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STAFF APPRAISAL REPORT

PORTUGAL

HOUSING FINANCE PROJECT

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Urban and Regional Development Projects Division

CURRENCY EQUIVALENT

Currency Unit = Escudo (Esc); Esc 1,000 = Conto 1 (C)
US$1 = Esc 153 (mid-1984)
C1 = US$6.5

FISCAL YEAR (FY)

January 1 - December 31

GLOSSARY OF ABBREVIATION

CGD	Caixa Geral de Depósitos (General Housing Deposit Bank)
CPP	Crédito Predial Português (Portuguese Housing Credit Bank)
EEC	European Economic Community
FAIH	Fundo de Apoio ao Investmento para a Habitaçao (Housing Investment Support Fund)
FFH	Fundo de Fomento de Habitaçao (Housing Development Fund)
GAT	Gabinete de Apoio Tecnico (Technical Assistance Office)
GEP	Gabinete de Estudos e Planeamento (Office of Studies and Planning)
HGP	US-AID Housing Guarantee Program
INH	Instituto Nacional de Habitaçao (National Housing Institute)
LNEC	Laboratorio Nacional de Engenharia Civil (National Civil Engineering Laboratory)
MSE	Ministerio de Equipamento Social (Ministry of Social Equipment)
MOF	Ministry of Finance
PRID	Programa de Recuperacao de Imoveis Degradados (Program for Improvement of Dilapidated Housing)
US-AID	US Agency for International Development

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This report, written by J-F. Landeau, is based on the findings of an appraisal mission which visited Lisbon in September-October 1984. The mission included J-F. Landeau (Mission leader), C. Hovnanian and M. Chrétien (Consultants).

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HOUSING FINANCE PROJECT

LOAN AND PROJECT SUMMARY

Borrower: The Republic of Portugal

Beneficiary Agency: The National Housing Fund (INH)

Loan Amount: US$25.0 million

Loan Terms: Standard

Project Objectives: To support the Government's social housing policy by providing low-cost affordable serviced plots and turnkey housing units to the lower income segment of the urban population through a financial institution specialized in low-cost housing finance.

Project Description: Financing of the construction of eligible sub-projects, then consolidation into co-financing of mortgage loans granted by three specialized institutions to the beneficiaries of these sub-projects.

Project Costs:

	US$'000	%
Plot Servicing, Housing Construction	56,000.0	98.9
Technical Assistance	600.0	1.1
	56,600.0	100.0

Financing Plan

	US$'000	%
World Bank	25,000.0	44.2
US-AID Housing Guarantee Loan	25,000.0	44.2
US-AID Technical Assistance Grant	600.0	1.1
Developers	6,000.0	10.6
	56,600.0	100.0

Estimated Disbursements	FY 1986	1987	1988	1989	1990
Annual	2.5	6.5	9.0	5.0	2.0
Cumulative	2.5	9.0	18.0	23.0	25.0

PORTUGAL

HOUSING FINANCE PROJECT

I. INTRODUCTION

1.01 The Government of Portugal has recently adopted new urban and housing policies. Until 1983, the focus was on provision of highly subsidized rental housing, tightly controlled from the center. Now the focus is decentralized with the participation of different downstream sectors, municipalities and commercial developers as well as non-profit organizations (cooperatives). The former policy had been costly and ineffective in reaching its intended beneficiaries. The new policy emphasizes cost reduction, affordable standards, and mobilization of private initiatives. It is in line with the findings and recommendations of the Urban Sector Discussion Paper.[1] The Discussion Paper suggested the need for the Government to shift its priority from the provision of fully finished housing to the supply of infrastructure and lower-cost housing units; it also stressed the need for adequate standards and cost recovery.

1.02 The proposed project has been formulated with the objective of supporting the Government's recent social housing policy orientation and the new institution, Instituto Nacional de Habitaçao (INH), established to implement it. The project would be the Bank's first operation in the housing sector in Portugal.

1.03 The project would be implemented through a US$25.0 million loan to the Republic of Portugal to be used in two successive phases. First, it would be on-lent as a medium-term line of credit to INH to finance the construction phase of low-cost housing (para. 2.27). Upon completion of the construction phase, it would be consolidated into a long-term line of credit from INH to three specialized institutions to finance mortgage loans (paras. 2.22-2.26). There would also be cofinancing in the form of a US$25 million loan from US commercial banks guaranteed by the US-AID Housing Guarantee Program (the first tranche of a US$50 million commitment). The first US-AID loan was approved in September 1984 and borrowing is scheduled for July 1985. A technical assistance component to strengthen INH is financed through a US$600,000 grant from US-AID (FY1985).

1/ Portugal - Urban Sector Discussion Paper (Report No. 4425-PO, March 21, 1983).

II. URBAN SECTOR BACKGROUND

A. Urbanization Trends

2.01 The urban population in continental Portugal increased from 1.9 million in 1960 to about 3.5 million in 1984.[1/] Despite this increase, Portugal remains the least urbanized country in Europe with only 37% of the total population living in urban areas. The relatively slow pace of urbanization (2.7 % p.a. since 1960) reflects a population decline in the early 1970s (largely due to out-migration to EEC countries) which was partly off-set by the post-1974 influx of about 600,000 "returnados"[2/] from the former colonies.

2.02 It is estimated that the current stock of urban housing is about 800,000 units, growing at about 3% annually. In 1981, a Ministry of Housing survey estimated that there was an unmet demand for about 300,000 ownership units in urban areas and growth was estimated at about 30,000 units annually. Current production (Annex 4, Table 2) is about 36,000, no more than 40% in urban areas. Moreover, there is suppressed demand created by rent control and also the influx of "returnados" occupying temporary shelters ("barracas"). Thus, it appears likely that the urban housing problem will become more acute. In practice, the housing gap has been filled by the densification of old established neighborhoods in major cities and the proliferation of informal housing settlements ("clandestinos").

2.03 Almost half of the total urban population lives in two cities, Lisbon and Oporto; another 30% is concentrated in other coastal cities. This concentration is projected to increase as many of the poorer eastern regions are experiencing rapid out-migration. To compound the problem, past housing policy led to an overall decline in the production of formal housing in urban areas, and remittances from workers in EEC countries were mostly invested in rural housing. The 1981 census established that 62,000 families lived in crowded neighborhoods and 36,000 others were in shanty towns. Many more, however, live in informal settlements not included in current definitions of "urban"; various surveys put the total informal units at about 600,000 in 1983 nationally. These settlements are illegal in that they are built on public or private land without clear title, building permit or prior infrastructure. Some consist of large clusters of houses soundly built where infrastructure could be added at reasonable cost, but others will be excessively costly to

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1/ This legal definition of urban boundaries does not include the illegal settlements on the urban periphery.

2/ Portuguese citizens returning from the former colonies (Angola, Mozambique).

upgrade. The authorities viewed these illegal settlements as an unacceptable response to the housing shortage, but no real effort to prevent their creation was undertaken until recently. Some municipalities have launched upgrading and land development programs to control their expansion.

2.04 The lack of adequate infrastructure is a major problem in Portugal, despite recent improvements. The 1981 census established that 26% of all housing was not connected to water, 10% was not connected to electricity, and 22% had no in-house toilet facilities.

B. The Government's Housing Policy Between 1974 - 1981

2.05 From the 1974 revolution until late 1982, the Government focused mainly on reducing the housing gap. The policy was based on the premise that controlling prices by providing subsidized housing for either rental or sale was the only solution to satisfy the demand from low-income groups. But the Government failed to develop a coherent policy framework on urban issues. Policy responses to the housing problem included (i) setting up a rent control system without regard for its long-term effects, (ii) stressing public production of relatively costly social housing with little attention paid to the provision of infrastructure in informal settlements, and (iii) offering loans to low income groups at below market interest rates.

2.06 The negative impact of these policies is apparent from the build up of housing construction (Annex 4, Table 2). The immediate result of rent control which was introduced in 1974 was the stagnation of the private rental market. While 40 to 50% of all housing units were rented in the early 1970s, none is built today for rental purposes. Landlords had little incentive to maintain the existing stock and the quality of many rental units deteriorated. Moreover, a system of "key money" has evolved to offset the rent control.

2.07 The impact was similar on housing built for sale. Private sector developers built about 10,000 units annually, mostly for middle and upper income families between 1975 and 1981 (Annex 4, Table 2). This fell far short of total housing needs and the Government's response was to organize housing production around a public agency, the Fundo de Fomento de Habitaçao (FFH); the cooperatives; and the private sector through negotiated "development contracts". During the period 1975-1981, municipalities were not involved in direct development activity.

2.08 The Fundo de Fomento de Habitaçao (FFH). Established in 1969 initially to provide serviced land for private developers, FFH was expanded after 1974 to implement subsidized social housing for lower income families. It was simultaneously the financier (through government capital contributions and rent income) and the executing agency for three programs: (i) large-scale subsidized rental projects known as "direct promotion" programs where FFH acted as developer of rental units either on behalf of municipalities or for itself (usually developed on municipal land); (ii) a support program to cooperatives and private developers under which it provided technical assistance and financing on concessionary terms, and (iii) a modest program of rehabilitation of existing dwellings through loans to individuals. Between 1975-1981, FFH cofinanced and completed about 42,500 units or about 18% of total production: 15,000 as a developer, 10,000 through development contracts and 17,500 for municipalities.

2.09 FFH's direct promotion program was plagued with serious problems from the outset. The excessively high standards adopted for social housing (a typical unit had three to four rooms, one-and-a-half bathrooms, and a wood-panelled floor) combined with the low rents charged led to financial difficulties for municipalities that sub-contracted FFH to implement their housing program, and siphoned off FFH's available funds at an alarming rate. FFH ran into liquidity problems which led to bankruptcy in 1981; in April 1982, it was dissolved.

2.10 The Cooperatives. Although cooperatives have existed in Portugal since 1894, they only took on any importance after 1974 when the Government encouraged them as a way to mobilize grass-roots initiative. There are about 260 housing cooperatives, varying in size from less than 100 members up to 3,000, and comprising about 97,000 households, many of them with below-median income. The membership is highly motivated by the prospects of owning dwelling and, in many cases, members provide their own labor which makes unfinished apartments an attractive option. Only the largest cooperatives, however, have in-house capacity to design and implement programs. Despite official encouragement through subsidies and tax exemptions, cooperatives only completed about 2,000 units between 1975 and 1981; and many are plagued with financial difficulties because of their tendency to embark on unaffordable programs. The establishment of INH and the implementation of less ambitious standards have introduced some realism in the cooperatives' expectations and as a result they could play a significant role in the proposed project.

2.11 The Private Sector. In 1982 and 1983, private housing production accounted for about 85% of total. In spite of the size of the private market, there are no professional real estate developers as such in Portugal. At least two-thirds of private housing is built by individuals arranging to have their house built by a contractor or by skilled workers. "Private developers" in Portugal are generally no more than civil works contractors. To encourage them to enter the low-income housing market, the Government launched the concept of "development contracts." Under those, developers received subsidized loans and technical assistance from FFH, and a guarantee that all unsold units would be bought by the municipalities. Despite these incentives, only about 10,000 units were completed under such contracts from 1975 to 1982 due to the reluctance of municipalities to face the marketing risk involved.

C. Policy Developments Since 1982

2.12 The housing policy pursued in the late 1970s was clearly ineffective. FFH was unable to meet the needs, the subsidies were increasingly difficult to carry and they had a limited impact on the housing situation. From 1975 to 1983, annual housing production remained below its 1974 level and the public sector share remained at about 15%. Informal private housing grew rapidly, while FFH became insolvent and other publicly supported programs stagnated. The Government is aware of these problems and has taken some measures, especially on rent control, credit subsidies, and building standards, to rectify them.

2.13 In November 1983, the Secretary of State for Housing presented a statement to modify its rent control policy in order to stimulate investment in rental housing. Since then, the Government has taken steps to improve its policy; there is no rent control on commercial buildings, and owners of residential buildings rehabilitated with credit financing are free to set initial rents after renovation. A bill on "Rules for Rental Housing" was voted in broad terms by the Parliament in February 1985. The bill will create three types of rents starting on January 1st, 1986, making a distinction between current and new leases: (i) Current leases: (a) in force before January 1st, 1980: Previously frozen rents could be increased in 1986 between 1.21 and 4 times depending on the geographical location of the building and the lease date (for example, 4 times would apply to pre-1960 leases on building with elevator and concierge in Lisbon and Oporto). The 1986 rents could be increased in 1987 1.5 times 75% of the consumption price index; (b) in force since January 1st, 1980: The inflation indexation would start in 1987; (c) all above leases would follow the controlled rent regime (see below) from 1988 on; (ii) New leases: (a) "free" rents set initially in agreement between landlords and tenants, but frozen at that level fo five years; (b) "controlled" rents: the initial rent could be equal to up to 8% of the dwelling's market value, and annually indexed thereafter according to figures published by the Government. The new law would be a substantial improvement over the existing one and would represent a major achievement in the Government's efforts to improve conditions in the rental market.

2.14 Interest rates have been raised to reflect inflation in the range of 25% p.a. (para. 2.26), with the effect of slowing down the growth of demand for housing credit to below the pace of inflation. The Government subsidy for low-income borrowers (called "family subsidy"; para 2.24) has been abolished for all but the lowest income families. But the major potential for improvement was the Government's recognition of the need to provide lower cost alternatives to traditional walk-up apartment buildings. This became evident in October 1983, when the low-income housing fund (then FAIH, later INH; see paras. 2.21 and 3.01-3.05) was authorized to finance not only land development and upgrading of illegal settlements, but also core units and unfinished apartments (where all the inside finishing is left to the buyer). To make social housing units more affordable to low income groups without excessive subsidies, stringent technical and cost criteria have been adopted (reduction of maximum built area, introduction of ceiling on cost/m^2, ban on 5-bedroom units, indexation of value ceilings at paces slower than inflation; see Annex 6). The average dwelling size would decline from 3.8 bedrooms and 131 m^2 in the early 1980's to 2.5 bedrooms and 92 m^2 in 1986. The new standards would reduce the cost for the average unit by about 30%.

2.15 This array of policy decisions, together with legislation recently enacted (see list in Annex 1), have laid the basis for sound development of the housing sector and would be supported by the proposed project. Project timing is also appropriate in view of the need to reactivate the construction sector currently depressed by the economic recession. Between 1981 and 1983, housing production by the private sector decreased by 12%, the employment index declined by 6% to its 1976 level, and the consumption of steel and cement dropped by 22% and 15% respectively. The construction sector has long been seen as critical to the sound long-term evolution of the Portuguese economy because of (1) its comparatively lower import content (about 30% of cost for material inputs); (2) its relatively high employment potential (9.6% of total labor force for 6.5% of total value-added in 1981); and (3) its contribution to total investment (52% during 1981-1983, of which one-third in housing alone). The proposed project would contribute to a timely revival of investment activity, help reactivate economic growth, and alleviate the unemployment problem.

D. Housing Finance Institutions

2.16 The Financial System. The number and variety of financial institutions is relatively limited for a country at Portugal's stage of development. Besides the central bank (Banco de Portugal), there are eight commercial banks, three specialized institutions classified as savings banks (Caixa Geral de Depósitos, Crédito Predial Português, and Montepio Geral) and an industrial development bank. Most of the system was nationalized in 1975, but there are 20 private savings institutions, mostly mutuals, of which Caixa Economica de Lisboa, linked to Montepio Geral, is the largest. Deposit institutions operate under strict credit ceilings set by the central bank for each institution on a monthly basis.

2.17 The share of housing credit in overall credit to the economy has risen steadily from about 2% in 1974 to about 12% in 1983. The three specialized institutions provide almost all the long-term financing for formal housing (87% at the end of 1983). Among them, CGD, which is the largest bank in Portugal, contributes close to 70%; CPP's share is around 16%; and Montepio Geral's share has been slowly declining from 15%. Commercial banks accounted for only 13% of all housing loans at the end of 1983, and most of it was for short-term construction finance.

2.18 Caixa Geral de Depósitos (CGD), established in 1876, CGD is Portugal's largest bank with US$5.7 billion in assets at the end of 1983, and accounting for one-fourth of all bank deposits at 300 branches. It lent about US$275 million for housing in 1983, 78% in the form of mortgage loans to 18,500 households, and US$55 million to local governments for infrastructure. At the end of 1983, housing and infrastructure accounted for 43% and 11% respectively of CGD's outstanding portfolio of US$3.4 billion (industry and export financing absorbed another 33%, public enterprise 7%, and agriculture 4%). CGD has a well trained staff and follows adequate appraisal procedures. It is the financial intermediary for credits from the European Investment Bank, KfW, and the World Bank.

2.19 Crédito Predial Português (CPP) collected 5% of all deposits in the banking system in 1983, that is only one-fifth of CGD's deposits, but it accounted for about half of all housing and construction finance in 1982 (US$130 million). By 1983, housing finance accounted for about half of CPP's activities, with 60% in medium-term construction loans and 40% in mortgage loans. CPP also has a well trained staff and appropriate appraisal techniques.

2.20 The Caixa Economica de Lisboa was established in 1840 as an outgrowth of the Montepio Geral, a mutual fund of government employees. Although the smallest of the three, it is the most specialized in housing finance, which accounts for 80% of its activities, with 43% in mortgage lending. Its staff is also well trained in appraisal techniques.

2.21 Fundo de Apoio ao Investimento para a Habitaçao (FAIH). Following the dismantlement of FFH, the Government established the FAIH in May 1982 to take over the financial responsibilities of FFH. To start its lending operations, FAIH was given a government equity contribution of US$18 million (at the 1982 exchange rate) and borrowed US$32 million from a British bank. By the end of 1983, however, the new Government determined that FAIH's structure was inadequate and that an institution with broader scope was needed. In May 1984, INH was established and charged with major functions under the Government's housing policy: planning and programming, financing and technical assistance (Chapter III); it took over FAIH's assets and liabilities.

E. Lending Terms, Interest Rates and Subsidies

Mortgage Loans

2.22 Lending Terms. The nominal interest rate on mortgage loans is the same as that for loans of over five years, currently 32.5% p.a., and is variable to the extent that rates are changed by the Government in relation with inflation. However, the Central Bank and the lending institutions provide interest rebates on mortgages for low and moderate price housing units. The interest rebate that is provided by Banco de Portugal to the specialized institutions, varies currently between 1.5 and 3.75 points p.a. depending on the house price and only dwellings below US$32,400 are eligible. The specialized institutions also grant an interest bonus ranging between 1.0 and 1.5 points p.a. for housing units costing less than US$27,000. Under a decree of December 1983, if the nominal interest rate is reduced, the Central Bank rebate and the lender's bonus will be revised downward, so as to leave the final borrower with a fixed reference interest rate of 27.25% for social housing, and between 28.75% and 32.5% for luxury housing (see also para. 2.25).

2.23 The maximum maturity is 25 years for low-cost units (below US$19,500), and the minimum 15 years for high-cost units (above US$27,000). The maximum loan-to-value ratio is highest (95%) for low-cost dwellings classified as social, and lowest (60%) for luxurious ones (above US$32,400) (see Table 1 below).

2.24 Interest Subsidy for Low Income Families. Financed on the Government budget, the "family" subsidy is granted for a limited period for housing whose cost is below US$19,500 to buyers whose income is below US$595 per month. Depending on income level, the initial subsidy starts at either 8, 5, or 3 points, which at the end of 1984, was up to respectively the 30th, 45th and 65th percentile of the national urban income distribution. Overall, it is well targeted and moreover, it is of a temporary nature as it is phased out by half a point p.a. during the first five years, and by one point thereafter. The family subsidy is therefore cancelled in 10, 7 or 5 years respectively. The impact on the State budget of the family subsidy was estimated at US$33 million in 1984, less than 3% of its current transfers. Compared to many other countries, these subsidies are reasonable; nonetheless, the Government is aware of the need to reduce subsidies further and is making its best efforts to reduce them.

2.25 Graduated Payment Mortgages. Given the high nominal interest rates, there is a need to lessen the debt-service burden of mortgage loans in the initial years. To achieve this, amortization follows a complex formula which for the first 5 years combines: (a) a grace period on the principal, (b) capitalization of a portion (40%) of the interest payments, and (c) graduation of monthly payments at 12% p.a. for the lowest income borrower (Category A in Table 1) and 15% p.a. for the others. As a result, monthly payments for a US$1,000 loan starts at between US$5.74 and US$12.17 depending on the borrower's income, compared to US$22.74 with level payments. The major drawback is the negative amortization effect which results in the principal being multiplied threefold for 25-year loans, and twofold for 15 and 20 year loans. Nonetheless, the increase in principal is slower than the anticipated inflation rate and, thus, the loan to value ratio is expected to decline. Furthermore, payments increase at a rate (between 12 and 20% p.a. taking into account the decreasing family subsidy) well below the average increase in hourly wages observed in the period 1981-83. In the sixth year, however, when the repayment of principal starts and monthly payments jump by 24-44%, a potential but temporary default situation is often observed until the amortization resumes its normal graduation pace.1/ The graduation formula, combined with the family subsidy, results in effective interest rates (in discounted terms) that are lower than nominal rates, 20.2% to 28.5% compared to 27.25% to 32.5%.

2.26 Interest Rates in Real Terms. Both the nominal reference interest rate (32.5%) and rate paid by the borrowers for social housing mortgages (27.25%) are positive in real terms in relation to both past inflation (24.3% over 1981-83) or projected (22.3% over 1985-87 and 20% thereafter). When the family subsidy is taken into account, interest rates (between 20.2% and 23.2%) are slightly negative in real terms for borrowers with below-median incomes, but they are cross-subsidized by higher income borrowers who, not eligible to the family subsidy, are charged rates (between 25.5% and 28.5%) that are clearly positive in real terms. Furthermore, nominal rates are kept positive

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1/ This would not affect the proposed project since the specialized institutions would absorb the default risk (Annex 8, article 9).

Table 1: INTEREST RATE STRUCTURE FOR MORTGAGE LOANS

Category of Dwelling	Cost of Dwelling (Maximum) (US$) /g	Total Monthly Family Income (Maximum) (US$) /g	INTEREST RATES: Statutory	Rebate from: Banco de Portugal	Rebate from: Specialized Institutions	Interest Rate to Borrower	Subsidy from Government	Effective Interest Rate /c
A. /a	19,500	360	32.5%	3.75%	1.5%	27.25%	8% /d	20.2%
		450					5% /e	22.1%
		595					3% /f	23.0%
		over 595					-	24.3%
B. /b	27,000	-	32.5%	2.75%	1.0%	28.75%	-	25.5%
C. /b	32,400	-	32.5%	1.5%	-	31.0%	-	27.3%
D. /b	over 32,400	-	32.5%	-	-	32.5%	-	28.5%

/a Eligible under HGP and World Bank Loan.
/b Not eligible under HGP and World Bank Loan.
/c On a discounted cash-flow basis.
/d Phased out over 10 years.
/e Phased out over 7 years.
/f Phased out over 5 years.
/g Figures converted at 185 Esc per US dollar because they were changed in early 1985.

in real terms by resetting them whenever inflation changes. While the upward interest risk is absorbed mainly by rebates granted by the Central Bank and the mortgage lenders, the final borrowers bear some interest risk if the nominal rate falls below 27.25%, in which case they would gain by refinancing their loans. The latter scenario is more likely as inflation is forecast to slow down from 28% in 1984, to 25% in 1986 and to 20% from 1987 through 1990. Interest rates can be expected to be adjusted accordingly, thus leading to the potential elimination of the interest rebates by the time mortgage loans would be needed under the proposed project (para. 4.02).

Construction Loans

2.27 Construction loans are made for up to five years with balloon repayments of principal. They are usually for three years and the current interest rate is 31.5% which is the rate for loans up to five years. Developers of low-cost housing are eligible for an interest subsidy that was increased from 6.5 to 10.5 points in September 1984 in an effort to stimulate a declining construction industry. Loans to municipalities for land acquisition and development (infrastructure) are made for either five years when the land is to be sold, or fifteen years when it is to be leased. The interest rate is 32.5%, with a 6.5 points subsidy for the first three years decreasing by one point p.a. The loan amount is currently limited to 190 Contos (US$1,250) per dwelling planned on the land.

F. Bank Strategy in the Sector and Project Rationale

2.28 The proposed project is the first project financed by the Bank in the housing sector in Portugal and has emerged from a two-and-a-half year dialogue on a number of sectoral issues. The overall Bank strategy in the sector is to assist the Government in (i) focusing its social expenditures on appropriate target groups; (ii) improving public and private access to government-provided urban services; (iii) lowering the cost per beneficiary to make housing and services more affordable; and (iv) increasing institutional delivery capacity.

2.29 Specifically, the proposed project is designed to assist the Government in implementing its new housing policies in urban areas. It promotes a sectoral approach to lending through a financial intermediary to maximize the efficiency of Bank intervention. It builds on INH as an instrument to target housing delivery to the lowest income groups, to enforce new construction standards, and to promote more cost efficient alternatives to fully built or finished shelter. The choice of INH as the financial intermediary was dictated by practical considerations. First, INH, although in competition for construction financing, has an exclusive mandate to finance low-cost infrastructure and housing. Second, INH was established directly under the tutelage of the ministry in charge of housing (MSE) as its banking arm. Third, and more importantly, the creation of INH provides the opportunity to build a sound financial institution and avoid the pitfalls into which FFH fell.

III. THE INSTITUTO NACIONAL DE HABITACAO

A. Legal Status, Objectives, and Functions

3.01 INH was established by decree-law No. 177/84 of May 25, 1984, as a public institute with financial and administrative autonomy. Administratively, it is located in the Ministry of Social Equipment (MSE).

3.02 INH was established to implement Portugal's social housing policy, articulated by MSE, by assuming certain ministerial functions (e.g. development of policy framework and implementing the policy approved by the Government) and all of FAIH's functions. INH operates as an intermediary, carrying out overall housing planning, mobilizing resources, and channelling Government financial assistance, applying Government-defined technical criteria to loan applications, granting construction financing, and providing technical assistance to borrowers. INH is not involved in direct housing development but its scope of intervention includes non-traditional types of housing finance, i.e. land development, infrastructure upgrading, and cost-effective alternatives to fully-finished dwellings.

3.03 By law, INH's attributions are to administer the housing sector within the policy framework laid down by the Government and to ensure the coordination of financial assistance to the sector. This involves in particular:

(a) Studying the housing situation in order to formulate proposals for political, legislative and regulatory measures;

(b) preparing a National Housing Plan and the annual and multi-annual plans of investment in the sector;

(c) coordinating and preparing the financial policy measures for the sector and participating in the financing of social housing programs promoted by the public sector, cooperative and private sector; and

(d) supervising both the execution of policy measures and the housing programs in accordance with approved norms and plans, and providing technical support to developers.

3.04 Specifically, the housing administration duties of INH are as follows:

(a) promoting inquiries and studies aimed at maintaining updated knowledge of housing problems;

(b) studying solutions and technical and economic norms that are more adequate for the implementation of housing policy;

(c) assessing the cost on the budget and to the public sector of the implementation of the general housing policy;

(d) supervising the execution of social housing projects that are either financed or subsidized by it;

(e) supporting research in the field of housing and proposing norms and standards relative to housing in coordination with the research institutes;

(f) promoting the execution of standard housing designs; and

(g) promoting training and advertising activities, and providing technical support to the developers.

The housing finance duties of INH are as follows:

(a) granting loans for financing social housing programs;

(b) granting interest rate subsidies to the specialized institutions which participate in financing construction and home improvement projects with funds provided by and managed on behalf of the Government;

(c) contracting loans in national or foreign currency;

(d) issuing bonds and mobilizing other domestic or foreign currency resources to finance its activity;

(e) signing development contracts or program contracts in the field of housing; and

(f) participating in companies which promote housing, construction, urbanization or management of social housing.

3.05 INH can also cofinance with the three specialized institutions, the construction phase of all types of housing projects which apply the revised standards (para. 2.14), but unlike them it cannot extend mortgage loans to the final beneficiaries. This gap will be bridged under the project by consolidating construction loans into mortgage loans (para. 4.09).

B. Organization, Management and Staffing

3.06 INH is under the dual tutelage of MSE and MOF, as delegated to the State Secretaries for Housing and Treasury. Tutelage is joint for: nominating board members, approving INH's financing plan and accounts. MOF's tutelage is exclusive for all financial matters, in particular borrowing locally or abroad. MSE's tutelage is exclusive for all technical matters, in particular regarding the activity program. Like all other financial institutions in Portugal, INH is also under the supervision of the Central Bank.

3.07 INH is governed by two bodies: an Administrative Council and an Advisory Board. As provided by Portuguese law, INH is currently managed by a temporary administrative council ("Installation Committee"), which has up to June 30, 1985 to complete the establishment of INH, (with the option of an additional year) and whose general mandate is as described in paras. 3.03 and 3.04. At present, the council is composed of five members (to be reduced to three in its final form) appointed jointly by MSE and MOF. The council is chaired by a president, who is a former board member of CGD in charge of housing operations and whose duties are mainly to ensure the coordination and implementation of administration and management decisions taken by the council. Management is collegial in nature with triple signature of all legal and administrative documents, and the council is responsible for the day to day administration of INH. All loan disbursements are checked a priori by a representative from the Ministry of Finance.

3.08 The current draft organization chart (Figure 1 in Annex 2) reflects the various tasks entrusted to INH. During the installation period, each council member is responsible for specific activities and/or functions; department directors and division chiefs have not therefore been appointed. The Installation Committee is considering a revised organization structure reflecting the difference in nature between lending and non-lending activities (e.g. housing policy making, investment programming, and technical assistance to its borrowers). Approval by the Government of INH's definitive organization structure and appointment by the Government of INH's board members as well as appointment by INH of its department directors and division chiefs will be a condition of effectiveness.

3.09 INH is based in Lisbon and has a branch office in Oporto. As of May 1985, it had 55 staff, 25 of them professional. Engineers and architects, readily available from the former FFH, account for 64% of higher-level staff. However, experienced economists/financial analysts and bankers are in short supply because INH's pay scale cannot easily attract them from the banking system. The Installation Committee realizes that if INH is to develop into an effective financial institution, a better balance has to be found between technical and financial staff and that INH needs to be given the means to attract and retain qualified and experienced personnel. Accordingly, INH has requested that its current personnel statute be modified to put it on a more equal footing with other similar agencies.

C. Policies and Procedures

3.10 Statement of General Policies. A Statement of General and Operational Policies spelling out key guidelines and safeguards related to its lending and financial operations was adopted in May 1985 by INH and endorsed by the Secretaries of State for Housing and Treasury prior to negotiations (Annex 3). With regard to INH's operating and project financing criteria, the policy statement provides that (i) activities fall within the priorities established by the Government; and (ii) projects will be financed on the basis of their economic priority and social merit, financial viability, and technical characteristics (see para. 4.06 for details on eligibility criteria). With regard to financial policy, the policy statement aims at safeguarding INH's creditworthiness, in particular by defining a maximum debt-equity ratio (4.0 to 1), a minimum debt-service ratio (1.15 to 1), a minimum spread on borrowed resources (3.5 points) and loan loss provisions (2% of portfolio), and exchange risk policy (para. 4.17). The statement also stipulates that INH can grant subsidies only if financed by Government budgetary funds specifically earmarked for that purpose. In addition, confirmation was obtained during negotiations that INH will (i) separate its lending and non-lending (e.g., technical assistance) activities; (ii) eventually ensure that cost of providing technical assistance is recovered from beneficiaries; and (iii) not engage in direct contracting programs (Project Agreement).

3.11 Appraisal of Loan Applications. INH has the engineers and architects necessary to appraise the technical feasibility of social housing projects submitted for its financing. They are experienced in this kind of analysis and the quality of technical appraisal is high. To streamline appraisal work and ensure that the new planning, design and construction standards are applied, INH has developed a detailed questionnaire that covers all the economic, financial and legal aspects of projects, including the applicants' experience and creditworthiness. Appraisal of economic and marketing aspects is still somewhat weak, but planned hiring of economists is expected to solve this problem. The experience of INH's staff in appraising land development or upgrading projects is presently limited but will be strengthened through training and exposure to land use analysis techniques under the proposed project (para. 4.13).

3.12 Supervision of Subprojects. INH has acknowledged the importance of the follow-up function as disbursements are linked to progress in construction. It has about fifty projects under active supervision carried out by seven technicians who make 1-3 control visits per month. In the future, every officer in charge of appraising a subproject would be also involved in its technical follow-up.

3.13 Procurement. Procurement for municipal projects is carried out under legal texts that stipulate unified regulations for public sector tendering of goods and services. They consist of open competitive bidding with advertising in three nation-wide publications and pre-qualification of at least three bidders. INH checks that municipalities follow the legal procedures and that price and implementation time-tables are documented; moreover, the financial controller of the Ministry of Interior supervises all contracts signed by municipalities. For projects submitted by cooperatives, INH requires a minimum of three bids and that the choice of the awardee be documented. As development contracts involve private developers who are usually general contractors (para. 2.11), INH accepts procurement on the basis of limited tendering, an acceptable procedure.

3.14 Disbursement Policy. Construction loans are disbursed in three tranches, usually 30% during the first year, 40% the second, and 30% the third, after site inspections by INH's technical staff. This procedure is satisfactory.

D. Operations and Finance

3.15 Past Operations. INH began lending in June 1984 on its predecessor's portfolio of applications which included 47 subprojects involving US$45 million in loans for 2,864 units previously approved by FAIH but not yet committed. In 1984, approvals amounted to Contos 9.2 million (US$60.4 million) for 4,267 units. Despite its rapid start-up, INH has fulfilled only 61% of its official target for 1984 (3,000 units by municipalities and 4,000 by cooperatives). During the first four months of 1985, approvals rose to Contos 2.1 million for 986 units.

3.16 Financial Position. INH took over FAIH's assets and liabilities and immediately had large unused resources: US$28.4 million in State contributions, US$27.5 million in borrowing from National Westminster Bank to be repaid in a balloon on December 29, 1990, and about US$4 million in free reserves. Most of these funds were invested in time deposits with the specialized institutions (mainly CPP), thus leaving INH in a highly liquid situation.

3.17 Forecast of Operations. Given the additional functions entrusted to it (e.g. infrastructure and upgrading), its newness, and developers' limited implementation capacity, the growth in INH's activities as projected by MSE in 1984 appears to be too ambitious. Projections were revised during negotiations (Annex 4 and Table 1 of Annex 5); they assume lending commitments of US$64.0 million in 1985 growing steadily to US$87.4 million in 1987. It is estimated that 49% will benefit cooperative projects, 43% municipal projects and the balance, private projects. About 95% of the lending will finance low-cost housing projects and the balance infrastructure development and upgrading projects. Projects promoted by private developers, and infrastructure and upgrading projects were assumed to be a small share of INH's activity for several reasons. First, a new decree under preparation should improve development contracts (para. 2.11) to attract private developers into housing construction, but it will have little effect before 1986. Second, only half of private developments are expected to be eligible under the new standards. Third, infrastructure development undertaken by municipalities will likely be financed by their traditional banker, CGD. Nevertheless, private participation will be encouraged and since there is no a priori allocation of financing, actual lending by INH and refinancing by the Bank could accommodate more financing of private developers and of infrastructure projects.

3.18 Financial Forecasts and Resource Requirements. Over the period 1985-1987, INH's loan portfolio is expected to grow from US$35.6 to US$154.3 million. The impact of this growth on INH's projected income statements, balance sheets, and cash flows for 1985-1987 is shown in Tables 2, 3, and 4 of Annex 5; the main assumptions are summarized at the beginning of Annex 5.

3.19 INH's projected lending on a commitment basis amounts to US$262.8 million for the period 1984-1987.[1/] At the beginning of 1984, there were US$45.4 million of unutilized resources, thus leaving US$217.4 million in

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1/ The financing plan of INH is presented with 1984 included because financial data for 1984 are preliminary.

resource requirements. On a disbursement basis, they are lower (US$116.8 million), but funding should be secured on a commitment basis to avoid uncovered lending. Identified resources would cover 92% of these requirements. The main sources would be: cash-flow generation (20%), State contribution to equity (31%), US-AID Housing Guarantee Program (25%), European Council's Resettlement Fund (9%), and the proposed Bank loan (13%) (para. 4.03 and Annex 5, Table 5). Assurances were obtained at negotiations on a plan for the remaining financing gap (US$18.2 million) and on annual discussions with the Bank of INH's financial projections. Given that there would be a sizable surplus (US$43.4 million) on a disbursement basis over the proposed commitment period of the Bank loan, the complementary financing plan presented by INH emphasizes the origins of resources rather than actual mobilization timetables. INH would rely on Government contributions for its domestic resources in its initial years. Bond issues are a remote possibility while loans from the specialized institutions have been discussed.

3.20 Projected performance indicators are shown in Annex 5, Table 6. INH's profitability is expected to reach quickly a healthy level (13.3% of assets by 1987) and the spread should allow INH to build up limited reserves (US$8.7 million). The debt-equity ratio is projected to remain well under the proposed limit: 1.1:1 compared to 4.0:1; the debt-service ratio of principal payments is also well covered over the period: 7.9:1 compared to 1.15:1 (para. 3.10). Confirmation was obtained during negotiations that (i) INH's debt-equity ratio would remain lower than 4.0:1, and (ii) INH's debt-service ratio would remain higher than 1.15:1.

IV. THE PROJECT

A. Objectives and Scope

4.01 The proposed project will support the reorientation of Government's social housing policy through INH, the institutional set up to implement it. Specifically, the objectives are:

(i) to provide low-cost affordable serviced plots and turnkey housing units to the lower income segment of the urban population;

(ii) to provide crucial initial institutional support to INH by developing and strengthening its organization, especially in the areas of subproject appraisal and financial policy; and

(iii) to encourage the participation of the three specialized institutions (Caixa Geral de Depósitos, Crédito Predial Português, and Montepio Geral) in mortgage financing for low income households.

4.02 To meet these objectives, the proposed project will consist of a US$25 million Bank loan to the Republic of Portugal, that will be used in two successive phases. First, it will be on-lent as a medium-term line of credit to INH to finance the construction phase (up to five years) of low-cost housing programs. Then, upon completion, the construction loans will be consolidated into a long-term line of credit made available by INH to the three specialized institutions to finance mortgage loans to the beneficiaries of INH-financed programs (Annex 8). The project will be co-financed with a US$25 million loan from the US-AID Housing Guarantee Program (para. 1.03). US-AID would also provide US$600,000 for technical assistance to INH.

Loan Amount

4.03 The size of the proposed Bank loan has been derived from a pipeline of subprojects potentially eligible for Bank financing. Although the pipeline calls for about US$141.6 million in financing, the proposed loan has been limited for the following reasons. First, some subprojects might not materialize during the expected commitment period despite substantial cuts made in the official targets and the assumption of a 10% cancellation factor between commitments and disbursements. Second, it is desirable to match the Bank loan with the first US$25 million tranche of the US$50 million US-AID assistance to INH since most subprojects would be eligible for financing by both institutions. Last, as this will be the first urban lending operation in Portugal, the absence of a track record on actual costs/benefits argues in favor of a conservative initial loan amount; moreover, the Government is facing a budget squeeze which argues in favor of a modest program.

4.04 The proposed loan will cover a small fraction (13%) of INH's projected total loan commitments over a two and a half-year period from mid-1985 to end-1987, the expected commitment period for the Bank loan. It will finance 18% of INH's eligible commitments estimated at US$141.6 million over the same period, and 35% of the corresponding direct and indirect foreign exchange requirements.

B. Project Description

Construction Financing Component

4.05 The proposed project will finance three types of housing through a line of credit to INH. The main features are derived from an analysis of developers' needs, and incorporate all recent regulations concerning infrastructure and housing finance. The description below applies to both the Bank and the US-AID loans. Assurances were obtained at negotiations that the proceeds of the Bank loan will be used for the following purposes. The loan will finance:

(a) Infrastructure and upgrading. Sub-loans for upgrading infrastructure in built up areas will be extended to municipalities under the Program for Home Improvement (PRID). Sub-loans for servicing urban land to be divided up and sold as plots will be extended to all developers. A new law and set of regulations give municipalities access to INH financing for land development. Loan terms are described in para. 2.27. The underlying objective of this component is that the beneficiary family will purchase the serviced plot from the municipality and build a dwelling, usually to standard specifications, over a two-year period. As the upgrading component (PRID) is entrusted to municipalities, it is expected that most financing needs will be satisfied by CGD which traditionally finances most municipal investments.

(b) Traditional Units: The housing developments to be financed under the project will consist of detached housed or walk-up apartment buildings of no more than four floors, of 15-20 apartments, ranging in size from one to three bedrooms, in a complex of several such buildings. Such developments will also cover secondary and tertiary on-site infrastructure. Although such developments might include commercial and social facilities, these will not be financed under the proposed loan since they have alternative sources of financing.

(c) Unfinished Units: Under this component, unit shells will be similar to those above, but the level of finishing will be reduced (e.g. without painting, flooring, bedroom partitions, doors on closets, and with minimum sanitary and kitchen appliances). The concept of marketing unfinished units is not new in Portugal, but it received increased impetus under a recent Decree Law (December 1983) regulating their production as part of the social housing program. It also provides municipalities the authority to grant temporary occupancy permits, thus removing a key bottleneck. When units are completed (usually within 1-3 years), owners are required to have a municipal inspection to obtain final occupancy permits.

4.06 Subproject Eligibility Criteria. To be eligible for Bank financing, subprojects will have to meet the following criteria:

(a) Price criteria.

(i) The maximum cost of on-site infrastructure improvement (i.e., recoverable expenditures, excluding connecting utilities and land) should not exceed Contos 2.0 (US$10.8)[1/] per m^2 of the land area reserved for housing (excluding primary roads and land occupied by community facilities).

(ii) The maximum selling price of serviced plots should not exceed Contos 4.5 (US$24.3) per m^2 of saleable land, and a total price of Contos 540 (US$2,920) per plot for an individual house or Contos 450 (US$2,430) per apartment for a multistorey building.

1/ All figures in this section are converted at Esc 185 per USdollar as they were changed early in 1985.

(iii) The maximum construction cost of housing units should not exceed Contos 17.6 (US$95) per m^2 of built area for an unfinished unit, or Contos 22 (US$120) per m^2 of built area for a finished unit.

(iv) The maximum selling price of housing units should not exceed Contos 1,700 (US$9,190) for the least expensive type (one-bedroon unfinished unit) and Contos 3,100 (US$16,760) for the most expensive (three bedroom finished unit). (See Annex 6 for further details).

(v) Selling prices are in mid-1985 values and include land acquisition and development cost, administrative costs, study and design fees, interest during construction, and contingencies. All above costs and prices are expressed in local currency in mid-1985 prices and will be adjusted on January 31 of each year to account for inflation, using the Construction Cost Index over the latest 12 months.

(b) Technical criteria. The general requirement that subprojects should be technically sound is included in the Statement of General Policy adopted by INH (para. 3.10). In addition, subprojects will have to meet specific technical requirements regarding (i) land use efficiency, (ii) maximum size of the units, (iii) building structure and design, and (iv) number of unit types per subproject. Specifically, for each subproject submitted for Bank financing:

(1) of all finished units, at least 10% will be one-bedroom, and none will be larger than 3 bedroom;

(2) of all unfinished units, at least 8% will be one-bedroom, and no more than 5% will be 4 bedroom, and no more than 50% will be 3 and 4 bedroom.

These criteria are consistent with the new standards defining social housing (dated May 1983), and the Technical Rules for Low-Cost Housing published by the National Civil Engineering Laboratory (LNEC) (July 1984). Eligibility criteria for infrastructure and land development subprojects have been also designed in accordance with MSE specifications.

(c) Financial criteria. All subprojects whose cost exceed US$1.5 million should have a financial rate of return (computed before financial expenses) at least equal to INH's lending rate for developers net of subsidies at the time of the loan (currently 21%). In addition, the loan-to-value ratio should not exceed 90%.

Agreement was obtained at negotiations that the subproject eligibility criteria would be as above. Analysis shows that they would be affordable to the targeted beneficiaries (Annex 7).

4.07 Beneficiary selection criteria. The final beneficiaries of subprojects will meet the following criteria that are specific to the proposed project:

(a) the target population being low-income households, their monthly income should not exceed Contos 60 (US$390) which corresponds to the median urban income as of mid-1984. This ceiling will be reviewed annually by the Bank, the Government, and INH to account for inflation;

(b) beneficiary will not already own another dwelling;

(c) housing units financed under the proposed loan will be used for residential purpose only; and

(d) for infrastructure subprojects, municipalities will have to demonstrate that at least 80% of the population in the area to be upgraded have incomes below the median urban income.

Legislation governing access to loans for social housing stipulates additional matters, including the level of interest subsidy (para. 2.24) which would apply under the project. Assurances were obtained at negotiations that selection criteria of final beneficiaries will be as above.

4.08 Bank Review and Approval. Subprojects will be financed on a first-come first-served basis. All subprojects with a total cost exceeding US$1.5 million will be reviewed and approved by the Bank prior to approval by INH to ascertain that all analysis has been properly performed and that the beneficiaries are within the target group. Subprojects with a total cost less than US$1.5 million will be reviewed by the Bank a posteriori on a sample basis, except for the first five subprojects which will be reviewed a priori. It is expected that about 10 subprojects p.a. will have to be reviewed by the Bank from mid-1985 to end-1987.

Mortgage Lending Component

4.09 As INH cannot extend mortgage loans to homeowners, a special agreement will be entered into between INH and the three specialized institutions whereby:

(i) the latter will commit themselves to grant mortgage loans to the final beneficiaries of subprojects financed by INH with funds from the US-AID Housing Guarantee Program (HGP) and the Bank; and

(ii) the financing of these mortgage loans will be done in part by consolidating HGP and Bank funds lent initially to developers through INH and repaid by them at the end of the construction period.

This scheme will establish the necessary linkage between upstream developer financing and downstream mortgage lending. It will ensure that all housing units financed under HGP and Bank loans will be refinanced by a mortgage institution, thus minimizing the marketing risk for the developers and allowing INH to satisfy itself that all final beneficiaries are both creditworthy and within the target group.

4.10 INH will enter into a sub-loan agreement with one of the specialized institutions each time an eligible dwelling is sold. The sub-loan maturity will be the number of years left on the Bank loan when the dwelling is completed (i.e. a maximum of 12 years). As a result, the specialized institutions will be responsible for financing the period remaining until maturity of the mortgage loans (up to 25 years). The interest rate will be the cost of Bank funds plus an exchange risk premium (that may be lower than that charged to INH para. 4.17), plus a commission of 0.25 point p.a. paid to INH by the specialized institutions. To ensure that mortgage loans are effectively provided, INH would repay the World Bank Loan (through the Treasury) if, within 12 months of the dwelling completion, no mortgage loan has been granted. To ensure rapid construction, hence lower costs, no consolidation of Bank funds will more than four years after subproject approval.

4.11 Assurances were obtained at negotiations that the content of the financing agreement will be as above. A draft agreement discussed with the Portuguese parties is shown in Annex 8. The signature of this agreement between INH, CGD, and one of the other two specialized institutions will be a condition of effectiveness of the proposed loan. The signature of the same agreement with the third specialized institution has been set at no later than February 28, 1986.

4.12 In the opinion of the specialized institutions, as long as the liquidity in the banking system continues to be high, an incentive mechanism will be a prerequisite to their utilization of the proposed Bank funds. To ensure their participation in the project, the specialized institutions will be granted a credit ceiling incentive whereby HGP and Bank funds will be deducted from their respective credit ceilings computed monthly by the central bank. A similar waiver has been granted by Banco de Portugal under recent Bank loans for agriculture and industry, and a KfW loan for municipalities. Assurances were obtained at negotiations that this arrangement has been approved by the central bank. No credit ceiling will be imposed on INH as it is a non-monetary financial institution.

Technical Assistance Component

4.13 Given its newness, INH is in need of technical assistance. US-AID has earmarked a US$600,000 grant for this purpose under its project . All INH staff are experienced in appraising social housing projects, but few are in appraising infrastructure and land development projects. The technical assistance program will aim at (i) strengthening INH's project appraisal procedures, and (ii) assisting INH in developing its own technical assistance to developers for preparing and executing projects. The mission ascertained that the program is satisfactory.

4.14 The technical assistance will take three forms:

(i) immediate short-term assistance: two consultants, one for institutional aspects and one for technical matters, spent eight man-weeks between November 1984 and April 1985 in INH, helping to set up its organization and procedures before the US-AID guaranteed loan is mobilized;

(ii) provision of a long-term resident advisor with an institutional management and housing finance background, to be attached to INH's presidency for three years; and

(iii) availability of financing for short-term consultancies, studies to satisfy specific institutional and program needs including improvement of development contracts and unfinished housing standards, and planning of in-house training for INH.

4.15 In addition, municipalities will tap the other source of technical assistance available, the Gabinet de Apoio Technico (GAT) which is a unit of the Ministry of Interior geared exclusively to assist municipalities. It has been operational since 1979 and has 51 branch offices in the country and 1,000 staff. Thus far, GATs have mostly been involved in designing infrastructure and housing projects, but are not staffed to implement or supervise projects.

C. Terms and Conditions

4.16 As INH is a new institution, the proposed Bank loan will be made to the Republic of Portugal. Terms and conditions will be those standard for Portugal: 15 years of maturity, including four years of grace, with fixed amortization schedule and variable interest rate. The Government will on-lend Bank funds to INH at the same maturity but at a different interest rate as described below. The conclusion of a subsidiary loan agreement between the Government and INH will be a condition of loan effectiveness.

4.17 INH will not bear the exchange risk on foreign currency resources as it is not equipped to manage the uncertainty of parity fluctuations. However, INH will be charged a flat exchange risk premium tailored to leave it with a three and a half percentage points spread over its foreign currency borrowings. This will thus leave INH with a fixed margin to cover its overheads and build up the reserves and provisions it needs in its early years of operations. Given its current lending rate of 31.5% p.a., INH will receive foreign funds at 28.0% p.a. US-AID has negotiated a similar arrangement for its HGP assistance. The proceeds of the proposed Bank loan to INH to finance infrastructure, land development, and housing development subprojects will all be on-lent at the current terms and conditions (paras. 2.22 and 2.26). Assurances were obtained at negotiations that the onlending arrangements for the Bank loan including terms and conditions will be as above.

D. Procurement and Disbursement

4.18 Procurement. The proposed loan will finance civil works (infrastructure and housing construction). For all contracts below US$1.5 million, the form of local competitive bidding specific to each type of developer and required by INH will apply (para. 3.13). For contracts above US$1.5 million, ICB will apply. However, it is expected that, on the basis of the pipeline of identified subprojects, local competitive bidding will prevail. The mission ascertained that INH staff have adequate experience in estimating local construction costs and evaluating bids.

4.19 Disbursement. The proposed Bank loan will be committed over a period of two and a half years (mid-1985 to end-1987). The final date for submission of subprojects to the Bank would be December 31, 1987. The estimated disbursement schedule (Annex 9) assumes full disbursement by the end of FY1990. Because it is a line of credit, the typical disbursement profile for traditional urban projects is not applicable. Yet, because only construction and civil works will be financed, it is 12 months shorter than the typical disbursement profile observed for DFC operations in the EMENA region. The pace of actual disbursements will be a function of INH's as yet unproven capacity to develop a sufficient volume of eligible lending. To allow for such delays, the closing date will be December 31, 1990. Disbursement on loans to developers will be made against statements of expenditures (SOE) submitted by INH through the Treasury. Disbursements will be limited to expenditures made less than one hundred and twenty days prior to the date on which the Bank has received the application for approval, if such expenditures were related to subprojects which would be reviewed a priori by the Bank (see para. 4.08).

4.20 Special Account. To avoid delays due to lengthy circuits and procedures for moving project funds to INH and then to promoters, a revolving fund of US$1.5 million will be established at the Treasury — the funds will correspond to about three months of expenditures and will be replenished against statements of expenditures — the details of processing and modalities for payments were discussed and agreed during negotiations.

4.21 Proceeds of the proposed loan for mortgage financing will be disbursed by INH through the Treasury and would cover 50% of INH's own disbursements on all sub-loans committed under the project. This is close to the actual foreign exchange component which was estimated at 48.6%, of which 11.1 points for interest during construction on foreign currency financing. It has been rounded to 50% as Portugal qualifies for the Special Action Program.

E. Monitoring

4.22 Audit. As INH has just completed its first fiscal year, an audit of its accounts was not available at the time of negotiations. Nevertheless, assurances were obtained at negotiations that INH's accounts for each fiscal year will be audited by an independent auditor satisfactory to the Bank and the audit report will be sent to the Bank within four months after the end of INH's fiscal year.

4.23 Subproject Appraisal Format. INH's appraisal reports for subprojects will document all eligibility criteria requirements described in paras. 4.06 and 4.07. For subprojects below the proposed free-limit of US$1.5 million IRR computations will not be mandatory. All reports translated into English will contain information on (i) the demand for social housing in the area, (ii) the creditworthiness of the target population and of the developer, (iii) the investment cost and execution time-table, and (iv) the procurement process. In the course of supervision, this appraisal format will be reviewed and up-dated as necessary.

4.24 Supervision. Basic monitoring and evaluation will be carried out through the quarterly reports and the project completion report to be prepared by INH. The project will require close supervision, both to pursue the sector dialogue with the authorities and to foster institution building. The supervision of the project will require about 35 man-weeks over the projected commitment period. The core team will include a financial analyst and an architect/engineer. Assurances were obtained at negotiations that review meetings between INH and Bank representatives will be held annually to assess the achievement of the project and to decide on corrective measures if warranted, including inter alia the updating of INH's financing plan.

V. PROJECT BENEFITS AND RISKS

Benefits

5.01 The proposed project will be the first urban project in Portugal. It will concretize a two and a half year long dialogue between the Bank and the Government that focussed on ways to improve the delivery of housing at standards affordable to families with below median incomes. Its major expected result will be the strengthening of INH, exclusively geared to financing social housing, that will be able to replicate projects by mobilizing its own resources on the domestic market (bonds) on the strength of its portfolio after a few years of operation. In the process, the project will support the Government's efforts to promote housing at affordable standards.

5.02 Although modest in scope, the project is expected to have an impact on the housing sector by promoting infrastructure investments, home ownership by low-income families, and stimulating the construction industry. It is expected that the project will cofinance the development of 900 serviced plots, the upgrading of 700 existing dwellings, and the construction of 4,000 new units. It is estimated that 45-60 jobs are created per US$1 million of investment in the construction sector alone and several times more in other sectors. Based on this conservative estimate, the project will generate directly up to 3,000 jobs during the construction period.

5.03 By the nature of its beneficiaries, a significant social impact on the urban poor will be achieved. The Bank project will benefit about 26,000 persons in the lower half of the urban income distribution. Furthermore, on the basis of the pipeline of subprojects reviewed, 40% of the beneficiaries will be among the urban poor whose income is below the urban poverty threshold estimated at US$200 per household per month in 1984. Through the allocations within subprojects (para. 4.06 (b)), at least 65% of finished dwelling and 50% of unfinished dwelling will be one- and two-bedrooms to ensure access to the low-income families. Since subprojects will be composed essentially of townhouses and 4-story walkup apartment buildings, the proposed project will promote population density in the current average and thus reasonable urban living standards. The Bank's financial assistance will also entail sensible economic allocation of funds. Economic rates of return computed for a sample of 26 subprojects submitted by INH cooperatives varied between 11.1% and

15.8%, and averaged 13.6%; similar figures for 21 subprojects submitted by municipalities were 11.9%, 15.8% and 14.1%. The sample was large enough to assume safely that similar subprojects in forthcoming years will yield comparable returns, well above the opportunity cost of capital (10%).

Risks

5.04 This project involves more risks than the standard sites and services project. The major risk is that the future effectiveness of INH remains uncertain and that the delicate institution-building efforts could be prolonged. This risk is, however, well worth taking and manageable through the technical assistance component, the Statement of General Policy, and project supervision. Moreover, since Bank funds will start to be onlent to large and experienced financial institutions after three years, the risk associated with INH is limited in time.

5.05 As INH is a new institution with a staff mostly familiar with financing traditional types of housing (i.e., walk-up apartments with all amenities), there is a risk that it will tend to finance subprojects in the highest price range allowed by the eligibility criteria. This risk, while acceptable if the beneficiaries are creditworthy, will be reduced by balancing the price eligibility criteria with technical criteria, imposing ceilings on the number of larger apartments in each subproject, and providing INH with technical assistance to improve its staff's capacity to deal with low-cost housing.

5.06 Another risk, associated with the pressure of demand resulting from a shortage of housing, is that higher income groups may obtain the shelter facilities targeted for lower income populations. This risk of shift in targeted beneficiaries will be considerably reduced as all subprojects will have to meet the beneficiary selection criteria at the time of INH financing.

VI. ASSURANCES AND RECOMMENDATIONS

6.01 The following documents were reviewed during negotiations:

(i) updated financing plan of INH (para. 3.15); and

(ii) updated project pipeline of INH (para. 4.03).

6.02 Assurances were obtained prior to negotiations that the Statement of General Policy has been adopted by INH's Installation Commission and its tutelage ministries (para. 3.10). This Statement includes all the dispositions spelled out in Annex 3.

6.03 Agreements were obtained on the following and recorded in the legal documents:

(i) the proceeds of the loan would be used to finance subprojects as defined in para. 4.05 (Loan Agreement) and procured as described in para. 4.18 (Project Agreement);

(ii) subproject eligibility criteria would be as defined in para. 4.06 (Project Agreement);

(iii) the final beneficiary selection criteria would be as described in para. 4.07 (Project Agreement);

(iv) the credit ceilings in favor of the specialized institutions using Bank funds would be reformulated (para. 4.12) (Loan Agreement);

(v) the on-lending arrangements for Bank funds would be as in para. 4.16 and 4.17 (Loan Agreement);

(vi) undertstanding was reached on the financing plan for the projected resource gap (para. 3.19);

(vii) the coverage of INH's foreign exchange risk would be as proposed in para. 4.17 including a minimum spread on foreign resources of three and a half points (Loan Agreement);

(viii) INH's maximum debt-equity ratio and minimum debt-service ratio would be 4.0:1 and 1.15:1 respectively (Project Agreement); INH's spread on borrowed resources would be at 3.5 points (para. 3.30) (Project Agreement);

(iv) the content of the on-lending agreement between INH and the specialized institutions would be as described in para. 4.10;

(x) INH's annual accounts will be audited by an independent auditor satisfactory to the Bank (para. 4.22) (Project Agreement); and

(xi) a review meeting between INH and Bank representatives be held annually to assess the achievement of the project and to decide on corrective measures if warranted (including inter alia updating INH financing plan) (paras. 3.19 and 4.24) (Project Agreement).

6.04 Prior to loan effectiveness:

(i) the on-lending agreement between Government and INH for Bank funds would be signed (para. 4.17);

(ii) the financing agreement between INH, CGP and either CPP or Montepio Geral-CEL would have been signed (para. 4.11); and

(iii) INH's definitive organization structure will be approved and INH's Board members will be appointed by the Government, and INH will appoint its department directors and its division chiefs.

6.05 Subject to Government's assurances on the above, the project is suitable for a loan of US$25 million.

ANNEX 1

PORTUGAL - HOUSING FINANCE PROJECT

Social Housing Legislation Enacted Since 1983 (Updated - May 1985)

GENERAL LEGISLATION

- Establishment of INH: Decreto-lei No. 177/84 dated May 25, 1984.
- Social Housing: Technical Instructions dated July 1984
- Unfinished Housing: Legal definition: Portaria No.1/84 dated 01/02/1984
- Illegal Housing admitted for Upgrading: Portaria No.283/84 dated 04/17/84
- Development Contract: Draft prepared by G.E.P. and dated September 1984.

PREFINANCING: New Figures and Standards

- Municipalities: (For sale) Decreto-Lei No.220/83 and Portaria No.609/83 dated 05/26/83. (For rent) Decreto-Lei No.110/85 and Portaria No.211/85 dated 04/17/85.
- Cooperatives: Decreto-lei No.349/83 dated 07/30/83, alteration of Decreto-lei No.246/82.
- Ceiling Prices: Portaria No.580/83 dated 05/17/83, alterated by Portaria No.113/85, dated 02/21/85.
- Development Contract: Ceiling prices fixed by Portaria No. 120/84 dated February 23, 1984.
- Upgrading (PRID): Decreto-lei 449/83 dated 12/26/83 and Portaria 1077/83 dated 12/31/1983. Despacho No.4/SEHU/85 dated 02/04/85.
- Infrastructure: Cooperatives: Portaria 1067/83 dated 12/28/83 Municipalities: Decrete-lei 6/84 dated 01/05/84, and Portaria 987-A/84 dated 12/28/84.

INTEREST SUBSIDY

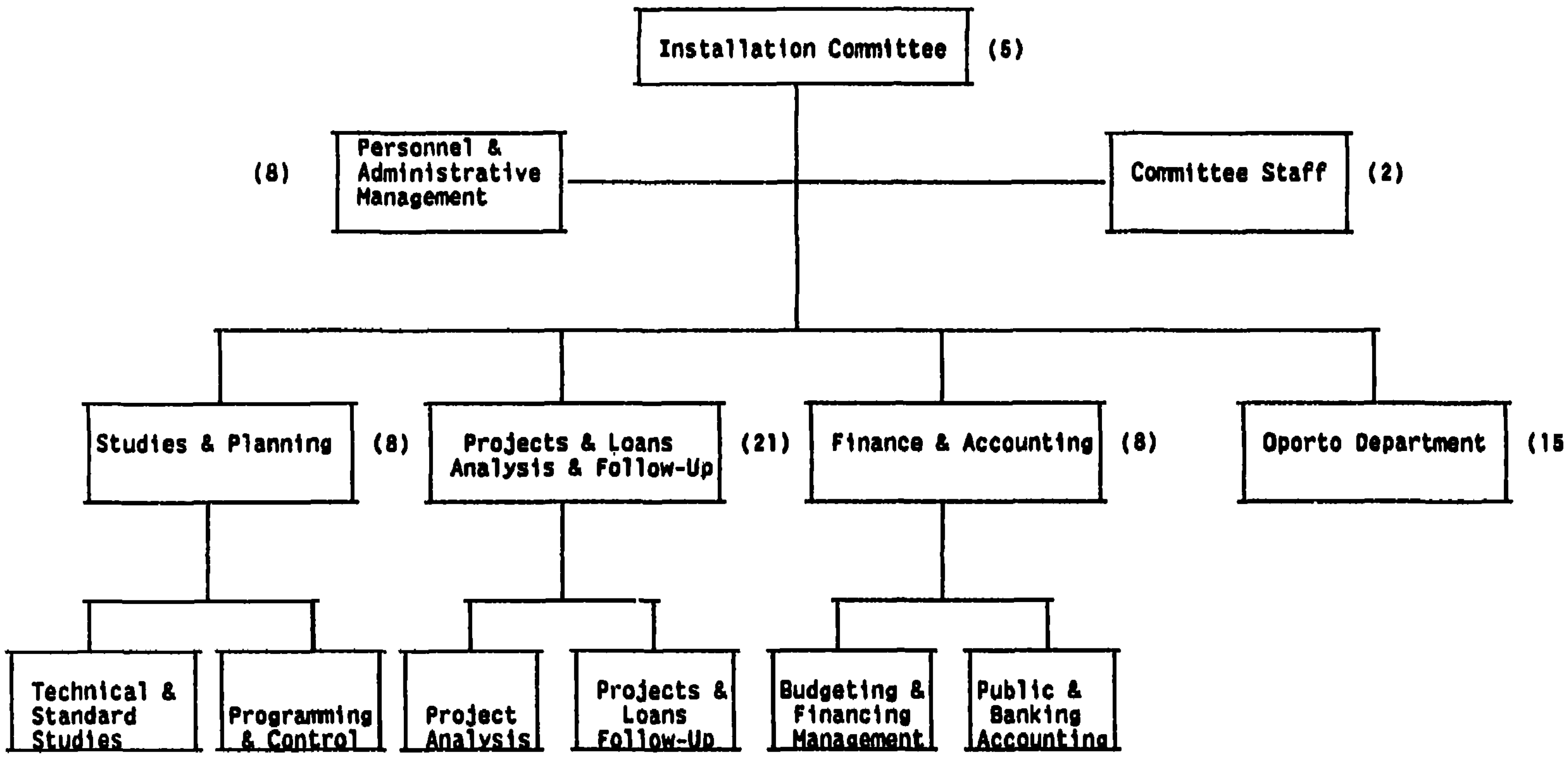
Decision of the council of State No.44/84 dated Sept.1984.

MORTGAGE FINANCING: Self construction, extension, upgrading and acquisition of the family house.

- Decreto-lei No.459/83 and 460/83 dated Dec. 30, 1983.
- Portaria No. 5/84 dated Jan. 04, 1984, and altered by Portaria No.124/85 dated 03/02/85.
- Decreto-lei No.244/84 and Portaria No.467/84 dated July 17, 1984.
- Decision of the Council of State No.20/85 dated 05/09/85 for improvement of housing finance for young households and students.

Figure 1: PORTUGAL - HOUSING FINANCE PROJECT

INH ORGANIZATION CHART



In parenthesis number of professional staff as of May 1985.

PORTUGAL

HOUSING FINANCE PROJECT

INSTITUTO NACIONAL DE HABITACAO (INH)

Statement of General and Operational Policies

1. INH is a public institution, with legal statutes and financial autonomy, established by the Decree-Law No. 177/84.

2. Objectives and Areas of Activity. INH's objectives, as indicated by its Decree-Law, are:

(a) Study the housing situation in order to formulate proposals for political, legislative and regulatory measures;

(b) Prepare a National Housing Plan and the annual and multi-annual plans of investment in the sector;

(c) Coordinate and prepare the financial policy measures of the sector and participate in the financing of social housing programs promoted by the public sector, cooperative and private sector;

(d) Supervise both the execution of policy measures and the housing programs in accordance with the approved norms and plans, and provide technical support to the above mentioned developers.

3. Eligible Projects. INH evaluates projects for financing or guarantee on the basis of their socio-economic merits, and of their technical and financial viability according to quantitative eligibility criteria stipulated by Decree.

4. Terms of Lending. Because INH's intervention is limited to the construction phase of projects, the maturity of its loans will be normally 3 years with a balloon repayment of principal. Maximum loan-to-value ratios will be set, not in excess of 90%. The interest rate will be the official rate set by the authorities. INH will physically inspect projects under execution and disburse its loans according to progress of construction.

5. Financial Policy. INH will aim at earning a stable positive spread of at least 3.5 points between the return on its average outstanding loan portfolio and the cost of its average debt. This will enable INH to set aside a provision for risk on its portfolio to be equal to 2% of its outstanding portfolio at the end of each fiscal year. During its first five years of activity, INH's total outstanding debt will not exceed four times its net

worth. Prudent financial management will dictate meeting a minimum debt-service ratio of 1.15:1. These two ratios could be relaxed in the light of experience with the prior agreement of INH's major lenders. INH will not bear the exchange risk associated with its foreign currency resources. In compensation for this, INH will pay an exchange risk premium to the authority which will bear this risk, in an amount to be determined a priori, from time to time, in consultation with the Ministry of Finance.

6. Management. The Board of Directors will examine and approve all financial commitments in accordance with the policies and regulations established by the authorities. The Board will review and approve the business plan during the fourth quarter of the fiscal year. The Board is responsible for the day-to-day operations of INH. INH will prepare an annual business plan, incorporating projected levels of activity, revenues and expenses. This plan will include alternative activity projections for the planning period (at least three years), and an analysis of the impact of the alternative scenarios on INH's assets, liabilities, and return to allow the Board to decide on the most realistic alternative for INH. The Board will ensure that the activities of INH are carried out in a responsible and professional manner.

7. Conflicts of Interest. INH will not participate, directly or indirectly, in any transaction with any directors, officers, or employees of INH which could involve a real or apparent conflict of interest between INH and these individuals or other entities with which they have a significant business relationship, unless such transaction has been approved by a formal and recorded decision of the Board of Directors.

8. Internal Organization. INH will aim at developing an efficient, effective and balanced internal organization suitable to the attainment of its objectives. INH will recruit and develop a highly qualified staff, for whose services appropriate compensation will be provided.

9. Reporting Requirements. The Board of Directors will furnish, at their request, its major lenders quarterly operating reports. These reports will include appropriate narrative and statistical information on activity conducted and financial statements, as well as variances from the annual business plan of INH. INH will provide its major lenders independently audited annual financial statements within four months after the end of the fiscal year. The auditors will also provide a detailed management letter covering, inter alia, accounting systems, compliance with internal guidelines and external regulations, and any other relevant matters they will deem materially affecting the financial position of INH.

10. Revision of Statement. Any proposal to modify this Statement of General and Operational Policies will be considered by the Board only after each member and, as may be required by specific agreements with the lenders, each major lender has been given adequate opportunity to study and comment on the proposal.

PORTUGAL

HOUSING FINANCE PROJECT

Table 1: PROJECTED COMMITMENT OF INH LENDING PROGRAM

Housing Units

Promoter	1983		1984		1985		1986		1987		Total (1985-87)	
	Total	Eligible	Total	Eligible	Total	Eligible	Total	Eligible	Total	Eligible	Total	Eligible
Municipalities	50		386		824	618	1,700	1,250	2,500	2,000	5,024	3,868
Cooperatives			2,241		4,840	2,052	4,700	3,200	3,500	2,500	13,040	7,752
Develop. Contract							800	750	1,200	1,000	2,000	1,750
Units	50	-	2,627		5,664	2,670	7,200	5,200	7,200	5,500	20,064	13,370
Upgrading			1,000		1,000	1,000	2,000	2,000	2,000	2,000	5,000	5,000
Infrastructure			1,000		1,000	1,000	2,000	2,000	3,000	3,000	6,000	6,000
Land Acquisition							1,000		1,500	-	2,500	-
TOTAL	50	-	4,627		7,664	4,670	12,200	9,200	13,700	10,500	33,564	24,370

PORTUGAL

HOUSING FINANCE PROJECT

Table 2: HOUSING UNITS BUILT ANNUALLY IN PORTUGAL 1/

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Private Sector														
Individual (built and occupied by owners)	10.270	13.096	13.711	16.434	13.930	14.274	15.214	16.567	19.105	18.526	18.441	21.383	21.702	19.792
For Rent	11.150	16.540	18.460	17.300	21.540	6.350	3.060	2.220	1.150	650	100	-	-	1
For Sale (by developers)	*	2.630	2.955	3.164	5.087	8.460	8.900	9.100	9.600	10.800	12.100	10.090	9.983	10.482
Cooperatives	*	143	295	233	253	222	227	167	77	330	530	361	590	749
Sub-Total	*	32.409	35.421	37.131	40.810	29.306	27.401	28.054	29.936	30.306	31.171	31.834	32.275	31.024
Public Sector	*	3.596	5.190	4.792	2.592	2.661	1.889	5.794	4.114	4.933	5.640	5.468	6.004	5.480
Total	28.140	36.005	40.611	41.923	43.402	31.967	29.290	33.848	33.050	35.239	36.811	37.302	38.279	36.504
No. of Units/House							*	1.71	1.69	1.72	1.74	1.98		
Gross area/unit (sq.m.)							*	121.0	126.0	131.2	135.3	131.2	130.8	139.5
Net area/unit (sq.m.)							*	65.3	61.4	61.4	65.1	65.8	67.0	68.3
No. Bedrooms/unit							*	3.8	3.9	3.9	3.9	3.8	3.8	3.8

* Figures are not available.

1/ Formal sector only.

PORTUGAL

HOUSING FINANCE PROJECT

Major Assumptions Underlying INH Projections

1. Loans commitments are as discussed with INH staff minus a 10% drop-out rate. Disbursements follow the industry pattern: 30% in year 1, 40% in year 2, and 30% in year 3.

2. Domestic inflation is assumed at 25% p.a. and the depreciation of the Escudo vis-à-vis the dollar is at 18% p.a.

3. Interest rate received on deposit is 26% p.a. "Personnel expenses" grow by 5% p.a. due to hiring plus 25% p.a. for cost-of-living and "other administrative expenses" grow by 25% p.a. "Provisions for exchange risk" in the Income Statement is associated with the 1984 interest payments on the National Westminster Bank loan. State contribution to equity for 1985 to 1987 is assumed to be 3.5 million contos p.a. "Cash" and "short-term borrowings" are used for balancing the balance sheet. "Local borrowings" are not yet identified while " other foreign borrowings represent a loan from the Fonds de Rétablissement of the European Council.

4. Projections have been developed on micro-computer using the spreadsheet software Lotus 1-2-3.

PORTUGAL

HOUSING FINANCE PROJECT

Table 1: ACTUAL AND PROJECTED LENDING OPERATIONS
(1983-1987, in US$ million)

	1983 (actual)	1984	1985	1986	1987
INH Total Lending Program	0.54	28.21	63.99	83.26	87.35
of which Onlending to Specialized Institutions	0.00	0.00	0.00	0.00	2.75
US-AID and IBRD Eligible Program					
Municipalities	0.00	0.00	6.93	14.26	23.20
Cooperatives	0.00	0.00	23.30	36.95	29.36
Development Contract	0.00	0.00	0.00	8.62	11.69
Infrastructure upgrading	0.00	0.00	0.46	1.06	1.08
Sub-total Eligible Program	0.00	0.00	30.69	60.89	65.33
INH Total Disbursements:	0.00	7.91	27.73	53.44	73.12
of which Eligible Disbursements:	0.00	0.00	8.39	27.80	50.87

Table 2: ACTUAL AND PROJECTED INCOME STATEMENTS
(1983-1987, in US$ million)

	1983 (Actual)	1984 (Preliminary)	1985	1986	1987
INCOME					
Interests on deposits (26%)	7.05	8.51	5.32	6.97	6.43
Interests on loans (31.5%)	0.00	1.25	6.90	19.77	38.09
(of which interest subsidy)	0.00	0.42	2.29	6.56	12.63
Other Incomes	0.00	0.10	0.11	0.12	0.14
Gross Income	7.05	9.86	12.33	26.87	44.66
EXPENSES					
Interests on borrowings	3.85	3.85	11.71	18.06	19.67
Personnel expenses	0.05	0.12	0.12	0.15	0.20
Other administrative expenses	0.02	0.13	0.16	0.20	0.25
Provisions for portfolio risks	0.00	0.08	0.46	1.25	1.30
Provisions for exchange risks	1.09	4.55	0.00	0.00	0.00
Total Expenses	5.01	8.73	12.44	19.65	21.42
NET INCOME	2.04	1.13	-0.11	7.21	23.23

PORTUGAL

HOUSING FINANCE PROJECT

Table 3: ACTUAL AND PROJECTED BALANCE SHEETS
(1983-1987, in US$ million)

	1983 (actual)	1984 (preliminary)	1985	1986	1987
ASSETS					
Current Assets					
Cash	0.00	27.14	50.87	11.80	0.00
Sight deposits	44.96	22.48	19.86	35.92	15.54
Term deposits	0.42	0.21	0.00	0.00	0.00
Total deposits	45.38	22.69	19.86	35.92	15.54
Current maturities of loans	0.00	0.00	0.01	7.92	27.53
Interest receivables	7.05	9.08	8.45	15.96	23.75
Total current assets	52.43	58.90	79.19	71.61	66.82
Loan Portfolio					
Loans outstanding	0.00	7.91	35.64	89.07	154.26
Less: Current maturities	0.00	0.00	0.01	7.92	27.53
Total net portfolio	0.00	7.91	35.63	81.15	126.73
Loans to specialized inst.	0.00	0.00	0.00	0.00	2.75
Deferred exchange risk West. Bank	0.00	4.96	0.00	0.00	0.00
Fixed assets (net)	0.00	0.05	0.10	0.15	0.20
TOTAL ASSETS	52.43	71.81	114.92	152.91	196.50
LIABILITIES					
Current Liabilities					
Current maturities of LT debts	0.00	0.00	0.00	0.50	1.00
Interest payables	1.73	1.73	5.27	8.13	8.85
Short-term borrowings	4.65	0.00	0.00	0.00	3.58
Provisions for exchange risks	1.09	4.55	0.00	0.00	0.00
Total Current Liabilities	7.47	6.28	5.27	8.63	13.44
Long-Term Debts					
National Westminster Bank	27.53	27.53	27.53	27.53	27.53
US-AID guaranteed loan	0.00	0.00	4.00	13.00	23.00
I.B.R.D.	0.00	0.00	1.50	5.00	13.00
Other foreign borrowings	0.00	0.00	18.78	18.78	18.78
Total for currency loans	27.53	27.53	51.81	64.31	82.31
Local borrowings	0.00	0.00	5.00	10.00	15.00
Total long-term debts	27.53	27.53	56.81	74.31	97.31
Less: Current maturities	0.00	0.00	0.00	0.50	1.00
Total Net Long-term Debts	27.53	27.53	56.81	73.81	96.31
Equity					
State contribution to equity	15.38	28.42	47.76	64.14	78.03
Provisions for portfolio risks	0.00	0.08	0.53	1.78	3.09
Provisions for exchange risks	0.00	4.96	0.00	0.00	0.00
Retained earnings	2.04	4.55	4.55	4.55	5.64
Total Equity	17.43	38.00	52.84	70.47	86.75
TOTAL LIABILITIES AND EQUITY	52.43	71.81	114.92	152.91	196.50

PORTUGAL

HOUSING FINANCE PROJECT

Table 4: ACTUAL AND PROJECTED SOURCES AND APPLICATIONS OF FUNDS
(1983-1987, in US$ million)

	1983 (actual)	1984 (preliminary)	1985	1986	1987
SOURCES					
Retained earnings	2.04	1.13	-0.11	7.21	23.23
Provisions for portfolio risks	0.00	0.08	0.46	1.25	1.30
Provisions for exchange risks	1.09	4.55	0.00	0.00	0.00
Total cash flow generation	3.13	5.76	0.35	8.46	24.54
Short-term debts	4.65	0.00	0.00	0.00	3.58
Current liabilities (increase)	1.73	1.73	5.27	8.63	9.85
Total short-term liabilities	6.38	1.73	5.27	8.63	13.44
Current assets (decrease)	0.00	0.00	0.00	7.58	4.79
Long-term debts					
National Westminster Bank	27.53	0.00	0.00	0.00	0.00
US-AID guaranteed loans	0.00	0.00	4.00	9.00	10.00
I.B.R.D.	0.00	0.00	1.50	3.50	8.00
Other foreign borrowings	0.00	0.00	18.78	0.00	0.00
Local borrowings	0.00	0.00	5.00	5.00	5.00
Total long-term debts	27.53	0.00	29.28	17.50	23.00
Loan collection (principal)	0.00	0.00	0.00	0.01	7.92
Equity (increase)	15.38	13.04	19.34	16.39	13.89
Others (exch. risk provision)	0.00	4.96	-4.96	0.00	0.00
TOTAL SOURCES	52.43	25.48	49.28	58.56	87.58
APPLICATIONS					
Loan disbursements	0.00	7.91	27.73	53.44	73.12
L.T. debt service (principal)	0.00	0.00	0.00	0.50	1.00
Cash (increase)	45.38	0.00	0.00	16.07	0.00
Current assets (increase)	7.05	2.03	-0.62	7.51	7.79
Current liabilities (decrease)	0.00	4.65	0.00	0.00	0.00
Treasury liab. (def. exch. risk)	0.00	4.96	-4.96	0.00	0.00
Fixed assets	0.00	0.05	0.05	0.05	0.05
Loan to specialized inst.	0.00	0.00	0.00	0.00	2.75
TOTAL APPLICATIONS	52.43	19.59	22.21	77.56	84.70
Financing needs (disb. basis)	0.00	0.00	0.00	19.00	0.00
Financing surplus (disb. basis)	0.00	5.89	27.07	0.00	2.88

PORTUGAL

HOUSING FINANCE PROJECT

Table 5: INH PROJECT FINANCING PLAN 1984-1987
(in US$ million)

	On Commitment Basis	On Disbursement Basis
Total project financing	262.81	162.20
Resource surplus at end 1984	45.38	45.38
Total financing needs	217.43	116.82
Resources Identified		
Net cash flow generation	39.10	39.10
Loan collection net of debt-service	3.68	3.68
Equity increase	62.65	62.65
US-AID authorized loan	25.00	23.00
I.B.R.D. proposed loan	25.00	13.00
Other foreign loans	18.78	18.78
US-AID approved loan	25.00	0.00
Total identified resources	199.21	160.21
Financing gap (-) or surplus (+)	18.22	-43.39

PORTUGAL

HOUSING FINANCE PROJECT

Table 6: PROJECTED PERFORMANCE INDICATORS (1984-1987)

	1984	1985	1986	1987
Operational Indicators				
Gross income/average total assets (1)	15.87	13.20	20.06	25.56
Administrative costs/average assets	0.53	0.78	1.19	1.00
Financial expen./average assets (2)	13.52	12.54	13.48	11.26
Loan income/average loan portfolio (3)	31.50	31.68	31.71	31.30
Cost L.T. debt/average L.T. debt (4)	30.52	27.76	27.54	22.93
Spread (3)-(4)	0.98	3.91	4.17	8.38
Margin (1)-(2)	2.34	0.66	6.58	14.30
Profitability Indicators				
Net income/average equity	4.47	-0.26	11.70	29.56
Net income/average assets	1.82	-0.12	5.39	13.30
Financial Structure Indicators				
Debt-equity ratio	0.83	1.08	1.05	1.12
Debt-service coverage (principal & inter.)	0.15	0.59	1.07	2.23
Debt-service coverage (principal only)	-	-	0.02	7.92

PORTUGAL - HOUSING FINANCE PROJECT

SUBPROJECT ELIGIBILITY CRITERIA

Housing Unit Types	Technical	Characteristics Land Use	Price [a/]	
I. DEVELOPED PLOTS				
1. Individual Plots	Secondary roads and utilities (Sewerage, drainage, water, electricity). Public lighting and car parks. Individual water, sewerage and electricity connections.	65% of land [(a/)] should be for residential use. Plot size: 120 sq.m. maximum. number of plots = 55/ha minimum.	Infrastructure only = 300 c/plot. Serviced land = 540 c/plot, or 4.5 c/net sq.m. [(c/)]	
2. Multi Storey Houses	Secondary roads and utilities up to the entrance of the houses. Public lighting and car parks (connections not included)	Maximum 40% of land [(a/)] should be for roads and utilities. Number of housing units = 75/ha minimum	Infrastructure only = 2 c/sq.m. or 270 c/unit. Serviced land = 3.4 c/sqm. or 450 c/unit.	
II. UPGRADING OF EXISTING HOUSES				
	To upgrade individual houses and multi-story buildings (inside and outside); to create new service connections (heating central units, water supply, sewerage, electricity) in ancient apartment buildings and individual houses.	No change in existing land use.	No limited costs for land-lords (private or Municipalities) Loans = 500 c/unit	
III. HOUSING UNITS				COMPOSITION OF ELIGIBLE SUBPROJECTS (see technical recommendations published February 14, 1985)
1. One or more multi-storey houses.	Unfinished houses = 1 living room. Area for 1 to 4 bedrooms 1 kitchen, 1 wetroom with shower, water, sewerage and electricity connections.	Built up areas (sp) for multistorey houses: T1 = 1 BR = 65s.qm. T2 = 2 BR = 85 s.qm. T3 = 3 BR = 100 s.qm. T4 = 4 BR = 114 s.qm.	Building 17.6 c/sq.m. total cost = 85% of costs for completed house (see below).	Unifinished houses. Number of T1 = 8% of total units Number of T4 = 5% " " " Less than 50% of T3 and T4 Median unit/subproject = T 2.5 of 92 sq.m.
	Completed houses = 1 living room. 1 to 3 bedrooms, 1 kitchen, 1 bathroom. All rooms complete with furnishing. All service connections.	Built-up areas (sp) for individual houses: 95% of the above areas	Building Costs = 22c/s.qm. Total Cost = T1 = 2000 c T2 = 2650 c T3 = 3100 c T4 = 3500 c	Completed Houses. Number of T1 = 10% of total units Maximum unit = 3T (except for special cases Less than 35% of T3/T4 Median unit/subproject = T 2.3 of 90 sq. m.

Note: Cost of land is taken into account for its actual value.
a) Maximum cost or selling prices in CONTOS (1985 value).
b) Land: urbanized land except land for community facilities and primary infrastructure.
c) net sq.m. = saleable land for individual plot.

PORTUGAL

HOUSING FINANCE PROJECT

AFFORDABILITY TEST
(in mid-1984 Contos = US$6.50)

Monthly Family Income	Relation with Income Distribution	Category of Borrowers 1/	Affordable House Price with a Debt/service Ratio of 33% if Downpayment = 5%	10%	Maximum Size of Affordable Housing if Downpayment = 5%	10%
27.1	10%	A1	1,657	1,749	unfinished 1 br.2/	finished 1 br.
39.2	20%	A1	2,397	2,530	finished 2 br.	finished 2 br. or unfinished 3 br.
44.6	30%	A1	2,727	2,879	finished 2 br. or unfinished 4 br.	finished 3 br. or unfinished 4 br.
53.2	40%	A2	2,305	2,433	unfinished 2 br.	finished 2 br. or unfinished 3 br.
59.5	50%	A2	2,578	2,721	unfinished 3 br.	unfinished 4 br.

1/ See Annex 1.

2/ br. = bedroom

PORTUGAL

FINANCE HOUSING PROJECT

Draft Sub-Loan Agreement for Consolidation World Bank Funds Into Mortgage Loans

Transfer of Funds

1. INH would make available World Bank funds as a loan to the three specialized institutions (SI) - i.e. Caixa Geral de Depósitos, Crédito Predial Português and Montepio Gera - Caixa Económica de Lisboa - when the house and/or plot is sold to the beneficiary. If within twelve months of the house and/or plot completion, no mortgage has been granted by any SI, the funds will be repaid by INH to the World Bank in anticipation to the agreed amortization schedule.

2. To ensure rapid constructon, hence lower costs, no transfer of World Bank funds will be allowed more than four years after a construction program has been approved for commitment under the proposed World Bank loan.

Eligibility of Beneficiaries

3. The list of beneficiaries of a construction program is proposed by its promoter with an additional 5% of standby beneficiaries to take into account possible defaults and rejections by SI.

4. The beneficiary's income must be lower than the medain of urban income observed or estimated from time to time.

5. The beneficiary must be deemed creditworthy by the SI which will take the credit risk in granting the mortgage loan.

Cost of Transferred Funds

6. INH will lend World Bank funds to SI's at its cost (e.g. World Bank interest rate plus an exchange risk premium to be agreed between INH and the Treasury) plus a 0.25 point commission on average outstanding amounts to cover INH's costs for administering the sub-loan.

7. Neither INH nor the SI's will bear an exchange risk beyond the premium to be stipulated in this Agreement.

Debt Servicing

8. World Bank funds will be repaid to INH according to the amortization schedule set forth in the proposed Loan Agreement (e.g. in 24 installments starting year 4 after the loan signature until year 15).

9. The SI will take full responsibility for arrears in interest or principal occurred on its mortgage loans, and for any financing implication of schemes where repayment of a portion of interest or/and principal is postponed to later years of the mortgage maturity.

Cofinancing by SI's

10. The SI's will provide their own financing to complement World Bank funds because (i) they may only contribute 50% of INH's financing of construction costs, and (ii) maturity (between 9 and 12 years) on their loans is shorter than the average mortgage loan (e.g. 25 years).

11. To ensure that INH's financing of low-cost housing is followed up with mortgage loans to low-income beneficiaries, Banco de Portugal has waived the SI's credit ceilings for such funds.

ANNEX 9

PORTUGAL

HOUSING FINANCE PROJECT

Estimated Disbursement Schedule

Semester Ending On	(FY)	Disbursement during period (US$ million)	Cumulative Disbursement (US$ million)	Cumulative Percentage
December 31, 1985	(86)	1.5	1.5	6.0
June 30, 1986	(86)	1.0	2.5	10.0
December 31, 1986	(87)	2.5	5.0	20.0
June 30, 1987	(87)	4.0	9.0	36.0
December 31, 1987	(88)	4.0	13.0	52.0
June 30, 1988	(88)	5.0	18.0	72.0
December 31, 1988	(89)	3.0	21.0	84.0
June 30, 1989	(89)	2.0	23.0	92.0
December 31, 1989	(90)	1.0	24.0	96.0
June 30, 1990	(90)	1.0	25.0	100.0

PORTUGAL

HOUSING FINANCE PROJECT

Inventory of Project Background Documents
(Data and Details Available in the Project File)

1. The Project

1.1 Public Strategies for housing in Portugal - PADCO - June 1979.

1.2 (a) An evaluation of AID shelter program in Portugal - USAID July 1983.
(b) Preliminary proposal for AID support of a low-cost housing program in Portugal - John Miller, Consultant, USAID - Jul.1983.

1.3 Premier Projet Urbain au Portugal - M. Chretien, Consultant

(a) Le secteur du financement de l'habitat - Oct. 1982.
(b) Mission de preparation - Jan. 1984.

1.4 Aspects techniques relatifs aux problèmes urbains et au logement social - C. Hovnanian, Consultant.

(a) Rapport préliminaire - Sept. 1982.
(b) Rapport de mission technique - Feb. 1983.
(c) Rapport complémentaire et annexes - Dec. 1983.

1.5 GEP/MES - (Gabinete de Estudos e Planamento) - (Ministerio do Equipamento Social).

(a) Programmaçào preliminar no dominio da habitaçào social - May 1983.
(b) Proposta de programa de medio prazo para o sector habitaçào 1983/86.
(c) Programmaçào para o emprestimo garantido pela - USAID - 1983.

1.6 Housing program Agreement between the Government of Portugal and the U.S.A. for low cost housing, USAID Draft - Nov. 20, 1984.

1.7 World Bank Housing Finance Project - Jan. 1984.

(a) FAIH/INH - Lending program - 1983.
(b) INH Project commitment of eligible lending program - 1984/87.
(c) Social housing program - Economic rate of return.

1.8 Rental system for housing purposes - Council of Ministers - Draft bill approved - June 19, 1984

1.9 Banco de Portugal - Letter No. 8223/Doc. dated December 6, 1984.

1.10 Pipeline of subprojects potentially eligible for W.B. financing GEP - April 1985.

1.11 Empréstimos aprovados por proposta do INH em contratados com o INH. Desde o inicio até 30. IV 1985. INH. May 1985.

2. Housing Finance in Portugal

2.1 GEP/MES

(a) Distriuiçào das familias per escalaòs de rendimento - Dec. 1980.
(b) O Credito bonificaçao a aquisaçào de casa propria en 1978 - Analisa economica e sociologica.
(c) Analise de sensibilidado de alternatives de programmaçào financeira para programmas de habitaçào social 1984/88 May 1984.

2.2 FAIH - Relatorio de Actividas 1983. Planeamento financeiro - 1984/86.

2.3 Banco de Portugal - Relatorio de conselho de Administraçào 1983.

2.4 Caixa Geral de Depositos - Relatorio e Contos 1981-1982-1983.

2.5 Credito Predia Portuguese.

(a) Relatorio e contos 1981-1982.
(b) Relatorio de prospeccào immobiliare 1983.

2.6 Secretario Estado do Planeamento - Portuguese economic - Situation in 1981.

2.7 Recomendacaes Técnicas para Habitaçao Social - Diario da Republica - II. Serie Numero 38. February 14, 1985.

3. General Background Information

3.1 GEP/MES

(a) Monografio sabvre a previsào ed a programmaçào de habitaçao Portugal Dec. 1977.
(b) Housing development fund program - Legislation - May 1978.
(c) Contratos de desenvolvimento para a habitaçào - June 1975.
(d) Situaçào da construçào clandestino March 1978.
(e) O Situaçào recente no domino da saneamento basico - Apr. 1978.
(f) Breve analise aos apuramentos preliminares do censo de 1981 June 1981.

(g) Relatorio estatistico 1981.
(h) Estudos de conjontura - From Jan. 1981 through Jan. 1984.
(i) Caracterizição sumaria dos sectores da construção e de habitação June 1982.

3.2 Instituto de Estudos para o desenvolvimento.

(a) Rendimento e riqueza desiguais 1980.
(b) Envelhecimento do stock construida da cidade de Lisboa 1982.

3.3 FFH (Fundo de Fomento de Habitação).
(a) Some aspects on housing in Portugal - June 1977
(b) Instruçàos para projetos de habitação promovida pelo Estato 1978
(c) Loi des sols - June 1978
(d) Housing cooperatives in Portugal - Feb. 1979

3.4 OECD (Organization of European Cooperation and Development)

Urban growth in Mediterranean countries - Portugal Nov. 1978.

3.5 EEC (European Economic Community)

(a) Tendances et politiques actuelles dans le domaine de l'habitation et de la planification - Portugal 1980.
(b) Logements sous équipés dans les villes - Portugal 1980.

3.6 Cooperação Luso - Suica

Monographia base sobre a situação de habitação em Portugal 1980.

3.7 Plano integrado di Almada - Monte de Caparica.

3.8 Cidade de Porto - Una experencia de renovação urbana - Ribeira Barreido - 1980.

3.9 Alto de Lumiar - Lisboa - Recuperação des areas degradades 1982.

4. Procurement

4.1 MES/MHOPT - Licencas de obras - Legislação 1975.

4.2 GEP/MES - Revisto do preços de empreitados - Jan. 1979.

4.3 Mission interministérielle de la qualité de l'habitat France - Architecture et commande publique au Portugal 1983.