

Project Name Iran, Islamic Republic of-Low Income Housing

Region Middle East and North Africa Region

Sector Urban Housing

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Implementing Agency (MOHUD)
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1. Country and Sector Background

The current 3rd Five Year Development Plan (1999/0-2003/4) has given a prominent role to the housing sector. It aims at poverty alleviation based on empowerment through employment creation, education and health and a more efficient and targeted social safety net for the poor. The plan targets a reduction of poverty headcount from 15% to 7%, and includes an ambitious generation of 765,000 jobs annually. The housing sector, as a labor-intensive activity with extensive linkages with other sectors and as a major user of intermediate materials is ideally placed for assuming such role. Indeed, in the present context of high unemployment (13.8% by the end of 2001), coupled with the need to create jobs for the baby boom generation, housing has the potential to become one of the key engines of growth for the Iranian economy. Thus, meeting the demand for housing can help address the current unemployment problem in Iran and may have a significant role to play in creating job opportunities for the young and the unskilled and in contributing towards the reduction of regional social imbalances. However, the high degree of centralized planning, the institutional and regulatory environment of directed credit and the significant involvement of the public sector in the supply of housing has resulted in an underdeveloped housing finance sector and in a weakened local capacity to effectively manage the fast urbanization taking place in Iran. Significant progress has been made and a series of structural reforms have been undertaken mainly after the fall of oil prices in 1995/6, some of which concerned the housing sector. These include the modification of the subsidies and tax incentives schemes and the gradual reduction of the government's role in the direct supply of housing. In order to meet the steep employment targets set, the current plan further commits the government to a series of fiscal and structural reforms and sets challenging housing targets by 2003/4. The 3rd Housing Development Plan envisages a total of about 142,060 million Rials (in 1999/0 prices) of government and private investment in housing during the period 1999/0-2003/4. It sets out four strategic objectives to be accomplished by 2003/4: (i) to increase the flow of long term domestic and foreign resources for housing finance in tandem with the adoption of adequate building technologies and the development of a professional and efficient construction industry, (ii) to promote financing for and mass production of small housing units adapted to the needs and affordability of

low-income and vulnerable households in urban and rural areas, (iii) to improve the efficiency of taxation and subsidies in the housing sector and to promote housing insurance, and (iv) to reduce government controls and to devolve responsibilities to local authorities (Provincial agencies and municipalities) for housing, urban land management (including government owned land) and promotion of rental housing and housing cooperatives. Achievement of the strategic objectives set out in the plan will require the Government to face the challenge of developing and establishing the right mechanisms to manage the fluctuations in the market that would guarantee the provision (mostly by the private sector) of housing particularly for the low-income groups. For this, several issues must be addressed as follows:

Natural ConstraintsIran is one of the most seismically active regions of the world. Of all natural catastrophes, earthquakes are considered to be the most destructive natural catastrophe that could hit Iran. Destructive earthquakes occur regularly resulting in significant economic and human losses in this country. The Iranian territory is frequently reminded of this by occurrences of disastrous Earthquakes such as the most recent ones, the Manjil Earthquake of 20 June 1990 (Ms=7.7), the Bojnurd Earthquake of 4 February 1997 (Ms=6.8), the Ardebil Earthquake of 28 February 1997 (Ms=6.1), and the Ardekul Earthquake of 10 May 1997 (Ms=7.3). In 1997 alone, earthquakes claimed more than 2,650 lives and left more than 100,000 homeless in this region. Earthquake risk creates an implicit fiscal liability to the Government. Government compensation packages are unlikely to be sufficient to compensate for private loss, leading to unmet expectations by masses and inequity in accessing relief funds.

Macroeconomic ConstraintsDespite significant progress made by the government in increasing the supply of housing over the last ten years, the challenge today is made more difficult by i) the still significant oil-dependency of the economy, ii) the prospects of rising inflation in the short and medium term worsened by the unification of the Rial, iii) the recent deterioration of income levels, iv) the current macroeconomic instability which magnifies the volatility of private housing output, and v) the weak fiscal base which hinders the ability of the government to target programs and subsidies effectively.

Demand ConstraintsUnderdeveloped housing finance: Lack of sustainable long-term funding for housing finance remains the main limiting factor for the expansion of the sector and is the main reason for the shortage of affordable housing and the sector's low share of GDP (5%). Despite the priority assigned to housing in credit allocation through the public banking system, the supply of housing loans remains small (3% of GDP) when compared to the demand and to the ambitious objectives set by the current development plan for affordable housing. This scarcity of appropriate finance has resulted in i) a highly volatile private housing market output, ii) an unbalanced output in favor of large units, iii) a very fragmented financing into numerous small public housing programs, and iv) an absence of financing for the purchase of existing housing units. This shows that an underdeveloped housing finance system is also the main constraint for the improvement of existing housing and the acquisition of rental investments. This reduces the value of the existing stock, the wealth of households, and the fluidity needed for an active housing market to operate, particularly for lower-income groups. In this situation, affordability of housing is severely reduced due to the high price to loan ratios and the large cash payments necessary to purchase housing.

Inefficient system of housing subsidies: Preliminary estimates suggest that housing subsidies in Iran are significant amounting to 2-4.5%

of GDP. Taking into account utility subsidies amounting to 3% of GDP, housing-related subsidies become excessive exceeding annual housing investment (4.7% of GDP in 1996/7). These subsidies are: i) mostly non-transparent and unaccounted for in any budget, ii) inefficiently delivered, iii) regressive in the form of interest rate and energy subsidies, and iv) provided through a highly fragmented system. As such, their benefits accrue largely to households in higher income brackets. Furthermore, subsidies are granted to developers, financing institutions and buyers, leading to inefficiencies, speculation and deviation of subsidies from their intended beneficiaries. With very few exceptions, such as the Imam Khomeini foundation, the intended population groups are not receiving the full benefits of government assistance. For many, such assistance is inaccessible.

Supply Constraints
Insufficient supply of undeveloped and serviced land: The establishment of the Urban Land Organization (ULO) in 1982, brought under its control all land belonging to the central Government and its agencies. As the policy pursued by this organization until 1985 of distribution of undeveloped land to individual households failed to address persistent housing shortages, MHUD has initiated a new urban land development policy with the intention of increasing substantially the availability of developable land. The focus of the ministry's strategy concerning land management has been to provide infrastructure for new residential areas (including the development of new/satellite towns), and to supply developed land to individuals, construction companies and developers. Although approximately 400,000 hectares were expropriated along the urban periphery, a relatively small portion of this land has been developed and/or distributed. Most of the land remains un-serviced and un-titled. Withholding such significant amounts of land, stifles private sector contribution to urban development and seriously restricts the efficient operation of land markets.

Constrained private sector construction: Public or quasi-public sector construction companies effectively control a large segment of the construction sector. They dominate low-cost mass housing construction where demand originates generally from government supported or financed projects. Their privileged access to financing and land places the private companies at a competitive disadvantage further deterring them from entering the unprofitable low segments of the market and confining them to the provision of upper middle and high income housing. The activities of private construction companies and entry into the sector are therefore seriously constrained by the lack of adequate and timely access to financing and land, and to a lesser extent equipment and materials. In particular, i) construction financing is highly regulated and covers only 20 to 30% of construction cost, ii) due to limited finance and inadequate regulations and incentives, the private equipment-leasing industry is small and it is dominated by two inefficient quasi-public companies, and iii) periodic shortages in the public production of critical commodities for housing such as cement and steel often translates into higher prices than official. Although laws and regulations do not appear to inhibit private firm entry into the construction sector, excessive building regulations and frequent amendments to them may add up to as much as 5 to 10% of construction cost.

Rigid Urban planning and management: Urban planning in Iran is directive and hierarchical in terms of both coverage and nature. The constraints created by the rigidity of urban plans and legal zoning has resulted in a proliferation of informal settlements in and around major cities. In response, the Government has started the rehabilitation of these under-serviced neighborhoods as part of a

comprehensive review of current urban planning and management process. Several pilot site initiatives have been undertaken during the past five years and studies are currently being carried out on simplifying and adapting the regulatory framework governing urban planning and management in line with the ongoing decentralization reforms. Overall, it is envisaged that local authorities and other stakeholders will ultimately be empowered to make decisions on planning, budgeting, execution and management of city policy in line with national development plans and policy guidelines. In addition, the Urban Development and Rehabilitation Organization (UDRO), created in 1996, has undertaken several upgrading and cultural heritage preservation projects in urban areas. Given the extent and magnitude of under-serviced settlements in the country there is considerable need for introducing best practice experience, capacity building to national and local authorities, and prioritized intervention.

Institutional Constraints
Lack of empowerment and engagement of local government: Although article 7 of the Constitution assigns major roles in the governance structure to elected councils, it was only until the 3rd development plan assigned a high priority to decentralization that actions conducive to it were undertaken. The first local elections which took place in 1999 resulted in the election of some 164,000 officials confirming the transformation of municipalities into autonomous entities which report to their respective city councils. A decentralization draft law, which is expected to be enacted by Parliament soon, will reinforce the roles and responsibilities of the city councils and will also create elected regional councils and inter-communal councils. In doing so, it will formalize the role and participation of civic society in governance, as well as the transfer of certain government functions to local government through the allocations of the corresponding budgetary resources. Responsibilities for land management, maintenance of cultural heritage housing and urban development (including upgrading) are being considered for transfer to local authorities. This devolution of responsibilities will require, among other things, considerable training and institutional capacity building at the local level.

Fragmentation of policy decision-making and of responsibilities: Numerous government institutions and organizations are involved with housing and urban policy setting and implementation. The MHUD must deal not only with other central government bodies but also with six affiliated organizations, the Housing Foundation and the Housing Bank. This has resulted in multiple and disjointed housing programs, making difficult the development of a coherent and well coordinated housing sector policy. Consequently, housing markets in Iran are highly heterogeneous; precise knowledge of real housing needs is lacking (despite the wealth of housing information available); and access to subsidies has less to do with income than with location/ employment affiliation.

Limited earthquake mitigation/ insurance capacity: Due to the construction practice as well as deficiencies of regular engineering inspections, it is expected that building performance would be similar to that of the Turkish buildings during the Izmit Earthquake. The impact of a future possible large earthquake on the city of Tehran may have disastrous economic, social and political effects on the country. Collapse of residential buildings will be the most dominant cause of human casualty as well as economic loss. According to EQECAT, a premier international earthquake risk modeling consultancy, the proximity of the city to active seismic sources, poor building quality and the geological condition of the city, could result in a massive loss of life and economic losses of over US\$10 billion in case of a large size event.

It is obvious that should such a disaster occur, the Iranian Government will find it very difficult to finance the reconstruction of destroyed dwellings and humanitarian assistance to the affected population. While in the past, the government relied on state-owned banks to provide interest free loans to the affected homeowners, this practice may not be sustainable in case of a large catastrophic event as it would have severe implications for the Iranian banking system. The insurance industry is extremely small and all companies are state owned, employing a total of 4,000 people in the companies and a lesser number in agencies and broking companies. Although there are no official statistics on the capitalization of the industry, it is perceived to be rather insignificant. All the Iranian insurance companies have the same net retention of \$750,000. The minimum capital requirement for all types of insurance companies is \$33,300, of which 50 percent must be fully paid. Such a low capitalization of the insurance industry and an extremely high rate of risk retention of 96.11 percent by Bimeh Markazi, a domestic reinsurer, makes the industry financially unstable and highly vulnerable to potential catastrophic events.

2. Objectives

The main objectives of the proposed program are to support the Government's effort in the housing sector in (a) providing affordable housing to low to moderate income households; and (b) further developing the market institutions of the housing sector (insurance, finance, construction, real estate). These objectives will be realized in three phases: A first phase focusing on housing sector reforms and priority interventions to improve living conditions of the poor in under-serviced settlements in three cities; a second phase focusing on increasing long term resource mobilization for housing finance and city wide upgrading in the urban centers of three cities; and a third phase focusing on deepening the impact of the housing sector reforms and up-scaling upgrading programs countrywide. The exact phasing of the APL and the triggers for the different phases will be discussed during project preparation and reviewed at pre-appraisal. Specifically, phase I will focus on: i) piloting improvements in housing conditions in some of the poorest urban areas in Iran; ii) reducing household vulnerability to earthquake risk; and iii) setting a strategy for housing policy reform (finance, subsidies, construction, land markets, and urban management). Phase II will launch the implementation of the strategy for housing policy reform developed and adopted in phase I. It will focus on: i) deepening of the housing finance sector (reducing credit rationing, deregulation, capital markets, secondary markets); ii) streamlining housing subsidy policy; and iii) improving livability in run down urban centers of historic cities. Phase III will scale up programs introduced in phases I and II. It will focus on: i) designing and funding a national fund for slum upgrading; ii) developing a national program for capacity building for municipalities in a decentralized context; and providing technical assistance on further policy reforms to be determined in phase II.

3. Rationale for Bank's Involvement

The Bank has accumulated best international practices in supporting housing and urban development, particularly through the integration of sector reforms and investments in infrastructure. Throughout the MNA Region, the Bank has assisted borrowers on housing finance (Jordan, WBG, Algeria, Egypt), slum upgrading (Morocco, Tunisia, Algeria, Jordan),

earthquake mitigation and insurance (Turkey). The Bank also has considerable experience to share from high inflation economies in Latin America and highly administered housing sectors in the Former Soviet Union and East Asia. In recent years, the Bank has been also renewing and strengthening its involvement in Iran through several on-going lending and grant operations in sectors such as banking regulation, sewerage and primary health care. The team will coordinate closely with other on-going Bank-financed projects and those financed by other donors to ensure coherence and integrity in supporting the sector reforms.

4. Description

Phase I of the proposed Program would have three components: Component A. Upgrading, services, and capacity building of targeted cities; Component B. Earthquake insurance and mitigation scheme; and, Component C. Technical assistance on housing sector reform and project management. Component A (US\$68 million): Upgrading, services, and capacity building of targeted cities: A.1 Upgrading poor neighborhoods (US\$25 million): Investment in infrastructure networks to improve access to basic services in poor urban settlements in selected cities. Selection criteria will be developed during the project preparation but it will be mainly determined through the level of poverty, deficiency in basic services and needs for social inclusion. The component is proposed to include both on-site improvement and off-site land development (see A3). A.2 Small infrastructure in support of employment generation (US\$15 million): To address the social needs of the population particularly women and youth, in parallel with the above upgrading sub-component, small social infrastructure are proposed to support income and employment generation activities at the settlement level. A.3 Trunk infrastructure for guided land development for low-income housing (US\$25 million): Off-site development is regarded as an extension of the currently expanding informal settlements in the peri-urban area to facilitate guided development in place of uncontrolled sprawl (this component will possibly be incorporated in the current water project under preparation). A.4 TA for city management capacity building (US\$3 million): TA is geared to support capacity development of staff at the provincial and municipal levels on city/urban management to improve capacity in prioritizing of needs, planning, budgeting, implementation and monitoring local-level investments. A participatory/enabling approach will be integrated in the TA. Component B (US\$62 million): Earthquake insurance and mitigation scheme: B.1 TA and business feasibility studies (US\$ 5 million) This includes studies, technical advisory services and acquisition of equipments including: (i) vulnerability assessments of Iranian housing stock, (ii) study to determine rates for earthquake insurance coverage in different parts of the country and preparation of GIS based hazard maps; (iii) modeling of the National Catastrophe Insurance Pool (NCIP) risk exposures and capitalization requirements; (iv) preparation of operational guidelines and NCIP business plan; (v) public information campaign; (vi) training for the NCIP staff; and, (vii) acquisition of IT systems for the NCIP. B.2 Reinsurance premium (US\$25 million) This subcomponent will finance the costs of the NCIP's first year reinsurance program. In the first several years of the ICIP's operation, its claims paying capacity will rely mainly on international reinsurance. The reinsurance industry requires reinsurance premiums to be paid up front at a time of the reinsurance placement. As the pool's surplus quickly builds up (in the absence of large earthquakes), it is expected that the NCIP would be able

to cover the costs of reinsurance premium in the second year of its operations. B.3 Contingent capital facility (US\$ 30 million) The proposed contingent capital facility will support the NCIP's claim paying capability. The facility will be made available to NCIP by the Government under a special sub-loan agreement and could be called only to pay claims according to the pre-agreed terms. B.4 Support for the BHRC for development and dissemination of technology (US\$5 million) : This TA provides technical advisory service, institutional strengthening so that the BHRD can develop affordable earthquake-resistant construction technology and effectively disseminate on a national-scale. Component C (US\$10 million): Technical assistance on housing sector reform C.1 TA on housing finance reform and business study for secondary mortgage (US\$3 million): This is geared to support reforms to reduce credit rationing; Housing Bank targeted reforms; improved access to the capital market; and development of secondary mortgage market. C.2 TA on subsidies reform (US\$1 million) : This TA is geared to developing a transitional plan to develop better targeted and direct subsidies in the housing sector. It will support preparation of pilot reforms to be implemented in Phase II. C.3 TA on a real estate observatory (US\$1 million) : TA to assist the design and implement housing policy support systems. C.4 Long term and short term TA to NHC, UDRO, MHUD, MPO, and CBI on program implementation (US\$5 million): Institutional strengthening and capacity development of staff in the above agencies to be equipped with necessary skills and knowledge to implement Phase I and replicate the program at the national level in Phase II and III.

A. Upgrading, services, and capacity building of targeted cities:

A.1 Upgrading poor neighborhoods

A.2 Small infrastructure in support of employment generation

A.3 Trunk infrastructure for land development

A.4 TA for city management capacity building

B. Earthquake insurance and mitigation scheme:

B.1 TA and business feasibility studies

B.2 Reinsurance premium

B.4 Support for the (BHRC) for development and dissemination of technology

C. TA on housing sector reform

C.1 TA on housing finance reform and business study for secondary mortgage

5. Financing

	Total (US\$m)
BORROWER	\$28.00
IBRD	\$112.00
IDA	
Total Project Cost	\$140.00

6. Implementation

Before appraisal, GOI will prepare a draft Program Implementation Plan, spelling out the detailed institutional and implementation arrangements. Ministry of Housing and Urban Development (MHUD): The Minister of Housing and Urban development would be responsible for the overall execution and coordination of the program. Two organizations within the MHUD umbrella: the National Land and Housing Organization (NLHO) and the Urban Development and Rehabilitation Organization (UDRO) will be directly involved in program execution. NLHO, represented by the Director of National Habitat Committee (NHC), will be responsible for overall program management. UDRO will be responsible for the technical coordinating of

component A directly with the targeted cities. Given its experience with neighborhood development and upgrading, UDRO will provide technical assistance to targeted cities through its own staff and hired consultants.

National Coordination Committee (NCC): NCC would be Chaired by the Minister of Housing and Urban Development. Members of the NCC would include representatives of ministries and agencies concerned such as Ministry of Interior, Ministry of Finance, the Central Bank, the Planning and Management Organization, the High Commission for Architecture and Urban Development, Urban Development and Rehabilitation Organization (UDRO). The NCC would be responsible for providing guidance to the reform strategy and coordinating the implementation of the proposed action plan. This committee will meet quarterly to review progress and remove impediments to timely program implementation. NHC Director will serve as the secretariat for NCC.

Local Coordinating Committee (LCC): A number of cities have already formed LCCs to coordinate neighborhood upgrading and delivery of services. They include representatives from 25 different national and local authorities, CBOs and NGOs.

Ministry of Finance and Economic Affairs (MOFEA): MOFEA regulates the insurance industry, including the national reinsurer, Bimeh Markazi; four composite insurers (Bimeh Iran, Bimeh Asia, Bimeh Alborz, and Bimeh Dana) and one specialist credit insurer. MOFEA will be responsible for the implementation of the earthquake insurance component.

The Central Bank of Iran (CBI): CBI will be responsible for implementing the TA components related to housing finance reform. Implementing agencies.

MHUD will be the executing agency of the program. NHC will be the implementing agency of the program. NHC is a lean agency with a Director and two support staff. NHC relies on local consultants, many of whom are short term experts for developing newsletters, reports, and sector studies. NHC has hired a part time accountant and procurement specialist to assist with program preparation under the PHRD. These positions are expected to continue through program implementation. While NHC will manage the Special Account, procurement of works, goods, and services will be carried out by municipalities with technical assistance from NHC on procurement methods, and UDRO on technical assessment. Technical assistance on housing finance reform will be implemented by CBI. The earthquake insurance component will be implemented by the MOFEA which regulates the insurance industry. NHC will coordinate the hiring of three full-time program managers (one placed with CBI, one with UDRO, and one with MOFEA), a procurement specialist, and an accountant. Short term engineers, environmental specialists, and community development specialist would also be hired. UDRO will liaise with local governments (provincial and municipal) and other participating agencies for implementation. Participating Municipalities would be implementing the infrastructure component, (with authority to sign contracts and authorize payments under technical supervision of UDRO and overall clearance by the NHC). They will be supported by contract technical staff to strengthen their technical and financial management capacities as appropriate.

Community-Based Organizations (CBOs) and local NGOs. They will play a major role in the design and implementation of community social infrastructure, the provision of urban environmental services, and the delivery of targeted interventions in under-serviced neighborhoods. Particularly CBOs, supported by the local NGOs will take the lead role in the preparation and implementation processes through organizing beneficiary residents, ensuring their participation and assisting the monitoring of the program implementation. By pre-appraisal, the institutional arrangements for program coordination and implementation

will be finalized, including the definition of needed technical assistance.

7. Sustainability

The benefits of the program are expected to be sustainable due to the strong emphasis on sequencing of reforms, capacity building, and institutional development in the program. There is also clear commitment by important stakeholders at the national and local governments' level and considerable participation of communities and other stakeholders in the design of the program at all stages. The housing sector reform will reduce the budgetary burden of the government as more of the housing supply will be provided by private sector and without need for subsidy. As for the upgrading part of the Program, the GOI is strongly supportive of an enabling approach through participation in the form of beneficiary contributions and avoiding a perception of "gift" to identified cities. In line with the establishment of a cost-recovery mechanism for infrastructure investments, modalities of tenure regularization will be sought during the Program preparation. This will lead to the increase of property value and be an incentive for people to contribute financially.

8. Lessons learned from past operations in the country/sector

Project Management Capacity: The common lessons in the past Bank-financed projects concerns the readiness of the borrower for implementation. It is important to ensure adequate capacity to be built for carrying out procurement and disbursement. In the program preparation, through the implementation of PHRD grant, intensive advisory support on the Bank's procedures are being provided. The Bank will organize seminar on procurement and disbursement during the Program's launch, paying particular attention to the training needs of program implementation teams at the municipal level.

Involvement of all stakeholders: MOI, MPO, and CBI are the key stakeholders in municipal management, budget allocation, and banking regulation. It is crucial that important stakeholders be fully involved in the program preparation to ensure full commitment and later cooperation. The program team has initiated contacts with the above during the program identification and it intends to closely coordinate with them during the program preparation. This is also important in view of securing availability of counterpart financing.

Drawing on best practices: The World Bank/IFC team which had developed the Turkish Catastrophe Insurance Pool (TCIP) is the same team working on the Iranian earthquake insurance scheme. This ensures that team can take stock of all lessons learned in designing and implementing the Turkey project.

Citywide strategy for capacity building: Projects which tend to focus on surgically upgrading an neighborhood in the absence of a citywide strategy for capacity building are not likely to be sustainable. The program focuses on training and capacity building of city officials and takes a citywide approach to upgrading which addresses future supply of affordable developed land as well as rehab of existing neighborhoods.

Addressing both supply and demand side constraints of the housing sector: Past experience has shown that Bank financed housing projects contribute mostly to institutional development and sustainability when they explicitly identify supply and demand constraints in the sector and adopt a strategic approach for reform.

9. Program of Targeted Intervention (PTI) N

10. Environment Aspects (including any public consultation)

Issues : No significant environmental issues are anticipated at this point. This will be looked into in more detail at pre-appraisal.

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Note: This is information on an evolving project. Certain components may not be necessarily included in the final project.

This PID was processed by the InfoShop during the week ending July 14, 2002.