



Report and Recommendation of the President to the Board of Directors

Project Number: 44318
August 2011

Proposed Multitranche Financing Facility
Republic of Uzbekistan: Housing for Integrated Rural
Development Investment Program

CURRENCY EQUIVALENTS

(as of 1 June 2011)

Currency Unit	–	sum (SUM)
SUM1.00	=	\$0.0005877547
\$1.00	=	SUM1,701.39

ABBREVIATIONS

ADB	–	Asian Development Bank
CBU	–	Central Bank of Uzbekistan
ESMS	–	environmental and social management system
FAM	–	facility administration manual
HIRDS	–	Housing for Integrated Rural Development Strategy
MFF	–	multitranches financing facility
MOE	–	Ministry of Economy
MSEs	–	micro and small enterprises
PCB	–	participating commercial bank
QQB	–	Qishloq Qurilish Bank
QQI	–	Qishloq Qurilish Invest
RDP	–	Rural Development Program
RHS	–	Rural Housing Scheme
SCAC	–	State Committee of Architecture and Construction
WIS	–	Welfare Improvement Strategy

NOTES

- (i) The fiscal year (FY) of the Government of Uzbekistan ends on 31 December. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2011 ends on 31 December 2011.
- (ii) In this report, "\$" refers to US dollars.

Vice-President	X. Zhao, Operations 1
Director General	J. Miranda, Central and West Asia Department (CWRD)
Director	D. Kertzman, Public Management, Financial Sector, and Trade Division, CWRD
Team leader	E. Glennie, Senior Finance Specialist, CWRD
Team members	R. Barreto, Young Professional, CWRD
	B. Gafurov, Senior Private Sector Development Officer, Uzbekistan Resident Mission (URM), CWRD
	M. Khudayberdiyeva, Senior Social Development Officer (Gender), URM, CWRD
	P. Knoll, Financial Sector Economist, CWRD
	M. Marcelino, Operations Analyst, CWRD
	R. Narasimham, Principal Public Management Specialist (Financial Management), CWRD
	J. Nicolas, Social Development Specialist (Safeguards), CWRD
	C. Png, Counsel, Office of the General Counsel
	L. Raquipiso, Senior Economics Officer, CWRD
	N. Talipova, Senior Social Sector Officer, URM, CWRD
	J. A. Tan III, Senior Economist (Public Finance), CWRD
	D. Utami, Principal Safeguards Specialist, URM, CWRD
Peer reviewer	B. Wilkinson, Principal Financial Sector Specialist, East Asia Department

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

CONTENTS

	Page
PROJECT AT A GLANCE	
I. THE PROPOSAL	1
II. THE INVESTMENT PROGRAM	1
A. Rationale	1
B. Impact and Outcome	5
C. Outputs	5
D. Investment and Financing Plans	5
E. Implementation Arrangements	6
III. DUE DILIGENCE	7
A. Economic and Financial	7
B. Governance	8
C. Poverty and Social	9
D. Technical – Construction Sector	9
E. Environmental and Social Safeguards	9
F. Risks and Mitigating Measures	9
IV. ASSURANCES AND CONDITIONS	10
V. RECOMMENDATION	10
APPENDIXES	
1. Design and Monitoring Framework for the Investment Program	11
2. List of Linked Documents	13

PROJECT AT A GLANCE

1. Project Name: Multitranches Financing Facility for Housing for Integrated Rural Development Investment Program		2. Project Number: 44318	
3. Country: Uzbekistan		4. Department/Division: Central and West Asia Department/ Public Management, Financial Sector, and Trade Division	
5. Sector Classification:			
Sectors		Primary	Subsectors
Multi-sector		√	Agriculture and Rural Sector Development Housing Finance
6. Thematic Classification:			
Themes		Primary	Subthemes
Economic growth		√	Promoting economic efficiency and enabling business environment
Governance			Widening access to markets and economic opportunities
Private sector development			Economic and financial governance
Capacity development			Public administration (national and decentralized)
			Policy reforms
			Institutional development
6a. Climate Change Impact No Climate Change Indicator available.		6b. Gender Mainstreaming	
		Effective gender mainstreaming (EGM)	√
		Gender equity theme (GEN)	
		No gender elements (NGE)	
		Some gender benefits (SGB)	
7. Targeting Classification:		8. Location Impact:	
General Intervention	Targeted Intervention		
	Geographic dimensions of inclusive growth	Millennium development goals	Income poverty at household level
√			
		National	High
		Rural	High
		Urban	Low
9. Project Risk Categorization: Complex			
10. Safeguards Categorization:			
Environment		FI (treated as C)	
Involuntary resettlement		FI (treated as C)	
Indigenous peoples		FI (treated as C)	
11. ADB Financing:			
Sovereign/Nonsovereign	Modality	Source	Amount (\$ Million)
Sovereign	MFF – FI Loan/s	Ordinary Capital Resources	500.00
Total			500.00
12. Cofinancing:			
13. Counterpart Financing:			
Source		Amount (\$ Million)	
Participating Commercial Banks		536.3	
Subborrowers (Down Payments)		833.5	
Government of Uzbekistan		799.1	
Private Sector		385.6	
Total Counterpart Financing		2,554.5	
14. Aid Effectiveness:			
Parallel project implementation unit		No	
Program-based approach		Yes	

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed multitranches financing facility (MFF) to the Republic of Uzbekistan for the Housing for Integrated Rural Development Investment Program.¹

II. THE INVESTMENT PROGRAM

A. Rationale

2. Uzbekistan has achieved high rates of economic growth in recent years (with gross domestic product growth of 8.5% in 2010), led by services (13.2%), industry (8.3%), and agriculture (7.1%).² Although growth is geographically widespread, rural development has not kept pace with urban development. Over 70% of the poor live in rural areas and, while declining, rural poverty remains higher (22.2% in 2009) than urban poverty (15.2% in 2009).

3. **Rural livelihoods.** Increases in the working age population (up from 54% in 2001 to 61% in 2007), higher population growth in rural areas, and significant retrenchment of agricultural jobs due to ongoing market reforms, are putting pressure on rural employment and jobs. As a result, migration to cities is on the rise, as is the share of people in seasonal jobs and informal employment. Changing this trend requires economic transformation, diversification, and industrialization, and a focus on private sector development and accelerated expansion of micro and small enterprises (MSEs) responsible for generating over 50% of rural jobs nationwide. Inputs to attract and retain professionals with the skills needed to drive this transition include (i) quality education and health, (ii) better telecommunications and reliable infrastructure services, (iii) regional investment promotion and development of regional industrial hubs, (iv) access to better housing and living standards, and (v) increased access to finance.

4. **Rural housing.** Most rural houses were built during the Soviet period and are occupied by extended multigenerational families. While rural access to basic utilities is widespread, services are inconsistent and unreliable. The 60,000 new houses that are constructed annually are insufficient to keep up with population growth (1.5% per year) and the needs of the 200,000 young families ready to leave the parental home each year. About 1.5 million households are in need of new housing or major renovation annually, and finance to underpin this investment has not been available.

5. **Housing finance.** The housing finance market is nascent. In 2009, the housing finance market amounted to about 1% of gross domestic product, with less than 10% of real estate deals financed through bank loans. Expansion of housing loan portfolios is constrained by lack of access to cost-effective long-term funding and high inflation risk.³ Affordable housing finance is almost nonexistent,⁴ and personal savings and informal loans remain the main source for new housing.

Table 1: Residential Housing Loans (SUM billion)

Item	2005		2006		2007		2008		2009		2010	
	No.	SUM	No.	SUM	No.	SUM	No.	SUM	No.	SUM	No.	SUM
Rural	28	0.4	97	1.2	1,272	20.1	2,258	42.5	2,471	59.6	7,818	267.3
Urban	172	2.2	672	9.7	4,434	99.7	6,360	208.4	3,952	128.5	2,064	75.2
Total	200	2.6	769	10.9	5,706	119.7	8,618	250.9	6,423	188.1	9,882	342.5

Source: Central Bank of Uzbekistan.

¹ The design and monitoring framework is in Appendix 1.

² Country Economic Indicators (accessible from the list of linked documents in Appendix 2).

³ Inflation reached 14.1% in 2009, and is estimated at 9.3% for 2010 and 9.5% for 2011. Asian Development Bank (ADB). 2010. *Asian Development Outlook 2010 Update*. Manila.

⁴ For creditworthy borrowers, interest rates for housing finance range from 12% to 20%, with a tenor of 5 to 15 years. Source: Central Bank of Uzbekistan (CBU).

6. As a strategic focus of the government's Rural Development Program (RDP), the Rural Housing Scheme (RHS) was initiated in 2009 to launch the rural housing finance market. One third of all rural housing loans issued in 2009 and 85% of those issued in 2010 fall under the RHS. The Qishloq Qurilish Bank (QQB), a majority state-owned bank with an extensive national branch network, is solely mandated to provide rural housing loans under the RHS. Under the RHS, the maximum loan size is 1,000 times the minimum monthly wage with a repayment period of 15 years (including a 6-month grace period), and an annual interest rate equal to 50% of the Central Bank of Uzbekistan (CBU) refinancing rate (12% effective as of 1 January 2011). RHS borrowers are required to make a minimum down payment of 25% and purchase mortgage insurance.

7. **Strategic context.** The Welfare Improvement Strategy 2008–2010 (WIS)⁵ sets out government priorities for inclusive economic growth and the context for the RDP and RHS. Under the RDP, which focuses on stimulating rural economic opportunities, 500,000 rural jobs have been created, 7,647 new rural houses built, and rural infrastructure and social and community facilities expanded and improved. The RHS, a critical pillar of the RDP, channels rural savings and remittances into investment in new housing and construction, and engages local contractors and uses local construction materials for RHS house construction to generate rural jobs. In 2011, building on the achievements of the RDP and the RHS, the government adopted the multisector Housing for Integrated Rural Development Strategy (HIRDS).

8. **Housing for Integrated Rural Development Strategy.** Under the HIRDS, integrated rural development will be supported through expanded access to affordable housing finance, new and improved rural housing and associated infrastructure and services, strengthened *hokimiyat* (local government) capacity, and MSE development. The provision of affordable modern rural housing is the strategic driver for accelerating rural development nationwide. The expansion of improved rural infrastructure, provided in conjunction with the RHS and close integration with the MSE strategy, will help address key constraints to MSE development and the generation of new livelihoods and employment opportunities. In addition to reforms to improve the enabling environment for MSEs, new modern homes with reliable access to electricity and water stimulate rural home-based microenterprises and cottage industries often run by women. The development of modern rural housing and expanded access to affordable housing finance supports MSE development to promote more inclusive growth.

9. The HIRDS encompasses a 5-year extension of the RHS from 2011 to 2015, under which an additional 40,800 houses will be built and over 40,000 construction jobs will be created annually. To accelerate the development of the rural construction sector, while increasing access to affordable housing finance and newly constructed RHS houses, government interest rate support and a number of tax concessions (offered to QQB, contractors, and construction material suppliers) will continue to be provided.⁶ Critical professionals—doctors, nurses, teachers, and entrepreneurs—who are needed to advance social welfare in rural areas and stimulate rural economic opportunities and growth, will be targeted for RHS housing and housing finance. While the HIRDS supports further downstreaming and greater outreach to moderate and low-income households, RHS beneficiaries who satisfy credit appraisal criteria will not be the poorest of the poor.⁷ Building on lessons and experiences from the RHS to date,

⁵ With ADB support, the government is preparing a new WIS for 2013–2015. In the interim, the WIS (2008–2010) continues to guide the government's development and investment programs.

⁶ Governments globally support housing subsidies: supply-side (to incentivize lenders, developers, builders, etc.) and demand-side (to ensure housing/housing finance is affordable to targeted groups). See Global Comparison of Housing Subsidies (accessible from the list of linked documents in Appendix 2).

⁷ During the first year of the RHS, without selection criteria, 99% of the 847 RHS homebuyers were households from the highest income quartile. Downstreaming was initiated in 2010 following intensive policy dialogue with ADB on

as well as those from previous housing programs (focused on urban areas), public awareness, transparency, and accountability of site, beneficiary and contractor selection processes are being improved, inventories of non-agricultural land for rural housing are being developed, and pricing of new houses and housing construction costs are being closely monitored.

10. The Ministry of Economy (MOE), which is responsible for overseeing the HIRDS, supports close coordination and better integration of the RHS and the RDP with the Financial Sector Development and MSE strategies to leverage synergies and improve development outcomes. Under the HIRDS, *hokimiyats* play a central role in preparing integrated rural development plans and regional investment strategies in close consultation with the private sector. Local governments are also important RHS and RDP stakeholders. District *hokimiyats* are required to provide RHS housing sites from state-reserved lands, assure that the sites are approved for residential use in accordance with state regulations, and coordinate the sites' access to basic infrastructure and utility services. Provincial *hokimiyats* engage local contractors to construct new RHS houses. District *hokimiyats*, in consultation with *mahallas* (citizen-based organizations) and local women's committees, are responsible for screening RHS applicants.

11. **Asian Development Bank (ADB) strategy.** Rural development is a priority for promoting pro-poor growth under both the WIS and the ADB country strategy and program (CSP).⁸ By helping to improve rural living conditions and livelihood opportunities, the investment program is consistent with both the government's and ADB's strategic objectives, and complements past and current ADB programs to improve rural and MSE development.⁹ ADB's current country strategy, anchored on the WIS, focuses ADB assistance on energy, transport, basic services (education, health, and water supply and sanitation), and agricultural development (including water management and irrigation), as well as private sector development and access to finance.

12. **Multitranches financing facility (MFF).** The government has requested ADB support through an MFF to help finance housing loans for moderate- and low-income households and support capacity development to strengthen implementation of the HIRDS. The MFF enables ADB to enter into a partnership with a longer-term government commitment built upon shared principles. The MFF also helps ADB sequence and link investment support to the HIRDS road map and policy framework, and implementation of programmed reforms, institutional change, and critical improvements in fiduciary oversight. Other ADB modalities considered did not address the requirements of the government. All MFF preconditions are in place: a strategy and road map, a policy framework, and an investment program and financing plan.

13. **Policy framework.** The HIRDS road map and policy framework provides a basis for an in-depth policy dialogue on the investment program, and enables ADB investment support for rural housing to be transparently structured and results-based. During tranche 1, public awareness and transparency of RHS beneficiary selection and procurement processes will be improved. RHS beneficiary selection criteria and selection process will be strengthened to reach moderate- to low-income borrowers (young families and first-time homeowners, teachers, and health care workers [two occupations in which women predominate]) and other skilled professionals,¹⁰ and targets will be set for subsequent tranches to improve outreach of the RHS

the investment program, and about 74% of RHS beneficiaries for 2010 are from the third income quartile. For 2011, about 85% of RHS beneficiaries are within the third (75%) and second (8%) income quartiles.

⁸ ADB. 2006. *Country Strategy and Program: Uzbekistan, 2006–2010*. Manila. A new country partnership strategy will be adopted in 2012.

⁹ The investment program is in ADB. 2011. *Country Operations Business Plan: Uzbekistan, 2011–2013*. Manila.

¹⁰ Selection criteria include income thresholds to reach households in the lowest three income quintiles and gender-beneficiary targets. Refer to the Facility Administration Manual (accessible from the list of linked documents in Appendix 2).

to low-income households. To mitigate real estate or land speculation, RHS homebuyers will be required to make significant down payments and maintain houses financed under the RHS as their primary residence. RHS site selection will be undertaken in full accordance with national and ADB safeguard policies. Measures to address fiduciary and governance concerns will be strengthened to ensure transparency and accountability for land acquisition, the selection of contractors, and procurement of construction materials. Additional measures will be adopted to ensure the quality of new houses and value for money. Programs to improve *hokimiyat* capacity, and address constraints to rural and MSE development, will be developed and rolled out.

14. Critical policy actions and reform measures will be preconditions for ADB finance post-tranche 1. For tranches 2 (2013), 3 (2014), and 4 (2015), benchmarks have been defined for phasing out interest rate support¹¹ and promoting greater competition and efficiency. By 1 January 2013 (tranche 2), the RHS will be open to other participating commercial banks (PCBs) on the same concessional terms. The multiple roles of the Qishloq Qurilish Invest (QQI), which currently acts as a construction supervisor and, through its subsidiaries, as a supplier of some RHS construction materials, will be phased out. By 1 January 2013 (tranche 2), QQI construction material factories will be spun off. By 1 January 2014 (tranche 3), QQI will be established as an independent legal entity, and the RHS will be open to other developers and construction supervisors on the same concessional terms. Based on a study undertaken during tranche 2, the government will pilot viable options for sustainable public support for low-income rural housing during tranche 3 and 4, and develop a strategy to expand outreach to low-income rural households for the next phase of the RHS. During subsequent tranches, training programs for *hokimiyats* will be enhanced, and key legislation and regulations needed to improve the enabling environment for housing finance and MSEs will be adopted.

15. **Capacity development.** MOE will strengthen intergovernmental coordination to achieve greater integration and synergies of government strategies and programs that support rural development. Training programs will be improved to strengthen *hokimiyat* capacity for integrated rural development planning and investment promotion. Rural job creation and demand-driven skills training and re-skilling programs will be closely coordinated with the private sector and with regional investment promotion strategies to generate sustainable rural employment opportunities. A review of global approaches and best practices will determine next steps for further enhancement of the MSE enabling environment and expansion of rural MSEs.

16. Opportunities will be explored to further improve the impact of the RHS. A results-based monitoring and evaluation framework will be developed and implemented to track outreach to targeted beneficiaries of RHS houses and mortgages, as well as rural growth, investment and job creation. Studies will be undertaken to evaluate: (i) sustainable options for extending public support for housing (particularly for lower-income housing); (ii) alternative energy and energy efficient options for improving RHS house designs; and (iii) measures to strengthen government procurement processes (and the oversight role of the State Committee of Architecture and Construction [SCAC] and related agencies). To ensure prudent expansion of rural mortgage portfolios, credit appraisal processes and portfolio risk management procedures and systems of PCBs will be strengthened.¹² An independent technical and financial performance audit will be

¹¹ With no established pricing benchmark for long-term mortgage loans to moderate and low-income rural households, the CBU refinancing rate serves as a proxy for the market rate. By tranche 4 (2015), the weighted average RHS interest rate will equal the market interest rate assuming the CBU refinancing rate falls to 7% in accordance with current government forecasts. For details of specific benchmarks see footnote 19.

¹² In addition to PCBs' own capacity strengthening programs (for which SUM5.8 billion [\$3.4 million] is allocated), standardized approaches for credit evaluation and portfolio risk management, in accordance with best practices, will be developed and adopted under the Financial Sector Development Strategy. For the latter, technical assistance (TA) support to the CBU and PCBs is being considered under ADB. 2010. *Technical Assistance for Financial Sector Development in Central and West Asia*. Manila (TA 7709-REG).

carried out annually to assure accountability and continuous improvement of RHS processes, and delivery of quality construction and value for money.

B. Impact and Outcome

17. In support of greater inclusive economic growth, the expected impact of the investment program is improved living standards for rural communities. With more and better rural housing, the outcome of the investment program is improved rural housing for targeted beneficiaries.

C. Outputs

18. The investment program will deliver three outputs: (i) finance for approximately 40,800 new rural houses through loans extended by PCBs to targeted RHS homebuyers, and strengthened investment program implementation to achieve greater development impact; (ii) capacity development for *hokimiyats* in project areas to prepare and better implement their integrated rural development plans and investment promotion strategies; and (iii) reforms to support an improved enabling environment to encourage and accelerate rural MSE development. Project 1 will finance approximately 10,300 houses, capacity development for *hokimiyats*, MOE, QQB and related bodies, and project management support. Other investment program outputs are detailed in Appendix 1.

D. Investment and Financing Plans

19. The total cost of the investment program is \$3.0 billion, most of which will be financed by the government. An MFF of up to \$500 million from ADB's ordinary capital resources is requested to enable the government to address demand for housing finance by targeted beneficiaries and to strengthen the investment program's development impact.

Table 2: Investment Program, FY2011–FY2015
(\$ million)

Item	Amount
Component 1: Rural housing loans for new rural housing	3,028.5 ^{a, b}
Component 2: Improving <i>hokimiyat</i> (local government) capacity	2.0
Component 3: Improving the enabling environment for micro and small enterprises	24.0
Total	3,054.5

^a Includes \$2.31 billion for new rural housing (\$1.48 billion for rural housing loans and \$833.5 million in homebuyer down payments); \$323 million for related utilities and social services; \$386 million for community and commercial facilities; and \$4.4 million for capacity development.

^b Does not include land, taxes, duties, interest, and other in-kind government contributions or incentives (tax concessions for RHS participating banks, contractors, and suppliers, and mortgage tax credits for homeowners).

Sources: Asian Development Bank and Government of Uzbekistan.

20. The MFF will consist of approximately four tranches, each conditioned on submission of related periodic financing requests, execution of related loan and project agreements for each tranche, and fulfillment of terms and conditions and undertakings set forth in the framework financing agreement.¹³ Tranche 1 of \$200 million will be provided as a loan with an 18-year term, including a grace period of 3 years, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15%, and such other terms and conditions set forth in the loan and project agreements. Further tranches will be subject to the availability of finance and allocation arrangements under ADB's ordinary capital resources.

¹³ The government has provided ADB with (i) the reasons for its decision to borrow under ADB's LIBOR-based lending facility based on these terms and conditions, and (ii) an undertaking that these choices were its own independent decision and not made in reliance on any communication or advice from ADB.

Table 3: Financing Plan for the Investment Program, FY 2011–FY2015

Source	Component 1 (\$ million)	Components 2 and 3 (\$ million)	Total Amount (\$ million)	Share of Total (%)
Asian Development Bank	500.0 ^a	...	500.0	16.4
Participating commercial banks	536.3 ^b	...	536.3	17.5
RHS homebuyers (down payments)	833.5	...	833.5	27.3
Government of Uzbekistan	773.1 ^c	26.0	799.1	26.2
Private sector	385.6	...	385.6	12.6
Total	3,028.5	26.0	3,054.5	100.0

... = not available, RHS = Rural Housing Scheme.

^a Includes \$1 million for capacity building under the investment program.

^b Includes \$3.4 million for capacity building under the investment program.

^c Includes \$450 million in concessional financing (\$90 million annually) to participating commercial banks.

Sources: Asian Development Bank and Government of Uzbekistan.

21. **Relending, foreign exchange risk, and interest rate support.** The ADB loans will be lent to the government in US dollars for 18 years (including a 3-year grace period). The ADB loans (less \$1 million for capacity development) will be relented to PCBs in SUM under the same terms. Recognizing the social focus of the RHS and without an established pricing benchmark for raising long-term SUM, the government will assume the foreign exchange risk¹⁴ and relend the SUM equivalent under subsidiary loan agreements to PCBs at an annual interest rate satisfactory to ADB.¹⁵ PCBs will onlend to RHS homebuyers (subborrowers) subloans in SUM at an annual interest rate to be determined in consultation with ADB, that allows for a sufficient operating and profit margin and supports the phase out of interest rate support.¹⁶ The maximum subloan size will be the lower of 1,000 times the minimum monthly wage or the SUM equivalent of \$50,000, offered for a term not exceeding 15 years (including a 6-month grace period).¹⁷ Under Tranche 1, \$199,600,000 will be relented by the government to QQB for onlending to the RHS homebuyers, and \$400,000 will be made available to MOE for implementing the capacity development and project management support activities.

E. Implementation Arrangements

22. The investment program will be implemented during 2011–2016, in accordance with arrangements and procedures outlined in the facility administration manual (FAM). MOE will be the executing agency, and MOE and PCBs will be the implementing agencies. The procurement process for selection of RHS contractors will follow established national commercial practices and procedures acceptable to ADB. Due to the remoteness and geographical scattering of rural housing sites, and relatively small values of civil work contracts, the works are likely to be carried out by local contractors using locally sourced construction materials and supplies.¹⁸

¹⁴ The cost of the foreign exchange risk is estimated at 8%–9% (CBU's forecast for SUM depreciation against the US dollar is used as a proxy). In accordance with ADB. 2003. Financial Intermediation Loans. *Operations Manual*. OM D6/BP. Manila (part D.4, paras. 17–19); and ADB. 2008. Foreign Exchange Risk. *Operations Manual*. OM H7/BP. Manila (part C.2, paras. 11–13), "ADB may consider subsidization of foreign exchange risk if warranted by country or project-specific considerations".

¹⁵ This arrangement assumes government interest rate support to PCBs for foreign exchange risk. ADB policies back such support provided that it is targeted, transparent, fiscally sustainable, and includes an exit strategy. In addition, the government provides a number of tax incentives and tax credits.

¹⁶ For tranche 1 (2012), the RHS interest rate will be fixed at 7%. For tranche 2 (2013), the RHS interest rate will be the weighted average of: 7% applied to years 1–10, and 100% of the CBU refinancing rate applied to years 11–15. For tranche 3 (2014) and tranche 4 (2015), the RHS interest rate will be the weighted average of: 7% applied to years 1–5, and 90% and 100%, respectively, of the CBU refinancing rate applied to years 6–15.

¹⁷ For 2011, ADB's financing share for each subloan is 0%. ADB's financing share for each subloan is 65% in 2012, 45% in 2013, 40% in 2014, and 35% in 2015. Over the 5-year MFF term, ADB's average financing share is 35%.

¹⁸ While international competitive bidding is not precluded, it is unlikely that foreign bidders will be attracted to the labor-intensive residential construction works to be undertaken at 300–400 sites across the country.

Procurement arrangements have been defined in the FAM in full consultation with ADB's Central Operations Services Office.

Table 4: Implementation Arrangements

Aspects	Arrangements
Implementation period	June 2011–July 2016
Estimated completion date	31 December 2016
Management	
(i) Executing agency	Ministry of Economy
(ii) Implementing agencies	Ministry of Economy, participating commercial banks
(iii) Implementation unit	Ministry of Economy project implementation unit
Procurement	Advance action for procurement will be undertaken.
Disbursement	Loan proceeds will be disbursed in accordance with the Asian Development Bank's <i>Loan Disbursement Handbook</i> (2007, as amended from time to time).

Source: Asian Development Bank.

23. **Single Source Selection of Qishloq Qurilish Invest.** ADB requires PCBs to ensure the construction of RHS houses financed by PCB loans are contracted for in accordance with procurement processes acceptable to ADB. While construction contracts will be awarded based on competitive bidding procedures, all RHS homebuyers are required to contract solely with QQI for the purchase of RHS houses. For QQI services, homebuyers will be directly responsible for all payments related to QQI's services.¹⁹ Thus, while costs related to QQI's services will not be financed by ADB, ADB procurement guidelines require that ADB satisfy itself that the procedures employed will result in the selection of a construction supervisor that has the necessary professional qualifications and will carry out the assignment in accordance with the agreed schedule; and that the scope of the assignment is consistent with the needs of the investment program. ADB is satisfied that the selection of QQI meets these criteria.

24. QQI was established to oversee and supervise the construction of RHS houses to ensure that the nationwide RHS is properly managed, transaction costs are minimized, and construction is timely and in accordance with state building and construction standards. In fulfilling its multiple roles, QQI has gained considerable experience and demonstrated satisfactory capacity to implement these tasks. Moreover, the quality and pace of the RHS will be difficult to ensure without the services of QQI and, as such, its involvement under initial tranches remains necessary. ADB procurement procedures allow for single source selection (by RHS homebuyers) under specific circumstances and will be applied with exclusivity to QQI only for tranches 1 and 2. Thereafter, QQI will be restructured as an independent legal entity, and the RHS program will be open for homebuyers to buy from other developers or construction supervisors. Subsequent to tranche 2, QQI will remain eligible to participate as long as it continues to meet program criteria, but will no longer be engaged on a single source basis.

III. DUE DILIGENCE

A. Economic and Financial

25. **Economic impact.** Housing investment stimulates economic activity and creates jobs. Long-term funding reduces liquidity risk for banks and boosts overall bank lending. Savings for down payments and loan repayments from homebuyers increase available financial assets and demand for financial services.

¹⁹ The government is the RHS "developer". The state owns the proposed housing sites and, together with relevant utility agencies, provides sites with access to basic services. QQI, a wholly owned subsidiary of QQB, is mandated as the sole construction supervisor for the RHS. As an agent for both *hokimiyats* and RHS homebuyers, QQI supervises construction quality and building standards of RHS houses. QQI also owns a number of construction material factories from which RHS contractors may procure supplies when they are not otherwise available.

26. **Demand and affordability.** Thus far, more than 65,000 inquiries have been registered for the RHS, with more than 10,000 applications received for the 7,400 houses to be built in 2011. There is significant demand by creditworthy beneficiaries, which will increase with broader public communication of the RHS (footnote 7). The price for RHS new houses built in 2011, broadly ranges from \$41,143 to \$52,898 (SUM70 million–SUM90 million). With less than 35% of household income in the form of formal wages, the annual income for targeted beneficiaries is estimated at \$7,656 to \$20,902. Assuming a minimum down payment of 25% and mortgage payment to income ratios (as is currently applied to rural households), house prices that range from \$25,513 to \$104,479 (SUM42 million–SUM173 million) are within the generally affordability of RHS targeted beneficiaries.²⁰ Specific targets for subsequent tranches will be defined during tranche 1 to ensure an increasing proportion of low-income households are reached. Viable options will be explored to expand outreach to lower-income beneficiaries over the longer term.

27. **Price setting and value for money.** The contract price for houses constructed under the RHS is cost-based and based on the final bid from the winning contractor. Costs additional to contractor costs are detailed in the homebuyer's purchase agreement. A number of significant cost-containment measures have been adopted and will remain in place.

28. **Financial viability and sustainability.** The investment program is financially viable and fiscally sustainable. QQB and other prospective PCBs have experience in housing finance and are committed to expanding rural mortgage lending portfolios in a prudent manner, and upgrading rural credit appraisal and mortgage portfolio risk management systems. Sustainability will be supported by opening the RHS to other PCBs and developers, phasing out interest rate support, and adopting measures to improve public support to the sector.

B. Governance

29. The investment program features important design elements to support good governance and ensure accountability and transparency: (i) adopting and broadly publicizing well-defined beneficiary selection criteria; (ii) implementing an accountable beneficiary selection process with coordinated involvement of district *hokimiyats*, *mahallas*, and branch offices of the women's committee; (iii) publicizing the RHS pricing mechanism, cost saving measures, and tax concessions; (iv) providing accessible recourse and grievance redress mechanisms; (v) undertaking of a technical–financial performance audit and value for money assessment; (vi) publishing a results-based performance report annually on the investment program; and (vii) supporting accelerated market development and greater competition with implementation of important measures under the policy framework (as outlined in para. 14).

30. The government and QQB's financial management capacity, and policies and procedures, have been assessed as satisfactory. A FAM outlining investment program implementation arrangements including additional measures to strengthen governance, accountability, and transparency, will be adhered to throughout implementation. Legal agreements include provisions specifying ADB's right to audit government and PCBs' records and accounts related to the investment program. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and QQB. The specific policy requirements and supplementary measures are described in the FAM.

²⁰ For 2011, the average down payment made by approved RHS applicants (of which more than 80% are within the targeted income threshold [i.e., within the second and third income quartiles]) is more than 35%. The affordability assessment is outlined in the Economic Analysis (accessible from the list of linked documents in Appendix 2).

C. Poverty and Social

31. The investment program, while not a targeted intervention, is aligned with the CSP and supports the government's goal of reducing poverty to 20% by 2015. By providing access to affordable housing finance and modern new rural housing, the program plays an important role in greater inclusive economic growth, improving rural living standards, and meeting the Millennium Development Goals. The investment program will contribute to poverty reduction through employment generation in the rural construction sector and ancillary industries and by enabling development and expansion of rural entrepreneurs and MSEs.

32. While Uzbekistan has a good record in gender equality, inequalities remain. Without regular income or collateral, women are constrained and unable to access finance for housing or business startups. Legally, men and women have equal access and property rights to housing and land. Traditionally, however, title is issued in the name of the registered borrower who, in most cases, are men. The investment program is categorized as effective gender mainstreaming because it aims to promote better outreach and access to rural housing finance and improved rural housing and employment opportunities for women.

D. Technical – Construction Sector

33. Uzbekistan's construction sector is well established and comprises engineering and design services, builders and contractors, and construction equipment and construction material factories. In 2009, over 20,000 construction companies were registered, of which more than 90% are privately owned. Construction firms have broad experience with infrastructure projects and public and commercial buildings. While there are few small residential housing developers, which generally focus on urban areas, a large number of contractors exist with significant interest and capacity to build RHS houses. At 10% of the total value of civil works undertaken annually, the investment program will significantly stimulate the rural construction sector.

34. To ensure transparency and accountability of construction quality assurance processes, the government has mandated oversight roles to SCAC and other key agencies. The SCAC assesses RHS house designs, engineering specifications, and unit costs, and oversees compliance with state building and construction standards. The SCAC also monitors construction compliance with state norms and standards, and ensures inspection requirements are adhered to. Adherence to requirements will be closely monitored, and assessed as an integral component of the annual independent technical–financial performance audit.

E. Environmental and Social Safeguards

35. Tranche 1 is classified as category FI (financial intermediary) and treated as impact category C for all safeguards. Environmental impacts are anticipated to be insignificant and only land sites with no involuntary resettlement or indigenous peoples' impacts will be considered. Each PCB will adopt an environmental and social management system (ESMS) with screening criteria and monitoring procedures to ensure that (i) subprojects have minimal or no adverse environmental or social risks; (ii) none of the housing sites have involuntary resettlement or indigenous peoples impacts; and (iii) all housing sites are (a) categorized as state-reserved lands and approved for residential use, and (b) certified as technically and environmentally appropriate for housing construction. Safeguard requirements for tranche 1 will also apply to all subsequent tranches, with a due diligence assessment carried out annually to ensure that all new houses and house lots financed by ADB are in compliance with ADB safeguards.

F. Risks and Mitigating Measures

36. The program is classified as a medium risk project. Major risks and mitigating measures are summarized in Table 5, with details in the risk assessment and risk management plan.

Table 5: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
Adverse selection of RHS homebuyers	Well-defined RHS eligibility criteria and transparent selection process that involves <i>mahallas</i> (citizen-based organizations) and the women's committee; broad communication of criteria, routine monitoring, and social reporting.
Conflicts of interest between PCB (QQB) and construction supervisor (QQI which is a wholly owned subsidiary of QQB), and between developer (QQI) and construction material factories (which are wholly owned subsidiaries of QQI)	Closely regulated cost-based pricing and procurement processes (defined in FAM); annual independent technical financial audit and value-for-money assessment.
Conflict of QQI multiple roles: as technical advisor to the procurement committee, conflict of interest arises in evaluation of bids which potentially includes materials manufactured by its subsidiaries.	Mortgage loan proceeds will be directly deposited in homebuyer's account with withdrawal rights limited to the homebuyer. Rights and obligations during construction phase and under mortgage will be defined in home purchase agreements (with a breakdown of construction costs, a performance-based payment schedule, and details of rights of inspection, the 1-year construction warranty, and the homebuyer's recourse options).
Low-interest credit line to one PCB may crowd out other players.	Procurement led by <i>hokimiyats</i> (local governments). Improved procurement process and roles and responsibilities of key agencies outlined in the FAM; use of standardized procurement documentation, defined process, publicized results; no conditions requiring contractors to source materials from QQI-owned factories, as well as other measures outlined in the FAM.
Long term sustainability and fiscal affordability of extended public support for rural housing as designed	Rural housing finance market nascent. Interest rate support phased out. Opening of RHS to other PCBs and developers
	Capacity development, policy dialogue, close monitoring, and incorporation of lessons learned. Viable alternatives for improving targeting of public support of housing for poor and low-income households will be explored.

FAM = facility administration manual, PCB = participating commercial bank, QQB = Qishloq Qurilish Bank, QQI = Qishloq Qurilish Invest, RHS = Rural Housing Scheme.

Source: Asian Development Bank.

IV. ASSURANCES AND CONDITIONS

37. The government and QQB have assured ADB that implementation of the investment program shall conform to all applicable ADB policies including those concerning anticorruption, safeguards, gender, procurement, consulting services and disbursement, as described in detail in the FAM and the loan documents. The government and QQB have given ADB certain undertakings for the MFF, which are set forth in the framework financing agreement. Specific covenants agreed by the government and PCBs with respect to individual tranches under the MFF are set forth in the loan agreement and the project agreement for the respective tranches. The government agreed that loan effectiveness for tranche 1 is subject to (i) adoption of a government resolution to approve the action plan for implementing the HIRDS for the period up to 2015 and establishment of the investment program implementation unit, and (ii) the government and QQB entering into a subsidiary loan agreement in form and substance satisfactory to ADB.

V. RECOMMENDATION

38. I am satisfied that the proposed multitranche financing facility would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the provision of loans under the multitranche financing facility in an aggregate principal amount not exceeding \$500,000,000 to the Republic of Uzbekistan for the Housing for Integrated Rural Development Investment Program from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, and such other terms and conditions as are substantially in accordance with those set forth in the framework financing agreement presented to the Board.

Haruhiko Kuroda
President

9 August 2011

DESIGN AND MONITORING FRAMEWORK FOR THE INVESTMENT PROGRAM

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p>Impact Rural communities have improved living standards</p>	<p>Average rural household formal income increases from SUM373,650 in 2010 to at least SUM816,769^a in 2015</p> <p>At least 75,000 rural construction jobs created annually from 2011 to 2015</p> <p>At least 450,000 rural MSE and home-based jobs created annually from 2010 to 2015</p> <p>At least 40,800 RHS rural houses constructed with access to improved utilities by 2015, up from 7,647 in 2010 to 48,447 in 2015</p> <p>At least 177 new or rehabilitated schools near RHS housing sites from 2011 to 2015</p> <p>At least 140 new or rehabilitated rural health clinics near RHS housing sites from 2011 to 2015</p>	<p>Specialized project reports submitted by MOE (executing agency) to ADB (with annual updates of funds allocated for the investment program and investment program outcomes achieved)</p>	<p>Assumptions Macroeconomic stability and growth continues on a similar trajectory.</p> <p>The government implements MFF road map actions and reforms on a timely basis.</p> <p>Risk Rural–urban migration continues due to exogenous factors.</p>
<p>Outcome Improved rural housing for targeted beneficiaries</p>	<p>At least 95% of 40,800 new rural modern homes under the RHS with access to basic utilities owned and occupied by “targeted” beneficiaries (moderate- to low-income households, young families, single-headed households, rural teachers, and health workers) (of which 30% are women)</p>	<p>Specialized project reports submitted by MOE to ADB</p>	<p>Assumption Demand for rural housing under RHS by targeted beneficiaries</p>
<p>Outputs</p> <ol style="list-style-type: none"> 1. Housing loans provided by PCBs to targeted creditworthy subborrowers in rural areas 2. Improved capacity of local governments to prepare and implement integrated rural development plans and investment promotion strategies 3. Improved enabling environment for entrepreneurs and MSEs to expand or establish new businesses in rural areas 	<p>At least 39,000 with a value of at least SUM2.4 trillion of housing loans provided to targeted beneficiaries, of which 30% are women</p> <p>At least 65,000 staff of local governments trained in integrated rural development planning and investment promotion strategies (sex-disaggregated)</p> <p>Total microcredit lending in rural areas increases from SUM485 billion in 2010 to SUM1,361 billion in 2015</p> <p>Number of newly established MSEs in project areas (disaggregated by sex of owner) (baseline to be established)</p> <p>Number (and list) of new or revised policies, regulations, and laws adopted (baseline to be established)</p>	<p>Reports submitted by PCBs to ADB</p> <p>Specialized project reports submitted by MOE to ADB</p> <p>Specialized project reports submitted by MOE to ADB (with annual updates of funds allocated for MSE development and MSE outcomes achieved)</p>	<p>Assumptions Continuing creditworthiness of the subborrowers over the life of the housing loans</p> <p>PCBs are interested in increasing housing loan portfolios in rural areas.</p> <p>Risk Inflation increases construction costs</p>

Activities with Milestones	Inputs
1.1 The government adopts a new gender-sensitive process for identifying, prioritizing, and selecting creditworthy targeted RHS beneficiaries (moderate- to low-income rural households), and teachers and health care professionals to receive RHS housing loans (subloans) (September 2011) and QQB initiates the broad RHS public awareness campaign to solicit applications for RHS housing loans to be disbursed in 2012 (initiate in September 2011).	ADB \$500.0 million PCBs \$535.4 million RHS Homebuyers \$834.0 million
1.2 The government amends RHS contractor selection in accordance with ADB's Procurement Guidelines (2010, as amended from time to time) and adopts amended process for selection of 2012 contractors (September 2011).	Government of Uzbekistan \$797.9 million
1.3 District <i>hokimiyats</i> (local governments), in coordination with relevant agencies, identify, select, and approve RHS land sites for 2012 (August–September 2011), and identify, prioritize, and recommend eligible 2012 RHS homebuyers (subborrowers) (September–November 2011).	Private Sector \$386.0 million
1.4 Provincial <i>hokimiyats</i> undertake open competitive selection of RHS contractors for 2012 (August–November 2011).	Total \$3,053.3 billion
1.5 QQB assesses eligible 2012 RHS homebuyers (subborrowers) for creditworthiness and approves 10,300 RHS housing loans (subloans) for 2012 (October–December 2011).	
1.6 ADB conducts due diligence of (i) selection of 2012 RHS housing sites in accordance with ADB safeguard requirements, (ii) selection process for 2012 RHS homebuyers (subborrowers), and (iii) selection process of 2012 RHS contractors (November–December 2011).	
1.7 ADB provides an advance of approximately \$150 million, based on the cash flow projection for 6 months, to Uzbekistan under tranche 1 (September–October 2011).	
1.8 MOF provides a loan to QQB in the amount of the local currency equivalent of \$199.6 million (with a first drawdown of \$150 million based on the cash flow projection for six months) under a subsidiary loan agreement (September–October 2011).	
1.9 MOE (PIU), in close coordination with ADB, develops and adopts implementation plans for: (i) HIRDS capacity development (March 2012); (ii) the GAP (March 2012); and (iii) an integrated and results-based monitoring, evaluation, and quarterly reporting framework (for HIRDS roadmap and policy framework, HIRDS capacity development, the GAP (first investment program progress report January 2012).	
1.10 QQB disburses RHS housing loans totaling SUM570.0 billion (\$335.0 million) to eligible RHS homebuyers (subborrowers) (January–June 2012).	
1.11 MOE (PIU), in coordination with ADB, undertakes the first technical–financial performance audit of RHS to evaluate transparency and accountability of amended processes (beneficiary selection, pricing, contractor selection, construction quality assurance) adopted for implementation in 2012, and evaluates value for money and construction quality of RHS houses built in 2009, 2010, and 2011 (initiate in November 2011 and complete by February 2012).	
1.12 ADB and the government agree on the size of tranche 2 (April 2012).	
1.13 ADB conducts due diligence assessment of commercial banks that express interest in participating in tranche 2 (May 2012).	
1.14 ADB processes and approves tranche 2 (December 2012).	
1.15 MOF provides loans to PCBs in the aggregate amount of the local currency equivalent of the amount of tranche 2 under subsidiary loan agreements (December 2012).	
1.16 PCBs disburse RHS housing loans totaling SUM467.0 billion (\$274.5 million) to eligible RHS homebuyers (subborrowers) (January–June 2013).	
1.17 Tranches 3 and 4 are prepared and disbursed in accordance with the same procedures as for tranche 2 (January–June 2014 for tranche 3, and January–June 2015 for tranche 4).	
2.1. MOE (PIU), in close coordination with ADB, develops and adopts an implementation plan for HIRDS training activities to improve capacity of local governments to prepare and implement integrated rural development plans and investment promotion strategies (March 2012).	
2.2. Develop HIRDS training programs for <i>hokimiyats</i> (March 2012).	
2.3. MOE (PIU) submits semiannual reports on HIRDS local government training programs (first report March 2012).	
3.1. MOE (PIU), in close consultation with ADB and key stakeholders, assesses main constraints to “rural” MSEs and develops a strategy and time-bound action plan for strengthening the “rural” MSE enabling environment. (March 2012).	
3.2. MOE (PIU) submits semiannual reports on MSE activities (first report March 2012).	

ADB = Asian Development Bank, GAP = gender action plan, HIRDS = Housing for Rural Integrated Development Strategy, MFF = multitranche financing facility, MOE = Ministry of Economy, MOF = Ministry of Finance, MSEs = micro and small enterprises, PCB = participating commercial bank, PIU = project implementation unit, QQB = Qishloq Qurilish Bank, RHS = rural housing scheme.

^a Assumes an annual increase in income of at least 20% in 2011, 2012, and 2013; 15% in 2014; and 10% in 2015.

Sources: Asian Development Bank and Government of Uzbekistan.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=44318-01-3>

1. Loan Agreement
2. Project Agreement
3. Framework Financing Agreement and Periodic Financing Request for Project 1
4. Sector Assessment (Summary): Multisector
5. Facility Administration Manual
6. Contribution to the ADB Results Framework
7. Development Coordination
8. Financial Analysis
9. Economic Analysis
10. Country Economic Indicators
11. Summary Poverty Reduction and Social Strategy
12. Gender Action Plan
13. Risk Assessment and Risk Management Plan

Supplementary Documents

14. Housing for Integrated Rural Development Capacity Development
15. Rural Housing Scheme: Main Partner Agencies
16. Rural Housing Scheme: Qishloq Qurilish Invest
17. Rural Housing Scheme: Pricing of New Houses
18. Rural Housing Scheme: Contractor Selection
19. Rural Housing Scheme: Construction Quality Assurance
20. Construction Sector Overview
21. Global Comparison of Housing Subsidies