

**MOROCCO – Housing Sector Development Policy Loan
(Loan 7314-MA)
Release of the Second Tranche and Request of One Waiver**

Tranche Release Document

1. The Board of Directors of the Bank approved the Housing Sector Development Policy Loan of US\$150 million equivalent on June 30, 2005 (report No. 32345-MA of June 1, 2005). The Loan Agreement was signed on July 18, 2005 and declared effective on August 24, 2005, when the front end fee of Euro 580,500 was applied. The first tranche of Euro 69,660,000 was disbursed on September 2, 2005. The Loan's original Closing Date of December 31st, 2007 was extended by six months to June 30, 2008.
2. The development objectives of the Loan are to: (i) strengthen the institutional, regulatory and fiscal environment for a well-functioning housing market and for the emergence of market-based solutions to the country's housing sector constraints and needs; and (ii) increase the access of low income and severely disadvantaged households to more affordable and higher quality housing.
3. Two Ministries have been substantially involved with the implementation of the reforms supported by the Loan: the Ministry of Finance and of the Economy (MF) and the Ministry of Housing, Urban Planning, and Territorial Development (MHUAE). The Ministry of Finance has been directly responsible for the design and implementation of the reforms in the realm of housing finance and of fiscal policies, while the Ministry of Housing has been in charge of those reforms that were related to the legislative and regulatory framework of the sector and for the social housing programs.
4. Three years after the approval of the Loan, the housing sector in Morocco has gone through profound transformations and is now considered one of the most dynamic sectors of the national economy. All indicators seem to confirm that the policy implemented by the Government as of early 2003, and which has been supported by the Bank's technical assistance at first, and by the present Loan for the past three years, has been successful in addressing some of the fundamental sector issues and in reaching the above development objectives.
5. In addition to normal supervision practices and reporting, the Loan was subject to specific monitoring and evaluation to track the indicators which were selected at appraisal and agreed upon with the Borrower (section VI.C of the Project Appraisal Document). Consequently, a Monitoring and Evaluation Report on the impact of the reforms under the first tranche of the loan, comparing end of 2004 to end of 2006 indicators, was issued by the Bank in June 2007. In addition, a Policy Note on the housing sector was issued by the Bank at the same time, and revised and updated in May 2008 under the title "The challenges of social housing in Morocco". It is now part of the overall report "Conditions for a higher and inclusive growth" which was issued in May 2008 (Report n 40197-MA). The Bank also carried out the "Poverty and Social Impact Assessment of the national slum upgrading program", which was supported under the Loan, and published and disseminated it in June 2006 (Report No. 36545-MOR).

6. This Tranche Release Document certifies that (i) the progress achieved by the Borrower in the carrying out of the program of reforms supported by the Loan is satisfactory; (ii) the macroeconomic framework of the Borrower is satisfactory, and in line with the program, as measured on the basis of indicators agreed upon between the Borrower and the Bank; and (iii) the actions agreed upon for the disbursement of the second tranche have been taken, with the exception of one action, for which a waiver is sought, as per below.

Progress achieved by the Borrower in carrying out of the program of reforms

7. In early 2003 the Housing Solidarity Fund (HSF) was established, in order to channel revenues for the social housing programs into a dedicated fund which is replenished via a tax on the sale of cement, currently in the order of 0.10 MAD per kilo. Given the considerable increase in construction activities, the yearly replenishment of the HSF has increased steadily, reaching MAD 1.4 billion in 2008 from MAD 400 million in 2004, and providing a reliable source of financing for the expansion of the social housing programs. During 2003-2007, the Government has also mobilized approximately 10,000 ha of public land to boost urban development and primarily residential activities. This has allowed for the implementation of the social housing programs, for the creation of new towns, and for the formal urbanization of peri-urban areas of major cities. While the on-site infrastructure is provided by the publicly owned Holding Al Omrane, the vast majority of the construction of residential units is now performed by private contractors, some of which have gone through spectacular financial growth.

8. The reorganization of the parastatal housing companies got under way in 2004 with the creation of Holding Al Omrane (HAO), which consolidated the land and financial capital, as well as the human and technical resources, previously managed by the National Shelter Upgrading Agency (ANHI), the National Equipment and Construction Corporation (SNEC), and Attacharouk, created to carry out a housing program in Greater Casablanca. The mission of the HAO was refocused on providing on-site infrastructure and urbanizing land to facilitate the implementation of residential projects by private developers and on implementing the social housing programs financed via the FSH. Several measures were also taken to capitalize and rehabilitate the financial standing of the regional parastatal development and construction establishments (ERACs). In late 2004 the total outstanding debts of these establishments vis-à-vis CIH, a property development public bank, were fully repaid in the amount of MAD 800 million; these organizations were also re-capitalized for MAD 900 million, thus making them again financially viable.

9. The “Cities Without Slums” program, designed and launched in July 2004, targets the upgrading of all slums in the country by the end of the decade. Its strategy is based on the city as the programming unit for a comprehensive and integrated intervention, on a contractual framework between the State, local governments, and operators to ensure joint respect of commitments and responsibilities, and on better targeting of the operations in order to optimize the resources at play in terms of the land tenure, financial, institutional, and social issues. From a quantitative standpoint, the results of program implementation remain encouraging. As of late March 2008, the number of slum units treated by the program, since its launch, amounted to 82,000, out of total of 293,000 slum households targeted. However, four years after the program launch, 19 cities with nearly 30 percent of the slum population still have not signed “city contracts” with MHUAE (Casablanca and Témara having signed only partial contracts), and the

apartment units and serviced plots produced but not yet transferred to the target households numbered 21,000 at end of March 2008, indicating limited adaptation of the products to the demand and the financial capacity of the households. Moreover, it is important to highlight the fact that the number of households targeted by the program has been increasing during the last years from 212,000 in 2004 to 293,000 in 2008.

10. Thanks to the release of large tracts of public land, to the ability of HAO to provide on-site infrastructure, to the simplification of the urban planning regulations and on account of the expanded access to credit, there was a substantial increase in the production of low-cost and social housing between 2004 and 2006. The production of lots intended for the construction of social housing almost doubled between 2004 and 2006, increasing from 22,000 units in 2004 to 45,000 units in 2006. This increase is primarily due to production by the parastatal companies, which nearly tripled over the 2004-2006 period. Similarly, the production of low-costs housing units increased substantially, by 30 percent, rising from 54,000 units in 2004 to 70,000 units in 2006. This growth is essentially due to the increased interest shown by private developers, alongside a gradual withdrawal of public operators which are focusing more on the urbanization of public lands.

11. FOGARIM (Guarantee Fund for households with low and/or irregular incomes), was created under the 2004 Budget Law, and replaced the system of across-the-board interest rebates on mortgages previously subsidized by the State. FOGARIM constitutes a complete innovation in Morocco, in that it finally enables access to housing credit by households of the informal sector, which represent a very large share of the population (nearly 40 percent of the labor force in urban areas in 2000, according to estimates by the Statistics Directorate). FOGARIM is directly supported through the FSH: during 2003-2007, MAD 400 million drawn from the FSH was transferred to the Central Guarantee Fund as the endowment of FOGARIM, to cover the risks borne by banking establishments in granting such loans. After a slow launch period, the efforts made by the public authorities to improve the operation of this fund, combined with a targeted communication and information policy, made it possible to increase activity from 2,600 loans guaranteed in 2005 to 10,500 in 2006, to 15,600 in 2007, for a cumulative total of 28,700 with an overall balance increasing from MAD 255 million in 2005 to MAD 1.5 billion in 2006, to MAD 4.76 billion in 2007.

12. The real estate sector has benefited over the past several years from a diversified offer of financial products and is witnessing serious competition among commercial banks, marked by a significant drop in rates and the lengthening of maturities. These favorable market conditions are the indirect consequence of a reduction in the national debt and of the resulting increase in the liquidity of the national banking system. The efforts made by the Government to facilitate access to property by the disadvantaged social groups, the production of low-cost housing, as well as the emergence of major developer and contractor groups all contributed to the takeoff of the sector. In this context, real estate lending rose in 2007 to MAD 76 billion, representing 22 percent of credits to the economy, as compared to 15 percent in 1998. In addition to the loans benefiting from State support (representing one-third of all housing lending in 2005), participation by banks improved by over 50 percent in volume terms, corresponding to a twofold increase in the number of lending operations, while the average commitment decreased from MAD 284,000 to MAD 218,000, thus underscoring the diversification of the portfolio and the targeting of new categories of customers.

13. Foreign direct investment in Moroccan real estate experienced a sizable boom in 2006, drawing in nearly DH 4 billion in a single year, that is, over 15 percent of the total flow of FDI, causing this sector to rank third after industry and tourism. This increased prominence since 2003 is explained by several factors: (i) the global dynamics of the real estate sector; (ii) the dynamism of the Moroccan economy, which grew at a record rate of 8.2 percent in 2006; and (iii) the launching of the massive programs to build new cities, as well as residential, commercial, and tourist property development. These investments, flowing in both from the Gulf States (the United Arab Emirates account for nearly 10 percent) and from Europe (primarily France, Spain, and the United Kingdom), allow for sizable concentrations of capital in the sector, the consolidation of major national groups, technology transfers from international groups, and the achievement of economies of scale.

Actions taken to fulfill the second tranche conditions

14. *For the purpose of modernizing urban planning standards and regulations, the Borrower's Conseil de Gouvernement has adopted a new urban planning code, satisfactory to the Bank.*

In May 2005 the Government started a process of consultation and technical work to completely overhaul the current legislation regulating urban planning, which dates back to 1990. MHUAE set out the principles and objectives of the reform in a policy document published in October 2005 which received the official endorsement of His Majesty. MHUAE then carried out a national survey of perceived requirements for the replacement legislation and a first-hand investigation of international best practices. In 2006 and 2007 it prepared the full text of the new Urban Planning Code which, if adopted by Parliament, would greatly simplify and modernize urban planning practices, and hence accelerate the production of formal residential units. Consultations were held with professional groups, at the regional level, and with other key Ministries, so as to ensure a shared commitment to the goals of the new legislation. The draft law was approved on June 12, 2008 by the Council of Government. This condition has been met.

15. *For the purpose of restructuring its public sector housing companies, the Borrower has implemented a restructuring plan, satisfactory to the Bank.*

The Holding Al Omrane has continued its process of internal organization and strengthening. The key financial ratios of the group (assets, profitability ratios, upfront payments by buyers, etc.) at end of 2004 were compared to end of 2006, and were found by the Bank to have all considerably improved. In addition, during 2007 the seven regional parastatal development and construction establishments (ERAC) were officially dissolved as state subsidiaries, re-established as publicly owned companies, and then transferred to HAO by the Government. Two more regional companies were also created with the purpose of completing a balanced coverage of the regions. HAO has become a powerful tool for the implementation of the public policies in the realm of social housing, but is also facilitating the investment of private companies into the housing sector. This condition has been met.

16. *For the purpose of rationalizing and simplifying real estate taxes and subsidies, the Borrower has introduced reforms to the real estate tax system in the draft Budget Law of 2007.*

Pursuant to the Bank funded study on the impact of real estate taxation carried out in 2006-2007, the related sector taxes have been revised as follows in the 2008 Budget Law: a) application of the normal VAT rate (20 percent, instead of the reduced rate of 14 percent) to all real estate operations, with the exception of social housing, which remains exempt; b) elimination of the provision of the 3 percent tax break on corporate taxes if applied to the construction of employee housing; and c) unification of registration fees (2.5% on the amount of the real estate transaction) with the notary public fee (0.5%). The new registration fees will be subject to a cumulative rate of 3%, with the exception of social housing that will benefit from the special cumulative rate of 1.5%; d) with regards to the fiscal incentives for the production of low-cost housing (Article 19), real estate companies producing low-cost residential units (value of MAD 200,000) will have to pay 50 percent of the corporate tax (while they were previously totally exempt), and the quantitative threshold to benefit from these fiscal incentives has been lowered to 1,500 units. The construction of low-cost units with a value up to MAD 140,000 will be entirely tax exempt, with a quantitative threshold of 500 units in urban areas and of 100 units in rural areas. This condition has been met.

17. *For the purpose of expanding urban slum upgrading and social housing programs, the Borrower has implemented the Cities without Slums (Villes sans Bidonvilles, VSB) program, according to an implementation plan prepared in May 2005, which shall have been evaluated on the basis of reports of the National Monitoring Committee of the VSB program.*

Based on cautious projections of the likely rate of implementation of the program, the target of 30,000 slum-dweller households to obtain resettlement on a serviced plot, in an apartment unit, or to benefit from on-site restructuring by end of 2006 had been agreed to. The monitoring and evaluation exercise conducted in partnership with MHUAE on the basis of their internal reporting data ascertained that 62,000 households had in fact benefited from the program by end of 2006. In addition, 19,000 units had been produced but had not been assigned to the beneficiary households yet. Therefore the results more than doubled the quantitative targets. As for its qualitative aspects, while some areas for improvement persist, in particular with regard to its responsiveness to the active participation of the beneficiaries and the affordability of some of the products, the program is considered satisfactory. This condition has been met.

18. *For the purpose of improving the efficiency of the residential rental market, the Borrower's Conseil de Gouvernement has adopted new draft legislation to regulate the residential rental sector.*

In May 2005 the Government launched a study of the residential rental sector, to identify ways for this segment of the housing market to perform better and to contribute to the satisfaction of the pent-up housing demand, primarily in the largest urban areas. The study was presented at a stakeholder workshop in April 2006. The recommendations of the study were to review upwards the current rental ceilings and to overhaul the corresponding legislation in order to better balance and regulate the rights of the landlords with the ones of the tenants. Their implementation would mobilize investments and ensure that some of the 800,000 residential units currently vacant would be put on the rental market. On this basis new draft legislation was prepared by MHUAE in 2007 with the collaboration of the Ministry of Justice. The latter was keen on participating in order to minimize the number of civil suits resulting from rental-related conflicts, which is

currently very high. The draft law was approved on June 12, 2008 by the Council of Government. This condition has been met.

19. *For the purpose of providing increased access to housing finance to the low-income households, the Borrower: a) has introduced modifications in the Convention between the Borrower and the Caisse Centrale de Garantie, governing FOGARIM; and b) has made decision on the possibility of introducing an insurance premium system for FOGARIM.*

The FOGARIM Steering Committee met regularly to review the performance of the guarantee fund and in 2006 made the agreed adjustments needed to facilitate access: a) the maximum monthly repayment amount was increased; b) the certification of informal revenues by the local delegate of the Ministry of Interior was replaced by an auto-certification; c) the guarantee was extended to the acquisition of housing units by multiple family members; d) the age limit of 60 for the final repayment of the mortgage was eliminated; and e) the guarantee was extended to the self-help construction of housing and acquisition of residential plots. During 2007 in view of the lengthy procedures required for the issuance of title deeds it was agreed to accept a guarantee by the housing operator instead. In 2007 the Steering Committee agreed to introduce insurance premiums to increase the financial coverage of the guarantee: a) a premium of 0,65% will be applied to the guaranteed amount (70% of the mortgage), which corresponds to an additional interest rate of 0,46% for beneficiaries; and b) a deduction on the premium corresponding to the cash contribution by the beneficiaries will be applied: for a contribution of 20%, a deduction of 20% is applied to the premium (premium of 0,36% instead of 0,46%). This condition has been met.

Request of waiver of one condition

20. *For the purpose of providing increased access to housing finance to low-income households, the Borrower has introduced, in the draft 2006 Budget Law, an adequate financial incentive system for housing saving schemes.*

The purpose of this housing finance measure was to encourage low-income households to open savings accounts in commercial banks in order to accumulate the amount required for a down-payment for a mortgage, and to internalize the ability to make monthly savings in view of future mortgage payments. Such saving accounts would have received either a fiscal incentive, or a cash contribution by the Government. Two main factors made the introduction of this measure not required: a) the lower interest rates, lower percentages of down-payment required by the banks, and greater maturities applied to mortgages since mid-2006, making access to credit further accessible; and b) the price escalation of the housing products, often in double digits, that the Moroccan housing market has been experiencing over the past years. Such price increases are sufficiently high to entirely erode the advantage of saving as opposed to initiating a mortgage, despite the public incentive. The Government and the management of the Bank therefore agreed that the benefits of the housing schemes as identified during appraisal would not have been obtained, and the technical work around its design was stopped. A waiver is requested, so that this measure may be not considered any more a condition for the disbursement of the second tranche.