will be collected through CBN's statistical department and CBN's regular supervisory activities. Capacity gaps will be filled through trainings. Progress reports will be published and will be accessible to managers and decision makers.

43. In parallel, a Project Steering Committee (PSC) will be established to provide policy oversight and strategic direction to implementation of the project. The PSC will be chaired by the Ministry of Finance and will comprise representatives from the Ministry of Finance, the Ministry of Lands, Housing and Urban Development, the CBN, the SEC, the priority states, the banking sector, and the donor partners DFID, GIZ, IFC, and World Bank. The PSC will convene as required, but a minimum of twice a year during the life of the project.

44. NMRC's performance also will be monitored with the following PDO level indicators: (a) 15 percent of loans originated being for an amount of NGN4 million or less, (b) number of total mortgage loans outstanding to exceed 200,000, and (c) proportion of total mortgage debt outstanding refinanced by NMRC to reach 20 percent.

45. In regard to the HMF pilot, the PAT established within CBN also will be responsible for implementing and supervising the credit line. These actions will include assessing and monitoring PFIs' compliance with the eligibility criteria, supervising withdrawal applications, and reporting on the credit line implementation progress. Supervision also will include annual review of audited financial statements, review of loan books, and periodic interaction with the PFIs' management. The World Bank also will have access to PFIs' loan books, and financial and operational information during the supervision process. The PAT will report quarterly to the World Bank on implementation progress.

46. The performance of MFBs would be monitored based on the following indicators of their HMF portfolio: (a) volume of disbursed loans, (b) number of disbursed loans, (c) number of active loans, (d) percentage of disbursed and active loans to women, (e) portfolio at risk at 30 days, (f) total outstanding portfolio, (g) average loan size and maturity, and (h) loan losses. Additional relevant indicators may be developed during the product design and piloting phases. Impact assessments/evaluation will be conducted following the piloting and roll-out stages.

47. Finally, continuous compliance with eligibility criteria will be monitored and ensured throughout project implementation.

Annex 12. NMRC Business Plan

Objective

1. The Nigeria Mortgage Refinance Company (NMRC) will be a specialized single-purpose institution involved in the development and promotion of the mortgage finance market (hence, residential construction) through the provision of liquidity to mortgage lenders and the development of the local bond market. In line with the above, NMRC will refinance eligible mortgage loans of mortgage originators or provide prefinancing backed by eligible collateral for the purposes of establishing mortgage portfolios. NMRC will fund loans to lenders by issuing simple corporate bonds in the local bond market. NMRC will not take deposits nor will it be involved in retail business.

Shareholders

2. **NMRC will be a majority-owned, private-sector institution, registered as a publicly listed company owned by Deposit Money Banks, Primary Mortgage Banks, and International Finance Institutions, with a 20 percent share owned by the Ministry of Finance**. NMRC will fall under the supervisory authority of Nigeria's Securities Exchange and Central Bank. NMRC will provide liquidity only to those mortgage lenders that also are shareholders in NMRC. NMRC is a private sector company with a public mission, and it is intended that the shareholding structure will reflect the public-private partnership. The NMRC should be (a) majority privately owned and (b) any public stake limited. The proposed shareholder mix will comprise the Ministry of Finance Incorporated (MOFI) and 3 groups of investors, namely (a) banks and PMBs; (b) international finance institutions such as the IFC, Shelter Afrique, ADB, FMO, and KFW; and (c) private investors such as pension funds, investment funds, private equity, and insurance companies. The Ministry of Finance will hold up to 20 percent preference shares, equivalent to 1.2 Billion Naira (US$7.6 million). The remaining shareholders will hold up to 90 percent ordinary shares, valued at 4.6 Billion Naira (US$29 million).

Board

3. **There could be 7 to 10 members of the Board of Directors, who are the Chief Executive Officers (CEOs) of the participating financial institutions**. The Board will be responsible for the formulation of policies and strategies of the company.

4. **More detailed and technical issues will be handled by Board Committees, which would receive delegated authority to decide on certain issues and to recommend the more important issues to the Board for approval**. The following Board Committees are suggested:

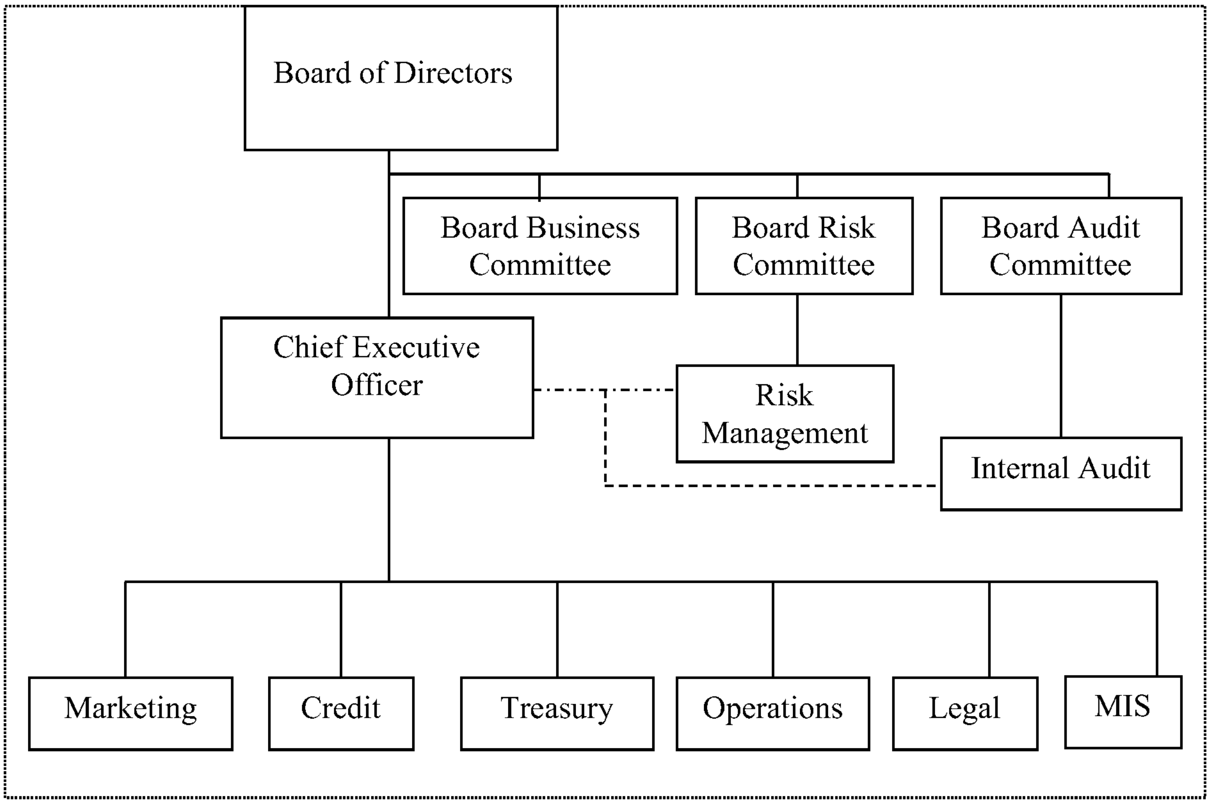
a. **Board Audit Committee.** Reviews the audit of the Company's operations as well as the effectiveness of the financial and internal controls. The Internal Auditor and External Auditors will report directly to the Board Audit Committee.

b. **Board Business Committee**. Responsible for overseeing the business operations—both refinancing and funding— of the Company.

c. **Board Risk Management Committee** (BRC). Overall responsibility to ensure there is proper oversight of risks of the Company. The Board sets the risk appetite and tolerance level consistent with the Company's overall business objectives and risk principles. The BRC assists the Board by ensuring that there is effective oversight and development of strategies, policies, and procedures to manage risks.

d. Organizational Structure.

Figure A10.1 NMRC Organizational Chart



5. **The Managing Director should have an entrepreneurial flair with good knowledge of risk management and the bond market.** Knowledge in housing finance will be a critical advantage. The MD preferably should be an experienced banker/investment banker who is well respected within the banking community and by all the authorities.

Charter

6. **The NMRC will be a licensed non-deposit-taking institution authorized by the CBN to conduct its business and by the Securities and Exchange Commission (SEC) to issue bonds.** The Charter of NMRC reflects its unique role as a single-purpose vehicle. The Charter restricts the Company from undertaking any other activities (taking deposits, commercial loan refinancing, or direct lending) apart from the ones for which the Company is established. The restrictive charter is to ensure that the Company focuses on supporting the growth of the mortgage market and the bond market by limiting its activities to the refinancing and prefinancing of mortgage loans and the issuance of bonds in support of these activities.

Regulation

7. **The main regulator for NMRC will be CBN**. NMRC will be licensed as non-depository financial institution with clear limitations on its scope of business limiting it to its core activity of refinancing mortgages. As NMRC seeks to fund itself in the bond market, it also will have to be licensed and regulated by the SEC as a bond issuer.

Refinancing and Prefinancing of Mortgage Loans

8. The NMRC will refinance eligible loans on a recourse basis. A sample of the eligibility criteria is given below. Since the refinancing is with recourse to the originators, the originators will replace defective loans with performing loans. Mortgage originators will obtain refinancing of their mortgage portfolios from NMRC in consideration, among other things, of an assignment, pledge, or other charge (that is, collateral security) in favor of NMRC of the relevant eligible first-ranking mortgage portfolio. Initially, NMRC loans may be for shorter maturities and will extend during the course of the project with loans of up to 15 years expected by year 5 of the project.

9. NMRC initially will have a window available for lenders that aim to build up eligible mortgage loans through prefinancing. Such funding would be made available for short durations and would be collateralized by high-quality liquid financial assets such as Government bonds. Unlike refinancing, the funds would be allocated for the specific purpose of originating mortgage loans. A mechanism would be put into place to ensure that the funds are used for this purpose or are recovered by NMRC potentially with penalty charges.

Funding

10. Initial funding will be by way of the IDA credit provided under the project. Over time, NMRC will fund part of its activities by issuing simple corporate bonds. Initially, these will be short-term bonds but progressively, as markets develop and market conditions allow for competitive longer term debt instruments, will increase their maturities.

Pricing of NMRC Loans

11. Other things being equal, pricing is an important determinant of the volume of business and profitability of the Company. The Company should price its loans based on its cost of funds and the desired profit margin (includes the operating cost). As a strategy, the Company may wish to aim for volumes. In such a case, the profit should be capped at an acceptable minimum level (1.00 percent). As a general rule, the profit margin should be a function of market demand and supply.

Regulatory Treatment/Concessions

12. Certain prudential conditions would facilitate the development of NMRC's bonds in the market. Subject to the approval of appropriate regulations:

a. NMRC's bonds could qualify as liquid assets.
b. Bonds should be subject to risk weight of 10 percent.

c. Funds received by PMBs and DMBs from NMRC should be exempted from statutory reserves and liquidity requirements.
d. Shelf registration system should be instituted for NMRC's bond issuance program.
e. Implement other concessions as may be required to ensure sustainability of NMRC.

Risks and Mitigation Measures for NMRC

a. Credit Risk

13. Credit risk is the possibility that a counterpart fails to fulfill its financial obligations when they fall due.

14. Mitigation measures: The mortgage originators will obtain refinancing of their mortgage portfolios from NMRC in consideration, among other things, of an assignment, pledge, or other charge (that is, collateral security) in favor of NMRC of the eligible first-ranking mortgage portfolio. The Operational Manual will require delivery to NMRC of a satisfactory legal opinion of an acceptable legal counsel confirming the validity of the assignment/pledge/charge and its opposability to third parties. Since the refinancing is with recourse, credit risk can be managed by setting credit limits on the counterparties for refinancing, setting prudent eligibility criteria, and conducting due diligence on at least a sample of the loans refinanced. Credit limits on counterparties should be reviewed periodically and determined based on external ratings, internal credit assessment, and business requirements.

b. Market Risk

15. Market risk is the potential loss arising from adverse movement of market interest rates. Market risk includes the pipeline risk that NMRC will face since the loans are refinanced at quoted rates before the issuance of bonds.

16. Mitigation measures: Market risk is minimized by having an effective asset and liability management (ALM) system and by undertaking regular duration and interest-income-sensibility analysis. The Company should not be allowed to undertake gapping. The very nature of the Company's operations requires it to ensure that its assets and liabilities are matched.

c. Liquidity Risk

17. Liquidity risk arises when the Company does not have sufficient funds to meet its obligations as and when they fall due.

18. Mitigation measures: Liquidity risk can be minimized by matching the timing of refinancing loans with the issuance of bonds. In addition, the Company should plan its cashflows and monitor them closely to ensure that available funds are sufficient to meet business requirements.

d. Operational risk

19. Operational risk is the loss arising from failed internal processes, people, and systems or even external events.

20. Mitigation measures:

   a. Establish comprehensive internal controls and procedures.
   b. Put in place a Business Continuity Plan to minimize the impact of any disaster and reduce the time to restore operations.
   c. Have good IT systems to increase efficiency, processing, and reporting capabilities and minimize the likelihood of errors due to manual processes.

Key Points of Credit Policy for Eligible Loans to Be Refinanced

a. Loans refinanced by NMRC should be fully disbursed and should be for the purchase, refinance, construction, or renovation of a residential unit.
b. NMRC will set a maximum price for the properties for which the loans are granted that could be eligible for refinancing.
c. NMRC will accept first liens only.
d. Mortgage loan payments are fully up to date at the point of sale.
e. Mortgage loan refinanced should, at the time of refinancing, have a remaining life that expires on or after the review date.
f. The mortgaged property is insured against fire up to its full insurable value with a loss-payable endorsement designating the mortgage originators as the payee.
g. To the best knowledge of the mortgage originators, the borrower is not an undischarged bankrupt or no bankruptcy proceedings have commenced against the borrower.
h. To the best knowledge of the mortgage originators, the borrower is not deceased.
i. There should be adequate provisions in the loan agreement enabling the mortgagee to transfer the loan or assign all its rights, interests, and obligations to any person as the mortgagee deems fit.
j. Mortgage loan has been issued in local currency.
k. Mortgage originators will obtain refinancing of their mortgage portfolios from NMRC in consideration, among other things, of an assignment, pledge, or other charge (that is, collateral security) in favor of NMRC of the relevant eligible first-ranking mortgage portfolio

The Operational Manual will require delivery to NMRC of a satisfactory legal opinion by an acceptable legal counsel confirming the validity of the assignment/pledge/charge and its opposability to third parties.