Public Disclosure Authorized

Public Disclosure Authorized

Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No. 15810

PROJECT COMPLETION REPORT

PHILIPPINES

HOUSING SECTOR PROJECT
(LOAN 2974-PH)

June 25, 1996

Infrastructure Operations Division
Country Department I
East Asia and Pacific Regional Office

This document has a restricted distribution and may be used by recipients only in the performance of their official duties. Its contents may not otherwise be disclosed without World Bank authorization.

CURRENCY EQUIVALENTS

Currency Unit	=	Philippine Pesos (P)
US$1.00	=	P 16 (1984)
"	=	P 27 (1993)

FISCAL YEAR

January 1 - December 31

MEASURES AND EQUIVALENTS

1 meter (m)	=	3.28 feet (ft)
1 kilometer (km)	=	0.62 miles (mi)
1 hectare (ha)	=	10,000 square meters (sq m) or 2.47 acres (ac)

ABBREVIATIONS AND ACRONYMS

CMP	=	Community Mortgage Program
GAAP	=	Generally Accepted Accounting Principles
GSIS	=	Government Social Insurance System
HDMF	=	Home Development Mutual Fund
HFC	=	Home Finance Corporation (later called HIGC)
HIGC	=	Housing Investment Guarantee Corporation
HLRB	=	Housing and Land Use Regulatory Board
HSRC	=	Human Settlements Regulatory Commission
LRA	=	Land Registry Authority
LRB	=	Land Registry Board
NHA	=	National Housing Authority
NHC	=	National Housing Corporation
NHMFC	=	National Home Mortgage Finance Corporation
SSS	=	Social Security System
UHLP	=	Unified Home Lending Program

FOR OFFICIAL USE ONLY

The World Bank
Washington, D.C. 20433
U.S.A.

Office of the Director-General
Operations Evaluation

June 25, 1996

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Project Completion Report on the Philippines Housing Sector Project (Loan 2974-PH)

Attached is the Project Completion Report (PCR) for the Philippines Housing Sector project (Loan 2974-PH, approved in FY88) prepared by the East Asia and Pacific Regional Office, with Part II contributed by the Borrower. The loan for US$160.0 million equivalent was approved in June 1988 and closed in April 1993, fourteen months ahead of schedule. About US$34.7 million was canceled. The project was cofinanced by the Japanese Grant Fund.

While the four previous housing loans focused on direct housing production, this project was the first one aiming at institutional and policy reforms. Its specific objectives were to: (i) streamline the institutional framework (through elimination of functional duplications, establishment of operational links between the National Housing Authority (NHA) and the National Home Mortgage Finance corporation (NHMFC), and strengthened financial viability for these agencies); (ii) improve efficiency in the use of public resources (through appropriate interest and spread policies, reduced subsidies, improved collections, and foreclosure enforcement); (iii) redirect new housing stock to lower income groups; (iv) facilitate greater prudence in financial and risk management; (v) stimulate the domestic economy and generate employment; and (vi) assist the construction industry by removing constraints on small contractors. The project comprised: (i) an adjustment component of US$75 million to be disbursed against the implementation of the agreed sector reforms; (ii) an investment component of US$80 million to support a time slice of the NHMFC's mortgage purchase program for low cost units built by NHA and private developers; and (iii) a technical assistance component of US$5 million for training, automation of selected management systems, and studies required to implement sectoral reforms.

Most of the project's sector adjustment objectives were met, and a substantial amount of institutional strengthening occurred under the technical assistance component. The streamlining of institutions reduced the total number of public housing agencies from ten to four, operational links were established between NHMFC and NHA, and loans were made at rates linked to NHMFC's cost of funds plus a spread. Consequently, the regressive interest rate structure was eliminated with the charging of lower rates on smaller loans, which improved targeting lower income groups, and reduced the level of subsidies to about 30 percent.

However, the NHMFC's failure to become a viable housing finance institution led to the eventual partial cancellation of the loan: NHMFC's collection performance stayed about the same (61 percent in 1994) and, in spite of a positive spread of 2 percent, NHMFC became insolvent. Regulatory oversight by the Central Bank had little effective impact. And only 2 years after loan approval, Government commitment was fading: a law issued in 1990 called for renewed guarantees on most mortgages and additional interest rate subsidies. Furthermore, the NHMFC's 1993 "Rehabilitation Plan" had little in common with the Bank's recommendations, reflecting the government's interest in mobilizing funds rather than fundamental policy reforms. This backtracking led the Bank to cancel the balance of the loan. The technical assistance component was, however, largely completed under the Japanese Grant Fund financing;

This document has a restricted distribution and may be used by recipients only in the performance of their official duties. Its contents may not otherwise be disclosed without World Bank authorization.

in particular, the land survey and titling systems were automated especially for use by small contractors.

For these reasons, project outcome is rated as only marginally satisfactory and its institutional development as moderate. Sustainability, however, is rated as unlikely because the goal of establishing NHMFC as a viable agency was never achieved and key aspects of sector policy reform, such as voluntary membership in the pension fund, were reversed. Bank performance is rated as satisfactory. These ratings are in line with the substance of the PCR.

The most important lesson is the need to realistically assess Government commitment to sector reform in an environment with high turnover of key actors and changing political priorities. Government ownership of the project could have been stronger if political and congressional bodies as well as critical regulatory agencies had been involved in project preparation.

No audit is planned.

PHILIPPINES

HOUSING SECTOR PROJECT (LOAN 2974-PH)

PROJECT COMPLETION REPORT

TABLE OF CONTENTS

Page no.

This document has a restricted distribution and may be used by recipients only in the performance of their official duties. Its contents may not otherwise be disclosed without World Bank authorization.

PHILIPPINES

HOUSING SECTOR PROJECT (LOAN 2974-PH)

PROJECT COMPLETION REPORT

PREFACE

This is the Project Completion Report (PCR) for the Housing Sector Project in the Philippines, for which Loan 2974-PH in the amount of US$ 160.0 million equivalent was approved on June 24, 1988. The loan agreement was signed on September 1, 1988, and the loan became effective on November 30, 1988. The original closing date for the loan was June 30, 1994, but disbursements were suspended on December 31, 1992, and the undisbursed portion of the loan, US$ 34.74 million equivalent, was canceled on April 28, 1993.

The PCR was jointly prepared by the Infrastructure Operations Division (EA1IN) of Country Department I of the East Asia and Pacific Region (Preface, Evaluation Summary, Parts I and III) and the National Home Mortgage Finance Corporation (Part II). On November 7, 1995, the Bank sent the Government of the Philippines Parts I and III requesting the comments of interested parties by December 15, but no reply was received.

The PCR was prepared by the Infrastructure Operations Division of Country Department I of the East Asia and Pacific Region (EA1IN), and is based, inter alia, on the Staff Appraisal Report (SAR), the Loan Agreement, supervision reports, the Borrower's own records, correspondence between the Bank and the Borrower, and internal Bank memoranda.

PHILIPPINES

HOUSING SECTOR PROJECT (LOAN 2974-PH)

PROJECT COMPLETION REPORT

EVALUATION SUMMARY

Objectives

1. The broad objective of the project was to support the development of an equitable and viable system of housing production and finance. Such a system would eventually be self-sustaining and would include an increasing degree of privatization.

2. The specific project objectives included: (a) streamlining the institutional framework (elimination of functional duplications, establishment of a programmatic link between NHA and NHMFC, and strengthened financial positions for these agencies); (b) improving efficiency in the use of public resources (more appropriate interest rate and spread policies, reduced subsidies, improved pricing, sales, collections, and sanctions enforcement); (c) redirecting new housing stock to lower income groups; (d) facilitating greater prudence in financial and risk management; (e) stimulating the domestic economy and boosting employment; and (f) assisting the construction industry.

3. The project aimed to support the Government's sectoral reform program as well as finance a portion of the five year investment program from 1988-1992. The project comprised: (a) an adjustment component (US$75 million) to support construction activities through import assistance for building materials; (b) an investment component (US$80 million) to support a time slice of NHMFC's mortgage purchase program for low cost units built by NHA and private developers; and (c) a technical assistance component (US$5 million) for training, equipment and studies required to implement sectoral reforms and to resolve anticipated bottlenecks in the construction industry.

Implementation Experience and Results

4. Most of the project's restructuring and divestiture objectives were met, and a substantial amount of institutional strengthening occurred under the TA component. However, actions by NHMFC contrary to project objectives constituted a critical deficiency, and the loan was suspended at the end of 1992 and canceled in early 1993 with $35 million undisbursed, representing about 44% of the investment component.

5. More specifically, objective by objective:

(a) Streamlining the institutional framework: Functional duplications among agencies and competition with the private sector were substantively eliminated with the eventual divestiture of the five corporations, and the total number of public shelter agencies dropped from ten to four. Streamlining resulted in lower public expenditures for activities which the private sector was capable of performing and thus a measure of improved efficiency in the use of public resources. This portion of the project's objectives was largely accomplished.

To reduce functional duplications between NHA and NHMFC, programmatic operational links were established with NHA selling mortgages to NHMFC. HIGC completed the study of privatization, but no follow-up has occurred, and its guarantee scheme both on mortgages and construction finance continues. One reform was reversed: HDMF's move to becoming a voluntary, and thus theoretically "private" savings scheme was reversed in 1993, and the "Pag-IBIG" contribution is again mandatory.

(b) Improving efficiency in the use of public resources: At the outset, the prevailing level of subsidy arising from NHA's compounded leakage from weak pricing, low sales and collections was about 64% on residential units and 82% on commercial and industrial units. Subsequent to implementing new arrangements, compounded subsidies dropped to about 26% in 1991, and then settled at about 30% at the time of project cancellation. However, collection performance, per se, improved only marginally from the approximate 60% level at the start to peak at 74% in 1991 and then decline back to 69% at the time of loan cancellation (and further to 61% by mid-1994). Though 30-40% subsidy from non-payment remains insufficient for sustainable operations, and thus resulted in the cancellation of the loan, it should be acknowledged that subsidies were effectively cut in half under the new structure, and their transparency somewhat improved.

With regard to achieving more appropriate interest rates and spread policies, the regressive interest rate structure of the housing finance system was eliminated, and a structure put in place which delivered lower rates to lower income households, and higher rates to the better off, ranging up to essentially market rates for largest loans to highest income groups. The NHMFC developed an appropriate adjustable rate mortgage policy in 1989, which matched mortgage terms to funding sources and eliminated previous interest rate risk and term match problems. Its negative spread was terminated, and a 200 basis point (2%) margin established on new loans. Had loan recovery rates been within a normal range, this spread would likely have been sufficient to allow NHMFC to earn a profit. However, the 2% margin could not compensate for a 30% default rate.

The 20% capital subsidy scheme established under the UHLP in 1988 for households at or below the 30th percentile improved both the targeting and budgetary predictability of subsidies. However, passage of the "Abot Kaya Pabahay" Law in January, 1990 introduced a more complex, and in the Bank's view, risky subsidy structure with graduated payments (paras. 30-31) which was to be offered as an alternative to the least financially sophisticated borrowers in the lowest income groups. Thus, the final picture on subsidy is mixed. While overall levels of subsidy appear to have been significantly reduced, and some improvements occurred initially in their targeting and transparency, later events occurred which complicated subsidies and made them more difficult to assess.

(c) Redirecting new housing stock to lower income groups: Both public sector financing and private sector production have moved down-market under the UHLP and the new Community Mortgage Program, which was introduced in 1989 and which provides loans to community groups for local projects.

Public production for the top half of the income curve was initially eliminated, and NHA focused almost exclusively on the lower half of the income curve, except for units providing agreed levels of social mix. However, under new leadership in the early 1990s the Authority began to develop completed medium-rise units affordable to more middle-income families.

(d) Facilitating greater prudence in financial and risk management: By elimination of HIGC's insurance, a degree of increased prudence occurred at the outset, followed by intensive technical assistance to NHMFC in 1990 to develop a proper loan classification system, and subsequent buildup of loan loss provisions from 1989-1992. HUDCC successfully developed monitoring indicators and a quarterly reporting system that revealed the Corporation's mounting problems. NHMFC is again insolvent, in spite of three layers of financial oversight (its own Board, the government auditor, and the Central Bank). Clearly while significant steps were taken to achieve this objective, the ultimate purpose of such prudence and oversight was not accomplished. Since this was a central objective of the project, the loan was canceled when it became clear that it would not be achieved.

(e) Stimulating the domestic economy and boosting employment: Though no detailed analysis was carried out at completion, it is reasonable to assume that the rapid expansion by NHMFC and far larger total investment in housing than anticipated at appraisal (resulting in a total portfolio of about P25 billion (approximately $1 billion) at the end of 1993, compared with P10 billion (approximately $400 million) estimated at appraisal) resulted in significantly greater economic stimulation and job creation than projected.

(f) Assisting the construction industry: The study of key bottlenecks to small (housing) contractors was completed in June 1989, financed under the Bank-financed Rural Roads Project. One major obstruction identified was the exceptionally slow processing of survey and titling by the Land Registry Board (LRB) and the Land Registry Authority (LRA), leading to the inclusion under the technical assistance component of a project to automate key aspects of the system. This was completed satisfactorily in 1993.

Sustainability

6. Selected aspects of the institutional reform under the adjustment component of the loan are likely to be sustainable, such as the divestitures of functions competing with the private sector and the streamlining of the sectoral institutional structure, as are many of the technical accomplishments of agencies in the housing sector. The goal of reestablishing NHMFC as a viable public housing finance agency was never achieved, and remains the primary failure of the project which led to the cancellation of the loan balance. Some aspects of policy reform have eroded, and the drive for financial viability and a transparent subsidy structure seem to have been abandoned by the new administration that took over in 1992.

7. However, as long as housing finance remains in the public domain, it appears unlikely that the project's unmet goals might yet be achieved. Since the Bank's loan cancellation in 1993, NHMFC initiated certain actions contrary to project objectives, including the: (i) reversal of loss reserves, which triggered an adverse opinion by the auditor; (ii) planned issuance of mortgage-back bonds, which would require subsidized funds; and (iii) possibility of bond financing, which would expose NHMFC to an asset-liability maturity mismatch.

8. A further constraint to project sustainability concerns a number of actions indicating that housing sector officials believed that sector problems were predominantly due to inadequate funding rather than to inappropriate policies and incentives. Examples of this include the reintroduction of mandatory contributions to HDMF and the reintroduction of partial HIGC guarantees for pension fund loans. A further example involves legislation prepared in October 1994 that sought to dramatically increase central government authorizations and budget outlays for housing by (1) supporting major social housing programs; (2) recapitalizing NHMFC for the third time; and (3) making permanent a fund for interest rate and mortgage guarantee subsidies. These increases in funding and subsidies would reduce the pressure for more fundamental reform, entrenching the current system of publicly dominated housing finance.

9. The key question was whether such extensive and often opaque subsidies would be needed if the private sector were used to manage the housing finance system in a more businesslike manner, with the Government's role restricted to the provision of direct, targeted, transparent subsidies. More disciplined management of loan schemes would substantially reduce the amount of funding lost to untargetted support of non-performing loans without regard to the income group receiving such support.

10. A further major barrier to an effective public mortgage finance system in the Philippines is the lack of political will among public housing finance agencies to bill and collect mortgage loans. Partly as a result, an entrenched non-payment culture has taken hold, which is not confined to the lower-income groups who have been the targets of political patronage programs over several decades.

11. The fundamental question remains whether private banks could achieve a more sustainable level of loan recovery if given the opportunity. NHMFC's new administration attributed its poor collections not only to legal impediments, but also to the relative uncreditworthiness of the borrowers approved by the preceding administration. Affordability analyses carried out during the project life, however, concluded that households were not devoting an undue share of income to housing expenditures.

12. Despite these reversals and impediments to reform, forces outside the housing sector could yet generate fundamental change in the housing finance system. Two forces moved the system closer to reform at the end of 1994 than it has been in the past: macroeconomic stability and international competition

Findings and Lessons Learned

13. Political Considerations. The most important lesson to gain from this project was to acknowledge the difficulty of assessing the political will for reform, which is critical to the success of adjustment operations and to sustaining viable financial institutions. The change of political actors and changing political priorities made such assessment all the more difficult, and it remains unclear what further assurances might have been secured or actions taken which would have enhanced the project's chances of success. However, laying a better groundwork in the form of collaborative studies with political and congressional bodies would have yielded a firmer basis on which to make the difficult judgements called for.

14. Regulatory Considerations. Project preparation did not adequately involve the critical regulatory agencies, i.e., the government auditor and the Central Bank Supervision and Examination authority. Such involvement might have subjected NHMFC (and other non-depository financial institutions) to inspections earlier, and alerted the Bank and regulators to NHMFC's unorthodox

accounting practices. Greater awareness of these issues during preparation might have enhanced the prospects of success, although adverse opinions and Central Bank inspections do not seem to have led to change.

15. Earlier cooperation and strengthening of government's own oversight and regulatory instruments would have eased pressures on the Bank to play these roles, and helped build regulatory capacity within the Government. Advancing the dialogue about issues of transparency and accountability might also have led to clearer understandings and agreements at appraisal regarding essential changes in accounting practices, which did not occur until mid-1991 when implementing these changes was indeed painful for NHMFC. It is doubtful, however, that it would have altered the final outcome of the project.

16. Private Auditor. The project would have benefitted from using a private auditor to review the financial statement of NHFMC. Although this was not Bank practice at the time and the quality of government audits improved over time, using a private auditor familiar with GAAP accounting for banks and financial institutions would have identified the critical accounting issues at an earlier stage.

17. Private Sector Involvement. Providing apex loans through the Central Bank to the commercial banks might have proved a better vehicle for increasing private sector involvement in the housing sector. Through careful design and risk sharing, such an approach might well ultimately reduce the level of total government subsidy, and improve the targeting and transparency of support to lower income groups. Exploring this possibility is one of the objectives of the Bank's continuing dialogue and TA in this sector.

PHILIPPINES

HOUSING SECTOR PROJECT (LOAN 2974-PH)

PROJECT COMPLETION REPORT

PART I: PROJECT REVIEW FROM BANK'S PERSPECTIVE

1. Project Identity

Project Name	:	Housing Sector Project
Loan Number	:	Loan 2974-PH
RVP Unit	:	East Asia and Pacific
Country	:	Philippines
Sector	:	Urban Development
Sub-sector	:	Housing

2. Background

2.1 The Philippines Housing Sector Project (Loan 2974-PH) was the first loan to the sector to focus on the institutional framework and policy, including financial policy. Four previous housing loans focused on direct housing production, and particularly on developing replicable, lower-cost housing solutions like slum upgrading and serviced sites, executed primarily by the National Housing Authority (NHA), a public housing agency. This loan addressed broader structural problems in the sector through an adjustment component, and focused on the main housing finance institution, the National Home Mortgage Finance Corporation (NHMFC), for the mortgage investment component.

2.2 NHMFC was formed in 1979 to purchase mortgages from originators and provide liquidity to the sector. The NHMFC set mortgage terms for originators -- government and private banks -- whose role would have been more accurately described as administrative functionaries rather than as independent mortgage banks. In the early 1980's it was expected that once NHMFC was fully operational in the primary market, it would eventually become a U.S.-style secondary-mortgage-market institution, purchasing and securitizing mortgages and integrating the housing finance system into the broader capital market. This however, could not occur before a successful primary market was established.

2.3 In addition to NHMFC and NHA, three national pension funds have been key players in the housing sector. At the time of project design, 1984-1986, two of these pension funds -- the Social Security System (SSS) and the Government Social Insurance System (GSIS) -- built housing units and offered mortgage finance to their members. The third, the Home Development Mutual Fund (HDMF), was the main source of funding for NHMFC's mortgage program. However, this led to a regressive subsidy with HDMF's predominantly low-income contributors financing NHMFC's predominantly high-income borrowers, at below-market rates. Nearly 70% of members fell in the bottom half of the income curve, with only 5% of NHMFC mortgages approved in this group. Meanwhile, NHA, government's sole low-income producer depended on foreign loans (predominantly the Bank) and when economic difficulties forced budgetary cuts, these low-income operations were severely curtailed, while those of NHMFC and the pension funds faced relatively modest reductions. NHA had never tapped any of the three pension and forced savings funds for financing.

2.4 NHMFC's spread between its fixed-rate mortgage lending rates and its costs was initially positive, with long-term, low rate mortgages funded by long-term, low rate (below-market) borrowings from HDMF's forced savings fund earmarked for housing. However, pressures to expand brought NHMFC into the capital market with shorter-term borrowings at higher rates. As yields rose, the Corporation's spread turned negative in the early 1980's. These years saw the worst inflation the Philippines faced in a decade, with inflation nudging 50% in 1984. Correspondingly high debt costs, combined with long-term, below-market fixed-rate mortgages, lack of sound financial planning, liberal loan terms, and a low loan collection rate of around 60% -- had pushed NHMFC into insolvency by 1985.

2.5 Technically, the "cash flow" guarantee provided by the public Housing Investment and Guaranty Corporation (HIGC) should have prevented this failure. However, the guarantee proved inoperative, with HIGC refusing to pay for defaults on large volumes of non-performing loans due to deficiencies in mortgage documentation. NHMFC in turn, withheld payment of insurance premiums to HIGC. As a result, neither agency took action on foreclosures, and sanctions for non-payment remained unenforced. Large sums began to build on both balance sheets as reciprocal payments were withheld until the dispute could be resolved. HIGC held no insurance fund and, beyond its own fairly low capitalization, would have been unable to meet the substantial obligations of a large non-performing portfolio.

2.6 Other problems plagued the sector. Recovery of direct costs (net of interest rate subsidies) was universally low by all direct builders and lenders including the social security system and NHA. The NHA, which produced and financed housing for the poor, was able to recover from beneficiaries only about 36% of its costs on residential projects and 18% on commercial/industrial (CI) projects, due to compounded losses from inappropriate pricing, low sales, and weak collections. Expected profits from the sale of CI units priced above cost was expected to cross-subsidize lower prices on residential units. Economic recession depressed the market for such units, which remained unsold while the subsidized residential units were snapped up. Poor coordination between these and other agencies plagued the sector. Among NHMFC, NHA, the National Housing Corporation (NHC), the pension funds (SSS, GSIS, and HDMF), and the Home Finance Corporation (HFC, and later renamed the Housing Investment Guarantee Corporation, HIGC) there was significant functional duplication, with most agencies building and financing housing for different or overlapping groups of beneficiaries. One manifestation of this duplication was a regressive mortgage interest-rate structure: NHA provided mortgage finance for lower-income borrowers at 12%, the pension funds for their middle-income members at 6%, and NHMFC for the better-off at 9%.

3. Project Objectives and Description

3.1 The project was appraised in August, 1987, following passage of EO 90 in late 1986, negotiated nine months later in May, 1988, and approved by the Bank's Board in June, 1988. The objectives listed in the SAR and agreed upon in the Loan Agreement included:

(a) streamlining the institutional framework, including elimination of functional duplications between public agencies and competition with the private sector, establishment of programmatic operational links between NHA and NHMFC, improved financial viability for these agencies, and greater specialization;

(b) improving efficiency in the use of public resources, e.g. more appropriate interest rate and spread policies, reduced subsidies with better transparency and targeting of those subsidies on the poor, improved cost recovery, and public sector withdrawal from direct production of units affordable to the upper half of the income curve, as well as from construction insurance;

(c) redirecting new housing stock to lower income groups through both redirection of the housing finance system (and thus private production) to low and middle income households between about the 40th and 80th percentiles, and through greater concentration by NHA on production of new stock as opposed to resettlement;

(d) facilitating greater prudence in financial and risk management and strengthening of HUDCC's sectoral monitoring capacity;

(e) stimulating the domestic economy and boosting employment; and

(f) assisting the construction industry by identifying and addressing key bottlenecks obstructing the recovery of small housing contractors.

3.2 To achieve these objectives, the project consisted of three parts: (i) an adjustment component; (ii) an investment component, and; (iii) technical assistance. The project was clearly ambitious, tackling for the first time many of the sector's broader key issues, after four production-oriented loans to NHA. The loan totalled $160 million. The adjustment component called for the disbursement of $75 million of general budgetary support, against a positive list comprising imported construction materials. This disbursement was tied to the passage and implementation of the agreed sectoral reforms under EO 90. The investment component provided $80 million to NHMFC to purchase mortgages from NHA and from the private sector -- funded units would be for lower income borrowers below a stipulated percentile of the income curve. The third component provided technical assistance totalling $5 million to NHA, NHMFC, and other agencies for studies of policy, privatization and legal obstructions to foreclosure, automation of selected systems, financial management training and TA, and other actions needed to achieve sectoral reforms and reduce or remove key bottlenecks.

3.3 The adjustment component called for termination of a number of public corporations, and the rationalization of functions which would remain public. Conditionality for the disbursement of this component was tied to reforms agreed to before loan effectiveness and made public in EO 90, as well as under the Sector Policy Statement and Action Plan, and individual Policy Statements and Action Plans for two of the remaining three agencies (NHMFC and NHA), formally adopted by their respective Boards of Directors and approved by Government.

3.4 The investment component's success hinged on NHMFC, which was the main recipient of investment funds and the administrator of the new UHLP. Since NHMFC's insolvency in 1985 was due partly to its weak loan recovery performance, which in turn was attributed to NHMFC's reliance on HIGC's cashflow guarantee, this guarantee was eliminated under EO 90. This move was intended to encourage prudent management since NHMFC would be responsible for covering its own losses, which, if incurred, would be transparent.

3.5 By itself, the shift from HIGC guarantees to self-insurance appeared sensible. For the first time, NHMFC had an incentive to be financially prudent since its safety net was removed. But shifting the cost of failure from HIGC to NHMFC represented only an initial step. The fundamentals of NHMFC's business also needed improvement.

3.6 The Bank and the government agreed to monitor more closely a number of crucial indicators: interest rate spreads, mortgage payment collection levels, debt-equity ratio, level of loss provisions, etc.. Key among these was NHMFC's collection levels (including realizations from liquidations) which were expected to rise from around 60% during project preparation to 85% in 1989, and to 95% in later years, as mortgage servicing improvements occurred and foreclosures and resales took place.

3.7 However, NHMFC faced powerful political incentives that overwhelmed the incentives intended to yield reform. Mortgage purchases and extension of credit, especially to lower-income families who comprise the vast bulk of the Philippine population, represent politically popular activities, and pressures are consequently intense for rapid credit expansion in years leading up to elections. These incentives caused NHMFC to emphasize asset growth over portfolio management, and to stop short of final liquidation, eroding the Corporation's reputation as a serious financial institution, and resulting in continued low collection levels. Second, legal barriers to prompt foreclosure which were identified at appraisal, and studied under the project, continued to impede NHMFC's foreclosure efforts.

3.8 Two laws, the Right of Redemption and the Maceda Law delay liquidation or increase a lender's loss in the case of default, reducing both the lender's incentive to foreclose and pressure on the borrower to make payments. The Right of Redemption applies to mortgages and allows a borrower to stay in possession for a year after formal foreclosure, which itself is not triggered until the loan is 8 months delinquent. The Maceda law applies to "contracts to sell," (effectively rental-purchase agreements under which a lender retains title until the borrower's last payment). This second law requires that a defaulted borrower be reimbursed 50% of payments made in the previous two years. Both laws aggravate expected losses, reducing the lender's incentive to foreclose and softening the threat to the borrower of foreclosure. It is noteworthy that these laws, which apply equally to public and private mortgages, have not undermined private banks' mortgage collection and foreclosure/liquidation efforts. The reason is that under another Philippine law, when an asset is foreclosed and sold by a lender, the lender may retain all proceeds of the sale. Thus, any equity built up by the borrower is lost. In contexts of high inflation and relatively low interest rates, collateral value often exceeds the outstanding loan amount, even including fees, legal costs, and delinquent interest. Most families choose to sell the collateral themselves, rather than allowing the lender to do so, in order to retain whatever equity may remain after loan payoff. Private banks thus assured the Bank at appraisal that while the laws were not helpful to lenders, neither did they represent lethal impediments to viable mortgage lending. For mortgages, which are NHMFC's preferred instrument, they simply delay liquidation of collateral by perhaps six months beyond what might otherwise occur. Consequently a study was included in the project to explore means of better balancing the interests of lender and borrower and prepare drafts of revisions to the laws.

3.9 The project's objectives might have been improved by addressing the legal framework directly through stronger conditionality, i.e. passage of new laws before Board presentation rather than a study. This would probably have required an additional year or two. Given the already considerable complexity of conditionality under the loan, the need for working with key legislators in designing such changes, and the fact that while creating delay, the laws were not considered serious impediments to successful mortgage operations by private banks, this task was consciously left to a later time. As noted above, deficiencies in the legal framework for foreclosure do not seriously impede private banks in similar efforts and the appraisal mission, following extensive dialogue with private bankers, concluded that this reform could be deferred to a later phase.

3.10 The project clearly underestimated the extent to which the weak collection performance and near-absence of previous foreclosure were politically driven imperatives that would survive the Marcos Administration. Assurances secured at negotiations from sector management and Government of their serious intent to enforce loan recovery and associated sanctions ultimately proved inadequate. It remains unclear, however, what further conditions or assurances might have proven effective in this context.

4. Project Design and Organization

4.1 As part of project preparation, which spanned nearly three years, the Bank worked with the government and the housing agencies to formulate a sector rationalization plan. Elements of the plan were carried out in late 1986, including the Government's elimination of the Ministry of Human Settlements (MHS), and implementation of Executive Order 90 (EO 90) in December of that year. These actions essentially fulfilled the conditionality for the adjustment measures being pursued through the loan. The main elements of the adjustment efforts were:

(a) the elimination of public sector competition with private sector input producers (land supply and building materials) and builders, through liquidation of four corporations (Woodwaste Development Corp. (WW), Builder's Bricks Development Corp. (BB), the Bliss Development Corp. (BDC), and the National Housing Corporation (NHC));

(b) functional separation among the remaining housing sector agencies; and

(c) establishment of a coordination mechanism through the Housing and Urban Development Coordinating Council (HUDCC) which replaced the MHS.

4.2 Functional separation of sector responsibilities meant that NHMFC would have primary control for finance, NHA for production of lower-cost units, and the pension funds for supplying capital to NHMFC to fund housing for their members. With housing finance concentrated at NHMFC, it was possible to reform the regressive interest rate structure. Loans were made available at rates linked to NHMFC's cost of funds plus a spread, initially 9% for the smallest loans, 12% for moderate-sized loans, and 16% for larger loans. This program, called the Unified Home Lending Program (UHLP), was structured to serve the lower 90% of the income distribution, with the wealthiest tenth relying on private commercial banks.

4.3 Executive Order 90 instituted other reforms, as well. First, NHMFC's then-existing mortgage portfolio -- known as Folio I, consisting of loans funded by HDMF for its members -- was transferred to HDMF. This transfer enabled HDMF to unwind the negative spread by reducing the rate paid to its depositors, and allowed NHMFC to begin anew. Second, membership in HDMF, which had been mandatory, was made voluntary, and the three pension funds agreed to fund NHMFC's purchases of their own members' mortgages through loans to the Corporation secured by the associated member mortgages. Thus, SSS would fund NHMFC's purchases of mortgages made to private-sector employees; GSIS would fund purchases of mortgages for public-sector employees; and HDMF would fund NHMFC's purchases of mortgages made to anyone who chose to be a member of HDMF. Third, NHMFC's loan repayments from borrowers would no longer be guaranteed by HIGC. NHMFC would directly manage collections and foreclosure on its portfolio, and "self-insure" against the risk of borrower non-payment by establishing a proper loan classification system and holding appropriate loss provisions.

4.4 In summary, EO 90 called for the reduction of the number of public housing agencies from ten to four. Five of the ten, or half, were eliminated (WW, BB, BDC, NHC, and MHS). A sixth, HDMF, was "privatized" in the sense that its membership would become voluntary rather than mandatory. A seventh, HIGC, would remain but agreed to terminate land pooling activities, divest the S&L bank that it held as a subsidiary, and undertake studies of its several remaining functions, with a view to privatizing or divesting some or all of these functions. Only three agencies would remain as public institutions: the NHA, which carried out squatter upgrading, and produced serviced sites for the poorest people, the NHMFC, specializing in mortgage finance, and the Human Settlements Regulatory Commission (HSRC) which regulated construction by private developers. (The two social security agencies (SSS and GSIS) were considered beyond the scope of the housing sector review, and were expected to continue to fund housing through voluntary loans to NHMFC.)

4.5 Assuming successful implementation of these initial reforms to eliminate competition with the private sector, reduce the public sector presence in the housing industry, and restore confidence in mortgage instruments under the project, a follow up housing sector loan was expected to be made, which would begin privatization of mortgage finance (NHMFC) and securitization of what was hoped would by then be a sound primary portfolio. This second operation, expected to span from about 1995-99 would need to tackle more directly the legal framework in the housing sector which was to be studied under the present loan (para. 3.8), continue support for rationalization of the tax incentive structure and guarantees through HIGC's transformation or privatization, and provide further assistance in design of support (subsidies) for lowest income groups.

4.6 The Bank did consider pushing reform further in this operation by circumventing the public sector entirely and directing funds under the investment component to private banks through an apex arrangement with the Central Bank. However, broad-based reforms of private banks were then underway, with many being insolvent, and Government was reluctant to initiate any further apex arrangement. Agreement was therefore reached to postpone these types of actions until the next stage of reform.

5. Project Implementation

5.1 NHMFC. Though implementation in the early years of 1988-1990 focused primarily on launching construction by private builders and the NHA for subsequent takeout by NHMFC, the Corporation began mortgage purchases in those years. As a result of both the purchase of NHA's lower-cost mortgages and some down-market movement by private builders, mortgages under NHMFC's new portfolio supported by the Bank were, on average, more affordable to the poor than the mortgages in Folio I had been. The average Folio I loan had been affordable to a household at the 90th percentile of the income distribution. By mid-1990, the average loan was affordable to a household at the 45th percentile. The shift down-market reflected NHMFC's changed mandate, and the results of both connecting NHA into pension fund sources via NHMFC and of a gradual increase in construction of lower-income units by private builders.

5.2 Another contributor to improved targeting under the UHLP was the Community Mortgage Program (CMP), under which NHMFC lent to communities for poverty-oriented slum-upgrading projects. Though assisting visibly in the Corporation's shift down-market, CMP mortgages generally lacked sanctions for non-payment arising from the lack of even simple agreements with individual households. NHMFC's sole recourse was to seize and sell the land of the entire community -- an action both administratively and politically impractical. Because of this defect, the Bank never financed most CMP mortgages despite their attractive poverty orientation.[1] By December 1993, the auditor reports 46% of mortgages under this program were in arrears more than a year. The program's poor performance may be due to a combination of the above defect in sanctions, the graduated payment subsidy introduced under the Abot Kaya Law, and/or general politicization of the program. Given the very modest sums involved, it is not likely to be attributable to affordability. It is unfortunate that such a poverty-focused program could not be made viable.

5.3 Several actions arising in the course of implementation signalled loose practices by NHMFC, and evidenced its growth orientation. First was that in its desire to improve targeting and initiate its lower-income links, NHMFC purchased a number of mortgages from NHA which lacked final individual titles, though they had proper Promissory Notes and other loan documentation. NHA possessed "mother title" and had submitted subdivision plans to LMB/LRA for approval, survey vetting and title issuance. The significant backlog of work in these organizations delayed issuance of final individual title. Under the agreement, NHA would repurchase the mortgages if title was not delivered within two years. However, two years later, the problem remained largely unresolved as new growth continued to outweigh portfolio management in NHMFC's resource use. The LMB/LRA TA program was launched during this period to help resolve the problem.

5.4 Second was that Folio I assets which, under a 1988 Agreement (signed as a condition of loan processing) were to have been transferred from NHMFC to HDMF, had been removed from NHMFC's books, but had not yet appeared on HDMF's balance sheet. Deficiencies in loan documentation and payment records required virtual reconstruction of each account, sometimes necessitating tracing records back to the original collecting banks, a slow process at best, and considered low priority by both agencies. Meanwhile, large undistributed collections remained frozen on NHMFC's books, and could neither be transferred nor taken into income since unsatisfactory portions of Folio I were being rejected by HDMF and returned to NHMFC as reconciliation continued. Transfer of Folio I was finally largely complete by the end of 1992, at which time the agencies had resolved 87% of the P4.4 billion Folio I total.

5.5 In 1990, it came to the Bank's attention that NHMFC had begun double-financing some mortgage takeouts by using Bank financed mortgages as collateral for loans from the pension funds. A portion of the resulting liquidity was placed in high-yield Treasury bills. The Bank informally halted disbursements for six months (from the middle to the end of 1990) while the double financing was resolved. NHMFC repaid 60% of the pension funds' loans collateralized with Bank mortgages, and provided new mortgages that qualified under the Bank's agreed terms for the remaining 40%.

---

[1] A small number of CMP mortgages were individualized for which Bank funding was used.

5.6 In January 1990, Congress passed the Abot Kaya Pabahay (Social Housing) Fund law which changed policy on guaranty and subsidy schemes enough to make them potentially inconsistent with the loan agreement. The Bank and the government spent most of 1990 negotiating a resolution that would utilize the implementing regulations to ensure compatibility between the law and the loan agreement.

5.7 The legislation called for renewed HIGC guarantees on most mortgages and an additional layer of interest rate subsidies added to the existing capital subsidy on small UHLP mortgages. Bringing back mortgage guarantees on NHMFC loans would have reversed the 1986 reforms under Executive Order 90, which attempted to impose financial responsibility on NHMFC. The additional subsidies consisted of reductions in payments for the first five years of the (typically twenty-five year) mortgage, during which time payments would be steeply graduated each year. In the politicized Philippine environment, the Bank thought that the initial very low payment would become entrenched and a significant proportion of low income borrowers would not pay the steep annual increases. As a result of the negotiations with the Bank, by the end of 1990 the government agreed (a) to limit guarantees only to direct lending by the pension funds (that is, excluding the UHLP and therefore NHMFC's mortgages), and (b) to make low-income mortgages subject to either the 20% capital subsidy or the Abot Kaya graduated subsidy, but not both, and (c) that NHMFC would closely monitor performance on graduated payments and would maintain adequate loan loss provisions commensurate with the risks undertaken. Further, the Bank would not finance mortgages subject to such graduated payments. The Community Mortgage Program was a primary beneficiary of the Abot Kaya subsidy. It's ultimately disappointing performance is discussed above in para. 5.2.

5.8 By mid-1990, two years after Board approval, as NHMFC began to purchase and service a growing volume of mortgages, evidence began to mount of weakness in loan recovery rates. Fundamental business problems underlay the emerging financial crisis. NHMFC showed little improvement in collections, and foreclosed on few delinquent loans. Growth remained the Corporation's principal focus, since it faced political pressure to support private sector production and because its success was measured in terms of loan volume, not loan performance. A financial management seminar took place during that year, financed under the TA component of the loan, and utilizing trainers who had trained World Bank staff in financial analysis, to try to strengthen the Corporation's understanding of the issues and improve its control systems.

5.9 To address the emerging problems, in November 1990, the Bank and NHMFC agreed to an Action Plan, which called for measures to reduce rising receivables, and for increased loss provisions commensurate with a proper loan classification system. Accounting changes were also needed to conform to generally accepted accounting principles (GAAP) as called for under the loan Agreement. NHMFC's accounting methods obscured its deteriorating financial condition. Income was recognized on all loans regardless of performance, masking losses in 1990 and probably in 1989, and loss provisions were inaccurately shown as a subset of the capital account. During 1991 the Bank provided technical assistance to NHMFC to formulate an appropriate provisioning policy, classify the loan portfolio, and identify a suitable level of loss provisions, both specific and general.

5.10 Following a year during which considerable effort and activity resulted in little net improvement in loan recovery rates, with consequent further deterioration in NHMFC's financial position, in November 1991 the Bank officially advised Government of its intention to suspend the loan unless NHMFC achieved the targets set out in a second, more formal plan initially established for 3 months. NHMFC argued that significant improvement in collections would require at least another year. The final Action Plan called for: (i) improvement in collection efficiency from 63% to 80% by December 1992, individualization of group ledgers in the Community Mortgage Program, and issuance of titles on NHA properties; (ii) confirmation of the loss provisioning policy, and increase in provisions to satisfactory levels; (iii) completion of the transfer of Folio I to HDMF and posting of undistributed collections; (iv) adoption of a satisfactory income recognition policy; (v) an increase of 2 points (about 0.4%) to NHMFC's spread; (vi) reversal of income recognized but not received on loans in arrears more than 18 months, phasing in of a 10 month standard by January 1993, and preparation of a plan for addressing NHMFC's resulting capital deficiency; and, (vii) establishment of full regulatory oversight by the Central Bank. (See Table 8)

5.11 The primary cause of NHMFC's problems remained its heavy focus on growth, at the expense of portfolio management. Total assets increased by 61%, 52% and 43% in each of the years from 1990-1992, and another 49% in 1993. NHMFC's CEO resigned in April of 1992, following national elections in 1991. The Corporation thus drifted during a critical, and perhaps pivotal 8 month period just prior to the change of administration.

5.12 By the end of 1992, it was clear that NHMFC would be unable to meet several crucial conditions of the 1991 Action Plan. Notably, collections remained at 63% in November, far below the 80% level agreed, and only 14% of loans that should have been in foreclosure actually were, with only .06% (18 out of 30,000) resolved via redemption, resale or restructuring. Half of all loans over a year old were in arrears by more than 8 months, and collections on CMP accounts had declined to 56%. Loss provisions continued to fall short of agreed levels, and the Corporation had a negative net worth estimated at about P500 million, and was thus seriously capital deficient. These represented substantive breaches of the project agreement. On December 31, 1992 the Bank suspended the loan and informed Government of its intention to exercise its right to cancel following the stipulated 30 day period.

5.13 Despite loan suspension, a number of accomplishments took place under the Action Plan. Transfer of Folio I was brought to 87% completion, though undistributed collections had not been addressed, and, in fact actually rose from P1.3 to P1.8 billion due to mounting backlogs of unposted collections on Folio II. A satisfactory income recognition policy had been adopted, and P398 million added to loss provisions, doubling provisions from 1.6% to 3.4%, but which still remained below the levels required by the loan classification exercise carried out in 1991. The Corporation added points and charges to increase its spread to between 3.0%-3.6% depending on loan size. The Central Bank initiated full supervisory functions and had completed its first inspection report on the Corporation, and the quality of the auditor's reports had gradually but steadily improved over the years, with adverse opinions having been rendered for the last several years due to the problems discussed in this report. These achievements increased the transparency of the Corporation's impending insolvency, but in themselves could not forestall failure. While NHMFC could defer payments and generate sufficient liquidity to keep its doors open, without significant improvements in loan recovery rates, it was clear that it would remain inviable.

5.14 The NHMFC's new CEO, appointed late in 1992 responded in early 1993 with a "Rehabilitation Plan" to improve its precarious financial position. This plan called for (a) mandated pension fund contributions to NHMFC; (b) reestablishment of compulsory membership in HDMF; (c) recapitalization of NHMFC using World Bank and pension fund (SSS/GSIS) loans which would be converted to equity; and (d) issuance of mortgage-backed bonds to the public, guaranteed by HIGC and subsidized by the Abot Kaya fund.

5.15 NHMFC's Rehabilitation Plan had little in common with the Bank's recommendations, and, in fact, would have reversed some of the 1988 reforms (i.e., voluntary HDMF membership). The Plan further eroded the targeting of subsidies on lower-income households and restored some of the pre-1986 problems. To slow NHMFC's supercharged growth, and allow management time to strengthen internal systems and controls, the Bank had suggested that further pension funding for housing be routed through commercial banks instead of NHMFC, and that a third recapitalization of NHMFC be deferred until its viability could be demonstrated. To stem NHMFC's impending hemorrhage of losses, the Bank also recommended temporarily negotiating a reduced rate on pension fund borrowings until mortgage recovery rates increased, and fundamental improvements in the primary mortgage market before considering any secondary market activity.

5.16 The gap between the Bank's recommendations for the sector and NHMFC's own was too wide to bridge, and following a further three month dialogue with the Corporation, the government and the pension funds, the Bank canceled the remainder of the loan on April 28, 1993. This cancellation withdrew funds which NHMFC hoped to use to support the Community Mortgage Program and the mortgage purchases of self-employed people. Increased lending from the pension funds replaced the financing that the Bank would have provided, under a "temporary" arrangement waiving the prevailing restriction that pension funds be used only for member loans.

5.17 Following loan cancellation in 1993, and despite the steady further deterioration of the portfolio (with collections dropping to 61% by mid-1994), the Corporation reversed its loss provisions, backing out P459 million which was apparently booked to interest income. Probably as a result, losses for the year which had reached P441 million in 1992, were reduced to only P64 million in 1993.

5.18 NHA. During the early years of implementation (1988-1990) NHA and the private sector constructed new units for refinancing by NHMFC through mortgage purchases on these units under the investment component of the loan. There were delays in this first component, due largely to slow land acquisition.

5.19 As a condition of Board presentation, the government agreed that NHA would restructure its balance sheet by the end of 1988. This restructuring included the transfer or write-off of P112 million receivables, and the transfer of an additional P887 million in assets representing schools, clinics, trunk water and sewer lines, etc. which NHA had built but which belonged within the mandate of to other agencies. Until transfer occurred, NHA continued to foot the maintenance bills for these facilities without any commensurate source of cost recovery. Though delayed, these transfers were eventually completed by mid-1990.

5.20 As part of its revised pricing policy, NHA terminated reliance on cross-subsidy, though it continued to use differential pricing to realize gains on social mix and CI units. Expenditures incurred for activities for which there was no source of cost recovery would be undertaken only through explicit government subsidies.

5.21 Technical Assistance Component. The technical assistance component survived the cancellation of the loan. Japanese grant funding had been secured, replacing loan funds, with the $5 million originally planned for technical assistance transferred to the mortgage component. The Japanese Grant Fund consisted of $1.9 million, of which $700,000 remained unspent at cancellation of the project. At the request of the Government, the Fund was continued to allow completion of institutional strengthening for a number of sectoral agencies, as well as to help NHMFC address its deficiencies. It was also used to support ongoing work to assist sector authorities in identifying obstacles to private sector participation in housing finance.

5.22 Despite implementation delays, a number of useful tasks were completed under the TA component. Key among these were the following: (i) a pilot automated land titling system at the Land Registry Authority and the Land Management Board; (ii) automation of several key NHA systems, including billing & collection (for mortgages which could not be refinanced with NHMFC), lot inventory, accounting and budget; (iii) a study on privatizing the HIGC; (iv) introduction of geographic information system (GIS) capabilities at the Housing and Land Use Regulatory Board (HLRB); (v) establishment of an improved monitoring capacity within HUDCC, dovetailed with the quarterly reports of the individual sectoral agencies; and, (vi) for NHMFC, a financial management seminar, loan classification and loss provisioning assistance, assistance in strengthening the corporation's regional presence, and assistance in strengthening of the CMP (individualization of mortgages), and overall collections. Delays in TA implementation were generally due to high turnover of local staff in affected agencies, and consequent setbacks in timetables while new staff were brought up to speed. The quality of some studies and automation work suffered from inadequate competition, itself a reflection of the prevailing strong preference by government for local consultants.

5.23 While no future operation is planned for the housing sector at this time, the Bank continues to provide some technical assistance to Government on housing sector issues which are being financed by the Japanese Grant Fund. This technical assistance includes policy development work in three areas: (1) analyzing the incentives associated with subsidies and other housing policies; (2) identifying opportunities for a larger private sector role in housing; and (3) reviewing land-use policies, particularly policies on urban redevelopment, urban-periphery land conversion, and new-town construction. Ongoing technical assistance is scheduled to end with the closing of the grant on December 31, 1995.

6. Project Results

6.1 Though most of the project's restructuring and divestiture objectives were met, and a substantial amount of institutional strengthening occurred under the TA component, the NHMFC's repeated failure constituted a critical deficiency and the loan was suspended at the end of 1992 and canceled in early 1993 with $35 million undisbursed, representing about 44% of the investment component.

6.2 More specifically, objective by objective (see para. 3.1):

(a) Streamlining the institutional framework: functional duplications among agencies and competition with the private sector in land stockpiling, high cost housing production, and building materials production were substantively eliminated with the eventual divestiture of the five corporations, and the total number of public shelter agencies dropped from ten to four. Streamlining resulted in lower public expenditures for activities which the private sector was capable of performing and thus a measure of improved efficiency in the use of public resources. This portion of the project's objectives was largely accomplished.

To reduce functional duplications between NHA and NHMFC, programmatic operational links were in fact established with NHA selling mortgages to NHMFC. This measure was intended to restructure incentives for NHA by providing finance after units were completed, appropriately priced and sold, rather than as construction proceeded, as under previous loans. This goal was also largely accomplished. HIGC completed the study of privatization, but no follow-up has occurred, and its guarantee scheme both on mortgages and construction finance continues, though Maunlad S&L was divested, and the land scheme terminated. One reform was reversed: HDMF's move to becoming a voluntary, and thus theoretically "private" savings scheme was reversed in 1993, and the "Pag-IBIG" contribution is again mandatory.

(b) Improving efficiency in the use of public resources: At the outset, the prevailing level of subsidy arising from NHA's compounded leakage from weak pricing, low sales and collections was about 64% on residential units and 82% on CI units (para. 2.6). In the first two years of the project, NHA adopted and generally observed a substantially improved pricing policy, and, since units financed by NHMFC required formal mortgage documentation, sales on such units were uniformly completed prior to takeout. Thus compounded subsidies under the new arrangements dropped to about 26% in 1991 when NHMFC's collection performance peaked, and then settled at about 30% at the time of project cancellation. [2] However, collection performance, per se, has improved only marginally from the approximate 60% level at the start to peak at 74% in 1991 and then decline back to 69% at the time of loan cancellation (and further to 61% by mid-1994). Though 30-40% subsidy from non-payment remains insufficient for sustainable operations, and thus resulted in the cancellation of the loan, it should be acknowledged that subsidies were effectively cut in half under the new structure, and their transparency somewhat improved.

With regard to achieving more appropriate interest rates and spread policies, the regressive interest rate structure of the housing finance system (para. 2.6) was eliminated, and a structure put in place under the UHLP which delivered lower rates to lower income households, and higher rates to the better off, ranging up to essentially market rates for largest loans to highest income groups. The NHMFC developed an appropriate adjustable rate mortgage policy in 1989, which matched mortgage terms to funding sources and eliminated previous interest rate risk and term match problems. Its negative spread was terminated, and a 200 basis point (2%) margin established on new loans. Had loan recovery rates been within a normal range, this spread would likely have been sufficient to allow NHMFC to earn a profit. However, the 2% margin could not compensate for a 30% default rate.

The 20% capital subsidy scheme established under the UHLP in 1988 for households at or below the 30th percentile improved both the targeting and budgetary predictability of subsidies. However, passage of the "Abot Kaya Pabahay" Law in January, 1990 introduced a more complex, and in the Bank's view, risky subsidy structure with graduated payments (paras. 5.6 and 5.7) which was to be offered as an alternative to the least financially sophisticated borrowers in the lowest income groups. Thus, the final picture on subsidy is mixed. While overall levels of subsidy appear to have been significantly reduced, and some improvements occurred initially in their targeting and transparency, later events occurred which complicated subsidies and made them more difficult to assess.

---

[2] Net of the effects of NHMFC's somewhat below-market interest rates which were estimated at approximately 340 basis points in 1991.

(c) Redirecting new housing stock to lower income groups: Both public sector financing and private sector production have in fact moved down-market under the UHLP and the new Community Mortgage Program, which was introduced in 1989 and which provides loans to community groups for local projects.

Public production for the top half of the income curve was initially eliminated with the termination of NHC and Bliss Development Corporation. NHA focused almost exclusively on the lower half of the income curve, except for units providing agreed levels of social mix. However, under new leadership in the early 1990s the Authority began to develop completed medium-rise units affordable to more middle-income families.

(d) Facilitating greater prudence in financial and risk management: By elimination of HIGC's insurance, a degree of increased prudence occurred at the outset, followed by intensive technical assistance to NHMFC in 1990 to develop a proper loan classification system, and subsequent buildup of loan loss provisions from 1989-1992. HUDCC successfully developed monitoring indicators and a quarterly reporting system that revealed the Corporation's mounting problems. Regulatory oversight and supervisory functions by the Central Bank began in 1990 and continued through loan termination, but with little effective impact. NHMFC is again insolvent, in spite of three layers of financial oversight (its own Board, the government auditor, and the Central Bank). Clearly while significant steps were taken to achieve this objective, the ultimate purpose of such prudence and oversight was not accomplished. Since this was a central objective of the project, the loan was canceled when it became clear that it would not be achieved.

(e) Stimulating the domestic economy and boosting employment: Though no detailed analysis was carried out at completion, it is reasonable to assume that the rapid expansion by NHMFC and far larger total investment in housing than anticipated at appraisal (resulting in a total portfolio of about P25 billion (approximately $1 billion) at the end of 1993, compared with P10 billion (approximately $400 million) estimated at appraisal) resulted in significantly greater economic stimulation and job creation than projected.

(f) Assisting the construction industry: The study of key bottlenecks to small (housing) contractors was completed in June 1989, financed under the Bank-financed Rural Roads Project. One major obstruction identified was the exceptionally slow processing of survey and titling by the Land Registry Board (LRB) and the Land Registry Authority (LRA), leading to the inclusion under the technical assistance component of a project to automate key aspects of the system. This was completed satisfactorily in 1993.

7. Project Sustainability

7.1 Accomplishments and Reversals. Selected aspects of institutional reform under the adjustment component of the loan are likely to be sustainable, such as the divestitures of functions competing with the private sector and streamlining of the sectoral institutional structure, as are many of the technical assistance accomplishments with agencies such as LMB/LRA, HLRB, NHA and HUDCC. Clearly the goal of reestablishing NHMFC as a viable public housing finance agency was never achieved, and remains the primary failure of the project which led to cancellation of the loan balance. Some aspects of policy reform have eroded, and the drive for financial viability and a transparent subsidy structure seem to have been abandoned by the new administration that took over in 1992.

7.2 Questions have been raised as to whether the project's unmet goals might still be achieved in the future. As long as housing finance remains in the public domain, this appears unlikely. Since the Bank's loan cancellation in 1993, the government appears to be implementing much of the Rehabilitation Plan proposed by NHMFC's new leadership in early 1993. As noted in para. 5.17, the bulk of loss reserves built up from 1989-1992 were reversed at the end of the year, triggering an adverse opinion by the auditor. The Corporation is developing plans for issuing mortgage-backed bonds, though the bulk of the underlying mortgage portfolio is of low quality. Abot Kaya funds would be used to bridge the gap between mortgage payment proceeds and the income investors would demand. Even if prudence were exercised in selecting only performing loans for securitization, these bonds are likely to require a relatively high rate to attract funding, in view of the fairly low public perception of NHMFC's portfolio quality and the widely known legal obstructions to liquidation. Skimming off performing loans would leave non-performing loans to collateralize NHMFC's pension fund borrowings, eroding the security of such investments and further weakening the social security system. Securitization of entire portfolio, including non-performing loans would require significant and probably unaffordable levels of government subsidy, with untargetted support to virtually anyone who chose to withhold payment to NHMFC, as well as extreme difficulty in predicting the budgetary impact of such support, since amounts would fluctuate annually both with payment levels and with the gap between NHMFC's fixed rate mortgages and current market rates. The bond flotation proposal as discussed with the Bank's team in 1993 would bring the government full circle back to the very dilemma that bankrupted NHMFC the first time in the early 1980s: long term, fixed-rate assets financed with short-term, variable rate liabilities, with the Government bridging the gap via subsidies.

7.3 The sector's problems have been characterized by sector officials as predominantly that of inadequate funding rather than of inappropriate policies or incentives. As a result, in 1993 mandatory contributions to HDMF of 5%-6% of reported payroll, split between employees and employers were reintroduced. This action reversed the 1986 reform that made contributions voluntary and is part of the attempt to repair the sector by directing more funds to it. The reintroduction of partial (80%) HIGC guarantees for pension fund loans to NHMFC helps explain the relative lack of concern of the social security funds with the deteriorating performance of the Corporation from 1990-1993, when the Bank loan was canceled, and their willingness to fill the relatively small comparative gap left by the Bank, which comprised about 25% of NHMFC's takeouts.

7.4 As of October 1994, government was in the advanced stages of passing legislation that would dramatically increase central government authorizations and budget outlays for housing. This legislation would appropriate around P35 billion over five years for: (1) supporting major social housing programs, including the Community Mortgage Program on which recovery rates have proven exceptionally low (para. 5.2); (2) recapitalizing NHMFC for the third time, with a total increase in authorized capital from P500 million to P5.5 billion, and that of HIGC from P1 billion to P2.5 billion; and (3) making permanent the Abot Kaya fund for interest-rate and mortgage guarantee subsidies. The legislation also would authorize the use of Abot Kaya funds to support the flotation of mortgage-backed bonds, as discussed above.

7.5 These increases in funding and subsidies would reduce the pressure for more fundamental reform, entrenching the current system of publicly dominated housing finance. With the central government appropriations, NHA and NHMFC would be guaranteed funding of their major programs. Private developers, who depend on continued funding of the UHLP as the primary source of finance for home buyers, would also be assured continued funding. These initiatives are likely to also be welcomed by the pension funds, since greater government support might ease pressures on them to support housing through loans which increasingly appear uncollectible, threatening the viability and solvency of the social security system.

7.6 The key question is whether such extensive and often opaque subsidies would be needed if the private sector were used to manage the housing finance system in a more businesslike manner, with government's role restricted to the provision of direct, targeted, transparent subsidies. More disciplined management of loan schemes would substantially reduce the amount of funding lost to untargetted support of non-performing loans without regard to the income group receiving such support.

7.7 Even the private banks, which are unable to compete with the UHLP's below-market mortgage rates, and are thus shut out of the vast bulk of housing finance, have not pushed for reform. Though government did achieve its objective of moving public mortgage finance down-market, because of the need to serve pension fund members it continued a role for the public sector in upper income ranges, and has not continued to move down-market, allowing or encouraging private builders and bankers to move into middle-income ranges. Private banks now provide all finance for approximately the top 10% of the market -- that segment not covered by the UHLP -- and use strict underwriting standards to insure the creditworthiness of borrowers. Since they lack access to long-term, fixed rate funds, private banks offer only adjustable-rate loans. Private banks have been reluctant to underwrite loans smaller than P500,000 (the UHLP funds loans up to P375,000) even though short term market interest rates have fallen below 16%, the UHLP long-term rate for its largest loans. Unlike some regional neighbors -- Thailand, for instance -- the private sector appears not to be competing with the public sector and leading the charge down-market.

7.8 The major barrier to an effective public mortgage finance system in the Philippines is the lack of political will among public housing finance agencies to bill and collect mortgage loans.

7.9 Partly as a result, an entrenched non-payment culture has taken hold, which is not confined to the lower-income groups who have been the targets of political patronage programs over several decades. There is consequent difficulty, both real and perceived, in collecting payments and foreclosing delinquent loans, rooted in Philippine politics and foreclosure law. Para. 3.8 describes the two laws which create delays and impediments in collateral liquidation by banks. The fundamental question remains whether private banks could achieve a more sustainable level of loan recovery if given the opportunity.

7.10 NHMFC's new administration attributes its poor collections not only to legal impediments, but also to the relative uncreditworthiness of the borrowers approved by the preceding administration. Affordability analyses carried out during the project life, however, concluded that households were not devoting an undue share of income to housing expenditures. The limits established in the underwriting guidelines for both the proportion of total income devoted to housing (of 33%) and for loan amount (of 1.6 times annual income for informally employed, and 2.5 times for those with formal employment) were being observed. These are well within internationally accepted ranges for lower income families, and, in fact, somewhat on the conservative side for the region.

7.11 <u>Prospects for Reform</u>. Despite these reversals and impediments to reform, forces outside the housing sector could yet generate fundamental change in the housing finance system. Two forces bring the system closer to reform at the end of 1994 than it has been in the past: macroeconomic stability and international competition.

7.12 The new macroeconomic stability has brought inflation down and has reduced the central government budget deficit. Short-term market interest rates had fallen to 14%-15% by the end of 1994, at least temporarily within the range of long-term rates charged for loans under the UHLP, where the nominal rates have remained at 9%, 12%, and 16% since its inception, but where points, fees and charges have steadily risen, with an average yield in 1992 of 12.3%, roughly 3.4% below a proxy long-term market rate. Reduced volatility in inflation rates and lower interest rates would encourage private banks to move down-market. They would also make a secondary market more plausible, since the return on UHLP loans might become attractive to investors. The banking sector is also opening to foreign competition. If confidence builds in government's ability to maintain macro stability, and if the legal impediments to collateral liquidation were reduced, foreign banks might be more aggressive in competing with the public sector mortgage programs and might also introduce wider use of adjustable-rate mortgages for smaller loans.

8. Bank Performance

8.1 With this project, the Bank turned its focus from housing production to reform of the broader mandate and institutional structure of the sector as a whole, and to attempting to strengthen housing finance. This shift was required because the four previous projects in the sector supported only housing production, and had not yet addressed the wider and increasingly tangled sectoral issues. The Bank prudently financed a project designed to improve the primary mortgage market, rather than one that tried to build a secondary market on a shaky primary base. Still, the Bank underestimated the depth of political commitment that was needed in the Philippine context to establish a viable primary mortgage market and, in particular, to sustain such reforms as waves of elections every 2-3 years brought new actors into both the political and administrative arenas. In this regard, it is unlikely that any additional assurances or covenants could have ensured a successful project.

8.2 The project set high and perhaps unrealistic expectations, addressing a broad set of sectoral issues and problems. It was comprehensive and ambitious. Interestingly, its failure was not attributable to its scope or complexity, but to the lack of political will to operate housing finance on a viable basis, with subsidies transparent, quantifiable, up-front, and clearly targeted on the poor. The preferred subsidies in the Philippine housing context have tended to be those which allow leveraging of greater benefits today with costs that are both difficult to quantify, and which fall due at some point in the future. While extensive efforts went into working with government agencies and ministries during preparation, in-depth dealings with the country's political structure were sensitive and restricted. In designing future projects, both the Bank and the Government Insufficient should exert due effort in laying the fundamental groundwork to ensure that agreed reforms could be carried out and sustained.

8.3 Shortly before Board presentation, the Bank got a clear signal that political pressures would be strong to continue past types of subsidy. The new Aquino government announced a reduction in interest rates on the smallest loans, a change that appeared to contradict the first year-to-year interest rate agreement reached at negotiations. Immediate consultation forged an agreement with government that brought the move into line with agreed policy. The new subsidy would (a) be targeted on the lowest 30% of households, and (b) would operate, in fact, as a capital subsidy (of approximately 20%), paid in full up front by the treasury to NHMFC for each mortgage written, delivering to NHMFC annually the 9% interest rate agreed with the Bank on the 80% loan balance. The volume of such mortgages would depend on the volume of budgetary support received from year to year. NHMFC would undertake no interest rate risk, nor would its yield drop below that agreed. This agreement brought the move in line with the subsidy principles and interest rates agreed with the Bank and the loan was presented on schedule to the Board. However, the last-minute nature of this shift was noted during Board discussion, and did not enhance the Bank's confidence in the depth of commitment to subsidy reform or the government's capacity to keep political initiatives in line with agreed policies. It proved to be a harbinger of further erosions in subsidy policy over the loan's life.

8.4 This pattern repeated itself with the Abot Kaya legislation, discussed in paras. 5.6 and 5.7 above, for which the implementing regulations were ultimately used to blunt the more troubling effects of the bill, and bring major conflicts back into line with agreed policy.

8.5 Though the Bank dialogue continued despite deepening of subsidies and the reintroduction of insurance (where agreement was incomplete and studies were then underway), the financial viability and solvency of NHMFC as embedded in the loan's legal covenants were considered sacrosanct. If unmet, the Bank made clear from the start the project would be in jeopardy. The Bank's supervision strategy was consistent with this design: staff monitored NHMFC's performance relative to these covenants intensely and as accurately as it could, given the slow introduction of key GAAP accounting principles which had been required under the loan. Technical assistance in loan classification and provisioning during 1990 helped pinpoint the rapidly deteriorating financial position of the agency, obscured by the two most common practices used by banks world-wide to hide losses--a liberal income recognition policy and inadequate loss provisioning.

8.6 The Bank showed considerable flexibility in its attempts to salvage the project. Each time the project's goals appeared threatened -- at Board presentation, when the Abot Kaya law was passed, and when NHMFC was clearly in financial trouble -- the Bank worked with the government to develop plans of action, creative implementing regulations which would preserve key policy principles, and to provide whatever technical assistance NHMFC was willing to accept. Once it became obvious that, regardless of the Bank's active supervision, critical aspects of the loan agreements were unfulfilled and likely to remain so, cancellation sent a clear message that the Bank considered the solvency of the key financial intermediary - NHMFC - a primary objective of the project which could not be sacrificed or compromised. It was a reasonable response to a project in serious trouble.

8.7 Questions have been raised as to whether the timing of cancellation was appropriate. Sector officials point out the new administration which was installed late in the transition year of 1992 had insufficient time to address NHMFC's serious problems, and feel that cancellation was premature. Some within the Bank argue that cancellation should have occurred much sooner, at the time NHMFC failed to achieve the first Action Plan or when the Abot Kaya Pabahay bill was passed, 18 months after start-up. However, potential conflicts from the bill's drafting, which the Government offered assurances it could fix, were insufficient justification for loan suspension, and such suspension could also not have been exercised, even at the end of 1991, due to legal deficiencies in the way the first Action Plan was established. When the Abot Kaya was passed, government assured the Bank apparent policy deviations could be brought substantively back in line through the implementing regulations, without which the law was meaningless. Supervising staff felt that, given the serious nature of loan suspension/cancellation, and the realistic timeframe required to achieve the agreed actions, an appropriate degree of forbearance was warranted from an institution like the Bank. The problems NHMFC faced, and the accounting rules it employed to obscure its losses were hardly unusual. It can, in fact, be argued that NHMFC was held to a higher standard than many public housing agencies supported by Bank loans. The question of the timing of the cancellation is one of judgement on which parties may reasonably come to different conclusions.

8.8 Key Lessons Learned. Perhaps the most fundamental lesson of this project is that the assessment of the sincerity and sustainability of political will for reform, which is absolutely pivotal to the success of adjustment operations and sustaining viable financial institutions, is a difficult judgement at best. Assurances may be secured verbally and in writing, through formal and informal undertakings which, in the end, may be overwhelmed by other, more powerful influences. It is a particularly troubling sign when legislative actions of the Borrower appear to contradict the loan agreement early on. Actors change, and with such change comes new perceptions and thus fluctuations in the level of commitment to the original undertakings. Intensive efforts were made throughout the life of the loan to brief new parties to the Bank's agreements, but high turnover made this a difficult and time-consuming task. As noted above, it remains unclear what further assurances might have been secured or actions taken which would have enhanced the project's chances of success.

8.9 Better groundwork in the form of collaborative studies with political and congressional bodies would have yielded a firmer basis on which to make the difficult judgements called for. Discussions of subsidy reform would have been improved with a more accurate and broadly focused understanding of government outlays--both direct and indirect. In debates about the 1994 housing reform bill, proponents of increased government outlays argued that government offers very little support to the housing sector, though, in fact, the support that the sector receives from the government-sponsored pension funds is considerable, though predominantly off-budget. A thorough review of subsidies, including those arising from low loan recovery rates, periodic recapitalization of insolvent institutions, interest rates, tax breaks and insurance schemes would have lengthened yet further the already extensive preparation time, but might also have greatly contributed to either more compatible legislation during the loan life, or a clear decision by the Bank not to proceed with the loan at all.

8.10 A second lesson is that preparation work did not adequately involve the critical regulatory agencies--the government auditor and Central Bank Supervision and Examination authority. Closer, more direct collaboration with these agencies during project development might have alerted the Bank to the "regulatory hole" into which NHMFC fell, that of non-bank (i.e. non-depository) financial institutions that, while technically within the purview of Central Bank regulatory authority, were not subjected to regular inspection. Such a dialogue might have initiated inspections earlier, and alerted both these agencies and the Bank to some of the unorthodox (though not uncommon) accounting practices used by the Corporation. Greater awareness of these issues during preparation might possibly have enhanced the prospects of success, although adverse opinions and Central Bank inspections, as noted above, do not seem to have led to change.

8.11 Earlier cooperation and strengthening of government's own oversight and regulatory instruments would have eased pressures on the Bank to play these roles, and helped build regulatory capacity within GOP. Advancing the dialogue about issues of transparency and accountability might also have led to clearer understandings and agreements at appraisal regarding essential changes in accounting practices, which did not occur until mid-1991 when implementing these changes was indeed painful for NHMFC. It is doubtful, however, that it would have altered the final outcome of the project.

8.12 Third, though not Bank policy at the time, a private auditor should have been used to review the Corporation's financial statements. Though the quality of government audit improved over the loan life, an experienced corporate auditor familiar with GAAP accounting for banks and financial institutions would have identified the Corporation's accounting issues much earlier.

8.13 Finally, it would appear with the benefit of hindsight that the original plan to apex loans through the Central Bank to private banks to achieve <u>greater private bank involvement in the role of loan management</u> might have achieved the viability that has eluded the public housing finance system in the Philippines and elsewhere. Provided that the risk involved in this approach (i.e., the borrower onlending funds to potentially uncreditworthy borrowers because they borrowings they are receiving from the World Bank are fully insured) could be mitigated by careful design and risk sharing, such an approach might well ultimately reduce the level of total government subsidy, and improve the targeting and transparency of support to lower income groups. Exploring this possibility is one of the objectives of the Bank's continuing dialogue and TA in this sector.

9. <u>Borrower Performance</u>

9.1 The housing sector in the Philippines has had a long history of political intervention. Specific legal provisions make collections and foreclosure difficult, and there has been a long-standing public perception that associated the housing system with the unpopular Marcos regime, a history of poor coordination and sectoral in-fighting between the public housing agencies, and frequent, politically-driven changes in subsidy programs. It was clearly a difficult political context in which to undertake ambitious reforms.

9.2 The PCR mission concluded that difficulties endemic to the sector represent an appropriate target for reform, and that further Bank advice should continue to pursue such reform. Considerable caution should be exercised, however, before committing the Bank to any further lending or guaranty operations.

9.3 Taking into account the difficult context, and despite strong assurances by key members of government during preparation and appraisal of GOP's commitment to and support of the project's objectives, the key agencies seemed to evidence little long-term commitment to and ownership of important elements of the project. At the outset, the champions of reform were few but outspoken. Toward the time of loan suspension many of those pressing for more conservative and professional management of the sector had left government or shifted position, and no longer had a direct voice in the direction or oversight of housing operations.

9.4 Sectoral leadership was unable or unwilling to manage the political environment, with the result that reversals and erosions in agreed policies, especially on subsidies, occurred throughout the life of the loan. Government's announcement that the smallest NHMFC loans would carry a 6% rather than the agreed 9% rate (para. 8.3 above) was the first such instance. The second was NHMFC's double-financing of mortgages by the pension funds and the Bank which violated the Bank's standing limitation on refinancing of assets financed with Bank loans (para. 5.5).

9.5 This was followed by passage of the Abot Kaya law. Like the earlier reduction in the lowest interest rate, this law conflicted with the agreed policy framework of the project. Though the Bank and government were able to reach a compromise on how to implement the law which preserved critical elements such as NHMFC's direct management of receivables, and "self-insurance" through loss provisioning, it renewed insurance on pension fund borrowings, and eroded the predictability of subsidies (paras. 5.6 and 5.7). These and the other actions covered in paras. 5.13-5.11 built a pattern that gave the Bank little confidence that further promises would be met.

9.6 The financial troubles of NHMFC have many causes: the politicization of the housing industry, an adverse legal context, a culture of non-payment, and weak management and internal systems were all factors. Since the Corporation was recapitalized under the project, and it's achievement of sustainable viability was a critical objective, it was incumbent on NHMFC to provide accurate, relevant information on its own financial position. The Corporation's accounting practices effectively obscured its precarious position, though the Bank and central government had a reasonably accurate picture of the situation. Through the early years of the project, the government auditor remained unconvinced of the need for loan loss reserves, taking the position that assets backed by real property collateral could not possibly realize a loss when eventually liquidated. Bank missions provided extensive material on the Savings and Loan crisis in the United States and the normal cyclic fluctuations of real estate values in a number of countries to convince the auditor to adopt more conservative assumptions.

9.7 By the time of cancellation, the most central problems of transparency in financial reporting had been largely resolved. The Corporation's underlying, more fundamental problem of low recovery rates had not, nor were there any signs of impending improvement, following two years of intense dialogue. Though the project did help initiate financial oversight of NHMFC by the Central Bank, its enforcement powers had been neither exercised nor tested, and an initiative was underway by late 1992 to terminate Central Bank authority over NHMFC and shift oversight functions to the SEC.

9.8 Following cancellation, NHMFC's reversal at the end of 1993 of P459 (US$18) million in loss reserves which had been built up during 1991-92 would seem to clearly indicate that the Corporation remained unconvinced of the value of more transparent accounting practices. To its credit, COA noted this reversal in its adverse audit opinion at the end of the year. It is unclear whether the more conventional income recognition (non-accrual) policies adopted in 1991 have also been abandoned.[3]

10. Project Documentation and Data

10.1 The Bank legal documents served the project adequately. It is unlikely than any additional covenants could have ensured a successful project. Data relevant to the preparation of the PCR was readily available.

---

[3] The Corporation initially recognized and booked all interest income regardless of whether the loan was performing or not. A revised policy was subsequently adopted allowing booking of income on nonperforming loans over 10 months only if received in cash, and backing out of previously recognized income on such loans.

REPUBLIC OF THE PHILIPPINES
HOUSING SECTOR PROJECT
LOAN 2974-PH

PART II: PROJECT REVIEW FROM BORROWER'S PERSPECTIVE

INTRODUCTION

In accordance with the World Bank's recent guidelines for the preparation of project completion reports, this document will focus on the main problems of the Housing Sector Project, Loan 2974-PH. In the absence of the Part I, NHMFC is not in a position to present its comments and reactions.

PART II is presented as follows:

A. Background

B. The Unified Housing Loan Program

C. Funding Requirements

D. Project Execution

E. Overall Assessment of the Project

  E.1. Performance of the Bank

  E.2. Performance of the NHMFC

F. Project Impact on Urban Development

G. Conclusion

A. Background

There has always been a need to address the acute demand for housing. Despite the significant increase in the overall housing production prior to 1986, the housing situation continues to be alarming.

NEDA has estimated the total housing need for the entire country for the period 1987-1992 at 3.4 million units. Of this number 1.8 million units are targetted for the rural areas while 1.6 million are for the urban areas. In terms of money values, the total cost required for house construction is about ₱30 billion. And yet to address the housing crisis goes beyond mere provision of the physical structure. The problem is invariably linked with economic growth, industrialization, urban migration, cultural norms and values, etc.

The change in administration in 1986 brought the changes that took place in the shelter sector. The Ministry of Human Settlements was replaced by the Housing and Urban Development Coordinating Council which represents the umbrella organization that oversees the network of housing agencies- namely: Home Development Mutual Fund; National Home Mortgage Finance Corporation; Human Settlements Regulatory Commission; National Housing Authority. The Aquino Administration initiated the integration and synchronization of the shelter system into three basic components: finance, production and regulation. These functions are implemented by key housing agencies together with the private sector.

National Home Mortgage Finance Corporation is mandated to serve as the major home mortgage institution whose primary function is to establish and operate a viable home mortgage system and to develop a secondary mortgage market system. It has to secure sources of fund and establish instruments directed dowards generation of funds to be utilized for the shelter program.

Simultaneous with the reorganization of the different agencies, came the unification of the various shelter programs of the government-the Unified Home Lending Program. This program sought to redirect the funds of the government to assist the low and middle income group.

B. Unified Home Lending Program

This program, administered by NHMFC integrates the different housing loan programs of the government prior to 1986 into a single system. Executive Order 90 issued by the Aquino Administration called for the rationalization of the shelter program. This rationalization required that an equitable distribution of the loan beneficiaries is represented by a cross section of society, the middle and low income group. Another revision was made in terms of interest rates vis a vis loan values. In this program, the higher the loan, the higher the interest rates. Unlike the previous program, whereby, the interest rate of nine percent was charged uniformly up to a maximum loan of ₱350 K of Pag-ibig members. It was further aggravated by the fact, that majority of the mortgage borrowers belong to the higher income bracket of society. And yet substantial contributions of the loan funds came from the employees belonging to the middle and low income group when the Pag-ibig membership was compulsory imposed. Hence, the new housing program rectified the policy on loan availments.

The UHLP was designed to provide for the housing assistance to the low and middle income families of society based on their affordability levels. The target beneficiaries include the members of SSS, GSIS and Pag-ibig of which funds for their loans are provided by these agencies, while non-members can avail of the loans via the limited funds of NHMFC. As the program becomes operational, the loan availers are to increase among the member and non-member borrowers. Hence, to ensure the continuity of the program, NHMFC needed to secure the necessary funds from World Bank.

The Loan Agreement was executed in the latter part of 1988 with an approved loan of $160 million US Dollars and the first drawdown was released during the first quarter of 1989.

While members of SSS, GSIS and HDMF can avail of the loan via the funding of these institutions, non-members can avail of the loan via the funding of the World Bank. However, these prospective borrowers should comply with the requirements of the UHLP. Members of the funding institutions must be members in good and active standing, and should not own a residential unit either as sole owner or co-owner and has not availed of any housing loan either as principal borrower or as a co-obligor, except for the purpose of residential lot purchase only.

The terms of the loan were as follows:

	LOAN PACKAGES	INTEREST RATE	TERM
A	₱60 K & below	6%	25 yrs
B	Over ₱60 to ₱90 K	9%	25 yrs
C	Over ₱90 to ₱120 K	12%	25 yrs
D	Over ₱120 to ₱180 K	15%	25 yrs
E	Over ₱180 to ₱250 K	16%	25 yrs

The program was geared towards establishing a mortgage system that would provide the funds required for long-term housing loans on a continuous and self-sustaining basis. It was designed to encourage the participation of the private sector in the production and delivery of the housing units. Housing developers were encouraged to participate in the mortgage origination of the program. Together with the financial institutions, developers became direct participants in the delivery of housing units and acquisition process.

In order to convince these key players, NHMFC was obliged to possess sufficient funds for the program hence, the assistance from the World Bank was very timely.

The mortgage origination system comprises of several activities namely: the accreditation of prospective originators; actual delivery of mortgage take-outs; release of funds as payments of the mortgages; establishment of records and monitoring of each account representing the collection system; installation of legal remedies in case of deliquencies; and account management of acquired assets.

Simultaneous with the operation of the UHLP, the Government further sought to promote low-cost community-based financing schemes operating through non-government organizations, local governments, civic and religious groups. It was then that the concept of "community mortgage" that was finally introduced.

The Community Mortgage Program is primarily intended to assist residents of blighted and depressed areas to avail of the housing loans. These housing loans would enable the beneficiaries to initially own the lots that they occupy and eventually build a decent house thereon to the full extent of their affordability. These associations however, must be organized into a duly registered community association.

World Bank funding was again tapped for this purpose. Through the representations of NHMFC, the World Bank agreed to expand the coverage of the Loan Agreement to the community mortgage program based on certain guidelines.

To qualify for the program, the title over the subject property should be clean and free from any liens and encumbrances. The initial loan covers the acquisition cost for the home lots and subsequent loans shall cover house construction and improvements.

Maximum loanable amounts for each borrower are as follows:

For lot acquisition of an undeveloped property	₱30 K
For lot acquisition of developed property	₱45 K

For lot acquisition, development and house construction ₱80 K

The loan carries a nine-percent interest rate with a twenty-five year repayment period.

The other program is the Corporate Housing Program designed to enable a wide range of employees/workers to avail of credit for housing at a lower price. The loan is offered to employers to provide its staff with a housing assistance program without necessarily incurring the full costs and administrative works usually involved in such programs.

The loan packages are as follows with a maximum of twenty-five year term:

A	Up to ₱60 K	6%
B	90 K	8%
C	120 K	11%
D	180 K	14%
E	250 K	15%

Subsequent amendments on the loan packages were initiated which resulted to the following:

A		0 to ₱150 K	9%
B	over	₱150 to ₱225 K	12%
C	over	₱225 to ₱375 K	16%

C. Funding Requirements

The SSS, GSIS and HDMF serve as funders for their respective member loan. Funding commitments of SSS, GSIS and HDMF are annually drawn while fund releases are made based on mortgage purchase schedules corresponding to the member loan category. These agencies get a guaranted yield of 10.125 per cent.

The initial funds of ₱7.67 million from SSS, annually increased to ₱3,828.28 billion in 1992. For the past five years, SSS has contributed ₱11,579.20 billion to housing. On the other hand, GSIS has contributed initially ₱3.97 million in 1987, this has reached the ₱725.65 marked in 1992. Consequently, GSIS's total loan assistance was ₱1,974.62 billion as of year end 1992. While HDMF has contributed an aggregate of ₱472.50 as of year end 1992.

World Bank funds channelled to the entire housing program amounted to ₱2,797.9 million as of year end 1992. Total loan released was equivalent to US $125,263.735 million which comprises of $76.635 million program loan and $48.627 million project loan. The loan was drawn on a reimbursement basis.

D. Project Execution

Together with financial institutions, developers became direct participants in the housing delivery and acquisition process. These originators became the marketing arm of the program and with the inclusion of developers as originators, growing awareness significantly contributed to the unabated growth of NHMFC. Under the program, these originators apply for accreditation as mortgage loan originators through the regular purchase commitment system.

The purchase commitment system, which is covered by a purchase commitment agreement, the prospective originator applies for a commitment line which embodies the commitment of NHMFC to purchase their mortgages for a period of six months. The line specifies the amount of mortgages and the corresponding drawdown schedule based on project time phase. In applying for a commitment line, a developer is required to submit the project concept and design of the property, which is referred to in the purchase commitment agreement as collateral of the mortgage loans. He is also required to secure the necessary permit and licenses neccesary in the development of the property. He further undertakes the development of the project site including construction of the housing units. The completed housing units or developed lots are then sold to prospective buyer/borrower which subsequently becomes the collateral of the housing loan.

All loan documents submitted to NHMFC are reviewed and the corresponding mortgage payment made. Release of the proceeds of loan is made through the originators. Borrower/s are also notified by NHMFC about the release of loan proceeds through the originators. The Notice to Borrower includes among others the take-out date or date of the loan release, the first and subsequent monthly amortization due dates, and the amount of regular monthly amortization. Payments of the monthly amortization is made by the borrower either through the authorized collecting bank or through salary deduction.

Since at the outset only government banks were authorized to receive the monthly amortization payments, NHMFC experienced poor collection and yet the loans were availed by borrowers nationwide. Thus, NHMFC secured the approval of Central Bank to authorize private banks to become collecting banks. This is now in line with the extensive collection campaign being pursued by the present administration.

In addition, the Corporation has also executed collection agreement with employers who qualifies to implement the salary deduction scheme. The formal launching of this campaign was made in middle part of 1993, and 1,568 employers have executed collection agreements with NHMFC. It is expected that effects of the amortization collections from this scheme shall be reflected in 1994.

E. Overall Assessment of the Project

1. Performance of the Bank

Through the Bank's timely assistance, NHMFC was able to extend the benefits of the program not only to the non-members of SSS, GSIS & HDMF, but also to the members of the community associations in the depressed areas.

As previously stated, the funds served so many non- member borrowers applied under this program especially those covered by the house and lot packages from the funds alloted to the UHLP. Under the Community Mortgage Program ₱126.88 M worth of projects equivalent to 4,766 housing units were generated from the assistance. In fact at the time the loan was cancelled, there were an estimated 1,000 projects in the pipeline which were being processed and were greatly affected.

The cancellation brought to fore the fund problem of NHMFC and how it could sustain the community mortgage program.

On the other hand, it could not be denied that the Bank closely monitored the operations and performance of NHMFC. Quarterly reports have always been provided. Consultation meetings were regular which were directed towards management of receivables. The primary objective was to reflect in the financial records the alleged "true" status of the accounts .

The Bank strongly recommended to NHMFC to change its income recognition policy as a consequence of its perceived complacent attitude towards the deteriorating condition of its collection performance. Previous policy required a periodic 5% charged as loan loss provision computed using the allowance method. The new policy enforced in 1991 required the following:

1) General provision of 1% of the outstanding balance of all CMP accounts.

5% of the loan value of all UHLP accounts.

2) Specific provisions of 10% of the outstanding balance of MCRs and Items in Litigation aged 12 to 24 months in arrears.

20% of the outstanding balance of MCRs and Items in Litigation aged over 24 months in arrears.

The change reflected substantial reversal of recorded accrued income and the discontinuance in the recognition of income from presumed deliquent accounts.

2. Performance of NHMFC

As NHMFC operates the program, under the one fund concept, it did not only exceed its volume target of mortgage-takeout but also the values of mortgage purchased. While it could not be denied that it has been, now and then, confronted by fund shortfalls brought about by the delays in the release of funds from the funders and the inability of its borrowers to update their accounts, it remains steadfast in its commitment to serve its mandate. Previous investigation revealed, that majority of the borrowers have contracted second mortgage with the originators covering the equity portion of the total housing unit cost, which are paid ahead of the NHMFC loan, aside from infusing structural improvements on the unit.

Purchase commitment lines, which is indicative of the strong participation of both the private and the public sectors in the government home financing program also registered a significant increase over the years. From a total of 71 purchase commitment lines valued at ₱706 M approved at year end 1987, these surged to 1,356 approved lines with an equivalent value of ₱19,500.7 M covering 102,966 units as of December 31, 1992 for the UHLP.

On the other hand, the CMP which was envisioned to be an effective vehicle in the delivery of shelter finance services to the lowest 30 percent of the population manifested its progress in 1989. PCL approvals under the program registered 159 accredited projects which benifitted 3,262 families as of year end 1989 which have notably increased to ₱777.232 M PCL for 307 projects covering 3,381 beneficiaries as of year end 1992.

The program is originated primarily by local government units and non-government organizations all over the country. Another indicator of the public's trust and confidence over the housing program is the noted increase in the number of accredited originators from 162 in 1987 to 268 in 1992.

NHMFC managed an initial performance of ₱12.9 M in actual mortgage take-outs at the end of 1987 representing 129 housing units for 162 beneficiaries. As of December 31, 1992, it had increased its purchases to an aggregate amount of ₱15.286 B worth of mortgages with an equivalent of 98,414 housing units and lot purchased combined for 111,526 beneficiaries. From these figures, ₱138.83 M were released from the Bank's fund representing 2,368 housing units. All these mortgage portfolios were availed by the borrowers from the thirteen regions of the country with Regions 4, NCR, 3 and 11 as the major beneficiaries.

Outright some 1,495 housing units with an equivalent of ₱94.88 M in mortgage values were covered by the first reimbursement from the Bank. However, as the program is accepted over the years, the funds coming from the Bank was utilized not only to satisfy the loan applications the non-member and the community associations but also the loan applications under the Developmental Loan Program and the economic housing units. The alloted funds for the Program Loan was ₱1,643.162 M while the Project Loan component was ₱1,154.827 M.

Through the assistance of the SSS, GSIS, HDMF and the World Bank it can now be claimed that NHMFC has contributed in alleviating the housing needs of the country. Aside from assuming a pivotal role in the housing industry it has become one of the catalysts in the economic programs of the government.

However, as the volume of mortgages is bolstered, there is a seeming deterioration in the quality of the accounts. NHMFC is now compelled to look into the payment profile of its accounts. As stated earlier, cumulative collections vis-a-vis cumulative billings remains very low, although it could be the highest among Government Financial Institutions doing silimar lending which compels NHMFC to enforce its existing strategies on collection. CMP accounts also contributed to the decline of collection efficiency. There are at present ten CMP projects considered as foreclosable.

With mortgage volume generation already surpassing expected levels, it has become incumbent for the NHMFC to ascertain acceptable quality of the MCR porfolio and keep amortization deliquencies within manageable limits.

The collection efficiency which stood at 68.60 percent for UHLP and 54.84 percent for CMP in 1992 is further dampened by the economic difficulties brought about by the series of combined natural calamities that beset the country during the previous years. There was the mounting pressure from the borrowers residing in the calamity stricken areas that NHMFC declared a moratorium in the collection of amortization effective July 1990. The cumulative collection performance went down since 1989.

Meanwhile, the effects of the change in the loan loss provision policy upon the strong recommendation of World Bank as reflected in the 1991 financial statements has taken its toll on the financial status of NHMFC.
Although there appears to be an unabated increase in the delinquency rate, NHMFC has yet to implement a systematic approach to its delinquent accounts which should consider the following concerns:

1) establishing direct linkages with the borrowers other than through the originators especially after the release of the proceeds of the loan;

2) conducting interviews with the borrowers to find out the reasons and causes of their failure to pay their amortization;

3) inspection of the collaterals of the deliquent accounts which could reveal improvements undertaken that contribute to the delay in the payment of amortization, however these increase the value of the collateral;

4) tracking down the location of the borrowers;

5) pursuing the warranties of the originators and initiating the buyback arrangement whenever necessary as in the case of major defects;

6) determine whether collecting banks are in the area and whether they are functioning based on the terms and conditions of the collection agreement;

7) Timeliness of NHMFC's records and responsiveness of its monitoring mechanisms;

Results of a thorough evaluation of the account inclusive of physical inspection of the unit and interview of the borrower could reveal factors that could lead to a more focused strategy towards recovering the exposure on the these accounts rather than applying a sweeping policy of subjecting all accounts into the disadvantageous general and specific loan loss provisions.

By its own admission the Bank was confronted by insufficient data for purposes of quantitative analysis and the monitoring systems were deficient to warrant objective results. However, the adjustments were relentlessly pursued.

Changes in the policies of accounting treatment involving income recognition from delinquent accounts starting 1991 substantially eroded the profitability of NHMFC. Total resources as of the end of 1992 amounted to ₱18,742.4 M as compared to ₱2,530.0 M in 1987 posting an increase of 640.79 percent over the level of 1987. The growth in total assets is attributed to the substantial increase in MCR Folio II. On the other hand, results of operations in 1992 showed a net loss of ₱441.455 M. Total liabilities accounted was ₱18,634.5 M in 1992 as compared to ₱2,040.1 M in 1987 or 813.4 percent increase. The contributions from the funders amounted to ₱15,709.5 M in 1992 as compared to ₱287.9 M in 1987. Again, the significant increase is attributed to the ever growing demand for housing assistance. Total networth at year end 1992 was recorded at a negative ₱162.77 M as compared to a positive ₱489.89 M in 1987.

F. Project Impact on Urban Development

In order to gauge correctly the impact of UHLP's performance to the industry as a whole, it is necessary to look at the bigger profile of the whole shelter system as registered in the phases of housing regulation, production and finance. This would include the development permits and license-to-sell granted by the Housing and Land Use Regulatory Board, loan insurance and development guarantees extended by the Home Insurance and Guaranty Corporation, government housing production from the National Housing Authority and borrower's request for Certificate of Loan Eligibility from the funding agencies which eventually translated into housing loans and units financed through the mortgage system of the Corporation.

The liquidity mechanism provided by NHMFC to the housing industry has pivoted the courses of action of the developers and financial institutions. They are now motivated to effectively plan their development projects over a longer time frame as they look forward to the assurance of available of funds to turnaround their investments.

It can be gleaned further that communities are building up within the subdivision creating stronger ties and camaraderie among borrowers which could be tap indirectly as an avenue for collection schemes. With the magnitude of its beneficiaries, UHLP should have become a by word of every family and the role of NHMFC, along its purposes and objectives, understood by them.

G. CONCLUSION

Through the loan extended to NHMFC, the Bank has satisfactorily assisted the Corporation in expanding its entitled beneficiaries. However, the government has yet to address the equity problem to guarantee the Corporation's stability and continued viability. In conformity with its long-term objectives, it cannot definitely operate with a ₱500 M capital, that is why for the past years, the Corporation was highly dependent on its leverage. It is now the Government's turn to respond and infuse funds via the capital account. The magnitude of NHMFC's exposure, the relatively low interest rates of the loan offered, the long-term recovery of its receivables and the fact that, it was able to operate though undercapitalized should be the creditable factors that warrants the infusion of additional capital to the Corporation.

Despite external and internal pressures, the UHLP remains a propelling factor in the infrastructure projects of the government and initiator of labor employment in the country.

Looking into the accomplishments of NHMFC, it could be claimed that through the UHLP the dream of every Filipino family to have a house of their own has become a reality. A total 1.2 million households have yet to realize this dream by 1998, however. Presently, the Corporation is now beset with greater challenges, primarily survival and greater relevance. And with the firm commitment of the Management to reinvigorate NHMFC, there is no reason why it could not sustain the demands for the housing finance.

PROFILE OF MORTGAGE TAKEN-OUT

	LOAN BRACKET	NO. OF UNITS	PERCEN-TAGE	NO. OF BENEFICIAR	TOTAL LOAN VALUE	LOAN VALUE/ BENEFICIARY
1987						
	0 TO 15	0	0.00%	0	0.00	
	15 TO 30	0	0.00%	0	0.00	
	30 TO 45	49	40.83%	49	2,167,200.00	44,228.57
	45 TO 60	2	1.67%	2	108,000.00	54,000.00
	60 TO 75	0	0.00%	0	0.00	
	75 TO 90	2	1.67%	2	162,600.00	81,300.00
	90 TO 105	7	5.83%	7	693,700.00	99,100.00
	105 TO 120	17	14.17%	22	2,012,357.00	91,470.77
	120 TO 135	10	8.33%	18	1,260,224.00	70,012.44
	135 TO 150	7	5.83%	11	1,013,061.00	92,096.45
SUB TOTAL		94	78.33%	111	7,417,142.00	66,821.10
	150 TO 165	7	5.83%	11	1,105,336.00	100,485.09
	165 TO 180	19	15.83%	26	3,296,785.00	126,799.42
	180 TO 195	0	0.00%	0	0.00	
	195 TO 210	0	0.00%	0	0.00	
	210 TO 225	0	0.00%	0	0.00	
SUB TOTAL		26	21.67%	37	4,402,121.00	118,976.24
	225 TO 240	0	0.00%	0	0.00	0.00
	240 TO 255	0	0.00%	0	0.00	0.00
	255 TO 270	0	0.00%	0	0.00	0.00
	270 TO 285	0	0.00%	0	0.00	0.00
	285 TO 300	0	0.00%	0	0.00	0.00
	300 TO 315	0	0.00%	0	0.00	0.00
	315 TO 330	0	0.00%	0	0.00	0.00
	330 TO 345	0	0.00%	0	0.00	0.00
	345 TO 360	0	0.00%	0	0.00	0.00
	360 TO 375	0	0.00%	0	0.00	0.00
SUB TOTAL		0	0.00%	0	0.00	0.00
TOTAL		120		148	11,819,263.00	79,859.89

PROFILE OF MORTGAGE TAKEN-OUT
1988

	0	TO	15	3	0.04%	3	43,500.00	14,500.00
	15	TO	30	173	2.34%	175	4,424,612.00	25,283.50
	30	TO	45	1,737	23.47%	1,743	72,530,130.00	41,612.24
	45	TO	60	343	4.63%	358	19,519,440.00	54,523.58
	60	TO	75	93	1.26%	97	6,454,632.00	66,542.60
	75	TO	90	243	3.28%	291	20,714,045.00	71,182.29
	90	TO	105	250	3.38%	343	24,895,332.00	72,581.14
	105	TO	120	1,400	18.91%	1,908	164,071,722.00	85,991.47
	120	TO	135	505	6.82%	690	65,113,093.00	94,366.80
	135	TO	150	705	9.52%	962	101,272,561.00	105,272.93
SUB TOTAL				5,452	73.66%	6,570	479,039,067.00	72,913.10
	150	TO	165	684	9.24%	966	108,064,106.00	111,867.60
	165	TO	180	1,098	14.83%	1,507	193,149,684.00	128,168.34
	180	TO	195	57	0.77%	73	10,751,350.00	147,278.77
	195	TO	210	39	0.53%	52	7,912,010.00	152,154.04
	210	TO	225	16	0.22%	20	3,457,400.00	172,870.00
SUB TOTAL				1,894	25.59%	2,618	323,334,550.00	123,504.41
	225	TO	240	20	0.27%	25	4,648,600.00	185,944.00
	240	TO	255	36	0.49%	45	8,988,900.00	199,753.33
	255	TO	270	0	0.00%	0	0.00	
	270	TO	285	0	0.00%	0	0.00	
	285	TO	300	0	0.00%	0	0.00	
	300	TO	315	0	0.00%	0	0.00	
	330	TO	345	0	0.00%	0	0.00	
	345	TO	360	0	0.00%	0	0.00	
	360	TO	375	0	0.00%	0	0.00	
SUB TOTAL				56	0.76%	70	13,637,500.00	194,821.43
TOTAL				7,402		9,258	816,011,117.00	88,141.19
CUM. TOTAL (1987-1988)				7,522		9,406	827,830,380.00	168,001.07

PROFILE OF MORTGAGE TAKEN-OUT
1989

	0	TO	15	100	0.52%	100	1,191,100.00	11,911.00
	15	TO	30	683	3.57%	686	16,677,473.00	24,311.19
	30	TO	45	4,647	24.28%	4,664	193,009,382.00	41,382.80
	45	TO	60	461	2.41%	492	26,527,931.00	53,918.56
	60	TO	75	357	1.86%	391	25,264,308.00	64,614.60
	75	TO	90	666	3.58%	821	58,535,564.00	71,297.89
	90	TO	105	595	3.11%	762	59,222,777.00	77,720.18
	105	TO	120	2,674	13.97%	3,711	313,469,823.00	84,470.45
	120	TO	135	591	3.09%	782	76,679,190.00	98,055.23
	135	TO	150	1,486	7.76%	1,931	213,791,954.80	110,715.67
SUB TOTAL				12,280	64.15%	14,340	984,369,502.80	68,645.01
	150	TO	165	1,448	7.56%	1,995	229,233,077.00	114,903.80
	165	TO	180	3,195	16.69%	4,296	564,250,046.00	131,343.12
	180	TO	195	286	1.49%	383	54,477,463.00	142,238.81
	195	TO	210	483	2.52%	659	97,551,809.00	148,030.06
	210	TO	225	392	2.05%	540	85,238,222.00	157,848.56
SUB TOTAL				5,804	30.32%	7,873	1,030,750,617	130,922.22
	225	TO	240	374	1.95%	508	87,294,475.00	171,839.52
	240	TO	255	422	2.20%	531	104,909,071.00	197,568.87
	255	TO	270	73	0.38%	96	19,113,964.00	199,103.79
	270	TO	285	74	0.39%	98	20,558,686.00	209,782.51
	285	TO	300	116	0.61%	148	34,598,156.00	233,771.32
	300	TO	315	0	0.00%	0	0.00	0.00
	315	TO	330	0	0.00%	0	0.00	0.00
	330	TO	345	0	0.00%	0	0.00	0.00
	345	TO	360	0	0.00%	0	0.00	0.00
	360	TO	375	0	0.00%	0	0.00	0.00
SUB-TOTAL				1,059	5.53%	1,381	266,474,352	192,957.53
TOTAL				19,143	1	23,594	2,281,594,472	96,702.32
CUM TOTAL (1987-89)				26,665	1	33,000	3,109,424,852	94,225.00

PROFILE OF MORTGAGE TAKEN-OUT
1990

	0	TO	15	238	1.14%	238	2,592,550.00	10,893.07
	15	TO	30	796	3.83%	797	18,689,387.00	23,449.67
	30	TO	45	3,286	15.80%	3,319	138,075,072.07	41,601.41
	45	TO	60	120	0.58%	126	6,765,885.00	53,697.50
	60	TO	75	938	4.51%	1,212	63,630,152.29	52,500.13
	75	TO	90	969	4.66%	1,079	79,260,864.80	73,457.71
	90	TO	105	570	2.74%	613	55,800,432.00	91,028.44
	105	TO	120	2,126	10.22%	2,719	250,644,256.00	92,182.51
	120	TO	135	297	1.43%	369	38,792,990.00	105,130.05
	135	TO	150	921	4.43%	1,177	133,480,089.88	113,407.04
SUB-TOTAL				10,261	49.34%	11,649	787,731,679	
	150	TO	165	1,157	5.56%	1,487	183,282,487.00	123,256.55
	165	TO	180	4,594	22.09%	5,985	815,739,155.00	136,297.27
	180	TO	195	204	0.98%	294	39,087,759.00	132,951.56
	195	TO	210	621	2.99%	863	126,143,250.00	146,168.31
	210	TO	225	594	2.86%	817	129,641,580.00	158,680.02
SUB-TOTAL				7,170	34.47%	9,446	1,293,894,231	136,978.00
	225	TO	240	897	4.31%	1,226	210,886,681.00	172,011.97
	240	TO	255	604	2.90%	800	150,242,194.00	187,802.74
	255	TO	270	473	2.27%	651	124,066,856.40	190,578.89
	270	TO	285	376	1.81%	496	104,288,910.00	210,259.90
	285	TO	300	1,017	4.89%	1,341	303,225,930.00	226,119.26
	300	TO	315	0	0.00%	0	0.00	0.00
	315	TO	330	0	0.00%	0	0.00	0.00
	330	TO	345	0	0.00%	0	0.00	0.00
	345	TO	360	0	0.00%	0	0.00	0.00
	360	TO	375	0	0.00%	0	0.00	0.00
SUB-TOTAL				3,367	16.19%	4,514	892,710,571.40	986773
TOTAL				20,798	1	25,609	2,974,336,481	116,144.19
CUM TOTAL (1987-90)				47,463		58,609	6,083,761,333	103,802.51

PROFILE OF MORTGAGE TAKEN-OUT
1991

	0 TO 15	298	1.11%	299	3,398,150.00	11,365.05
	15 TO 30	1,998	7.46%	2,002	44,622,360.00	22,288.89
	30 TO 45	2,829	10.57%	2,875	117,160,535.00	40,751.49
	45 TO 60	130	0.49%	197	7,338,500.00	37,251.27
	60 TO 75	854	3.19%	992	59,430,696.89	59,909.98
	75 TO 90	1,059	3.95%	1,173	87,094,074.00	74,249.00
	90 TO 105	1,272	4.75%	1,331	124,497,214.00	93,536.60
	105 TO 120	1,929	7.20%	2,254	220,263,937.00	97,721.36
	120 TO 135	760	2.84%	829	96,273,634.00	116,132.25
	135 TO 150	1,639	6.12%	1,956	240,300,123.14	122,852.82
SUB-TOTAL		12,768	47.68%	13,908	1,000,379,224.03	71,928.33
	150 TO 165	483	1.80%	593	76,713,707.67	129,365.44
	165 TO 180	2,694	10.06%	3,322	478,369,985.00	144,000.60
	180 TO 195	461	1.72%	572	87,133,240.00	152,330.84
	195 TO 210	956	3.57%	1,218	194,332,126.00	159,550.19
	210 TO 225	2,991	11.17%	3,768	662,949,885.91	175,942.11
SUB-TOTAL		7,585	28.33%	9,473	1,499,498,944.58	158,291.88
	225 TO 240	494	1.84%	656	116,230,100.00	177,180.03
	240 TO 255	957	3.57%	1,190	237,561,072.00	199,631.15
	255 TO 270	942	3.52%	1,166	247,823,660.00	212,541.73
	270 TO 285	815	3.04%	1,019	226,236,870.00	222,018.52
	285 TO 300	1,531	5.72%	1,958	454,255,823.60	231,999.91
	300 TO 315	239	0.89%	298	73,561,400.00	246,850.34
	315 TO 330	303	1.13%	382	97,995,490.00	256,532.70
	330 TO 345	211	0.79%	268	71,373,200.00	266,317.91
	345 TO 360	245	0.91%	313	86,494,567.00	276,340.47
	360 TO 375	687	2.57%	856	256,344,300.00	299,467.64
SUB-TOTAL		6,424	23.99%	8,106	1,867,876,482.60	230,431.35
TOTAL		26,777		31,487	4,367,754,651.21	138,716.13
CUM TOTAL (1987-91)		74,240		90,096	10,451,515,984.45	116,004.22

PROFILE OF MORTGAGE TAKEN-OUT
1992

	0	TO	15	298	1.23%	298	3,880,875.00	13,023.07
	15	TO	30	901	3.73%	905	19,774,703.00	21,850.50
	30	TO	45	1,552	6.42%	1,585	64,136,880.67	40,464.91
	45	TO	60	93	0.38%	144	5,238,212.50	36,376.48
	60	TO	75	58	0.24%	73	3,845,069.30	52,672.18
	75	TO	90	524	2.17%	611	43,642,573.73	71,428.11
	90	TO	105	882	3.65%	1,005	87,783,682.70	87,346.95
	105	TO	120	1,225	5.07%	1,423	141,494,667.00	99,434.06
	120	TO	135	946	3.91%	1,049	121,961,863.65	116,264.88
	135	TO	150	3,154	13.05%	3,721	479,052,941.89	128,743.06
SUB TOTAL				9,633	39.85%	10,814	970,811,469.44	89,773.58
	150	TO	165	276	1.14%	322	44,577,460.79	138,439.32
	165	TO	180	1,136	4.70%	1,318	202,278,787.17	153,474.04
	180	TO	195	507	2.10%	584	96,781,927.05	165,722.48
	195	TO	210	684	2.83%	840	140,964,498.25	167,814.88
	210	TO	225	4,696	19.43%	5,678	1,065,849,717.63	187,715.70
SUB TOTAL				7,299	30.19%	8,742	1,550,452,390.89	177,356.71
	225	TO	240	165	0.68%	198	39,271,575.67	198,341.29
	240	TO	255	450	1.86%	568	113,683,600.36	200,147.18
	255	TO	270	827	3.42%	1,013	221,108,354.81	218,270.83
	270	TO	285	939	3.88%	1,172	265,056,939.00	226,157.80
	285	TO	300	913	3.78%	1,141	273,439,717.50	239,649.18
	300	TO	315	677	2.80%	851	212,843,191.50	250,109.51
	315	TO	330	509	2.11%	633	167,148,727.00	264,058.02
	330	TO	345	477	1.97%	589	163,926,247.00	278,312.81
	345	TO	360	510	2.11%	634	183,729,637.86	289,794.38
	360	TO	375	1,775	7.34%	2,168	673,356,215.00	310,588.66
SUB TOTAL				7,242	29.96%	8,967	2,313,564,205.70	258,008.72
TOTAL				24,174		21,430	4,834,828,066.03	225,610.27
CUM TOTAL				98,414		111,526	15,286,344,050.48	137,065.29

EGIONAL DISTRIBUTION OF MORTGAGE TAKE-OUTS
UMULATIVE 1987-1992 (BASED ON LOAN VALUE)

EGION	1987 CUM	1988 CUM	1988 INC.	1989 CUM	1989 INC	1990 CUM	1990 INC	1991 CUM	1991 INC	1992 CUM	1992 INC
1	0.045	11.513	99.61%	43.899	73.77%	63.410	30.77%	80.253	20.99%	96.355	16.71%
2	0.000	21.163	100.00%	40.053	47.16%	61.151	34.50%	89.701	31.83%	140.343	36.08%
3	0.277	71.248	99.61%	276.208	74.20%	505.874	45.40%	826.457	38.79%	1,321.250	37.45%
4	4.179	332.015	98.74%	1,318.300	74.81%	2,697.734	51.13%	4,757.133	43.29%	7,043.684	32.46%
5	0.000	2.339	100.00%	48.210	95.15%	79.441	39.31%	107.116	25.84%	132.632	19.24%
6	1.072	20.145	94.68%	71.376	71.78%	139.988	49.01%	212.536	34.13%	293.072	27.48%
7	0.000	2.383	100.00%	29.896	92.03%	61.340	51.26%	87.375	29.80%	191.845	54.46%
8	0.000	0.945	100.00%	7.122	86.73%	11.591	38.56%	23.833	51.37%	32.793	27.32%
9	0.000	10.304	100.00%	30.651	66.38%	49.539	38.13%	68.711	27.90%	93.585	26.58%
10	0.000	4.757	100.00%	61.585	92.28%	131.953	53.33%	193.077	31.66%	404.939	52.32%
11	0.000	9.693	100.00%	87.419	88.91%	269.314	67.54%	591.326	54.46%	1,024.248	42.27%
12	0.000	1.407	100.00%	16.059	91.24%	34.638	53.64%	61.553	43.73%	78.883	21.97%
NCR	6.247	339.858	98.16%	1,078.587	68.49%	1,977.728	45.46%	3,352.385	41.01%	4,432.653	24.37%
TAL	11.819	827.770	98.57%	3,109.365	73.38%	6,083.701	48.89%	10,451.456	41.79%	15,286.282	31.63%

IONAL DISTRIBUTION OF MORTGAGE TAKE-OUTS
IULATIVE 1987-1992 BASED ON NO. OF UNITS

ION	1987 CUM	1988 CUM	1988 INC.	1989 CUM	1989 INC	1990 CUM	1990 INC	1991 CUM	1991 INC	1992 CUM	1992 INC
1	1	147	99.32%	473	68.92%	638	25.86%	774	17.57%	863	10.31%
2	0	235	100.00%	546	56.96%	792	31.06%	1,047	24.36%	1,413	25.90%
3	5	1,029	99.51%	3,444	70.12%	5,621	38.73%	7,943	29.23%	10,290	22.81%
4	42	2,881	98.54%	10,324	72.09%	18,519	44.25%	28,912	35.95%	38,693	25.28%
5	0	47	100.00%	683	93.12%	1,057	35.38%	1,434	26.29%	1,673	14.29%
6	24	411	94.16%	1,125	63.47%	1,661	32.27%	2,083	20.26%	2,605	20.04%
7	0	29	100.00%	325	91.08%	601	45.92%	748	19.65%	1,180	36.61%
8	0	12	100.00%	70	82.86%	103	32.04%	179	42.46%	241	25.73%
9	0	134	100.00%	347	61.38%	490	29.18%	636	22.96%	833	23.65%
10	0	44	100.00%	519	91.52%	1,093	52.52%	1,462	25.24%	2,779	47.39%
11	0	108	100.00%	921	88.27%	2,496	63.10%	5,135	51.39%	7,971	35.58%
12	0	13	100.00%	162	91.98%	332	51.20%	489	32.11%	618	20.87%
NCR	48	2,384	97.99%	7,678	68.95%	14,040	45.31%	23,378	39.94%	29,235	20.03%
AL	119	7,474	98.41%	26,617	71.92%	47,443	43.90%	74,220	36.08%	98,394	24.57%

PHILIPPINES

HOUSING SECTOR PROJECT (LOAN 2974-PH)

PROJECT COMPLETION REPORT

PART III: STATISTICAL INFORMATION

Table 1: Related Bank Loans

Loan title	Purpose	Year of approval	Status
Manila Urban Development Project Ln. 1272/82-PH	Upgraded Tondo Foreshore and built Phase I of Dagat-Dagatan serviced site project	1976	completed
Second Urban Development Project Ln. 1647-PH	Extended serviced sites and upgrading to regional cities	1978	completed
Third Urban Development Project Ln. 1821-PH	Expanded slum upgrading in Metro Manila	1980	completed
Regional Cities Development Project Ln. 2257-PH	Initiated a broad-based municipal development loan fund	1983	completed

Table 2: Project Timetable

Steps in project cycle	Date planned	Date actual
Identification	1984	
Preparation	1985-1987	
Appraisal	Aug-87	
Negotiations	May-88	
Board presentation	Jun-88	
Signing	Sep-88	
Effectiveness	Dec-88	
Project completion	Jun-93	NA
Loan closing	Jun-94	Apr-93

Table 3: Loan Disbursements (Cumulative)

	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95
Appraisal estimate	0.0	38.5	80.9	88.4	110.7	141.5	155.0	160.0
Actual	0.0	82.6	104.3	104.3	114.2	125.3 1	NA	NA
Actual as % of estimate		215%	129%	118%	103%	89%	NA	NA
Cancellation						34.7	NA	NA

1/ Suspended December 31, 1992, and Cancelled in April 1993.

Table 4: Key Indicators for Project Implementation

Year	NHMFC lending, units	NHMFC average loan size	NHMFC Average Loan Affordability (percentile)
1988	7,402	110,242	90th
1989	19,143	119,187	
1990	20,798	143,011	
1991	26,777	163,116	45th
1992	24,174	200,001	

Year	NHMFC collections ratio	NHMFC debt-equity ratio	NHA debt-equity ratio
1988	65%	Recapitalized 3/	
1989	67%	7.5	
1990	65%	38.4	0.4
1991	74%	47.0	0.5
1992	63% 1/	(negative equity)	0.3
1993	NA	NA	NA
1994	61% 2/		

1/ As of October 1992 (year to date).
2/ As of mid-year (year to date).
3/ First year following recapitalization. Debt negligible.

Table 5a: Project Costs

Item	Appraisal estimate			Actual		
	Local costs	Foreign costs	Total	Local costs	Foreign costs	Total
Adjustment Component	**0.0**	**75.0**	**75.0**	**0.0**	**76.6**	**76.6**
NHMFC mortgage purchases:						
from NHA	31.5	13.5	45.0	NA	NA	NA
from private sector	140.0	60.0	200.0	NA	NA	NA
subtotal	**171.5**	**73.5**	**245.0**	**422.0**	**180.0**	**602.0**
TA/training/studies	**2.5**	**2.5**	**5.0**	**2.0**	**0.0**	**2.0**
TOTAL	**174.0**	**151.0**	**325.0**	**424.0**	**256.6**	**680.6**

Table 5b: Project Financing

Item	Appraisal estimate			Actual		
	SSS/GSIS/ HDMF	World Bank	Total	SSS/GSIS HDMF/ OTHER	World Bank	Total
Adjustment Component	**0.0**	**75.0**	**75.0**	**0.0**	**76.6**	**76.6**
NHMFC mortgage purchases:						
from NHA	15.0	30.0	45.0		* —	—
from private sector	150.0	50.0	200.0		* —	—
subtotal	**165.0**	**80.0**	**245.0**	**553.4**	**48.6**	**602.0**
TA/training/studies	**0.0**	**5.0**	**5.0**	**2.0**	** **0.0**	**2.0**
TOTAL	**165.0**	**160.0**	**325.0**	**555.4**	**125.2**	**680.6**

* accounting did not distinguish these categories

** funding covered by Japanese Grant Fund

Mortgage Contracts from 1988-1992 estimated at appraisal to be P.5.0 billion ($245 million at 20.4 exchange rate). Actual growth was P.15.1 billion ($602 million @ 25.1 exchange rate) or almost three times that projected.

Table 6: Status of Legal Covenants

Covenant	Status
Loan Agreement	
3.02: The Borrower shall make available funding for TA and studies	Satisfactory
4.01: Government audit for TA, training, studies, and import component	Satisfactory
4.02: Maintenance of sectoral coordination mechanism	Satisfactory
4.03: Provision of NHA rollover construction funds	Satisfactory
4.03: Carrying out of Sector Policy and Action Plan	Unsatisfactory
Sch5: Interest rate from Borrower to NHMFC as agreed with the Bank, 20 years/5 yrs grace	Satisfactory
Sch5: Relending by NHMFC to sub-borrowers at agreed interest rates	See Discussion
NHMFC Project Agreement	
2.04: Project beneficiaries shall be below the 70th percentile and shall comply with the agreed criteria	Satisfactory
2.06: Mortgage purchases from NHA will be carried out	Satisfactory
2.08: NHMFC will raise collection levels to 95%	Unsatisfactory
2.09: NHMFC will implement an ARM policy with respect to mortgages funded by variable rate funding	Satisfactory
2.10: NHMFC will complete study of future funding	Pending
2.11: NHMFC will carry out policy and action plan	Unsatisfactory
4.02: NHMFC shall earn a positive return on equity starting 12/89	Unsatisfactory
4.03: NHMFC to maintain debt/equity of not over 20:1	Unsatisfactory
4.03: NHMFC to maintain internal cash generation of at least 1.1 times projected debt service	Unsatisfactory
4.03: NHMFC to maintain positive spread of at least 2%	Satisfactory
NHA Project Agreement	
2.01: NHA shall carry out Part B of project (construction to utilize mortgage funding)	Satisfactory
2.05: NHA shall carry out policy and institutional action plan on a timely basis	Satisfactory
4.01: Audit submitted	Satisfactory
4.02: NHA shall earn a real return on equity starting FY 1993	NA
4.02: Profitability review by NHA due annually	Unsatisfactory
4.02: Five-year projections twice annually	Satisfactory
4.03: NHA shall maintain debt/equity ratio of not over 15:1	Satisfactory
4.03: NHA shall maintain internal cash generation of at least 1.1 times projected debt service	Satisfactory

Table 7: Bank Resources

Stage	Staffweeks	Dollars (000's)
Preparation	107	261
Appraisal	28	82
Negotiation	22	61
Supervision	111	290
ICR/evaluation	18	46
TOTAL	**286**	**740**

Table 8

ACTION PLAN
NATIONAL HOME MORTGAGE FINANCE CORPORATION

	Issue	Agreed Action	Responsible Agency	Date	Status May 1992	Status October 1992
1.	Low Collection Efficiency	#A-Action Plan for improved collections including individualization of CMP mortgages and clean-up of titles on NHA properties, with proposal for use of grant funds	NHMFC	12/31/91	Satisfactory Plan received and CMP individualization to begin with JGF assistance	Unsatisfactory No staff hired. JGF funds stalled. 3 computers received only. Individualization not started yet.
		#B-Improved collection efficiency Including interest realizations on arrears and from liquidations:				
		a. from 63% to 80%	NHMFC	12/31/92	—— Not yet due	Unsatisfactory. 63% 10/92
		b. from 80% to 96%	NHMFC	12/31/93	—— Not yet due	
2.	Loss Provisions	#A-Confirmation of acceptable provisioning methodology involving:	NHMFC	12/31/91		
		(a) specific provision based on ageing of arrears (10% for MCRs & items in lit w/arrears from 12-24mo; 20% for MCRs & items in lit over 24 mo & for acquired assets), plus			(a) Satisfactory Accepted by the Board 12/91	(a) Unsatisfactory Board approved policy not being applied. 1% specific provision/3.7% IL vs 20%
		(b) general provision commensurate with assessed risks of both general portfolio and any unclassified assets but not less than 1%. Review of provisions at least annually.			(b) General Provision principle accepted actual level below 1% (0.5% as of 4/92)	(b) Unsatisfactory actual level below 1% (still 0.5% as of 6/92)
		#B-Establishment of an appropriate level of loss provision at:	NHMFC	12/31/91		
		P131 m specific provision for assets reviewed 3/91			Accepted with Deficiencies -Specific provision OK for Folio II; none for Folio I, CMP or Development Loans Receivable which together total P1.6b or 11% of total assets, and portions of which can be analyzed.	- Folio II dropped to 1%; but added Folio I, CMP, and DLR provisions of 1% each; IL = 3.7%
		P200 m 2% general provision until P1.6b of assets can be analyzed per above methodology (then 1%)		Not done........	-General Provision = 0.5% vs. 2% rec 12/91 Statements still to be finalized to increase this figure. CB to review. Also positioned wrong with Folio II.	- General Provision 0.5% as of 8/91 - not yet corrected
		P331 m Total required			Total established — P172 Specific P 56 General P228 Total (69%)	P 189 specific 8/92 P 86 general 8/92 P 275 Total (P15,416R,RI,CMP,DLR and IL = 1.8% total)
		#C-Appropriate accounting treatment of both provisions (net frm gross loans)	NHMFC	12/31/91	Satisfactory	Satisfactory
3.	Transfer of Folio I	#A-Complete transfer of Folio I	HDMF and NHMFC	12/31/91	85% Satisfactory (3.74/4.4 = 85%) Balance to be rebooked by NHMFC	87% Satisfactory (3.858/4.417 = 87.3%)
		#B-Post undistributed collections in NHMFC's balance sheet	NHMFC	3/31/92	—— Not yet due	Unsatisfactory Undistrib coll increased from P1.3b to P1.8b. No R/RI bkdn

Table 8

ACTION PLAN
NATIONAL HOME MORTGAGE FINANCE CORPORATION

	Issue	Agreed Action	Responsible Agency	Date	Status May 1992	Status October 1992
		#C-Complete payment of reciprocal balances between HDMF and NHMFC, and rebook any loans not transferred	HDMF and NHMFC	6/30/92	—— Not yet due	Unsatisfactory
4.	Income Recognition	#A-Adoption and implementation of a satisfactory income recognition (non-accrual) policy including backing out of all income recognized to date on loans in arrears of the following number of months:				
		- 24 months by 12/31/91	NHMFC	12/31/91	Satisfactory	Satisfactory
		- 18 months by 1/31/92	NHMFC	1/31/92	—— Not yet due	Reported Satisfactory (can't confirm)
		- 10 months by 1/31/93	NHMFC	1/31/93	—— Not yet due	—— Not yet due
5.	Spread	#A-Increase of 2 points in NHMFC's portion of spread, representing an increase from 2.6% to 2.85%-3.0%	NHMFC	12/31/91	Satisfactory/Exceeded (a) added 5 points 3/92 (b) retained 1% commitmt fee by developers, = 0.5% aprox Total increase = 1.1%-1.7% added to 1.9% = 3.0%-3.6% or 60%-90% increase	Technically Satisfactory. However, spread is not inadequate to remain profitable at present level of arrearage
		#B-Review of Profitability and further adjustments to spread	NHMFC	6/30/92	—— Not yet due	Unsatisfactory Spread will not maintain profitability at present levels of a when 10 months introduced
6.	Capital Deficiency	Further growth combined with backing out of Income recognized on loans in arrears from 1/92-1/93 will bring NHMFC's capital into deficiency during 1992. Aggressive collection will help restore some retained earnings, but further capitalization will be needed.				Capital at 3% vs. 5% required. Now dubious whether recapitalization is advisable
		#A-Preparation of a Plan for capital Increase	NHMFC	12/31/91	Token Plan Received substance to be dealt with by next administration	Status Unchanged
		#B-Approval of an increase in authorized capital	Congress	12/31/92	—— Not yet due	Status Unchanged
		#C-Suspension of dividend of NHMFC when capital is deficient until restored to satisfactory levels	DOF	12/31/92	Satisfactory	Satisfactory
7.	Regulatory Oversight	#A-Government to name a regulatory body for NHMFC	DOF/CB	12/31/91	Satisfactory first inspection took place 2/92	Quasi-Satisfactory final report not yet issued 10/92
8.	Treatment of Subsidy Income	Recognize as earned	NHMFC	1/31/92	Satisfactory	Satisfactory

ACTIONP.NHM

IMAGING

Report No: 15810
Type: PCR