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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
PROGRAM DOCUMENT  
FOR A PROPOSED  
PROGRAMMATIC LOAN FOR SUSTAINABLE AND EQUITABLE GROWTH:  
HOUSING SECTOR REFORM  
IN THE AMOUNT OF US\$ 502.5 MILLION  
TO THE  
FEDERATIVE REPUBLIC OF BRAZIL  
May 11, 2005

**Finance, Private Sector and Infrastructure Unit  
Brazil Country Management Unit  
Latin America and the Caribbean Region**

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## **CURRENCY EQUIVALENTS**

Currency Unit: Real (R\$)

## **EXCHANGE RATE**

December 31, 2001: R\$2.65 = US\$1

December 31, 2002: R\$3.52 = US\$1

December 31, 2003: R\$2.90 = US\$1

December 31, 2004: R\$2.65 = US\$1

## **WEIGHTS AND MEASURES**

Metric System

## **FISCAL YEAR**

January 1 – December 31

## **ABBREVIATION AND ACRONYMS**

CEF	Caixa Econômica Federal (Federal Loan and Savings Bank)
CNM	Conselho Monetário Nacional (National Monetary Council)
CVM	Comissão de Valores Mobiliários (Security and Exchange Commission)
DPL	Development Policy Loan
FAT	Fundo de Amparo ao Trabalhador (Worker Support Fund)
FNHIS	Fundo Nacional de Habitação de Interesse Social (National Social Interest Housing Fund)
FGTS	Fundo de Garantia do Tempo de Serviço (Workers Severance Fund)
IBGE	Instituto Brasileiro de Geografia e Estatística (Brazilian Statistical Institute)
IHPH	Interministerial Housing Policy Group
IPEA	Instituto de Pesquisa Econômica Aplicada (Institute of Applied Economics)
MOC	Ministério das Cidades (Ministry of Cities)
MP	Medida Provisória (Project Law Issued by the Executive)
MW	Minimum wage (Currently 1MW=R\$260)
NHP	National Housing Policy
PAR	Programa de Arrendamento Residencial (Social Rental Program)
PAU	Policy Analysis Unit
PSH	Programa de Habitação de Interesse Social (Social Housing Subsidy Program)
SBPE	Sistema Brasileiro de Poupança e Empréstimo (Savings and Loan System)
SFH	Sistema Financeiro de Habitação (Housing Finance System)
SFI	Sistema Financeiro Imobiliário (Real State Financial System)
STN	Secretaria do Tesouro Nacional (Treasury)
SWAp	Sector Wide Approach
TAL	Technical Assistance Loan
TR	Taxa Referencial (Reference Interest Rate)

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### GLOSSARY OF INSTITUTIONS AND MAIN ACTORS

**Bolsa Familia.** A National Program of Subsidies that targets needed families with well-defined characteristics. It merged several social programs into a single well-targeted and monitored program

**CEF Caixa Econômica Federal** is the largest Federal Public Bank in Brazil and a major player in the housing finance system. It accounts for 40% of the outstanding direct housing credit system (SBPE) lending. Uses most of the FGTS funds that are on-lent for housing; manages the accounts of the FGTS members; and distributes the bulk of the public housing subsidy resources.

**Estatuto da Cidade** (the City Statute) is a law related to urban development which decentralized to municipalities a number of housing and land responsibilities and required cities to develop their institutional capacity, as well as participatory urban plans.

**FAT** (*Fundo de Amparo ao Trabalhador*) equivalent to a provident fund with contribution of employers.

**FGTS** *Fundo de Garantia do Tempo de Serviço* is the cornerstone of both the directed credit system -- financing 70% of all of housing credit in the past decade -- as well as the housing subsidy system, financing more than 50% of the subsidies. It is funded by the monthly compulsory contributions of salaried employees and individual accounts managed by CEF. Net assets are close to R\$10 billion.

**FCVS** was a public insurance fund created in 1968 to address the effects of adverse macroeconomic circumstances on the value of outstanding mortgages. It is mostly funded by public debt. The program stopped insuring loans originated after 1993.

**MOC (Ministry of Cities).** Created in 2003, the ministry filled an important vacuum in terms of urban and housing policy. It has made important advances to coordinate and define low-income housing policies, sharing with STN the management of the new social housing program. The World Bank has provided continued support to MOC in terms of policy dialogue and sector diagnosis; Cities Alliance has provided financial assistance on specific projects to help strengthen the MOC technical capacity.

**MP** (*Medida Provisoria*), a legal instrument issued by the President with the force of law but that has not been approved by the Parliament.

**NHP (National Housing Policy)** was prepared by the Ministry of Cities in wide consultation with partners and civil society. The Bank has been very active in the review of early drafts and in sharing methodology and conceptual framework. The document has been discussed and will be finalized in a couple of months.

**NHPL (National Housing Plan)** is the road map for the National Housing Policy determining specific targets for a certain period and accepting the responsibilities of each public agency, as well as the financial needs and sources of finance.

**SFH (Housing Finance System).** Created in 1964, the SFH is a classic closed-circuit housing finance system offering below-market rates on a limited pool of funds. It includes the SBPE, the savings and loans arm of the system, FGTS, FCVS, and CEF.

**PSH (Social Housing Subsidy Program) Parcelamento** is the component of the PSH that provides upfront subsidies to the beneficiaries and pays financial institutions to supervise the actual construction or purchase of the house. Municipalities contribute with the land and enforce the contracts

**PSH (Social Housing Subsidy Program) Financiamento** is the component of the PSH that subsidizes both the final beneficiary as well as the Bank to finance low-income households. In most cases, municipalities are the guarantors of the loan advanced to the households

**SBPE (Sistema Brasileiro de Poupança e Empréstimo)** is an old system that offers liquid and tax free saving accounts (*cadernetas de poupança*), at a relatively low interest rate. Part of the funds are compulsory dedicated to finance housing loans.

**SFI (Sistema Financeiro Imobiliário)** is the new market-based housing finance system that the government is trying to develop.

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**BRAZIL**  
**EQUITABLE AND SUSTAINABLE GROWTH: HOUSING SECTOR REFORM**

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## BRAZIL

### PROGRAMMATIC LOAN FOR SUSTAINABLE AND EQUITABLE GROWTH: HOUSING SECTOR REFORM LOAN AND PROGRAM SUMMARY

<b>Borrower</b>	The Federative Republic of Brazil
<b>Implementing Agency:</b>	Ministry of Finance
<b>Poverty Category</b>	Not Applicable
<b>Amount</b>	US\$ 502.5 million
<b>Terms</b>	Fixed Spread US Dollar Loan with repayment period of 17 years including 5 years of grace with commitment-linked repayment schedule and level repayments or principal.
<b>Commitment Fee</b>	0.85% per annum during the first four years and 0.75% per annum thereafter on undisbursed loan amounts, beginning 60 days after the loan agreement is signed.
<b>Front-End Fee</b>	0.5% of the loan amount, capitalized and financed under the loan.
<b>Objective, Description and Benefits</b>	<p>The proposed operation is part of the set of loans to support the Government of Brazil in its agenda for sustainable and equitable growth. This loan focuses on one key component of this agenda: housing sector reform. It thus deepens the reform agenda to promote efficiency of the financial sector and improve economic opportunity. The proposed loan, in an amount of US\$502.5 million, will support initiatives already completed. An accompanying Technical Assistance Loan is expected to be presented to the Board shortly to assist the Government in pursuing its housing policy and design the necessary policy reforms which will be supported by further Bank lending to finance an integrated housing program and the national urban upgrading efforts.</p>

The objective of the program is to support the Government's efforts to improve access of the poor to improved housing and serviced/serviceable land, while maintaining fiscal discipline. Brazil has witnessed enormous progress in all economic and social fronts, the exception being the critical situation of the shelter for the poor. Continuing urban growth, coupled with persisting income inequality and absence of targeted shelter policies, has led to a situation where more than 60% of the households coming to the market are unable to find an affordable shelter solution and join the ranks of informality. The Government is committed to address this challenge by supporting the needs of the very poor and the development of a market that could and should cater to the less poor.

Specifically, the proposed operation supports the Government in its efforts to: (a) develop a sound national policy and institutional framework for housing and urban development; (b) strengthen the housing credit and savings systems, and provide incentives for the housing finance market to expand as well as move “downmarket”; (c) design and implement a unified federal housing subsidy system to address the affordability of housing solutions for the poor; and (d) reduce the costs of formal urban land development by strengthening land legislation and regulations and real property registries.

**Risks**

Timing and expectations. The natural time lag between policy reform and impact on housing markets could be seen as a weakness of the program. Mitigation: the Government has led open discussions and adopted a broad dissemination policy. The proposed monitoring and evaluation approach aims to provide information on the approach in the very short-term, and along the phases of the program.

Coordination and institutional risks. The program includes a number of actors, inside and outside the Government (Ministry of Cities, Ministry of Finance, Central Bank, local authorities) and coordination will be essential for the success of the program. Mitigation: the Government has established an inter-ministerial committee – the Interministerial Housing Policy Group – to supervise the housing reform program (including the accompanying TAL) and to ensure that all reforms are consistently implemented.

Macroeconomic developments and interest rate volatility. The development of the housing market is a function of the market interest rates which at the present are high given the monetary policy adopted by the Brazilian government. Continued high interest rates will hamper the expected development of the housing finance market and housing subsidies will remain necessary in the medium-term. Mitigation: The Government is committed to pursue its fiscal adjustment policy which should lead to a decline in overall debt and lower market interest rates. The program provides a conceptual framework to help the Government monitor the segments of the housing market including those relevant for poor and middle-income families.

**Financing Plan** Not Applicable

**Net Present Value** Not Applicable

**Project ID Number** P078716.



## PREFACE

1. ***The proposed operation is a single-tranche Loan in Support of the Growth Agenda to the Federative Republic of Brazil in an amount of US\$502.5 million.*** The proposed Loan would support the development of microeconomic, institutional, and policy reforms in the housing sector and particularly regarding low-income housing, aimed at increasing housing affordability and improving urban development as part of a broader set of measures pursuing sustainable and equitable growth.
2. ***The recent CAS for Brazil structures the Bank support along three pillars: Equity, Sustainability and Growth.*** The Bank support to the Growth agenda has pressed forward a cluster of activities under the growth pillar. Such activities have included, inter-alia, the Sustainable and Equitable Growth Series whose first loan was approved by the Board in 2004. That series supports a wide agenda of microeconomic and regulatory reforms. The first loan targeted investment and productivity while attempting to minimize inefficient microeconomic policies or the creation of fiscal liabilities. Increased investment and productivity were key objectives of a broad set of microeconomic, institutional and policy reforms that started with four reform areas (logistics, the business environment, financial efficiency and depth) as part of a longer list of growth-oriented reforms on which the Government was acting. ***A second loan of the program is envisaged in the next eight to twelve months to support key developments in the core areas established by the first operation.*** Reforms supported by the first operation are progressing satisfactorily with the approval of key legislation – such as the Public Private Partnership and Innovation and Bankruptcy laws – while significant steps are being taken towards its implementation.
3. ***The proposed housing sector loan – supporting low-income housing and housing finance market development - will deepen the financial sector component within the growth program initiated by the previous Programmatic Loan for Sustainable and Equitable Growth.*** The proposed loan extends the growth program based on deep new reforms to an important area, the readiness of which for policy-based lending support was uncertain when the previous loan was prepared. Steps towards improving housing market instruments, shifting to market structures, and promoting secondary mortgage markets have given a clear sign to both investors and lenders that the Government is committed to support a market-based housing finance system. A dialogue with the judiciary to improve contract enforcement and a commitment to persist in the deregulation and improved competition of the system are to be acknowledged. The overall impact will be felt in increased access to housing finance, release of private savings which have been tied up to now in excessive down payments and high housing costs, and improved competitiveness among financial agents. It will also impact fiscal sustainability by improving the targeting and transparency of housing subsidies and coordinating with local governments and private agents.
4. ***The reform in housing sector policy is a key component to reinforce the growth program*** objectives given the impact of housing and housing finance in promoting poverty alleviation and expanding the efficiency of the financial sector. Brazilian history has shown that due to persistent poverty, structural market failures, and poor regulation, economic growth by itself will not increase access of the poor to housing, which directly affects the “equity” dimension of the program. Unregulated urban agglomerations, lacking basic services such as water and sanitation, usually have a major impact on health and on the environment. These reforms therefore represent an important part of Brazil’s agenda for economic growth, and in particular the equitable sharing of that growth.

5. ***Reforms in the low-income housing field also reinforce economic growth itself.*** By favoring private investment in housing, the reforms in this field will raise capital accumulation while increased housing access may help to increase labor productivity. Improving urban development and housing access may help to reduce crime in major cities and thereby improve the “investment climate.” The boosting of the housing industry will also raise labor demand and employment opportunities, particularly for low-skill workers.

6. Although housing policy reforms were not originally envisaged to emerge now as part of the sustainable and equitable growth program, ***housing reforms are of fundamental importance for growth.*** This is particularly so if it is to be equitably shared, and the inclusion of the housing sector is therefore proposed within the Bank’s programmatic lending for sustainable and equitable growth. Broadening and deepening the agenda to include housing would confer flexibility going forward for the government to pursue reforms where they are most viable politically, while maintaining four streams of programmatic DPLs corresponding to the pillars of the 2004-2007 CAS, as requested by Government.

7. The initial operation in this sustainable and equitable growth cluster was approved on February 19, 2004, to support the Government’s policy initiatives to reduce logistics costs, improve the business environment, enhance the efficiency and depth of the financial system, and increase innovation capacity to transform knowledge into productivity gains. Reform progress on these four elements of the Government’s growth agenda has been significant. The policy triggers for further financial support for these elements of the growth agenda have largely been met, and a follow-on loan is under preparation.

8. ***The proposed loan is a centerpiece of the Bank’s planned support to a high-performing Government in a key strategic policy area.*** Since coming to power, the Government has a strong track record of policy-setting and leadership, showing firm commitment in the face of long odds to combining macroeconomic rigor with ambitious social objectives. While housing and the attendant social, economic, environmental, and health issues have been a clear concern for the Government, progress may have been slow in the last two years, due to the need to develop an institutional framework for the sector and continuing fiscal restrictions. The increasing pressure of unmet demand for shelter by low-income people continues to haunt both central and local governments. The pressure is magnified by highly publicized events showing the struggle of poor families trying to settle in privately owned land.

9. ***The proposed operation has its underpinnings in detailed analytical work and dialogue.*** While the Bank has had a visible presence in urban upgrading and municipal projects in Brazil with a marked success, dialogue on housing policy and low-income housing deepened in the last four years. After access to shelter services was identified as a priority area for Bank intervention during the pre-CAS consultation process, towards the end of 2000, the Bank launched field work that led to a comprehensive piece of ESW (Brazil Progressive Low-Income Housing: Alternatives for the Poor, Report 22032-BR). In addition, the Bank provided regular assistance and feedback to background papers and policy documents; offered training sessions to large groups of officials dealing with housing issues; organized the presence of a large number of Brazilian officials in internationally recognized housing finance training courses; commented on draft laws and national debates and tried to avoid major discontinuities in the dialogue during the change in administrations.

10. ***The proposed operation reflects the Government's considerable progress in defining new low-income housing and urban development policies.*** The Government has produced a National Housing Policy document, which has been discussed with a large array of stakeholders containing the proposals of the Ministry of Cities to the formulation of the National Housing Plan as well as the principles, guidelines and objectives for the sector. An inter-ministerial working group has been agreed upon to provide for the seamless support to some of the shelter and housing sector reforms. Milestones have been reached toward enhancing the institutional framework for low-income housing policy, introducing housing finance reforms, improving subsidy policy and addressing obstacles for land development and housing creation.

11. ***The creation of the Ministry of Cities (MoC) is a major step towards rationalizing sector institutions and strengthening their capacity to implement sound housing and urban development policies.*** Over the last fifteen years, responsibility for housing and urban issues has been shared by a number of ministries and secretariats, resulting in a weakened management of the sector and a lack of policy direction. The MoC issued a National Housing Policy and has undertaken broad consultation to foster consensus building and facilitate its implementation. The MoC also created a Policy Analysis Unit to improve systematic information collection and improve policy design. Further, the Council of Cities was created to facilitate broad participation and major private, civil society and public sector actors in the formulation of urban development policy.

12. ***The Government's explicit policy agenda to create a liquid and efficient integrated formal housing market based on private capital-markets is a clear departure from a history of directed credit and market segmentation.*** Major achievements in this area include: (i) the creation of a sophisticated legal framework for new mortgage-backed securities and mortgage bond markets, including mortgage-backed instruments; (ii) the creation of the *alienação fiduciária* (trust deed) as a stronger mechanism for collateralization than the mortgage lien and of the *patrimônio de afetação* ("affected assets") to segregate the advance payments made by households during the construction against the possible bankruptcy of a developer; and (iii) the approval of Law 10.931 of 2004, which strengthens the trust of credit institutions in housing finance instruments and legalizes secondary market products such as mortgage bonds.

13. ***Brazil's housing subsidy policy has undergone important changes, with a clear shift from implicit interest subsidies to transparent and targeted upfront subsidies.*** In 2001/2002, the Government launched an innovative upfront subsidy program – the *Programa de Subsídios à Habitação de Interesse Social* (PSH) – with funds coming from the Federal Government's budget and allocation done by competitive auctions to financial institutions. Since its inception in 2001, PSH has been greatly improved, notably in terms of regional balance, adjusted slope of the upfront subsidy amount, and expansion of participating lenders. The Government also split the program in a non-credit linked upfront grant program (*parcelamento*) and a credit-linked program (*financiamento*), which represent a further improvement to the program. Moreover, the FGTS (*Fundo de Garantia do Tempo de Serviço*) initiated steps to prioritize the use of its funds to households earning less than six minimum wages and established a new upfront subsidy program and has taken initial steps to prioritize the use of FGTS loan funds for households earning less than six minimum wages.

14. ***The Brazilian Government has also confronted key challenges in the field of urban development and land occupation.*** A draft law complementing the legal framework established in the 1998 Constitution and Law 10257 of 2001 (*Estatuto das Cidades*) is being considered by Congress. The draft law establishes new criteria and directives concerning land subdivision requirements and also procedures to regularize informal settlements, especially with regard to

property registries, legalizes the use of progressive land development and infrastructure introduction and transfers to municipal governments the central role in setting technical standards and enacting local legislation on land subdivision and urban land management in general.

15. ***The Government has requested a Development Policy Loan from the Bank to support its low-income housing program and its reform agenda for the sector as a whole.*** This document therefore proposes loans to support the Government program, included within the cluster of activities to support the growth agenda of the Government and the Growth pillar of the CAS.

16. ***The low-income housing policy area would be supported by an accompanying Technical Assistance Loan.*** The TAL, which will be presented to the Bank's Board of Directors shortly after this DPL, would aim to strengthen the capacity of the Government to formulate and implement housing and urban development policy as well as set the stage for future DPLs and a requested housing-linked SWAp

**PROGRAM DOCUMENT**  
**FOR A PROGRAMMATIC LOAN FOR SUSTAINABLE AND EQUITABLE GROWTH:**  
**HOUSING SECTOR REFORM**

**1. INTRODUCTION**

1.1 ***Successful macroeconomic policy and recent growth recovery will not necessarily increase access of the poor to housing and serviced land.*** In the past decade, Brazil has transformed itself economically and laid the institutional foundations for solid macroeconomic management while economic growth has recovered in the last two years. Yet the housing “deficit”, estimated at 7.1 million units mostly for households with incomes of less than 5 minimum wages, equivalent to 28 million people without access to adequate shelter, persists. A large share of housing is unauthorized (ranging from 32 percent in Recife to 9.4 percent in São Paulo), and informal urban settlements are growing 4 times faster than average urban growth. An estimated 50 percent to 65 percent (depending on the market) of new households formed annually cannot afford the most basic house produced in the formal market.<sup>1</sup>

1.2 ***At the same time, poor performance in the housing sector also affects economic growth and poverty reduction.*** Annual investments in housing currently contribute to 11 percent of the annual capital formation in Brazil. Housing accounts for 6 percent of GDP<sup>2</sup> while housing construction employs 5 percent of the labor force and empirical evidence suggests that the multiplier effect of housing construction on labor demand, particularly unskilled labor, is high. Access to improved shelter leads to higher returns for children’s education and expanded opportunities for higher paying jobs. Improving urban development and housing access also help to reduce crime in major cities. Authorized housing and its associated infrastructure services, such as water and sanitation, also have a positive impact on health and the environment. Improving access to housing and reliable urban services, therefore, improves labor productivity and the overall “investment climate.”

1.3 ***Persistent poverty, failures in the house financing system and inappropriate regulation are among the main causes of the housing sector problems.*** Affordability is the main cause of housing deficit: it is estimated that 60 to 70 percent of urban households cannot afford to buy the lowest-priced market house. High interest rates and constrained access to financial intermediation further decrease housing affordability. The housing finance sector is underdeveloped with an outstanding residential mortgage debt of about 3-4% of GDP (compared with 15% in Chile or 65% in the US). Inadequate housing finance regulation – such as those for the use of collaterals – blocked the development of housing finance services. Excessive land use regulations and cumbersome procedural requirements have also been a major impediment to construction of affordable authorized housing.

1.4 ***Historically, public policy in housing has been characterized by dirigisme and untargeted subsidies.*** The housing finance system has been overly dependent on public institutions using implicit interest rate subsidies and directed credit to finance mostly middle income groups. The sector has been in disarray for a long time, as the urban policy responsibility was scattered among institutions. Lack of administrative oversight led to frequent swings in policy and a lack of a reliable flow of resources to the sector. Urban and housing development

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<sup>1</sup> Fundacao Joao Pinheiro, Brazilian Housing Deficit (2004) and World Bank, Policy Note June 2002.

<sup>2</sup> Which is low compared with other countries at the same level of development.

tended to be seen as the way to distribute political favors rather than to promote one of the most important sectors in the economy.

**1.5 *The Government has initiated a comprehensive housing sector reform program by improving its housing finance sector regulations and introducing more efficient subsidies and initiating incentives for a more appropriate land regulation system.*** The long-term vision of Government policy for the sector is the establishment of a well-functioning housing market that serves the majority of the population with housing through ample new formal construction and upward filtering of households into better quality housing. Such housing market will require an efficient and effective housing finance system, efficient land markets and reforms in the Government directed housing finance and subsidy systems. Better targeted and transparent housing subsidies will assist households who cannot access markets yet without government support. While the full deregulation of the current government-directed housing finance system will not be feasible until several variables move in the right direction (e.g., sustained decline of interest rates and further development of the secondary market for mortgages), the Government has made important changes towards broader market-based finance. The Government has clearly defined housing and urban issues as part of the core policy agenda, making it a priority for the near future. Housing policy and programs have become a locus for multiple Government agency coordination (including Treasury, Ministry of Finance, Central Bank). On the subsidy front, the Government has shifted from implicit interest rate subsidies to upfront and transparent systems which allow the accounting, targeting and monitoring of their impact. On the finance side, strengthening of the housing credit instruments and the shift to market structures, promoting the development of secondary mortgage markets, have been steps in the right direction, giving a clear sign to both investors and lenders that the Government is committed to support a market-based housing finance system. A dialogue with the judiciary to improve contract enforcement and a commitment to persist in the deregulation and improved competition of the system are to be acknowledged as well. On land regulation, the Government has made important strides to review key legislation that has limited the capacity of the private sector to address excess demand, and to put in place a flexible land regulation system that will help the poor to access serviced land and to acquire or rent housing in the formal sector. The process is a long-term one and will take a number of years, but the first steps are important as they represent a rupture with the past and a commitment to maintain a healthy and market-driven housing market.

**1.6 *The new housing strategy is a clear development of the Government's microeconomic agenda of reforms.*** The development of mortgage credit, ensuring effective property rights, and removing obstacles to commercial lending for housing, are among the pillars of a sound housing strategy. These match perfectly the broader initiatives of supporting private sector development, improving the business environment, and increasing financial depth that represent the key ingredients of the Government growth strategy.<sup>3</sup> Better and streamlined regulation for land use are also an ingredient of the larger task of improving infrastructure regulation and simplifying business entry and operation, also elements of such agenda.

**1.7 *The new housing strategy is also part of a broader effort to increase the efficiency of social expenditure.*** The emphasis on targeted subsidies and the use of auctioning procedures to allocate subsidies are indicators of significant improvements in the housing subsidy strategy and are part of a broader effort to rationalize social expenditures, as for example in the case of *Bolsa Família*. At the same time, creative mechanisms to expand transparency and public participation in policy making, such as the *Conselho das Cidades* (Council of Cities), have been introduced to encourage consensus and political cohesion around key policies.

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<sup>3</sup> See World Bank Report No.27507-BR.

1.8 ***Brazil's new administration was elected on a platform that emphasizes economic growth and inclusion.*** President *Lula da Silva's* Government represents perhaps the first experiment in which a democratically chosen candidate, with the strong support of social movements in a highly unequal society, proposes to combine a clear commitment to social justice with a sound economic program. However, social disappointment and distress, to which the housing deficit contributes significantly, is a major threat.

1.9 ***The objective of the Growth Program is to foster economic growth,*** thereby reducing poverty and social tensions. On February 19, 2004, the Bank approved the First Programmatic Loan for Sustainable and Equitable Growth to support the Government's policy initiatives to reduce logistics costs, improve the business environment, enhance the efficiency and depth of the financial system, and increase innovation capacity to transform knowledge into productivity gains.<sup>4</sup> As discussed in Section 4A of the Program Document for that loan (pages 11-14), the Growth Program as defined above forms a subset of a broader growth agenda, which includes other microeconomic reform areas important for growth. The Growth Program encompasses legal, infra-legal, and institutional measures to improve market efficiency, including defining approaches to public-private interactions, strengthening the institutional capacity of agencies to plan and regulate, and enforcing laws and regulations consistently and predictably.

1.10 ***Reform progress on these elements of the growth agenda has been significant,*** and the policy triggers for subsequent lending to support them have largely been met with the approval of key legislation, most notably three key laws governing Public Private Partnership, Innovation, and Bankruptcy. A follow-up loan to support these elements of the Government's sustainable and equitable growth agenda is under preparation and is expected to be presented to the Board in Fiscal Year 2006.

1.11 At the same time, the government has been able to move ahead more quickly than expected with the far-reaching reforms to housing policy described in this document. Although these reforms were not originally envisaged as part of the growth program, they are of fundamental importance for growth, and in particular if it is to be equitably shared.

1.12 For this reason, the present document proposes the inclusion of these reforms within the Bank's programmatic lending for sustainable and equitable growth. Future DPL support to the housing policy agenda would also be integrated within the framework of the Bank's programmatic lending to support the Government's sustainable and equitable growth agenda. This would confer greater flexibility going forward for the government to pursue reforms where they are most viable politically, while maintaining four streams of programmatic DPL within the Brazil country program laid out in the 2003-2007 CAS, discussed by the Board on December 9, 2003.<sup>5</sup>

## 2. RECENT ECONOMIC DEVELOPMENTS

2.1 Without understating the importance of further structural reforms for long-term economic growth and poverty reduction, ***Brazil has now entered a more comfortable phase of economic management.*** For the first time since the 1970s, the Brazilian economy is experiencing a healthy combination of brisk growth, single-digit inflation, and a current account surplus. Prospects for

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<sup>4</sup> Report No. 27507-BR.

<sup>5</sup> Report No. 27043-BR.

2005 are good, and, although some risks remain, the country has established a track record of responding appropriately to shocks.

2.2 As a consequence of improved exports and an aggressive debt management strategy, *the Brazilian economy is also much less vulnerable to external shocks* than it was just a few years ago. In 2004, exports grew by 30 percent in dollar terms, imports grew at about the same rate, and the current account surplus was almost 2 percent of GDP. External financing requirements fell to US\$27 billion, less than half the requirement of as recently as 2001. Even as the Brazilian real has appreciated against the US dollar in recent months (to 2.72 at end 2004 from 3.07 at end 2003), the current account is expected to remain balanced or at a small surplus in the next few years.

2.3 *Export growth has been broad-based both in terms of destination and industry.* The EU is Brazil's largest market and accounts for almost 25 percent of exports, followed by the US and Latin America at just over 20 percent each. The recovering Latin American market has been the most important regional block in explaining Brazil's increasing exports and current account surplus, followed by the EU (see Table 1). This explains in part why the recent appreciation of the real relative to the US dollar is of only mild concern.

**Table 1: Brazilian Trade Patterns, 2003-2004**

	Exports, US\$ billion, fob					Trade Surplus, US\$ billion				
	2003	2004	Share of Total	Growth	Growth decomposition	2003	2004	Share of Total	Growth	Growth decomposition
Total	73.1	96.5	100%	32%	100%	24.8	33.7	100%	36%	100%
Latin America	12.9	19.8	21%	53%	29%	4.7	9.7	29%	106%	56%
Mercosur	5.7	9.0	9.0	58%	14%	0.0	2.6	8%	n.a	29%
EU	18.5	24.2	25%	31%	24%	5.4	8.2	24%	52%	31%
US	16.9	20.0	21%	18%	13%	7.1	8.7	26%	23%	18%
Asia	11.7	14.5	15%	24%	12%	2.8	2.3	7%	-18%	-6%
O/W: China	4.5	5.4	6%	20%	4%	2.4	1.7	5%	-28%	-8%

Source: Central Bank

2.4 Exports are varied: about half are manufactures, one-third primary resources; and export categories have shown growth in proportion with their overall share, illustrating the robustness of Brazil's recent export performance. While the real has appreciated against the dollar, it has remained stable against the currencies of other major trading partners. The real effective exchange rate appreciated by about 5 percent in 2004.

2.5 *Strong fiscal performance, anchored by the fiscal responsibility law, has led to a significant reduction of the level of the public debt* from its 2002 peak, falling to 77 percent of GDP in gross terms and 55 percent of GDP in net terms by end 2004. At the same time, high international liquidity has allowed Brazil to improve its debt composition markedly while accumulating foreign exchange reserves. The share of inflation-indexed or fixed-rate federal debt has reached 28 percent, up from 10 percent in 2002, whereas the share of foreign-exchange linked debt has shrunk to less than 5 percent.

2.6 *Risks remain.* In particular, expected rising US interest rates in the near future will exert a negative influence. This is primarily because they raise Brazil's cost of financing abroad and, by lowering demand for Brazilian assets and currency, elicit higher nominal interest rates in Brazil. This is particularly risky for Brazil given the relatively high public debt, the short term maturity of public domestic debt, and its degree of indexation to short-term instruments. Indeed,



since 45 percent of total public debt is still tied to the overnight inter-bank rate used by the central bank to target inflation (the SELIC), there is also a direct effect on the public finances (a one percent higher SELIC for one year causes a rise in the debt-to-GDP ratio of more than 0.2 percent).

**2.7 *Nonetheless, Brazil has shown through a series of episodes under different governments that it is willing and able to react through both fiscal and monetary policy when circumstances worsen.*** The four recent episodes of note in this respect are the floating of the currency in January 1999 in response to the Russian default, curtailed growth from the 2001 energy shortage in Brazil, contagion from the Argentine default, and the recession of 2002-03 around the general election. In all cases rigorous monetary policy was combined with fiscal tightening to weather the storm (Table 2).

**Table 2: Fiscal and Monetary Policy Instruments**

Year	Average SELIC (%)	Primary Balance (% GDP)
2001	17.46	3.6
2002	19.20	3.9
2003	23.47	4.3
2004	16.38	4.6
2005	18.20	4.3

Source: Central Bank, IMF.

**2.8 *Most recently the central bank has had to act in order to reign in inflationary expectations,*** driven by administered prices, international oil prices, and strong domestic demand across the board. Capacity utilization has been approaching levels historically associated with rising prices, underlining the need for capital investment to sustain growth in the short term. Twelve-month inflation peaked in January 2004, while the central bank has raised the SELIC to 19.5 percent from 16.0 percent in a series of hikes since September 2004. As a result of this monetary tightening, inflation fell within its revised target band for 2004, an important achievement signaling the central bank's commitment to its inflation targeting system.

**2.9** Polls of market participants and prices reflected in the domestic yield curve suggest that ***interest rates will come down in the second half of 2005,*** once inflationary expectations subside and there are enough signs of a cooling economy to merit a monetary easing. However, inflationary expectations, although decreasing, remain slightly above the 2005 inflation target, possibly pointing towards further interest rate rises before an easing cycle begins.

**2.10 *Sustainable lower interest rates depend on a further remaining structural reform agenda.*** Over different time horizons, important elements of this agenda are reforms to the pension system, to public spending, to taxation, and to the legal system and business climate.

**2.11 *Public spending and investment.*** World Bank research and the recent Joint Pilot on Public Investment led by the IMF have highlighted the importance of increasing both the level and the efficiency of public investment in Brazil. Improvements in the effectiveness of public infrastructure investment are vital to relieve serious bottlenecks, particularly in roads and ports, and to ensure that any future increases in public investment are not wasted. The Bank is actively engaged with the infrastructure line ministries and with the Ministries of Planning and of Finance, in improving project selection, analyzing rates of return, rationalizing investment programs, and building monitoring and evaluation capacity. The financial vehicles for this assistance are TA lending, programmatic DPL, investment lending, and an IDF grant.

2.12 **Taxation.** A comprehensive reform of taxation would not be politically feasible within the present Government's mandate. Nonetheless, Brazil's tax burden, at around 35 percent of GDP in recent years, is high by middle-income standards and is made up of many taxes that are highly distorting, such as taxes on payroll, sales, and financial transactions. Moving towards a greater reliance on direct taxation and reducing marginal tax rates faced by businesses will be an important part of the reform agenda over the medium term. It should be noted that direct taxation, in addition to reducing the distortions faced by business, could also be a fairer way of raising revenues, with the rich paying a higher share. Moreover, the high taxation of payroll and sales seems to be an important reason behind the fact that a large proportion of the Brazilian workforce is employed informally, beyond the reach of many traditional forms of social policy, including housing finance.

2.13 **Pensions.** The present Government introduced an important reform to the parameters of the civil servants' pension system in December 2003, which was upheld by the Supreme Court in August 2004. This reform program will be the subject of further programmatic DPL and TA from the Bank. There may be little public appetite for further parametric reforms to the social security system in the near future until the system is made more efficient, but this does not diminish the long-term importance of bringing the system in line both with international norms and with the capacity of the Brazilian public sector to finance it. As with taxation, such reforms would enhance both efficiency and equity.

2.14 **Interest rates.** Brazil's real interest rate, currently above ten percent (for overnight inter-bank lending), is among the highest in the world. Its level is not explained by the level of public debt or public borrowing alone, which are higher in many other developing economies such as Turkey, India, or the Philippines. In addition, microeconomic causes such as the taxation of financial transactions, very high reserve requirements, banks' administrative costs, high directed lending, and weak protection of creditor rights are also factors contributing to the predominance of very wide intermediation spreads.

2.15 The Bank is currently conducting a research project into the high level of interest rates and intermediation spreads: preliminary evidence suggests that the high real domestic rate not only sets the floor for loan pricing but also plays a predominant role in determining spreads, perhaps partly through adverse selection effects. Thus while microeconomic reforms remain vital in the longer term as interest rates fall, **the greatest short-run impact on the cost of capital may come from further fiscal efforts and their effects on base rates.** Beyond the short-run effects of monetary policy, whereby nominal rates should begin to fall in the second half of 2005, as microeconomic and macroeconomic reforms continue, both nominal and real interest rates are expected to fall in the longer term.

2.16 **The investment climate.** As the availability of domestic financing increases, and in order to attract higher levels of foreign investment, the Government's program of microeconomic reforms to the business environment is a key component of the growth agenda. Recent reforms include a new bankruptcy law, an improved framework governing technological innovation, and a new law for public-private partnerships. Some of the reforms described later in this program document on housing finance are an important part of the investment climate agenda for a large part of Brazilian industry.

2.17 While progress will always be faster in some areas than in others, perhaps most important is that macroeconomic stability, and a degree of political consensus about the importance of these reforms, mean that they can now be viewed as a long-term agenda for growth and poverty reduction. Many areas command technical agreement even if they face political hurdles. **There is**

a high level of confidence that this agenda will be pursued by successive governments on a sustained basis.

**Table 3: Principal Economic Indicators**

Year	2000	2001	2002	2003	2004
Real GDP Growth (%)	4.4	1.3	1.9	(0.2)	5.2
IPCA Inflation (%)	6.0	7.7	12.5	9.3	6.5
SELIC Interest Rate (average)	15.8	17.5	19.20	23.5	16.4
Nominal Balance (PSBR, % of GDP)	(4.5)	(5.2)	(10.3)	(3.7)	(2.5)
Primary Balance (% of GDP)	3.5	3.6	3.9	4.3	4.6
Net Public Sector Debt (% of GDP)	48.8	52.6	55.5	58.2	51.8
Trade Balance (US\$ billion)	(0.8)	2.7	13.2	24.8	33.7
Current Account (US\$ billion)	(24.3)	(23.2)	(7.7)	4.1	11.7
FDI (US\$ billion)	32.8	22.5	16.6	10.1	18.2

### 3. PRINCIPAL SECTOR ISSUES

3.1 **Background and Key Sector Issues.** Brazil is among the most urbanized countries in Latin America, with approximately 80% of the population living in urban areas and 90% of the country's GDP being generated in cities. Access to housing and reliable urban services is essential to poverty reduction and growth in Brazil. Housing is also an important component of the economy both on the consumption and investment sides; it contributes to job creation and creation of household wealth. Brazil's housing sector has, however, performed poorly in fulfilling its potential for either poverty alleviation or economic growth: the housing "deficit" is estimated at 7.1 million units mostly for households with incomes of less than 5 minimum wages (equivalent to 28 million people without access to adequate shelter); informal urban settlements are growing twice as fast as the average urban growth; and an estimated 50% of new households formed annually cannot afford the most basic house produced in the formal market even with deep finance subsidies.<sup>6</sup> Moreover, the quantity of new houses constructed by the developer / construction industry, including by small builders, is inadequate. It is estimated that only 250,000 units were constructed in 2003 by developers and small builders, compared to more than 1 million new households formed in urban areas per year (Diamond and Rottmann, 2004). Such low formal sector housing production makes it impossible to deal with the housing backlog and the problem of informal settlements.

3.2 **Housing is a large economic sector with significant forward and backward linkages, making it an important instrument for anti-cyclical policies and sustained economic performance.** Empirical data indicate the importance of the sector in the economy across countries. In terms of consumption, housing-related spending accounts for 20 to 50% of household expenditures (35% in Brazil). It forms 80-90% of household wealth, and approximately 45% of national wealth. In Brazil housing accounts for 6% of GDP (but this figure could be increased considerably) and 11% of annual capital formation (22% for the construction sector as a whole). In addition, residential construction, real estate services and the housing finance industry are important employment sectors in most countries. Brazil's housing sector employs about 5% of the labor force, while direct jobs for the construction sector represent 9.3% and 17.3% if indirect jobs are considered. Multiplier effects are high both in terms of labor and

<sup>6</sup> Fundacao Joao Pinheiro, Brazilian Housing Deficit (2004) and World Bank, Policy Note June 2002.

expenditure (between 1.4 and 1.81)<sup>7</sup>. Housing has a large weight in the price index – 29% in Brazil<sup>8</sup>. Housing finance is an important component of the financial sector and often drives innovations in the financial sector at large. In most developed countries, mortgage related assets represent more than half of total financial assets. In the USA and Japan, mortgage loans represent more than 50% of GDP; while in Brazil this figure is barely 5%.

**3.3 Construction activity in Brazil has followed the vagaries of the public investment program.** The economic stabilization effort has resulted in substantial decline in public works which in turn led to a decline in the sector GDP (-13% in 2003). Increase in formal sector residential construction would provide a good opportunity for a renewed boost in the sector. As an indication of the potential demand for housing, in 2004, 70% of all cement sales were for self-help construction. The construction industry is well aware of this potential demand in the lower income segment and is eager to collaborate with the public sector in the development of low-cost solutions. The institutional and regulatory inefficiencies in the land and finance markets have prevented the industry from realizing this growth potential in this lower-middle income market.

**3.4 In February 2001, Brazil's Congress passed a constitutional amendment which guarantees the right to adequate housing for all Brazilians,** making shelter an essential social service similar to education and health. Accomplishing this goal, while maintaining fiscal discipline, is a major challenge. Defining the role of the public sector in meeting the housing needs of Brazil's poor population includes comprehensive and sustained policy and regulatory reforms and the creation of incentives to mobilize financial sector resources and private sector savings. While the issue of housing and the attendant social, economic, environmental, and health issues was a priority in the electoral campaign of President Luiz Inácio "Lula" da Silva elected in 2002, progress in housing outcomes has been limited. This is in large part due to the fact that the new Government had to develop an institutional and policy framework for the sector from the ground up. Fiscal restrictions, self-imposed by the Government, further limited the ability to launch new housing investment programs.

**3.5 There are several reasons for the poor housing sector performance.** Brazil is a middle income country with modest population and urban growth. It has subsidized its housing sector deeply and over a long period of time. Yet, compared to countries with similar economic and demographic characteristics, housing conditions are worse than would be expected. General lagging economic performance over the last few decades and decreasing real incomes explain part of the housing sector's inadequate outcomes especially for the very poor. Furthermore, lingering high government real interest rates make housing finance a less attractive investment in general. The small size of the housing finance system (both private and public) attests to that; Brazil has an outstanding residential mortgage debt of about 3-4% of GDP and the real estate securities market has not developed beyond a pilot stage.

**3.6 However, the inadequacy of the institutional frameworks and deficient finance and subsidy policy** have had a major impact on the poor sector performance. On the institutional front, the formal housing system in Brazil has been a complex web of federal entities, state and local governments, private sector developers and financial institutions. Over the last fifteen years, responsibility for housing and urban issues has been shared by a number of ministries and secretariats, resulting in a weakened management of the sector and a lack of policy direction.

**3.7 Legal and institutional bottlenecks in the housing finance sector have helped prevent the creation of a liquid and efficient formal housing market and constrained demand for**

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<sup>7</sup> CBIC/FGV (2004), based on 2002 data on the construction sector.

<sup>8</sup> According to IBGE's POF – *Pesquisa de Orçamentos Familiares*.

**housing.** Brazil's housing finance markets are incomplete and do not serve large segments of the middle and low-income population because the transaction costs and risks to do so are too high. Housing finance has been dominated by government institutions dependent on directed credit and does not respond well to demand pressures. The absence of a well-functioning mortgage market limits the production of middle income housing and the related downward filtering of existing housing to lower-income households. The existing sector institutions and financing mechanism will need to change to a more encompassing, sustainable and competitive systems.

3.8 *Until recently, the bulk of housing subsidies in Brazil were provided through the government housing finance system to a broad spectrum of middle income households.* Households earning incomes below the median, for whom neither the housing market nor the government mortgage system delivered, were largely excluded from federal subsidies, with the exception of limited upgrading subsidies. While 88 percent of the housing deficit is concentrated on poor people (earning less than 5 minimum wages) there were no measures to *establish a consistent and broad program of subsidies for the poor.*<sup>9</sup>

- **SBPE** – The *Sistema Brasileiro de Poupança e Empréstimo* is a system of tax free liquid saving accounts (*cadernetas de poupança*), with capped interest rates. Banks which receive SBPE savings are required to use a percentage of these resources to finance housing loans. The system carries implicit subsidies, as savings are tax exempt and guaranteed by Government. However, SBPE savings deposits are remunerated at below-market interest rates and allow lending to take place at “subsidized” levels as well (TR + 12%). To date, SBPE lending for housing has been both limited in scope<sup>10</sup> and, equally important, invested in almost exclusively high-income housing. New regulation has made it obligatory for banks to invest more of the SBPE funds in housing loans. In 2004 54,500 loans were made, up from 29,000 in 2002. A total of R\$3,060 million was disbursed in 2004 out of a total of R\$120 billion in savings outstanding. SBPE accounts for 15% of the total housing finance.
- **FGTS** (*Fundo de Garantia do Tempo de Serviço*) is a compulsory provident savings system based on a payroll tax (8% paid by employers in the formal sector). FGTS as a payroll tax fund owned by its members is not directly controlled by Government although it is under public management and general public guidelines and comprises different government agencies on its board of directors (Curator Council). FGTS is at the same time a large employer tax (equivalent to 4% of GDP) and the largest federal housing finance subsidy program. Contributors receive a return of 3 percent plus TR, which might turn out to be a negative real rate of return, on their savings accounts in order to allow the funds to be used to finance below market housing loans, both for members and non-members. FGTS savings are managed by the *Caixa Economica Federal* (CEF), the state housing bank, which is responsible for guaranteeing a minimum return on FGTS deposits. Funds are, in principle, available to qualified financial institutions (almost exclusively the largest domestic banks) for onlending at fixed, below-market rates. FGTS is the largest source of mortgage and housing construction loans. It financed 155,275 loans in 2004 for a total of R\$2,355 million (43% of total loans).

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<sup>9</sup> Well-targeted subsidies are an important aspect of most housing markets in emerging economies as a large part of the low-income strata cannot afford the cheapest house produced in the formal market and the private market is reluctant to enter the low-income housing market because of smaller profit margins and high risks. Subsidies can in the short-term help bridge the wide affordability gap. In principle, this gap should narrow in the medium-term as cumbersome and thus costly urban planning and development regulations are removed, land management systems are made more effective, and the structure and efficiency of the housing finance system improved.

<sup>10</sup> In the past, Banks have been able to meet their SBPE lending requirements through the purchase of debt obligations related to the former National Housing Bank, (BNH), without extending actual credit for home purchase or refinance.

- **Caixa Econômica Federal** – CEF is a large public sector bank which fulfills multiple roles in the management and administration of FGTS funds. CEF holds the deposits of FGTS and as the legal administrator of FGTS, it is responsible for guaranteeing acceptable returns on FGTS deposits and is thus responsible for accreditation of financial institutions which request access to FGTS savings. At the same time, CEF is the primary lender of FGTS monies, making more than 60 percent of the housing loans in the country (state-owned banks in general make approximately 80 percent of housing loans). CEF was recapitalized and restructured in 2001.

**Table 4: Medium-and Long-Term Housing Loans, by Housing Finance Systems  
2004**

	#loans	%	Average loan size (R\$)	Total R\$ (Million)
Developers: Medium term finance (estimate)*	50,000	14%	70,000	3,500
Consorcio and Cooperatives (estimate)**	40,000	11%	80,000	3,200
SBPE (TR + 12%), plus SBPE market; through private banks and CEF	54,500	15%	56,000	3,060
FGTS (TR + 6% to 10.16%) depending on income level through CEF	155,275	43%	15,200	2,355
FAT TR + 6% through CEF	2,600	1%	22,300	58
PSH <i>financiamento</i> TR+6 (***)	56,000	16%	2,400	132
Total	358,375	100%		

\* Diamond and Rottman, 2004

\*\* BACEN, ABAC

\*\*\* This subsidized loan component is complemented by an average upfront subsidy to borrowers of R\$4,700 and a lender compensation of R\$900. The new component of PSH, *parcelamento* (not linked to a housing loan) has just started and no houses are yet delivered under this program.

3.9 The dominance of these directed credit and public housing finance systems is clear (Table 4). Out of about 360,000 housing loans made in 2004, 75% were financed through the systems of FGTS, FAT and SBPE, using tax-based funding or tax-subsidies and using CEF as its main lender. State governments do often have their own funds to make housing loans for underserved groups, bringing the *proportion of loans made through public sector institutions closer to 80 percent*. While these systems have allowed housing lending to continue during periods of macro-economic volatility and high interest rates for housing loans, they are costly, are uneven in the depth of subsidies they provide and in their current coverage of segments of the “market”. They can not easily respond to increased demand for finance.

3.10 *The lack of expansion of private housing finance as well as the lack of use of subsidized funds by private banks has several causes*. These include Brazil’s history of macro-economic instability, the judicial protection of borrowers, and the dominance of special government funding and lending systems. *The most important reason, however, appears to be the high SELIC rate (set at 19.25% in March)*, the real domestic interest rate, which offers investors risk-free and liquid assets at attractive returns. This rate is the main instrument of the monetary policy adopted by the Government to stabilize the economy. While a stable macro economy is critical for the performance of the housing finance sector, the current high Selic rate puts a floor in the housing finance market. As long as the SELIC rate remains high relative to

investments in more risky and administratively more costly housing finance loans, the development of the private mortgage market will remain limited. In addition, the high real interest rates make borrowing unaffordable for most households. Also, with current high real government rates and high lending risks in the housing finance sector, subsidized funding for housing finance is not attractive for lenders when compared to other risk-adjusted market investments.<sup>11</sup> Graph 1 shows the evolution of yearly average real interest rates since 2000, including: (i) subsidized loans funded by the FGTS at TR+6% (plus a spread of 2.16%); (ii) SBPE housing loans priced at TR +12%; (iii) risk-free SELIC short-term market rates; and (iv) an estimated price of market-base SFI housing loans (from pilot securitization deals). The graph also shows the gradual narrowing of the gap between SBPE and market rate housing loans, a trend that may continue as a result of further macro-economic strengthening.

**3.11 Restrictive land subdivisions, inefficient registry and complex permitting system all constrain the elasticity of urban land supply** limiting the access of the poor to urbanized land, and increasing the costs of housing solutions.

**3.12 Long-term vision: The vision for the sector is a combination of a well-functioning housing market and targeted policy interventions to attend to market failures and address the affordability gap.** In this scenario,

- (a) new households will be able to access formal shelter – either renting or purchasing it – according to their preferences and income level; low-income households who qualify for a loan with some help would be served with credit-linked subsidies to help them with down payment in complement to their own savings; for those who do not qualify for finance, non-credit linked subsidies would be provided by municipalities in the form of serviced land or partially built housing units<sup>12</sup>;
- (b) as interest rates come down, microeconomic policies improve credit risk and risk insurance and secondary real estate finance provide attractive long-term assets for investors the housing finance would likely grow rapidly (as it has in other countries) possibly reaching 10% of GDP in 5-7 years and 15% in another 5 years and will serve an increasing proportion of the upper- and middle-income market; as interest rates come down, the existing directed credit system (SBPE) would be deregulated over time, in tandem with an expansion of the capital market to serve the middle and upper levels of demand;
- (c) FGTS would continue in the intermediate term to provide finance-linked subsidies (depending on the decision of its Board of Directors<sup>13</sup>). It will be able to leverage the participation of private lenders and other housing finance institutions into moderate income sector; in the medium term, when the Government can expand its subsidies through the PSH, FGTS is likely to increase the return on its assets and might decrease its role as the housing provider of last resort;
- (d) resources available for the federal housing policy would be used to leverage resources available at the state and local levels, stimulating regulatory change to improve land supply for low-income housing and preventing further expansion of informal settlements and providing titles to slum dwellers with a minimum of administrative problems;

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<sup>11</sup> These subsidized funds are moreover often limited (FGTS) or costly to accumulate (savings accounts of the tax exempted SBPE system).

<sup>12</sup> These families would be able to contribute through self-help efforts or by taking out micro-finance loans to complete their “authorized” house.

<sup>13</sup> FGTS The FGTS Board of Directors (Conselho Curador) is comprised by representatives of its members (4 workers’ unions), of contributors (4 business class associations) and government (8 from different ministries and agencies), all of them appointed by the government

- (e) municipalities would adopt well-designed plans, drawn jointly with local populations and aimed at pre-empting illegal occupations or squatting on non-serviced land plots. In such a scenario, risks are better measured and priced, and pension funds, insurance companies, and other long-term savers believe that the housing market is sufficiently secure and attractive to deserve part of their funds. While the market could increasingly take care of the newcomers, the public sector would have better chances to address the housing deficit in a sustained way. This will take more than one decade.

3.13 ***The Government has taken steps towards the implementation of the above vision and is committed to significant policy changes.*** With the gradual stabilization of the macro economy and increase in economic growth (GDP growth of approximately 5% is expected in 2005), the Government is focusing attention on the core areas of institutional and regulatory reforms in the land and finance sector that hinder the expansion of housing production and the investment in existing substandard housing. The *core areas of reform* include:

- ***Institutional Framework.*** In the context of the Government's decision to make housing a national priority, efforts are being made *to establish a coherent public sector structure* able to formulate national housing and urban policy and to coordinate the various agents and authorities at the federal, state and local levels. The creation of the Ministry of Cities (MOC) in 2002 with full responsibility for sector policy represented an important first step. Further efforts are needed to:
  - articulate the strategic direction for the housing sector;
  - establish a coherent federal program to improve access to housing finance and rationalize housing subsidies;
  - link federal housing policy and finances to other policy efforts at the local and state level; and
  - significantly strengthen the Ministry of Cities' capacity and policy relevance.
- ***Finance.*** While the financial system and markets are in large part driven by macroeconomic conditions and public sector debt-related interest rate dynamics, it is critical to pursue a short- and medium-term policy agenda to ensure that mortgage contracts are fulfilled, credit information is generally accessible, and new credit instruments are created for the financing of housing. The Government's policy agenda focuses on the strengthening of a capital-markets based housing finance system, and a gradual ***transitioning away from the current directed credit systems*** and segmented markets. Simultaneous efforts are needed to encourage more banks and non-bank financial institutions to participate in the housing finance market by:
  - improving the legal and regulatory framework which governs the formal housing finance market (both government and market-based segments);
  - establishing a liquid secondary market for tradable real-estate instruments;
  - increasing access by lenders to existing special funds for housing finance and subsidy programs and allowing lenders to price their products according to competitive profit incentives; and
  - ensuring that related markets, such as construction and land markets, operate competitively and are not constrained by cumbersome procedures or inappropriate regulations.
- ***Housing subsidy policy to assist the poor while improving formal housing market output within the context of limited fiscal resources*** is the driving force behind the new government policy. A major challenge is to improve targeting and transparency of existing housing subsidies, adjusting subsidy instruments to medium and long-term



macro-economic expectations, and to leverage investments by the financial system, sub-national governments and individual households.

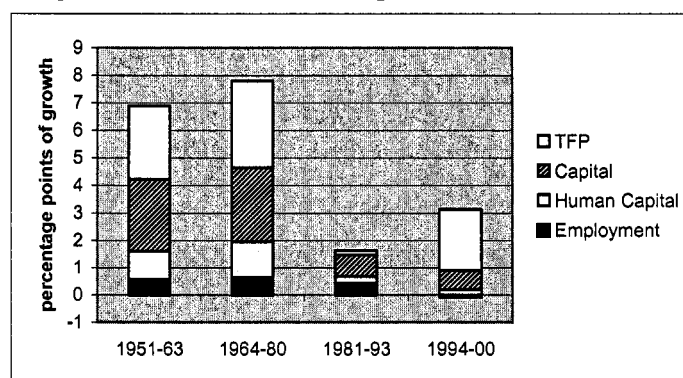
- **Land Supply Rigidities.** The obstacles to formal land development accessible to the urban poor are a key driver of the creation of slums (*favelas*) and the vicious cycle of marginalization of Brazil's urban poor. Inhabitants of informal / illegal settlements are often unable to access public services and have limited access to legal recourse. It has taken decades for Brazil to recognize that a policy environment which creates incentives for private sector housing development is a key pillar of both urban development and the overall poverty-reduction and growth agenda. *The key challenges for Brazil are to address both the stock and flow of informal developments through:*
  - a concerted effort to formalize existing slums and improve their access to basic public services by developing a national slum upgrading strategy and a program of financing for urban upgrading; and
  - reducing the regulatory complexity and excess, costs and time it takes to subdivide and develop new land, and register titles.

#### 4. THE GOVERNMENT'S HOUSING SECTOR REFORM AGENDA

##### The Growth Agenda and the New Low-Income Housing Policy

4.1 The disappointing track record of the reforms of the 1990s has its roots in both slow capital accumulation and limited productivity growth. Not even in the 1980s was the contribution of capital accumulation to growth as low as it was in the 1990s (Figure 1). Gross annual capital formation decreased from 23.5 percent of GDP in the mid-seventies to less than 15 percent in the early nineties, bouncing back slightly to 17 percent in 2000. Emerging economies such as Chile and China as well as OECD countries have sustained investment ratios much larger than Brazil during the last fifteen years.

Figure 1: Growth Accounting for Brazil, 1951-2000 <sup>14</sup>



4.2 *Since 2003, the Government has established an agenda of microeconomic and institutional reforms to foster capital accumulation and productivity gains and thereby favor*

<sup>14</sup> Global Development Network Growth Project, 2001.

***sustainable and equitable growth.*** Decline in investment levels in infrastructure have been large. Productivity performance has been relatively better but a poor “investment climate” is still a major obstacle to further productivity gains. The reforms were structured around four pillars: (a) reducing logistics costs to raise productivity and ease trade; (b) improve the business environment to enable better market functioning; (c) enhance financial efficiency and depth; and (d) transforming knowledge into productivity through innovation. These were considered a sufficient and politically feasible set of reforms and still part of broader development strategy to promote sustainable and equitable growth.

**4.3 *The new housing strategy is a deepening of the government’s microeconomic agenda of reforms.*** Increased mortgage credit, effective property rights, and removing obstacles to commercial lending for housing are among the pillars of a sound housing strategy. These match the broader initiatives of supporting private sector development, improving the business environment, and increasing financial depth, which are ingredients of the government’s growth agenda. Better and streamlined regulation for land use is also an ingredient of the larger task of improving infrastructure regulation and simplifying business entry and operation, other elements of this agenda. And the emphasis on targeted subsidies and auctioning is part of a broader effort to increase the efficiency of social expenditure. The new housing policy will thus galvanize the government’s microeconomic agenda, reduce social distress and improve fiscal management.

**4.4 *The Government is committed to a Low-Income Housing strategy*** aimed at improving the living conditions of the poor and strengthening their access to assets, notably housing and serviced/serviceable land, and to expand new housing construction in the formal housing market while maintaining fiscal discipline. Specifically, the Government’s agenda includes efforts to: (a) develop a sound national policy and institutional framework for housing and urban development; (b) strengthen the housing credit and savings systems, and provide incentives for the housing finance market to expand as well as move “downmarket”; (c) reform the existing federal housing subsidy system to increase the affordability of housing solutions for the lower income groups, and make subsidies more transparent and efficient; and (d) reduce the costs of formal urban land development by strengthening land legislation and regulations and real property registries and rights so as to increase the supply of serviced and serviceable land.

**4.5 *The final goal is to improve the wealth basis of the poor and the living conditions of the 20% of the population that lives in less-than-adequate housing conditions*** (40 to 50% in some states) and would be an important element in the efforts to improve public health and environmental conditions in which the urban poor live.<sup>15</sup> The government program aims to support the expansion of the housing finance system and to facilitate the construction of new low-income housing. The approach builds on the country’s comparative advantage in having active private developer and construction markets and sophisticated financial systems which can be called upon to play a role in the development of the housing markets. It further benefits from international lessons on housing sector interventions, including the need to address housing and urban policy reform in a comprehensive manner, to address the linkages between (a) public sector subsidy programs for the poor; (b) the financial sector and formal housing finance markets; and (c) “real” side issues, including markets for land and the construction sector.

**4.6 *Housing Policy and Poverty.*** The Government has committed itself to the objective of reducing Brazil’s rate of extreme poverty by 50% by the year 2015. The strategy to achieve this objective includes sustained economic growth based on financial stability, investments in the poor through better education, health and other social services as well as improved access to physical and financial capital, improved access and enhanced social protection including social

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<sup>15</sup> Including the achievement of Millennium Development Goal (MDG) 7.

assistance and conditional cash transfers linked to specific social targets. World Bank financed projects support several elements of this poverty reduction strategy. World Bank analysis shows that the government poverty reduction strategy can be achieved through a combination of 4.5% annual growth, continued increases in educational outcomes and human capital and further improvements in social policies. The proposed reforms would have a bearing on poverty reduction by: (a) increasing access of the poor to essential shelter services; (b) enhancing the capacity to accumulate and improve housing assets, by expanding access to housing credit and upfront subsidies for housing, Indirectly, access to improved shelter in poor communities has been demonstrated to lead to improved self-image, higher returns for children's education and increasing opportunities for better paid jobs.<sup>16</sup>

4.7 The reforms the Government is undertaking will help increase the access to adequate shelter in different ways, including:

- (a) better targeted subsidies to the poor (formerly excluded from all the housing subsidized public lending);
- (b) improved availability of mortgage credit to low-income families – with the benefit of teaching the financial market how to work with these type of clients and therefore contributing to risk reduction;
- (c) contributing to a more liquid and seamless housing finance market attracting a wider base of resources for the low-income segment; and
- (d) expansion of the policy-making capacity of government entities in terms of land policy, regulations and other supply bottlenecks.

4.8 While the program does not aim directly at promoting the housing or construction industry, the envisaged policy actions – both on the demand and the supply side – would, within the medium term, *result in greater housing output, lower house prices, improved access to finance, and a general increase in local economic activity and employment in the sector* (mostly in the low-income sector). Particularly important measures supported by the loan include:

- (a) the simplification of the land and urbanization codes, property rights and land registration systems;
- (b) the improvement of the capacity of local governments to supervise their low-income housing activities, and support and organize demand for low-income housing;
- (c) the reduction of credit costs due to improved credit information, lower costs of conflict resolution and transaction costs, improved legal instruments, and increased competition in the sector; and

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<sup>16</sup> Access to adequate shelter or housing services can help predict subsequent improvement in both cash income of the family as well as its well-being measured by health indicators, education performance (including dropout rates) and probability of exiting extreme poverty (Geoffrey Payne, 2004). In addition to providing shelter, housing also plays a more standard role as an asset, as acquisition for the urban poor offers the opportunity for small incremental investments (World Bank, November 2004, Report No 30465, The Urban Poor in Latin America ). The returns to housing as an asset include the flow of housing services it provides some of which can be monetized in case of need by taking in new tenants or extended household members who share in the upkeep of the household. In addition, homeownership provides a constant flow of services and frees the family from the constraint of having to generate a fixed sum for rent every month. Given the large share of the poor employed in the informal markets, the poor will prefer to own their own shelter and avoid commitment to a fixed and regular payment as a housing rent. This can be important especially at time of crisis: in Uruguay, 10% of renters declared they had to move following the crisis in order to cut down on cash payments. Evidence from surveys on risk management in Chile and Peru finds that investment in housing acts as a substitute for formal retirement systems. Home ownership in LAC tends to be higher than in other parts of the world and some authors tend to believe that this is a way to cope with uncertainty and the negative consequences of financial crisis and macroeconomic disasters.

- (d) the introduction/expansion of self-help efforts and beneficiary equity in the subsidy schemes, the improved targeting and transparency of existing subsidies both to lenders and households.

4.9 ***The Government's Program.*** The Government has embarked on an ambitious program to reform the housing sector and improve access of Brazil's poor to affordable housing and services. The Bank would support the Government's program in ***four areas of housing sector and urban development policy reform.*** The Matrix of Policy Reforms (Annex 2) reflects the four focal areas of reforms to be supported by the proposed operation.

## **Policy Area #1: Strengthening the Housing Policy and Government Institutional Framework**

### **Background and Issues**

4.10 The Government has made considerable progress in the development of sector institutions to formulate and implement a National Housing Policy.<sup>17</sup> Until the creation of the Ministry of Cities in 2002, the housing system in Brazil was driven by a set of federal entities, state and local governments without a clear articulation of policies or a plan to address the housing and urban development problems of the country. In the past, Government programs supported a perverse incentive system that favored federal investments and implicit subsidies to the upper levels of the income distribution, increasing discrepancies in an already inequitable housing system. Conflicting policies between public and market housing finance systems, compounded by unfavorable macro conditions, also prevented a competitive housing finance system from developing. Transforming the sector and making housing a national priority requires a governmental structure able to formulate and implement a national housing policy, coordinate the efforts of the myriad of actors that play a role in the sector and provide a credible plan of action for the sector, based on rigorous analysis of existing constraints and alternative scenarios for their solution.

### **Recent Achievements and Future Challenges**

4.11 To date, the Government has made significant progress in ***strengthening housing policy institutions.*** ***Some of the key actions achieved to date include:***

- The preparation and dissemination of the National Housing Policy document. The Ministry of Cities has undertaken broad consultations for the development of a National Housing Policy document whose broad dissemination has been completed. The National Housing Policy will be complemented by a **National Housing Plan** under preparation, which will articulate the targets, priorities, and sector investments for the coming four years. The NHP provides guidelines for the implementation of new land and housing finance regulations, the design and targeting of subsidy programs and related housing developments, instruments to leverage private investment in the housing sector, and coordination of investments by different levels of government.

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<sup>17</sup> As in many other countries, the National Housing Policy document is a product of compromise between different parties and viewpoints on how to improve the access of shelter to the poor. The ultimate housing policy implementation will depend on actual legislative actions and budget allocations and will be embodied in a multi-year Housing National Plan.

- The strengthening of the Ministry of Cities to establish the necessary institutional framework for housing sector development and to build the core capacity of the Ministry to become a credible force in sector policy making. The ministerial reform efforts have included the creation of a National Housing Secretariat (SNH) as the federal entity responsible for development, execution and monitoring of housing sector policy and programmatic actions. SNH will include a technical unit that will design the housing plan and conduct associated monitoring and evaluation of the plan. Further strengthening of MOC will include the creation of a unit to conduct policy analysis and the coordination of monitoring and evaluation of programs, and the general improvement and expansion of systematic information collection and analysis on the sector. SNH will foster sector analytical work in collaboration with existing research institutes such as IPEA, IBGE as well as the Secretariat of Economic Policy in the Ministry of Finance and the Central Bank.
- The creation of a coordinating group, the Interministerial Housing Policy Group (IHPG), to facilitate implementation of the common agenda on housing across Government institutions. The existing Council of Cities was created to facilitate the broad participation of private sector and civil society in the formulation of urban development policy. However, the actual *implementation and monitoring* of regulations, legal provisions and housing programs calls for a coordinating institution involving the Ministry of Cities, *Casa Civil*, Ministry of Finance, and the Central Bank. The IHPG would supervise the work to rationalize atomized subsidy design and coordinate monitoring activities which are currently scattered between the Central Bank, Ministry of Finance, Ministry of Cities, CEF, and the Board of Directors of the FGTS<sup>18</sup>, oversee the targeting and monitoring of programs as well as the design of a subsidy prioritization and verification system which goes beyond the current approach of self-declaration of income. The critical importance of the IHPG's tasks requires that a core group of experts be appointed to conduct the needed analysis and propose adjustments to subsidy programs.

4.12 ***The Government is committed to consolidating financial resources for Federal housing programs*** so as to increase their impact and homogenize their allocation criteria. Recent achievements include:

- The design of a National Social Interest Housing Fund (FNHIS) to coordinate transfers, subsidies and funding structures for housing. Federal Government resources to finance the NHP are dispersed across a wide range of public sector entities (including the National Treasury, line ministries, FGTS, CEF, and the FAT). By the end of 2004, the Government has articulated a legislation proposal to establish the FNHIS. The FNHIS Draft law has passed in the lower house and is expected to be approved by Congress during 2005. As the FNHIS is formally operationalized, some challenges need to be addressed, such as (a) inclusion of the *different federal subsidies* in the Fund; (b) adoption of adequate management and supervision structures for the FNHIS; (c) resolution of the potential conflict of interest arising from the fact that FNHIS' administration should be independent from the use of its funds; (d) definition of mechanisms to ensure wide access to the Fund's resources; (e) the establishment of

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<sup>18</sup> For example, an evaluation of the relatively new programs such as PAR and PSH is urgently needed. PAR, a large program of residential leasing finance funded by FGTS and operated by the CEF has encountered severe repayment problems, and unfavorable judiciary decisions (tenants being considered as owners proved difficult to evict). It needs to be evaluated on its credit repayment performance, proposed credit features including applied credit rates, the participation of local governments, and the behavior of the beneficiaries as tenants and/or future owners.

adequate criteria if access of sub-national entities to FNHIS is to be granted; and (f) the need to codify subsidy mechanisms and subsidy calculations used by the FNHIS.

- Efforts to ensure the transparency of all off-budget housing subsidies. As most of the current housing subsidies are implicit (and their costs not immediately apparent), and not efficiently attuned to the changing macroeconomic conditions, the Government has committed to move towards subsidy transparency and towards instruments that move the subsidy towards the early phases of the lending process (more appropriate in high interest rate environments); recent changes to the FGTS subsidy programs regarding transparency of subsidy amounts and the conversion of all direct subsidies into upfront subsidies are an important achievement.

4.13 ***The Government has also taken steps to strengthen subnational entities to implement housing policy.*** The role of local governments has become increasingly important as a result of the Government's policy reforms. Municipal governments and some state entities are responsible for (a) the allocation of low-income housing subsidies, including the identification of beneficiaries; (b) the organization of subsidy demand; (c) provision of serviced land; (d) implementation and enforcement of cost recovery on local government investments in land and infrastructure; (e) regularizing and upgrading the existing stock of informal settlements; and (f) providing the regulatory framework and oversight for land subdivision and zoning and promoting land delivery for the poor. For the many, particularly medium-sized, municipalities that currently experience severe development pressures but have weak technical capacities, this is a formidable task. The Ministry of Cities has begun a municipal assistance program (to assist 2000 municipalities in 2005) and further scaling-up and targeting of this program will take place in 2006. The Ministry has further implemented measures to map and assess the capacity of the sub-national agencies involved with housing planning and policy including housing cooperatives which cater to low-income groups and coordinate efforts with local governments. *The major challenge is the need to expand its program of capacity building of sub-national entities, including through the development of tool kits for local housing planning by enabling local governments to play an active role in the implementation of the National Housing Plan.*

4.14 ***Anticipated Results:*** In the medium to long term, one would expect to have in place a solid institutional framework including greater institutional articulation of the specific competencies of individual agencies (MoC, STN, BACEN) reinforcing their common goal and reference. A 10 year plan is expected to be agreed upon and used as reference for the multi-year investment plans and annual budgets and the expected outcomes and results would be advertised and used to monitor the implementation of the program and its success. Ample consultation with private sector, NGOs and demand groups would be institutionalized and will help monitor the program and the promised results.

## **Policy Area #2: Reforms to Increase the Stability and Scale of the Housing Finance Market**

### **Background and Issues**

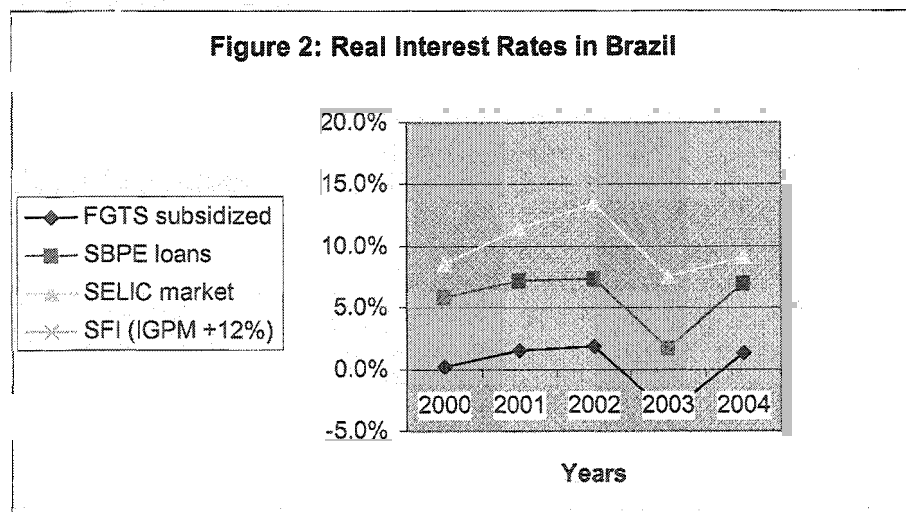
4.15 Since the mid-90s, Brazilian authorities have attempted to restructure the country's housing finance sector and have embarked on the gradual transition from a system of directed credit in a highly segmented market towards an integrated and capital market-driven housing finance system, with an increased role of private universal banks in the immediate-term and a functioning secondary mortgage market in the medium-term (the market-based system is known as the *Sistema Financeiro Imobiliário* or SFI). While major progress has been made in the improvement of the regulatory and legal frameworks for the primary and secondary housing finance market, there are still serious constraints preventing private banks from entering the

market. The high credit risk in the housing finance market, the lack of a market for instruments to deal with interest rate risk, and the restrictions on the spreads in the SBPE market (and for the use of FGTS funds) are only some of the reasons for this lack of interest. Housing finance loans are exposed to a persistent high default risk and high losses in case of default because of a widespread lack of contract enforcement by the judiciary. The lack of credit information hampers the assessment of credit risk and inhibits the possibility to effectively price differentially for credit risk or insure such risk. In addition, there are limited options in the financial markets to facilitate asset and liability management, since capital markets for mortgage securities have not developed under the current persistently high interest rates. Lastly, spreads in the SBPE market are considered only marginally attractive given the high credit and interest rate risks and the high administrative cost of maintaining SBPE savings accounts.

4.16 Similarly, *banks have not accessed FGTS funds (for housing finance) and thus have little ability to enter the broad middle income market in the current interest rate / affordability environment*, especially due to the low spreads allowed, given market risks. The Government is also willing to address other potential obstacles to the access of FGTS resources by a broader range of financial institutions. While it is clear that the reason for the lack of interest in FGTS lending at this point in time stems from the high real government interest rates and the credit risk in the sector, other operational issues may become binding constraints in the future.

4.17 *The result is that, in general, private lenders limit their mortgage lending to relatively large loans to upper-income customers* and have avoided using the required proportion of their SBPE savings for housing finance, although Government resolutions are changing this situation. Apart from the main banks, there are few qualified alternative lenders in the market that can serve lower and middle-income households. In the short term, the Government-dominated housing finance funding and lending institutions remain the only source of housing finance for the lower- and middle-income groups. Increased support to non-traditional agents (e.g. micro-credit or cooperatives) under appropriate regulation needs to be considered.

4.18 *The housing sector is highly dependent on the availability of medium to long-term finance because of the high cost of housing relative to household incomes.* Such long-term financing is generally raised in financial markets and distributed through private financial actors. In many Latin American countries, including Brazil, the development of market-based housing finance did not happen until the 1990s, a consequence of widespread macroeconomic instability, and the existence of state-dominated, often closed circuit systems, offering below-market rate mortgages on a limited pool of funds.



4.19 **Medium term vision:** *In anticipation of a gradual normalization of the SELIC rate, it is critical to address the regulatory, legal and institutional issues which hurt the profitability of the housing finance sector and which will have a more binding effect on the intermediation spreads when the SELIC rate decreases.*<sup>19</sup> Such legal and institutional improvements will, moreover, increase the efficiency of lending in the directed credit (SBPE) and closed circuit (FGTS/FAT) systems on which the housing sector relies in the short and medium term. ***When interest rates normalize and converge and the secondary market for mortgage is fully consolidated, the directed credit system such as SBPE may gradually be phased out.*** The FGTS system, which serves a lower income bracket (see Annex 7), will still be needed for the time being as a main source of housing finance funding, especially while alternative subsidies (such as new PSH upfront subsidy program) cannot be sufficiently funded to allow a larger proportion of lower income households access to housing finance with an upfront subsidy. In the medium term, FGTS may focus increasingly on its role as a provident fund rather than as the supplier of deeply subsidized credit. *FGTS is gradually moving to a more transparent and efficient way of providing subsidies.* The proposed loan supports policy and micro institutional reforms in the housing lending sector and the funding markets, while facilitating reforms in the SBPE and FGTS systems to promote the development of a more integrated housing finance system.

### **Recent Achievements and Future Challenges**

4.20 ***The Government is committed to a comprehensive reform agenda for the housing finance sector*** anticipating its take-off when macro-economic improvements are sustained. Its strategy includes four key areas:

- improvements in the legal and regulatory environment that will focus on the reduction of credit risks while strengthening capital market funding systems;
- expansion of alternative lenders for non-collateralized housing lending;
- reforms to the SBPE; and
- increased transparency, efficiency, and improved targeting of FGTS.

4.21 ***The Government is addressing the legal uncertainty related to housing credit.*** The improvement of credit contract enforcement is among the highest priorities for the healthy expansion of the housing finance sector. Efforts undertaken to date include the adoption of Law 10.931 of 2004<sup>20</sup> to improve the legal framework for housing finance through (a) the creation of the *alienação fiduciária* (the trust deed instrument) as a potentially stronger mechanism for collateralization than the mortgage lien; (b) the regulation of *patrimônio de afetação* (affected assets<sup>21</sup>) to segregate the advance payments made by households during the construction against the possible bankruptcy of a developer; and (c) regulations requiring that borrowers continue credit repayments even when the amount of debt balance remains disputed in court. A study is currently underway to review options for improving the legal environment for lending by clarifying the rights and obligations of consumers of credit and financial agents.

4.22 ***In the future, additional measures are needed to further reduce uncertainty*** and the cost of conflict resolution in housing finance by: (a) increasing the awareness of the importance of execution of credit contracts among the members of the judiciary, congressional committees, NGOs and community organizations through workshops and seminars; (b) presenting proposals

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<sup>19</sup> See Augusto de la Torre, mimeo February 2004, for a lucid explanation for the reasons of the high SELIC rate and the requirements for its downward adjustment.

<sup>20</sup> The Law confirmed prior MPs, 2122 and 2123.



to introduce housing finance specific consumer protection regulation; (c) solving the legal ambiguity on the issue of capitalization of interest rates; (d) legal measures to expand the use of payroll deduction for housing loans (Ministry of Finance); and (e) standardization of the mortgage instrument (undertaken by ABECIP).

4.23 To **improve credit information** the Ministry of Finance and BACEN have committed to (a) introduce a cadastre of *positive credit information* which will include mortgage credit information, and (b) provide aggregate managerial information on housing lending to be consolidated and made available to the public. With these elements, the Government would be able to assess the potential for private credit insurance. When these combined measures to alleviate credit risk and improve sector information are implemented, it will be possible to strengthen the management of credit risk by introducing private housing credit insurance.

4.24 Measures have been taken to **strengthen the capital market basis for housing finance as part of the official strategy to move away from a directed credit approach to a market-based approach**. The first step has been the creation of the legal framework for real estate finance securitization.<sup>21</sup> The Government has instituted legal reforms to allow lenders to securitize their real estate loans, facilitate the creation of private securitization companies and establish the legal framework for capital market instruments for mortgage derivatives. Law 10.931 of 2004 further legalized products such as mortgage bonds<sup>22</sup> and simplified the taxation of real-estate finance assets. A resolution of the CMN (Resolution 3.155) created trust-letters for the repurchase of such mortgage bonds,<sup>23</sup> which should increase the liquidity of these instruments and the security of the credit holders.

4.25 **To increase the attractiveness of real estate finance securities** the Government has passed laws (Law 11.053/04 and 11.033/04) which provide tax incentives for the purchasers of real estate securities and reduce the minimum amount of an individual mortgage-backed-security. The equity and effectiveness of the tax measures are, however, not evident especially in the medium term and the Government will undertake an assessment of current measures to stimulate a secondary housing finance market and a revision of those measures that prove to be ineffective and inequitable. Such efforts are expected to lead to the adoption of new measures, possibly including a consideration for special incentives for securities based on down-market social housing loans.

4.26 **A second avenue is to strengthen the role of alternative lenders for non-collateralized lending**. At present there is very little information on non-official housing lending. Estimates indicate that about 15% of the housing loans are generated from cooperatives and consortia but there are no firm data. The weakness of the current non-bank alternative lenders engaged in the housing finance sector and the lack of information and regular monitoring of the sector is an area of growing concern. A large part of the potential housing finance market is underserved because long-term credit instruments and the institutions that operate in the long-term housing finance market are not geared to serve that market (for example the growing number of low-income

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<sup>21</sup> Securitization will contribute to the expansion of the housing finance market as it will allow for the negotiation of part of the housing portfolio.

<sup>22</sup> Certificados de Recebíveis Imobiliários (CRIs), Certificados de Crédito Imobiliários (CCIs) and Letras de Crédito Imobiliário (LCIs), respectively. CCIs are instrument issued at the moment of a housing loan is granted and represents the ownership of the credit derived from that operation. LCIs are securities that can only be issued by financial institutions and their collateral are made of housing credits guaranteed by mortgages or by a trust deed held b the issuer of the LCI.

<sup>23</sup> Letter of Guarantee for the Re-purchase of CRIs.

informally employed would have difficulties qualifying for medium and long-term loans). Alternative lenders, specializing in more appropriate savings and credit products could potentially fill that gap, as long as efforts to expand their presence in the market are accompanied by institutional strengthening and clear criteria for eligibility. As a **first but important step**, the Government has included the issue of information collection on alternative housing finance agents in the existing working group on micro-credit (established by the Ministry of Finance, BACEN, Casa Civil, and Ministry of Labor). Within the program, BACEN will improve the regulatory and monitoring system of micro-lenders and cooperatives involved in housing credit based on technical work that will support a diagnosis of the performance of the sector and the development of a proposal to improve their operation and expansion in the housing finance market (including refinancing options (alternative lenders do not and should not have access to SBPE savings), loan pricing mechanisms, alternative forms of collateral, costs of instruction of customers). It will further support training for alternative lenders.

4.27 *The Government has initiated the reform of SBPE<sup>24</sup> to expand its scope, move SBPE downmarket, with a view of achieving further market integration.* Government has made several changes in the SBPE regulations meant to increase the use of SBPE savings for housing finance loans. In the past, lenders could avoid investing the required proportion of SBPE savings in actual housing loans by investing in paper related to the former housing institutions which were eliminated in the early 1990s. The Government has closed that loophole and moved to significantly expand the pool of SBPE housing loans and transition it downmarket. *Resolution 3005* of the National Monetary Council pushed private banks to significantly increase their portfolios of SBPE-funded housing loans over a period of 100 months beginning in June 2003. *Resolution 3177* of the NMC doubled the speed of this process and set severe penalties for non-compliance. Since such a measure would increase SBPE lending about threefold in one year, it was questionable whether sufficient demand for and supply of housing could be mustered in the market place and whether banks could make such transition. As a consequence, *Resolution 3.259* revised some of the conditions of the earlier resolution to bring them in line with the capacity of the market, assuming an approximate increase of 30 percent per year in the aggregate SBPE housing credit portfolio. It further introduced a weighting system that favors smaller loans made to lower-income households (300 percent for the lowest income/value bracket) and introduced severe penalties for non-compliance.

4.28 *Reviewing the SBPE.* While the measures taken so far will increase SBPE funded housing finance loans in the coming years, the larger issues related to its relevance and equity as a subsidized housing finance system have not yet been addressed. SBPE is considered a regressive subsidy since it funds mostly higher income loans and the tax exemptions on savings benefit mostly the large, high income account holders rather than the many small savers in the system. Further, the current SBPE system needs frequent changes of its regulations that can be destabilizing. The regulatory pressure to make qualifying housing loans and hold them on the balance sheet to comply with SBPE regulations constrain the possibilities for commercial banks to securitize their eligible housing loan portfolio, although the use of such modern financial tools could assist them to improve their funding and risk management policy, as well as provide them with some capital relief. **The major challenge** (around which there seems to be a consensus) is the need to review the SBPE system and assess the impact of its potential phasing out in the medium term as conditions enable such a transition and housing finance becomes an attractive alternative for commercial lending.

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<sup>24</sup> Earlier measures to normalize the government housing finance system included ending the FCVS insurance scheme in 1993 and the gradual liquidation of the FCVS-insured portfolio. It also re-capitalized Caixa Econômica Federal in 2001 which improved its performance.

4.29 The Government is undertaking a number of studies to address these broader issues and prepare for the medium term transition, notably: (a) diagnosis and identification of measures to decrease, in the short term, the gap between the income groups served by SBPE and FGTS systems in order to allow access to finance by all lower/middle income groups; (b) studies to determine the effects of a possible phasing out of the SBPE systems and proposals for different scenarios to implement such deregulation; and (c) proposals for the introduction of alternative modalities to increase saving for housing.

4.30 ***Improve the Targeting and Transparency of FGTS Interest- Rate Subsidies, and Extend Access to FGTS Funds.*** A politically sensitive issue in the sector is the need to focus FGTS-linked lending towards lower-income households, improve the transparency of its subsidies, and broaden restricted access to FGTS funding for below-market interest lending to a greater number of financial institutions (currently CEF is the principal user of FGTS funds for housing finance). To date, important actions have been taken, including: (a) increased targeting of FGTS funds towards the poor, rationalizing the use of FGTS savings and focusing these below-market rate resources on the “bankable” poor. These initial reforms include the issuance of Resolution 460 of the Board of directors of FGTS which provides a 4-year transition for all FGTS funds to be used for the benefit of households below 10 MW and efforts to significantly increase in the focusing of 2005 FGTS funds available for housing loans to households below 6 MW; and (b) enhanced transparency of FGTS subsidies by both allowing an upfront calculation of the cost and risk to lenders of the implicit FGTS interest rate subsidies and issuing upfront subsidies to be used in addition to the interest rate subsidies .

4.31 ***Further actions are needed to expand access to FGTS funds.*** In the short- and medium-term, the Government will need to address (a) CEF’s *de facto* position as the sole user of FGTS funds for lending and the related concentration of housing credit risk with Government, and the apparent discomfort of financial institutions in accessing FGTS funds through CEF and (b) reducing the gap between the FGTS and SBPE interest rates to improve access to credit by most moderate income households (see under SBPE). A strategic study of FGTS, funded under the TAL, will develop scenarios to improve its efficiency, transparency, pricing and access policy.

4.32 ***In the longer term***, when housing finance markets improve and current deep subsidies may no longer be necessary or only for a smaller proportion of the population, ***FGTS may review its roles as a provident fund for its members*** and as a provider of most of the national funding for urban development at below-market conditions.

4.33 ***Anticipated Results.*** Improved certainty and transparency in measuring and pricing of credit risk will expand the size of the housing finance market even if market rates do not come down immediately. With lower interest rates and continuing increase in general consumer purchasing power, we would expect a rapid expansion of the housing finance market. The sustained decline in interest rates is a pre-condition to make SBPE obsolete and will allow its further integration into market finance (to be studied in the next 10 months as a condition of the second DPL). It is expected that FGTS will remain in the intermediate term the main source of interest rate subsidies until the public finance situation will allow for a gradual transition from off-budget indirect taxation as a source of subsidies to on-budget subsidies. The strategic study on FGTS will provide guidance to the process of its gradual transformation.

### Policy Area #3: Improving the Effectiveness of Federal Housing Subsidies

#### Background and Issues

4.34 *Housing subsidies in Brazil have traditionally been embedded in below-market interest rates inherent in the FGTS system and to a lesser degree by the SBPE system* (see above). The Government is aware of the inefficiencies, allocative distortions and inequities produced by these systems – especially since the savers are rarely those who benefit from the subsidized interest rate loans. The Government has initiated improvements in the current systems. In particular FGTS has moved to greater transparency of its subsidy system, both subsidies to lenders and borrowers, and has improved its targeting to lower-income borrowers.

4.35 *Subsidies are still needed.* High interest rates and high house prices relative to incomes caused by constraints in the land market and inappropriate regulations make housing in the formal sector unaffordable for three-quarters of newly formed households that come into the urban housing market each year. While the priority is to address the constraints in the financial and land sectors, subsidies are needed in the medium term to (a) support households to acquire formal sector housing and curb the expansion of informal settlements, and (b) upgrade existing informal housing. However, subsidies need to be designed to leverage household contributions, private sector participation, and improvements in land regulations by municipalities. (See Annex 6).

4.36 *Housing affordability is a major issue in Brazil*, directly associated with low income levels relative to the price of formal housing and limited access to and the high price of housing finance. Regulatory inefficiencies in the land market and the high transaction costs related to acquiring permits to assemble, subdivide and develop land, and inefficient land registry systems prevent profitable low-income housing development by developers. The lowest-cost developer produced house (approximately 35m<sup>2</sup> to 40m<sup>2</sup>) on the outskirts of metropolitan areas, sells for R\$35,000 to R\$40,000<sup>25</sup>. However, at current income levels (the median urban household income at the end of 2004 is estimated at R\$1000)<sup>26</sup> *a market produced house can only be afforded by the top 25 percent of the income distribution without subsidies*, and even with deep interest rate subsidies under the FGTS program this figure only comes down to the 50<sup>th</sup> percentile<sup>27</sup> (see Table 5). Regular production of such lower- and middle-income housing is further hampered by limited and uneven availability of subsidized mortgage finance in the public housing finance system. Most households, therefore, have to self-finance their homes from income and savings, which lowers the quality of the house that can be acquired.

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<sup>25</sup> Other new construction figures for special subsidy programs show prices as low as R\$22,400 for apartments of 20m<sup>2</sup> (PAR) and PSH supported houses of \$28,000 to R\$10,000, depending on the region.

<sup>26</sup> We compared household income data for all households in the six large cities, using minimum wage and consumption information. The results show consistent data.

<sup>27</sup> Current mortgage interest rates range from TR + 6 - 10.16% for FGTS loans, TR +12% for SBPE, compared to and nominal rates of between 18% to 20 % in the free market. See Bank analytical work on the subject: "Keeping the Reform Momentum, June 2002; Low Income Progressive Housing," December 2002.

**Table 5: Affordable Housing Scenarios for Household Expenditure Deciles**

Urban Households, 2004									
Decile Type of Subsidy	10% PSH Parcel.	20% PSH Financ.	30% PSH Financ.	40% FGTS loans	50% FGTS loans	60% FGTS loan	70% FGTS loan	80% SBPE loan	90% Market Loan
Monthly Income based on Expenditures in R\$\$s	410	595	675	885	1,020	1,110	1,435	1700	2,350
Borrowing Capacity	10%	20%	20%	255	25%	25%	25%	20%	20%
Monthly payt. Capacity	41	119	135	201	255	278	359	340	470
Term	2	6	620	20	20	20	20	15	15
Interest rate nominal	25%	8%	8%	8%	11%	11%	13%	15%	20%
Affordable loan = affordable house with loan alone	<b>768</b>	<b>6,787</b>	<b>7,700</b>	<b>24,060</b>	<b>24,705</b>	<b>26,885</b>	<b>30,621</b>	<b>24,899</b>	<b>26,761</b>
Savings/down payment	10%	19%	10%	30%	30%	30%	30%	40%	40%
Afford with down payment	<b>854</b>	<b>7,541</b>	<b>8,555</b>	<b>34,372</b>	<b>35,293</b>	<b>38,407</b>	<b>43,745</b>	<b>41,499</b>	<b>44,601</b>
Upfront subsidy	10,000	4,700	4,700	5,000					
Afford with down payment and upfront subsidy	<b>10,854</b>	<b>12,241</b>	<b>13,255</b>	<b>39,372</b>					

Based on data from 1996/97 PPV Survey

Note: Assuming that about 1 million new urban households will form every year, at least 100,000 new housing units will have to be produced in each decile group (not taking into account backlog figures).

4.37 Brazilian poor – consistent with international experience – often find a way to protect themselves against weather inclemency and to create a minimum of privacy. In fact, the annual production of housing units is estimated at roughly keeping up with household formation.<sup>28</sup> However, only an estimated 20% of this new construction is authorized (World Bank 2004). The bulk of other housing units are built without being in compliance with the planning and building regulations and result in informal settlements and slums – e.g. *favelas*, *invasões*, and improvised housing. Estimates of the current stock of unauthorized housing range from 32 % in Recife to 14 % in Rio de Janeiro and 9.4 % in Sao Paulo.<sup>29</sup> These units do not have a minimum infrastructure, are easy victims of violence and crime, and often face discrimination in the labor market. The total housing deficit is estimated at about 7 million units, consisting of substandard housing, units that are overcrowded, and units that are excessively expensive relative to the income of occupying households.

4.38 **Solving the problem of access of the poor to formal shelter would call for both a boost in the purchasing power of households in the below medium income bracket through improved access to housing finance and well-targeted household subsidies and measures to reduce the cost of housing units through a reduction in the cost of land supply – improving land policies, zoning regulations, and property rights and registry systems.** Such an approach would further require efforts to address the backlog of deficient housing stock through support for the upgrading of neighborhoods with large proportions of substandard unauthorized houses and addressing issues of environmental risk.

<sup>28</sup> Instituto Cidadania, 2000. This observation is consistent with backlog figures for 2000 showing relatively less overcrowding.

<sup>29</sup> IPEA/DIRUR

## Recent Achievements and Future Challenges

4.39 ***Brazil's housing subsidy policy has undergone important changes, with a clear shift from implicit interest subsidies to transparent upfront subsidies and improved targeting*** to underserved and poor households and increased budget allocations for Federal housing subsidies. In 2001/2002, the Government launched an innovative upfront subsidy program (PSH, *Programa de Subsídios à Habitação*). The PSH *financiamento* program combines an upfront down-payment subsidy to households with an upfront subsidy to lenders to compensate them for the extra risks and costs in lending to lower-income households. In 2004, PSH added a special program component for households who cannot access credit and would qualify for a non-finance-linked upfront subsidy, called *parcelamento*, which, when combined with municipal land resources, provides for a simple home. PSH funds come from the Federal budget and are auctioned to financial institutions or other intermediaries.

4.40 ***FGTS has also established a new upfront subsidy program*** for households below 6 minimum wages (Resolution 460). The program of subsidies (\$R1.2 billion in 2005) is funded through a partial allocation of the recent exceptionally large FGTS financial revenues (a result of high market returns from its large portfolio of Government securities).<sup>30</sup> In 2001/2002, FGTS had already moved to compensate lenders – in an upfront and transparent way – for the extra risks and costs related to low-income loans made from FGTS funds. These new upfront subsidy programs are considerably more efficient than the interest rate subsidies that have been imbedded in Brazil's housing efforts for thirty years. *The combination of FGTS and PSH upfront subsidy programs offers the Government a great opportunity to move to a comprehensive Federal subsidy program that addresses different sections of the housing market.*

4.41 ***Targeting of both FGTS and PSH programs has been improved.*** PSH is targeted to households with incomes below 3MW. FGTS has increased its credit allocation to households below 6 MW and aims to further concentrate the totality of its loans to households below 10 MW by 2008. FGTS new program of upfront subsidy is reserved only for households with incomes of 6 MW and below. Targeting across regions has improved for PSH in relation to housing deficit figures for each region and the new FGTS upfront subsidy program will use a similar regional targeting approach.

4.42 ***Resources for housing subsidies and subsidized housing finance have sharply increased*** in the last two years, being now at R\$1.5 billion. First, the new FGTS upfront subsidy program financed out of extraordinary profits is planned for the next three years, adding R\$1.2 billion per year in upfront subsidies. FGTS has also expanded its subsidized housing credit program to R\$6 billion for 2005 offering credits at subsidized interest rates of TR+6+2.16. Second, budgeted funds to PSH are expected to increase from R\$350 million to R\$500 million for the next few years. Finally, local government subsidy contributions leveraged by the PSH program appear to have increased as well.<sup>31</sup> On the other hand, the housing leasing program

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<sup>30</sup> This equity assistance is reserved for households pre-qualified for an FGTS loan and with monthly incomes between 3 to 6 MW. The subsidy amount is determined by a formula that estimates a household's loan repayment capacity and different down-payment requirements (varying from 5% to 15%). While the maximum house price for the FGTS program in general remains R\$ 72,000, the program applies several discount rates on this value for the different regions of the country to calculate the needed subsidy amount for different income brackets. Subsidies are progressive: the higher the income, the lower the subsidy. Because of the house-prices adopted by the program, subsidies are high (a maximum of R\$ 14,000 in Sao Paulo and Rio, R\$ 10,000 in large cities, and R\$ 7000 in smaller ones).

<sup>31</sup> There are no comprehensive data for local government housing subsidies or for local contributions to federal programs.

(PAR), funded from the FGTS, has decreased its spending this year because of reported poor performance.

4.43 The Government has committed to further improve the housing subsidy policy and individual programs in the short- and medium-term through: (a) the consolidation and rationalization of different Federal housing subsidies; (b) improved targeting, monitoring and evaluation of subsidy programs; (c) further consolidation of PSH; and (d) continued improvements in FGTS' upfront subsidy.

4.44 ***Consolidation and Rationalization of Federal Housing Subsidies.*** *Under the current design, the subsidy amounts across different programs differ considerably, even for the same income groups.* Differences are particularly large when the upfront subsidies are added to the interest subsidies on the loan component. Subsidies, to a great extent, have not been designed to maximize household contributions through loans or savings. In fact, the current designs stimulate underreporting of income to gain the highest subsidy. In addition, the maximum house prices financed under each program differ considerably, and these differences are not only inequitable but cause widespread misstatement of incomes, a low valuation of house by beneficiaries, and housing abandonment. On the side of lenders, such discrepancies will favor programs with the deepest subsidies (e.g. FGTS upfront subsidies linked to a subsidized FGTS loan). Finance-linked subsidies offered by the PSH's *financiamento* are, however, much needed for households at the 2 to 3 MW level. The Government's actions to harmonize subsidies include:

- Rationalization of subsidy programs. In addition to the actions already undertaken, the Government is analyzing how the various subsidy programs ought to be rationalized and better coordinated. Within 18 months, the Government expects to have published a plan for the harmonization of those subsidy programs to address, *inter alia*: income targeting, upfront subsidy amounts, required household contribution, loan amount, and maximum house price for comparable income and need groups. Such a plan would include the harmonization of the allocation procedures across subsidy programs as well; for example, both FGTS and PSH subsidy programs could use an auction system for lenders to access subsidy resources.
- Improving the criteria and procedures for household access to subsidy funds; the rules of access to subsidies based on clear criteria using available databases and rigorous *ex-post* monitoring including income verification, *all beneficiaries* of credit-linked subsidies will be checked against existing credit performance information, savings or other forms of owner investment will be required to strengthen owners' equity in the house and encourage loan-repayments where possible (except in special circumstances when such contribution is not possible).

4.45 ***Monitoring and Evaluation System.*** Currently, no systematic monitoring and evaluation is conducted on the subsidy programs, apart from some internal auditing by CEF and PSH. One of the highest priorities is to put in place a comprehensive monitoring, auditing and evaluation system that will include all subsidy programs and assess the effectiveness, unexpected side-effects on households, housing markets, lenders, the efficiency and appropriateness of procedures, etcetera. Such a system will allow the regular adjustment and fine-tuning of subsidy programs. The Government's efforts in this regard include:

- The implementation of a Monitoring and Evaluation System. The M&E component has an important position in the government program. Preparation of a framework for the monitoring and evaluation of government housing programs, with a particular focus on the subsidy component, but also addressing the impact and actions of housing and urban development initiatives at the local level.

- An evaluation of the PAR and PSH subsidy programs. PAR, a large program of residential leasing finance operated by the CEF appears to have encountered severe repayment problems, and unfavorable judiciary decisions (tenants being considered as owners proved difficult to evict). There is a need to evaluate these programs on its credit repayment performance, proposed credit features including applied credit rates, the participation of local governments, *and the behavior of the beneficiaries* as tenants and/or future owners. Such evaluation will feed the necessary adjustment of the programs. Similarly, past implementations of PSH subsidy allocations through different financial institutions need to be carefully assessed to assist in improving the selection procedures of financial institutions and local governments, and adjusting design features of the program.

4.46 ***Improve the budget financed, upfront housing subsidy program (PSH).*** PSH, as the first upfront housing subsidy program in Brazil, was established in 2001 using a very innovative and transparent auction system to allocate subsidies. Since then, *PSH has been greatly improved*, in terms of regional balance, adjusted slope of the upfront subsidy amount, targeting to low-income households, the decreased amount of subsidy to lenders and the expansion of participating lenders. The Government *has further advanced the program by splitting the PSH* program in two components – a non-credit linked upfront grant program (*parcelamento*) and a credit-linked program (*financiamento*). These changes have helped to ameliorate a shortcoming of the earlier approach – the bearing of credit risk by local governments who were fully responsible for repayment of the credit linked to the subsidies – though further reforms need to be implemented to insure that local government capture a return on their land development investments under the program.

4.47 As a way to improve the program, the Government is committed to ***creating a competitive environment for alternative lenders to be funded by the PSH subsidy program.*** This will entail establishing an improved system of prequalification of lenders and other agents, including local public companies, based on their capacity to manage and oversee investment programs. There is also a need to take further measures so as to (a) improve the technical accreditation process to reduce the risk of underbidding and possible unfair/illegal practices and (b) establish formal sanctions when winning bidders do not deliver or are found to be changing the terms of their bid during implementation (e.g. adding additional charges to end beneficiaries or participating municipalities).

4.48 ***The Government will further conduct an assessment of the impact of possible changing of the interest rate cap, according to income and risk of the borrowers, on the financiamento program,*** at least for some separate auctions. The current program establishes a maximum interest rate which can be charged to end beneficiaries of TR+6 which is below the cost of borrowing for smaller lenders who lack access to subsidized TR+6 (plus 2.16% spread) FGTS resources and is thus *de facto* limited to CEF and other large financial institutions with access to FGTS funds.

4.49 It will ***also improve the transparency of municipal contributions to PSH.*** Since the municipal contribution to the subsidy program is considerable, the Government will conduct a study on how the municipal contribution can be entered in the bid together with their NGO, private sector financial institution or development managers. Such an approach would create incentives for active and more transparent municipal participation and could improve the leveraging power of the PSH to require conditions for the municipalities to gain access to PSH funds (e.g. improvement of the regulatory system as it relates to low-income housing development). Initially, PSH will study the feasibility of including the value of municipal contributions on the bids for *parcelamento* simply as information rather than as part of the competitive conditions.



4.50 **Establishment of the FGTS Upfront Subsidy.** FGTS' new upfront housing subsidies for households with incomes below 6 MW was established in January 2005 through Resolution 460. Its procedures were redefined and include (a) a tiered system for beneficiary prioritization, based on priority for collective applications and income group targets; (b) acceptance of existing houses; and (c) increased owner equity as an eligibility criterion.

4.51 There is a clear and recognized need to improve this program by means of (a) *broadening the lending distribution channels to attract more lenders to this lower-middle income market.* Since the upfront subsidy program is linked to access to FGTS credit, the issue of opening up access to FGTS credit to lenders other than CEF is specifically important for this program; and (b) *harmonizing the FGTS subsidy program with PSH and other subsidy programs.* In the medium-term, and consistent with the Government's efforts to rationalize subsidies across the range of income groups, a concerted effort would be made to harmonize the FGTS up-front subsidy with the PSH approach and eligibility criteria.

4.52 **Rental Housing** both of new or old houses, particularly for a mobile labor force is a high priority. In Brazil, like in most Latin American countries, low-income groups tend to own (or declare as owning) the dwelling where they live. Rental solutions tend to be chosen by young people or newly formed households, as consolidated families prefer to invest their savings to purchase a plot (or the right to use a plot) and build their housing progressively. Due to the large number of vacant units in Brazil and the excessive demand for housing, there is a clear market failure in this market. Legislation is favorable to rental (there is no rental control and it is not difficult to evict non-paying tenants) but there is very little recorded investment in rental housing especially for the poor. The Government is looking at this issue as part of the overall competitiveness and growth package.

4.53 **Anticipated Results:** Within 3-5 years the Government expects the following fundamental changes. The Government will have a road map for the allocation of all subsidy resources and programs across priority groups either households or local government, in line with overall housing policy goals. The Government will have a national plan with defined priorities taking into account projected urban growth and shelter needs across regions. An improved targeting, prioritization and selection process will be established for all beneficiaries and a comprehensive monitoring and evaluation system will be in place. FGTS and PSH will increase the number of credit institutions participating in the credit-linked subsidies, increasing competition. PSH will seek a more transparent involvement of local governments in the parcelamento. Implicit, non-transparent subsidies will be declining; upfront or buy-down interest rate subsidies will be improved and the Government will have multi-year subsidy allocation figures that allows it to negotiate an annual program of low-income housing developments with lender, developers and construction companies. Low-income housing would increasingly be financed by previous savings, subsidies, and a small credit based on the credit history of each participant

## **Policy Area #4: Land and Urban Development**

### **Background and Issues**

4.54 In addition to actions geared to stimulate demand for housing and to enable the subsidies to help the lowest income brackets, efforts are required to complement demand-side adjustments with supply-side reforms. Without efforts to improve the supply of housing, demand-side efforts would not yield the desired impact on increased formal housing production and a serious effort is made to quickly stimulate the supply of urban land for the poorest families as well as for the middle-income levels. There is a consensus that land supply in Brazil is constrained by excessive

regulation, conservative zoning, and over restrictive devices, albeit their purpose of protecting the poor against speculation and to guaranteeing a minimal level of human dignity. In addition, since local governments have the responsibility for urban development, the Government is correctly concerned with the need to quickly strengthen the capacity of the local entities to reduce the “cost of formality” and the supply of land.

4.55 The national legislation that regulates the subdivision of land for urban purposes is comprised of Law 6.766 of 19 December, 1979 and Law 9.785 of 29 January 1999. These acts establish the general norms of urban law concerning land subdivision for urban purposes and make other provisions of a contractual, criminal and bureaucratic nature, as well as establish provisions on expropriation of real property for the purpose of urbanization or re-development of works, demolition, reconstruction and defines the rules for registering property. However, Law 6.766/79 was enacted before the 1988 Constitution and both laws 6.766/79 and 9.785/99 were enacted before the City Statute of 2001(Federal Law 10.257/01). Thus, their provisions must be examined in the context of the 1988 Constitution and the City Statute, which provided for certain limitations to the right to subdivision and further asserted the principle of the social function of property, which has been repeated in every constitution since 1934. Among the legislative advances thought to be advanced by the City Statute in 2001 are: (a) the rights and instruments of municipalities to deal with city planning issues and the development of underutilized land; (b) the inclusion of incentives for the preparation of city development plans for every city over 20,000 inhabitants; (c) incentives to promote participatory planning processes; and (d) the regularization of some existing landholdings for occupants of plots of 250m<sup>2</sup> or less who have been living on the land for five years or more.

4.56 Despite the intentions of Law 6.766/79 to effectively regulate land subdivision and the process of registration, it has long been *blamed as a major impetus to the growth of informal land subdivisions*, resulting from the law’s excessive technical requirements, its impact on land prices (making prices rise) and the municipal administrations’ lack of capacity to cope with the cumbersome bureaucratic procedures established in the law. Law 9.795/99 attempted to address some of these deficiencies, introducing, for example, new mechanisms to facilitate the regularization of irregular land subdivisions and to reduce the percentage of land that must be reserved for public purposes in new land subdivisions. However, these changes are largely perceived to have been insufficient as regards creating an enabling environment for the development of urban land, the registration of land and the regularization of irregular subdivisions and settlements.

4.57 Revision of law 6.766/79 has been a priority since the mid 1990s, and the Ministry of Cities has since its creation in 2003 played a critical role in facilitating public debate on the law and its reform. It is the goal of the Ministry of Cities that any revision of the law be consistent with the main principles underlying the Government’s policies on land and housing, namely:

- broad democratization of the legal, political, financial and institutional conditions of access to urban land and housing;
- the production of new social housing developments and serviced sites for low-income groups, by the public authorities in all spheres of government;
- the opening of new opportunities for housing finance, especially for the population between 0-3 minimum salaries;
- inclusive urban planning and democratic management of cities, especially through the instruments, mechanisms and processes of urban land use as per the 2001 City Statute, in order to induce the occupation of vacant land, rehabilitation of urban centers and the full realization of the socio-environmental function of urban property and of the city;

- the promotion of urban land regularization programs, which should be considered as one of the central axes in formulating municipal master plans, such as required by the 1988 Federal Constitution and the 2001 City Statute;
- the use of redistributive fiscal and extra fiscal policies, as well as mechanisms for surplus value-capture by the public authorities, always in the terms of the 2001 City Statute;
- the creation of mechanisms and processes of various orders to involve the formal land and property market in the production of regular serviced sites and buildings for the low-income population, in good locations, accessible prices, and sufficient quantities;
- encouraging housing co-operatives; and
- incentives for the formation of public-private partnerships.

### Recent Accomplishments and Future Challenges

4.58 The Government has begun a process to improve the legal and institutional framework as regards urban development and formal settlement creation to address both the backlog of needed investment (thus upgrading and regularizing the stock) and to create an enabling environment for the orderly incorporation of new land subdivisions (the flow). The key challenges for the Government in this regard include the need to:

- Establish urban development criteria that do not have the adverse impact of increasing the price of land, both in formal and informal property markets and in this regard keep focus on the target of facilitating access to urbanized land for those families earning less than 5MW
- Take into account the management and administrative capacity of municipal governments when defining procedures and technical criteria, being careful not to undermine the impacts of giving greater autonomy to local governments in determining development standards by requiring too excessive administrative procedures at the local level<sup>32</sup>
- Allow for progressive infrastructure provision that balances environmental and health concerns with facilitating access to urbanized land
- Integrate subdivision approval and environmental licensing processes, breaking the current duplication of procedures
- Establish a benchmark timetable for municipal administrations to approve (or not) land subdivision projects<sup>33</sup>
- Integrate the approval and regularization processes of horizontal condominiums into any new law regarding land subdivision approval and regularization
- Promote a clear and legal distinction between the existing forms of informality in order to define the most appropriate technical criteria, obligations and procedures for regularization<sup>34</sup>

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<sup>32</sup> E.g. some draft versions to revise the law would require geo-referencing and complex subdivision approval processes and monitoring systems of land subdivision that would not be feasible for most Brazilian municipalities.

<sup>33</sup> Current procedures take an average of three to five years to complete. This cumbersome process is considered to be one of the main drivers of informal subdivision development in Brazil.

<sup>34</sup> There is a distinction between informal settlements occupied by low-income people where there is a collective right to regularization and informal settlements where regularization is a matter of discretionary action of public authorities. In addition, any law should treat several issues of informality specifically: the effective regularization of informal settlements on land directly or indirectly belonging to the Union, especially coastal land, by removing obstacles to municipal and state regularization programs; find a

- Further reinforce the importance of creating ZEIS – Special Zone of Social Interest, corresponding to informal settlements to be regularized
- Include provisions for the registration of land developments (new land subdivisions and condominiums) and the regularization of informal land settlements that would simplify procedures and lower the financial costs of registration.

4.59 The process of debate and reformulation of Law 6.766/79 was begun in 1999, prior to the creation of the Ministry of Cities. However, the final version of the law was never sent to the house floor for debate, remaining instead in committee. The bill in its current form does not adequately meet the criteria for proper reform of the law as listed above. This presents an opportunity for the Ministry of Cities to establish a new process of public debate and allow for a re-drafting of the reforms that would advance the objective of simplifying subdivision and registry processes, in the spirit of increasing the supply of urbanized land accessible to a broader market, specifically those families earning less than 5MW. The proposed loan would provide support to that process through the Ministry of City's on-going program of public dialogue and input into the reformulation of Law 6.766/79, as well as supporting the Ministry's programs to regularize land tenure in informal settlements by providing municipalities with the resources to undertake these programs.

4.60 **Slum Upgrading Efforts.** Much of the housing deficit in Brazil (estimated at 7.1 million units) is qualitative, meaning that most of these families are housed, albeit in substandard conditions. To address these needs the Government has several programs, although at a small scale relative to the size of the problem, to urbanize informal settlements. The urbanization process includes the provision of basic infrastructure, resettlement of families in areas unsuitable for occupation and the regularization of tenure. Habitar-Brasil, financed by the Inter-American Development Bank, and PAT-PROSANEAR, financed by the World Bank and executed by the Secretariat of Sanitation, as well as the FGTS's ProMoradia program, make up the universe of Federal Government programs aimed at comprehensive urban upgrading. These programs lack better coordination and are of small scale. It is in the medium-term trajectory of the Government's reform agenda to scale-up its efforts at informal settlement's regularization. As the problem is greatest in metropolitan regions, the Government envisages a national upgrading program aimed at metropolitan regions, that would promote partnerships with states and municipalities, through a matching grants program and would be supported under the PDPLs.

4.61 The effective implementation of these mechanisms will require an intense process of technical assistance to municipalities. In addition to the legal and administrative reforms supported by the proposed operation, the Government has launched a program to assist 2000 local governments to prepare their *Planos Diretores* in 2005. These efforts – along with initiatives to strengthen the use and management of local land registries and cadastres – are in the process to be implemented. ***Within 18-20 months, the Government would have accomplished several benchmarks, including:***

- supported a revised version of the Law of Territorial Responsibility with an integrated vision for new land divisions and the regularization of illegal or informal settlements;
- launching a national program for urban upgrading in metropolitan areas;
- financing – with Federal resources – the preparation of 250 municipal *Planos Diretores*;
- inclusion in the National Housing Plan the policy elements to increase the supply of urban land defining instruments, incentives to all types of governments, and ways to

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solution to the regularization of consolidated informal settlements in areas somehow subject to environmental regulation; and integrate registrars into the integrated licensing and approval process.

reduce the administrative costs to access urban land market and to undertake the necessary subdivision.

4.62 **Anticipated Results.** Within 5-10 years, the Government expects to have achieved the following results: (a) local governments would have the knowledge and capacity to deal with informal settlements, formal titling, and the development of new land for new settlers; (b) local and state governments would have discussed ways of collaborating to share infrastructure costs in preparing urbanized land for newcomers; (c) the Federal Government would have developed a monitoring system to follow progress and understand priorities and identify urgent interventions; (d) private developers would again become interested in working with localities; and (e) the Government would have designed and implemented a Bank-supported program to launch a major upgrading scheme (based on an output-based approach) and to finance the subsidy program.

## 5. LOAN CONTENT AND BANK SUPPORT

### Bank Support to the Government's Program.

5.1 Bank support to the Government's reform and investment program will be structured over the next four years or so and would comprise (a) loans aligned with the Government's budget cycle and linked to federal policy reform efforts, including the establishment of a sector-wide housing subsidy program; (b) a Technical Assistance Loan (TAL), which will be presented to the Bank's Board of Directors shortly after the present loan and which aims to strengthen the capacity of the Government to formulate and implement housing sector policy – see Annex 9; and (c) a possible investment-linked operation, to be prepared under the Sector Wide Approach (SWAp) modality, which the Government has requested to finance the national harmonized subsidy program expected to emerge before the second phase of the program. The proposed loan supports the establishment of the institutional and policy environment for sustainable housing sector development consistent with the emerging national priorities and would identify the medium-term trajectory of housing and urban policy, setting the stage for follow-on DPL, the focus of which will be to enhance the effectiveness of the housing finance system and the targeting and transparency of subsidy programs.

**Table 6: Government Request Bank Support for Housing Sector Reform and Investment**

Instrument	Requested Bank Financing (US\$ million)
Phase I	500.0
Technical Assistance Loan	5.0
Phase II	200.0
Housing Subsidy Sector Investment Program (SWAp)	300.0
Phase III	200.0

### CAS Linkage.

5.2 The program is fully consistent with the Brazil CAS discussed by the Bank's Board of Directors on December 9, 2003 as it supports the CAS' three main pillars of equity, sustainability and competitiveness. Most fundamentally, the operation would improve access to affordable

housing and basic services, and would strengthen the real assets of the poor. Housing often serves as a key source of capital accumulation and income generation for low/moderate-income households, and improving urban development enhances the efficiency and competitiveness of cities, which account disproportionately for national economic growth. In addition, the program will increase the sustainability and competitiveness of the housing finance sector and improve land markets and hence the productivity in the housing construction sector. The Bank's program of interventions would also generate highly positive environmental impacts by supporting a policy environment for the upgrading of existing slums and promoting formal-sector development on appropriate sites. Further, the results-based-CAS set the framework for monitoring progress towards achieving the CAS goals. Within that framework, it states specifically that the housing operations would contribute to a more sustainable Brazil. It sets out as medium-term outcomes: (a) housing programs better targeted to the poorest; and (b) the reform of housing finance and land development regulation. This is entirely consistent with the main thrust of the Program objectives.

**5.3 *Rationale for Bank Involvement.*** The Bank is uniquely positioned to support the Government's program. First, the Bank is a natural partner given its lead in engaging the Government in housing and urban development policy dialogue over the last three years. Second, the proposed program is fully consistent with the CAS objective of building a more sustainable and equitable Brazil, as it will support the Government's efforts to increase the number of households with access to safe and secure formal housing and services. Third, the proposed operation supports the Government's efforts to maximize the efficiency of policy interventions in the housing market through improvements to the structure and targeting of federal subsidy programs and through the reduction of supply-side constraints for housing and land development. Fourth, the Bank's proposed engagement leverages its ability to simultaneously bring financial support for programmatic policy reform, technical assistance for policy design and capacity building, and investment-linked support for housing subsidy programs. Fifth, there is a natural synergy between the undertaking of policy and program reforms at the macro level, and the direct investment in urban slum upgrading and urban planning work the Bank is doing at the local level with many municipal clients.

**5.4 *Analytical Underpinnings.*** The proposed operation has its underpinnings in detailed analytical work and dialogue. While the Bank has had a visible presence in urban upgrading and municipal projects in Brazil with a marked success, dialogue on housing policy and low-income housing deepened in the last four years. After access to shelter services was identified as a priority area for Bank intervention during the pre-CAS consultation process, towards the end of 2000, the Bank launched field work that led to a comprehensive piece of ESW (Brazil Progressive Low-Income Housing: Alternatives for the Poor, Report 22032-BR). In 2001, the Brazilian authorities explicitly requested Bank assistance in preparing a National Housing Policy for Brazil taking into account the new macroeconomic stability of Brazil, the much wanted deregulation of the credit system, and the increased potential for capital market development. The Bank produced several policy notes and *aides memoire* reviewing the major impediments for the development of the housing sector as a whole, with particular attention to the institutional framework, subsidy policies, housing finance and land markets (Maintaining Momentum for Reform, June 2002). In addition, the Bank provided regular assistance and feedback to background papers and policy documents; offered training sessions to large groups of officials dealing with housing issues; organized the presence of a large number of Brazilian officials in the Wharton Housing Finance course offered annually; commented on draft laws and national debates and tried to avoid major discontinuities in the dialogue during the change in administrations.

**5.5 *The loans and related TAL also draw from the Bank's broad experience on shelter and housing finance.*** World Bank involvement in urban shelter has evolved considerably from the

early poverty-oriented projects, (namely the so-called sites and services projects), initiated by President McNamara in the early 1970's.<sup>35</sup> Reflecting a major shift in policy that favors enabling better markets rather than public intervention and construction of public housing ("Housing: Enabling Markets to Work", World Bank 1993), the new crop of projects focuses on both broader policy-based initiatives, as well as on financial projects supported by the Bank, and increasingly the IFC. Now, thirty years after it began lending for housing, the Bank has supported over 250 projects and more than \$13 billion in lending. Lending for the housing sector has traditionally been one of the strongest performing sectors in the Bank, with 95 percent of the last decade's outcomes being rated satisfactory.<sup>36</sup> *Lessons learned in the recent past deal with how to scale up the efforts leading to the MDG11*, how to combine slum upgrading and poverty alleviation with the emerging elements of housing policy, given the fundamental role played by the broader policy environment. In contrast with the early loans that focused on enclaves that could not be scaled up, the recent crop of loans gives much greater emphasis to the policy issues that constrain the sector. These policy-oriented loans are now the dominant form of lending in the sector as it is recognized that this would be the best way for Bank to effectively contribute to the MDG goal on slums and generally improve the functioning of housing markets outcomes for the poor. The recent and successful examples of Mexico (Housing Structural Adjustment Loan and Housing Technical Assistance Loan), Morocco, Poland, Russia attest to the need to consider the housing sector in its entirety to enable the parallel development of more efficient organization of demand (including subsidies), more responsive supply (including land policies) and adequate institutional and policy framework. Further, Bank support for tackling the larger policy issues at the federal level will complement – and enhance – the efforts the Bank is taking to address living conditions in slums at the local level throughout Brazil.<sup>37</sup>

**5.6** *The loan draws from the long experience with programmatic lending to Brazil* in several sectors and more recently in areas related to the pillars of the CAS. The loan also relates to several ongoing operations and is within the cluster of activities supporting the Growth pillar of the CAS, which includes the Programmatic Loans for Sustainable and Equitable Growth. The operation is closely related to ongoing municipal programs that aim at improving municipal management and provision of social housing and urban upgrading as well as with programs designed to improve the welfare programs designed for the poor. The loan has also been designed to benefit from the lessons of those operations (e.g. the monitoring and evaluation component has drawn from the identical component prepared under Bolsa Familia).

### **Design of DPL.**

**5.7** The design of the loan takes into account the lessons learned from the recent DPLs in Brazil and the latest thinking on Development Policy lending for well performing middle income countries.<sup>38</sup> The underlying principles of this operation include (a) upfront actions rather than ex-

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<sup>35</sup> Robert Buckley, 2005

<sup>36</sup> From 1972-1981 the satisfactory outcome rate for shelter projects was 85% relative to almost 80% for infrastructure lending. After declining to 81% in the 1980s – still a relatively high value for that volatile decade – outcomes in the most recent decade increased to 95% satisfactory. Annex 1, based on Buckley and Kalarickal (2004) presents summary data, which was approved by OED as being representative, on the Bank's shelter portfolio.

<sup>37</sup> The Bank is working directly in 6 state capitals, and this will likely increase - all on urban upgrading projects – in areas where housing problems are most acute.

<sup>38</sup> World Bank 2004. Programmatic Adjustment Lending Retrospective and World bank 2004: Good Practice

post conditionality; (b) support of reform program instead of specific conditionality; and (c) aligning program loans with budgetary cycle.

**5.8 Programmatic Framework:** The proposed loan supports actions in four areas: (a) institutional framework; (b) housing finance; (c) subsidies for low-income households; and (d) land policy. It is expected that in the first loans more emphasis would be placed in the first three areas and that the emphasis would shift towards the last area as the capacity building efforts taking place at local level bear fruit. The Policy framework is included in Annex 2. The key measures highlighted as prior actions for this loan are the following:

*Institutional Framework*

- National Housing Policy discussed with society
- Introduction to Legislative of law creating the National Housing Fund (Project of law No 36/2004).
- Creation of an inter-ministerial committee to follow up on and elaborate proposals for the market based and subsidy components of the housing financial system.

*Deepening and Strengthening Housing Finance Markets*

- Approval of improvements in the Housing credit regulatory framework (Federal Law 10.931/2004)
- Progress in SBPE regulations (Resolution 3,259 of January 2005 of Conselho Monetario nacional) bringing them in line with sector capacity; weighing in favor of low income/low housing value.
- Resolution of the Conselho Curador do FGTS 460, Dec 2004, improving the targeting and transparency of the FGTS with explicit upfront calculation of the cost and risk of the subsidy and establishing that, by 2008, all FGTS resources will benefit households of less than 10 MW. Increased the amount of credit available for households earning less than 6 MW in 2005.

*Improving the Effectiveness of Federal Housing Subsidies*

- Approval of Law 10.008/2004 – based on Provisional Measure 2.112/2001 – creating PSH – *Progama de Subsidio à Habitacao de Interesse Social*.
- Preparation of a Framework for the Monitoring and Evaluation system of the Housing Program of the Government, with particular attention to the Subsidies component.

*Improving the Land and Urban Markets*

- Implemented national policy for sustainable urban land tenure regularization – *politica nacional de regularizacao fundiaria sustentavel - Programa Papel Passado* aimed at guaranteeing the title of the land to poor people.

**5.9 Triggers for future DPL support to the housing policy area.** The operation has been designed to provide timely, appropriate support to a policy reform program which is, by its very nature, medium-term in scope. Eight key actions have been identified as “triggers” for the preparation of subsequent DPL – completion of these actions would serve as a clear signal of the Government’s intention to maintain the policy trajectory of the program:

*Housing Policies and Institutional Framework*

- The Government will have finalized the National Housing Plan and its monitoring system.
- The Government will have regulated the National Housing Subsidy Funds (upon approval by Congress) and addressed the questions of management and access.



#### *Housing Finance Market*

- The Government will have promoted the access of financial institutions to FGTS funds.
- Diagnosis of SBPE performance, and proposals to improve it with the objective of integrating it in the market in the future when the macroeconomic conditions allow and the interest rates go down.

#### *Housing Subsidies*

- The Government will have published the plan to harmonize and rationalize the different subsidy programs in terms of (a) financing as % of house value; (b) maximum value to be financed; (c) depth of subsidies across income levels, improved access to subsidies including better targeting system.
- Design an implementation of a comprehensive M&E system for the NHP and its components.

#### *Land and Urban Development*

- Inclusion in the NHP policy directives to increase the supply of urban land based on the identification of the constraints that limit the rapid and effective supply of land for the lowest income groups.
- Launching the national urban upgrading program for metropolitan areas accounting for 90% of the informal settlements.

### **Social and Environmental Impact**

5.10 The team considers that most of the specific policy measures that are supported by this loan are expected to have significant positive poverty impacts. Of the major components to be supported in the program are the implementation of a better targeted and transparent subsidy system, reduced cost in land supply and housing construction, great access to house finance both by the usual intermediaries as by means of encouraging non-traditional institutions such as micro-credit institutions. During the establishment of the monitoring and evaluation system, particular attention will be given to the targeting of the beneficiaries and to the evaluation whether the targeting is accurate and reliable. A strategic social assessment of the Government's program was undertaken during the proposed programmatic loan preparation.

5.11 Actions under the proposed project are not expected to have any significant negative environmental impacts. An environmental institutional assessment has been prepared (Annex 5) to assess the institutional framework in place to ensure that housing policies are monitored and there are incentives to avoid settlements and formal sub-divisions in risk-prone areas. The assessment looks in detail at the new law being prepared by Congress and identifies some issues related to unrealistic expectations or requirements imposed in municipalities which may not have the necessary technical capacity.

### **Fiduciary Aspects / Disbursements and Auditing**

#### **Flow of Funds and Audit Arrangements**

5.12 Once the Bank formally notifies the borrower that the loan is available for withdrawal, the borrower may submit a withdrawal application so that the proceeds of the loan would be deposited by the Bank into an account of the National Treasury of the Federative Republic of Brazil, established at the Central Bank of Brazil for the borrower's use.

5.13 The Bank will disburse the single tranche of the loan proceeds into an account of the Central Bank denominated in USD. The Central Bank will subsequently credit the amount of the Loan to the National Treasury's account at the Central Bank. This is a government account that is used to finance budgetary obligations. The National Treasury will then provide the Bank written confirmation of the transaction.

5.14 The IMF Safeguards Assessment of the Central Bank of Brazil concluded that, Banco Central does not present widespread vulnerabilities that could compromise the safeguarding of Fund resources. In particular its audit is conducted by an internationally recognized audit firm, while its internal audit function contributes effectively to internal control systems. Therefore from a fiduciary point of view, the control environment, procedures and regulations governing the bank's operations are generally adequate. Given that there is adequate knowledge about the soundness of the country's public financial management system, additional fiduciary arrangements (such as using a dedicated Deposit Account) have not been deemed necessary in this case.

### **Financial Management**

5.15 For development policy lending (DPL), effective management of Government finances provides the best assurance that Bank funds are used appropriately. A fiduciary framework for DPLs starts with a sound knowledge of borrower public financial management (PFM) arrangements and an appreciation of the risks they pose to Bank programs and funds. This information may be generated by a Country Financial Accountability Assessment (CFAA).

5.16 A CFAA analyzes the performance and transparency of budget management institutions and systems in the public sector. The analysis and recommendations contained in these reports seek to help government and the Bank to meet their fiduciary objectives by identifying risks to the use of public funds posed by weaknesses in PFM arrangements and areas where further improvements in public financial management could help to strengthen fiscal discipline, increase operational efficiency, and improve the country's governance environment.

5.17 The World Bank finalized in 2002 a CFAA for Brazil, that was discussed with the Government and which has been used to draw key conclusions on the country PFM. Brazil has well developed financial management (among the most robust in the Latin America and the Caribbean Region), thus ensuring that Bank lending is done in context of acceptable oversight arrangements. Notwithstanding some desirable improvements that could be made (and which are being tackled within the scope of the reforms launched to sustain the Government's focus to improve and modernize public sector management), the Brazilian system of public financial management provides reliable information, and adequate systems do exist to manage and track the receipt and use of funds at national level and there is a high level of fiscal transparency. In particular, improved budget formats and enhanced internal controls to support managerial decisions and external oversight; a new institutional set up for the government's audit function; as well as the expansion of SIAFI to increase its programmatic functionality are all important developments which took place after the delivery of the CFAA. All these conditions would support any DPL program. In light of the adequate control framework assisting public finance operations, the risk to both Bank and country own funds is low.

5.18 The conclusion, which is taken into account in deciding the design of the proposed operation, is that financial management risk is low and that no additional conditionality need be introduced with respect to financial management. To support supervision of the operation, the Borrower will generate appropriate reports to demonstrate that the funds were included in the budgeted sources of funding and that uses of these funds, along with all other sources, were duly recorded and reported in the budget expenditure report.

## Benefits, Monitoring and Evaluation

5.19 The program is aimed at improving access of low-income people to shelter services through the implementation of reforms to the housing, urban development, and finance sectors. The series of operations – including the proposed loan, TAL, and possible SWAp – would address the core reform and investment agenda, and thus directly contribute to growth and poverty reduction. The project's direct impacts will be measured in a variety of ways.

5.20 *First*, we expect that Board approval and disbursement by mid-calendar year 2005 of this proposed loan would help meet the Government's financial objectives and provide financing on more favorable terms than alternatives for its 2005 budget. This would support Government goals of fiscal stabilization and continuing improvement in the macroeconomic agenda.

5.21 *Second*, most of the reforms undertaken for this loan were discussed with the Bank and influenced by joint analytical work. The proposed loan would be recognition of the reform achievements so far. Timely support by the Bank would be also important in forming the basis for strong engagement in the housing sector. The Letter of Development Policy indicates the new administration's commitments on a range of issues where the Bank has worked with the Government or intends to. The proposed loan would provide the vehicle for continuity in policy dialogue on the range of issues which will form the basis for future loans.

5.22 **Impact/Results:** In terms of the vision of the future, the program is expected to enhance the possibilities for a better situation in the near and medium term. For example, within 12 to 18 months the Government will have spelled out the National Housing Plan with precise targets, investments and a "road map" to address the social problems associate with inadequate housing and accumulated deficits. We anticipate a proactive, flexible and agile National Housing Policy working in greater partnership with private sectors and local authorities, helping to promote urban growth and development in a more sustainable manner. Success will be measured in terms of ***production of new housing at affordable prices***, development of the rental market for younger households, decline in unmet demand for social housing, response to illegal or irregular settlements.

5.23 In addition, we anticipate a more efficient and liquid housing finance market translated in number of housing or real state credits. We can anticipate a substantial increase in the size of housing finance in line with results observed in such countries as Spain and Portugal following the macroeconomic adjustment and market liberalization – and increased housing finance from ***5% of GDP to 10% of GDP in 5-7 years*** could be realistic provided the interest rates fall from the current heights.

5.24 We can also expect the implementation of a coherent national program for **upfront housing subsidies** to avoid discontinuity in income levels, price of housing, size and type of subsidy between the 4-5 types of subsidy programs. This will result in an optimization of the scarce volume of resources available for housing subsidy financed by the central government. We can expect (a) better targeting at both local and central level; (b) better synergies and leverage between central and local housing program; (c) enhanced capacity to understand and monitor the housing program in terms of understanding whether the program is able to answer the annual demand for new household shelter.

5.25 *Finally*, improvements in the ***performance of local governments*** in undertaking their responsibilities as regards land reform and zoning are to be expected. Local governments are the main financiers of infrastructure for housing and will remain so. The impact of the program is

expected in increased leverage between levels of governments and a well-designed national program to “tease” and guide the local governments to address with priority the need to increase the supply of serviceable land, allow households to adopt progressive housing approaches keeping a good eye on the future demand for land and the alternatives for new households coming into the market.

5.26 **Monitoring and evaluation** of the impact of the Government’s efforts is critical to the progressive fine-tuning of the instruments and programs for supporting low-income housing. In particular, the development of mechanisms to assess the targeting of subsidies and delivery capacity of local financial institutions, developers and municipalities will make or break the impact of the Government’s efforts to improve the efficiency of housing subsidy policy. In the very short run, the Government will define a results matrix which reflects the expected impacts and outcomes of the program as well as a concrete set of activities to be financed under the TAL to create relevant capacity and ensure that performance monitoring and evaluation is mainstreamed in the Government’s housing policy.

## 6. RISKS AND MITIGATION

6.1 A comprehensive program of reforms is inherently risky in any country, and more so in the context of the high level of visibility and priority given to social programs for the urban poor by the current administration in Brazil. The team has identified seven key risks to the effective implementation of the Program:

6.2 *First*, there will inevitably be a **time lag in the implementation** of reforms and their impact on housing markets and land development. There is the risk that in a highly politicized environment, the program may seem to be unsuccessful in the absence of immediate fruits. This risk is deemed to be moderate: the inclusion of subsidy monitoring and targeting efforts, for example, will provide information on the approach in the very short-term, and the pace of Government action in recent months is highly encouraging.

6.3 *Second*, a key player in the housing finance and subsidy agenda, FGTS, is an independent fund and thus technically “outside the system.” However, given the central importance of FGTS in the move towards upfront subsidy systems, both MOC and STN would discuss with FGTS ways to improve the overall subsidy program to increase its effectiveness and avoid distortion impacts. The Government, through the MOC and Ministry of Finance, has a prominent position on the Board of Directors of FGTS and it is clear that FGTS is eager to accommodate the recommendations of the Government, provided they are consistent with its mandate and with adequate profitability of its investment funds. Progress to date has been highly consistent with the Bank’s dialogue with both FGTS and the Government.

6.4 *Third*, while many reforms are being undertaken by the Federal Government, the role of the **local governments** is essential, notably in the provision of urban land and in the removal of supply constraints. This risk is deemed to be moderate: large municipalities in Brazil have highly trained officials and the central Government has embarked on an ambitious program to support capacity building at the local level in areas directly related to the proposed Program. The TAL and direct oversight and supervision of the Bank will aim to support these efforts.

6.5 *Fourth*, there are **coordination and institutional risks**. The sectors affected by the Program include a number of actors, inside and outside the Government. Coordination will be a central aspect of the successful implementation of the reform agenda, and there is a risk that interagency cooperation breaks down. This risk is deemed to be high; coordination difficulties are

inevitable and a major political bottleneck would be likely to significantly sidetrack the reforms now in motion. Nonetheless, the formation of the Interministerial Housing Policy Group should be seen as an important step in the direction of coordination.

6.6 *Fifth, the roles of the CEF and FGTS* need to be assessed in the medium-term. The long-term expansion of the housing finance calls for an increase in competition of agents in the market. CEF has an enormous and invaluable experience in the sector (especially the lower income brackets) and this capital needs to be well guarded. However, there is a clear need to increase competition in accessing cheap funds such as FGTS. Whether this would be feasible will depend on how interested the private banks are to enter the low-income housing market. However, the risk of not requiring major ex-ante reform of Caixa's role will negatively impact the proposed policy reforms is deemed to be low: the team believes that the scope of the operation should be focused on those areas which can be achieved in the immediate-term and provide a clear path for improving sector performance while taking into account the peculiarities and political economy of the policy environment, including the current position of Caixa.

6.7 *Sixth*, there are *inherent macroeconomic risks* associated with any policy-based program of support and this is particularly true in the case of housing finance. Macroeconomic shocks could have a profoundly negative impact on the financial sector. Nonetheless, this risk is deemed to be low: in the current macroeconomic environment – particularly as regards fiscal discipline – the likelihood and benefits of future declining interest rates and financial sector stability outweigh the downside risks.

6.8 *Finally*, there is some risk in the timing of operations as the program is being initiated in the middle of *the current administration's term*. The second phase and the requested SWAp may come at the end of the current administration which may slow down the commitment of the reforms and impact the preparation of the second phase and the SWAp. The agreement of a National Housing Plan with clear objectives shared by a wide range of parties could help the program to stay on track during the transition period.

## ANNEX 1: LETTER OF DEVELOPMENT POLICY



### CARTA DE POLÍTICA PARA O SETOR HABITACIONAL

Brasília, 06 de maio de 2005.

Sr. James Wolfensohn  
Presidente  
Banco Mundial  
Washington, D.C.

Prezado Senhor Wolfensohn,

O Governo do Presidente Luiz Inácio Lula da Silva tem implementado uma importante agenda de reformas microeconômicas, destinada a promover o aumento da produtividade da economia brasileira e o crescimento equitativo. Nesse contexto, a fim de apoiar o financiamento do seu esforço de reformas para o setor habitacional, o Governo Brasileiro solicitou ao Banco Mundial um programa de Empréstimos para Política de Desenvolvimento (DPLs). Essas reformas fazem parte do grupo de atividades que o Banco Mundial vem apoiando na área de Crescimento Equitativo e Sustentado, cujo primeiro empréstimo foi aprovado no ano passado.

2. O Governo atual tem dado ao setor habitacional para a população de baixa renda uma grande importância, em função do impacto que a habitação tem na vida cotidiana dos segmentos de mais baixa renda da população, bem como na criação de empregos e na promoção da atividade econômica. Abaixo, estão mencionadas as medidas mais importantes já adotadas, ou planejadas, para enfrentar as principais questões que afetam o setor habitacional no Brasil.

3. O Governo está ciente dos enormes desafios que o setor apresenta. O déficit habitacional brasileiro está estimado em cerca de 7 milhões de unidades, sendo que 88% desse déficit estão concentrados em famílias com renda inferior a 5 salários mínimos. Esses indicadores não melhorarão se não conseguirmos enfrentar o excesso de demanda por serviços de habitação gerados por novas unidades familiares que se formam anualmente. Parcela significativa do número de famílias formadas anualmente não consegue ter acesso às residências mais baratas produzidas pelo mercado e recorrem ao mercado informal de habitação.

4. O Governo já identificou quatro áreas em que medidas e reformas são cruciais para aumentar o acesso dos mais pobres à moradia adequada. Primeiro, o Governo está trabalhando para fortalecer as instituições que atuam no setor, bem como sua capacidade de coordenação, tendo por base informações estatísticas adequadas e análises detalhadas, a fim de definir um plano de médio prazo, com prioridades claras e metas financeiras realistas. Segundo, o

Governo está empenhado em uma maior integração do mercado financeiro de habitação, apoiada na consolidação da estabilização macroeconômica e em reformas estruturais que permitam a redução consistente da taxa de juros básica e dos spreads cobrados no sistema financeiro. A estratégia governamental é de, no curto prazo, melhorar a situação do sistema financeiro habitacional, promover maior eficiência entre os agentes financeiros que operam no setor, harmonizando subsídios implícitos e explícitos e criando mecanismos que reduzam o risco jurídico dos contratos, protegendo tanto mutuários quanto agentes financeiros. Desta forma, estarão estabelecidas as condições para que, no futuro, se alcance maior integração dos mercados de financiamento habitacional. Terceiro, o Governo continuará seus esforços para modernizar o setor de financiamento habitacional e os instrumentos do mercado de capitais, a fim de adequar o volume de recursos financeiros do setor habitacional e permitir uma reorientação gradual desse financiamento para as classes de renda mais baixa. Quarto, o Governo está trabalhando na melhora da oferta de terra urbanizada formal. Muitos dos desafios encontram-se no nível dos governos estaduais e municipais, em particular na oferta de solo urbano, incluindo formalidades para titulação e parcelamento do solo, licenciamento de construções e licenciamentos urbanístico e ambiental.

#### Fortalecimento Institucional

5. As questões referentes à política e financiamento habitacional no Brasil têm sido responsabilidade de várias agências governamentais, o que requer uma coordenação entre elas. Nesse contexto, o Governo tomou importantes medidas, começando com a criação do Ministério das Cidades (Lei 10.683, de 28 de maio de 2003) e sua Secretaria Nacional da Habitação, como órgão federal responsável pela política habitacional, seus programas e ações. Outras medidas foram adotadas, visando assegurar a capacidade técnica e administrativa da Secretaria Nacional da Habitação, incluindo: (a) a criação de unidade técnica para elaborar, monitorar e avaliar o Plano Nacional de Habitação e (b) a contratação de pessoal/consultores para assegurar adequada capacidade técnica interna.

6. Com a criação do Ministério das Cidades, o Governo, em colaboração com amplos setores da sociedade civil, avançou na preparação de sua política habitacional, visando estabelecer as coordenadas da ação governamental que assegure o acesso da população a moradia adequada. Esse esforço resultou na publicação, em 2004, pelo Ministério das Cidades, de documento intitulado Política Nacional de Habitação, o qual define as principais diretrizes para o setor, além de propostas para sua implementação. Ajustes provavelmente ocorrerão durante o processo de implementação da política e de sua consolidação efetiva por meio de lei e de plano de investimentos plurianual contendo objetivos, metas e indicadores.

7. Em consonância com esse esforço, o Congresso Nacional está apreciando Projeto de Lei que cria o Fundo Nacional para Habitação de Interesse Social (FNHIS), para coordenar transferências, subsídios, recursos e financiamento à política de habitação. O Projeto de Lei foi aprovado pela Câmara dos Deputados e aguarda sua aprovação pelo Senado. A criação do Fundo representa uma tentativa de articular os recursos orçamentários utilizados para fins de política habitacional e de aumentar sinergias entre programas financiados pelo setor público. No curto prazo, e após a aprovação pelo Congresso Nacional, será necessário regulamentar a operacionalização e funcionamento do FNHIS, definindo sua estrutura de gestão e promovendo inclusão progressiva dos subsídios orçamentários nesta única estrutura, na forma definida em lei.

8. Para consolidar a colaboração e coordenação entre os entes envolvidos, o Governo criou um Grupo Interministerial de Acompanhamento das Políticas de Financiamento e Subsídios à Habitação, que acompanhará os componentes da Política Habitacional nas bases de mercado e de interesse social, assim como os trabalhos desenvolvidos com apoio do empréstimo de assistência técnica do Banco Mundial para o setor.

9. Para reforçar a capacidade de implementação dessas políticas, o Governo lançou um programa abrangente de capacitação, visando o fortalecimento dos municípios na operação de programas e políticas do Ministério das Cidades. Esta ação está sendo acompanhada de medidas para mapear e avaliar a capacidade das agências sub-nacionais envolvidas com planejamento e política habitacional. Finalmente, estamos reforçando as atividades institucionais e de treinamento em municípios, com foco em instrumentos e práticas de políticas urbanas e habitacionais.

#### **Ampliando o Financiamento Habitacional**

10. O financiamento habitacional é um dos pilares para a promoção de amplo acesso à habitação. No Brasil, grandes reformas têm sido feitas nos últimos anos para estimular o desenvolvimento de mercados secundários e a emissão de papéis securitizados que podem ser transacionados no mercado com segurança e lucratividade. Nossa experiência tem sido bem sucedida. Embora o mercado de títulos lastreados em financiamento habitacional seja ainda incipiente, apresenta um forte potencial de crescimento, o qual deve aumentar *pari passu* com a consolidação da melhora das condições macroeconômicas que temos observado nos últimos meses. Importantes medidas foram tomadas para estimular a canalização de poupança para o setor, tal como a aprovação da Lei 10.931, que inclui: (a) o fortalecimento da *alienação fiduciária* (criada em 1997, Lei 9.514) como um sistema alternativo de garantia; (b) o reforço do grau de confiança das instituições de crédito interessadas em financiamento habitacional, tornando possível regulamentar títulos de crédito imobiliário (CRI e LCI); (c) a regulamentação do *Patrimônio de Afetação* em incorporações imobiliárias; (d) a introdução de meios eficazes de fiscalização, tornando viável a continuidade dos trabalhos de construção, em caso de falência dos empreendedores; (e) a simplificação do imposto incidente sobre as receitas do Patrimônio de Afetação, mediante instituição do Regime de Tributação Especial (RTE), com agrupamento de taxas e contribuições federais em uma única alíquota; e (f) a regulamentação da solução de disputas legais controversas.

11. Além disso, o Governo instituiu reformas legais que permitem aos credores securitizar seus empréstimos habitacionais e facilitar a criação de companhias privadas de securitização, assim como, estabeleceu arcabouço legal para os instrumentos do mercado de títulos derivativos de empréstimos lastreados em garantia imobiliária (CRI). A Carta de Garantia de Recompra de CRFs – *Certificado de Recebíveis Imobiliários* – foi criada pela Res. 3155/2003, do Conselho Monetário Nacional (CMN), com o objetivo de aumentar a liquidez desses títulos, melhorando a segurança dos detentores dos créditos e estimulando a expansão de um mercado secundário de hipotecas. Finalmente, as Leis 11.053/04 e 11.033/04 facilitam o desenvolvimento do mercado de papéis lastreados em garantias imobiliárias, por incluir incentivos fiscais para fundos mútuos e de pensão na compra de papéis de longo prazo, além de instituir a isenção de imposto de renda para investidores de varejo que tenham papéis com lastro em crédito imobiliário (LH, LCI e CRI).



12. Com o propósito de consolidar e expandir o mercado, o Governo pretende continuar o aprimoramento do arcabouço legal, apresentando propostas para reduzir o risco jurídico dos contratos de crédito imobiliário e promover a instituição de um banco de dados de proteção ao consumidor (*cadastro positivo*), contemplando os mutuários do setor habitacional. Além disso, pretende-se estudar o potencial de desenvolvimento do seguro de crédito e trabalhar com o Judiciário para refletir conjuntamente sobre as condições específicas do mercado habitacional e a necessidade de reforçar os contratos como medida vital para que o mercado floresça.

13. A consolidação da estabilidade macroeconômica e as reformas de caráter microeconômico que vêm sendo adotadas já contribuem e vão certamente proporcionar um ambiente ainda mais favorável a uma maior participação dos bancos privados no financiamento habitacional, tornando mais interessante para o setor financeiro conceder financiamentos habitacionais.

14. Durante esse período de consolidação de reformas, o mercado financeiro habitacional de longo prazo requer regulamentação e proteção adequada. Os dois segmentos de mercado que contabilizam mais de 75% do mercado habitacional incluem o SBPE e o FGTS. O primeiro tem suprido cerca de 25% dos empréstimos habitacionais. Financiado por cadernetas de poupança, que desfrutam de isenção de impostos, o SBPE (Sistema Brasileiro de Poupança e Empréstimo) tem à sua disposição um grande volume de recursos, parcialmente direcionados para empréstimos habitacionais. Dada a baixa lucratividade relativa desses créditos e a ainda pequena atuação dos bancos privados nesse segmento, o Conselho Monetário Nacional determinou um aumento na aplicação em empréstimos habitacionais dos recursos captados pela poupança, bem como instituiu mecanismos de monitoramento para que os bancos atendam a essa determinação. Acreditamos que, no futuro, tal sistema não seja mais necessário, quando as condições permitirem sua integração ao sistema de mercado. Mais recentemente, a Resolução 3.259, de janeiro de 2005, compatibilizou as obrigações de aplicação em crédito imobiliário à capacidade do mercado de produzir unidades habitacionais, e definiu incentivos para o financiamento a imóveis para a população de baixa renda ou de baixo valor.

15. O Fundo de Garantia do Tempo de Serviço (FGTS) permanecerá sendo, mesmo em um horizonte mais longo, uma fonte importante de financiamento para habitação social. Ele responde por mais de metade do total de créditos habitacionais e é intenção do Governo focá-lo na população de baixa renda, mantendo sua lucratividade e segurança. No passado recente, o FGTS melhorou seus procedimentos de gestão de forma notável pela inclusão do cálculo explícito dos subsídios que concede nos financiamentos habitacionais (Resolução 460, CCFGTS). Além disso, determinou que, por volta de 2008, todos os recursos do FGTS beneficiarão famílias com menos de 10 salários mínimos (SM), aumentando, já em 2005, a quantia de crédito disponível para famílias de renda inferior a 6 SM.

16. No curto prazo, o Governo continuará empenhado em assegurar uma gestão eficiente do FGTS, no seu duplo papel de fundo providente e de fonte de financiamento habitacional, procurando explorar opções que estimulem o uso de tais recursos por um grupo mais amplo de instituições financeiras.

### **Melhorando a Eficiência dos Subsídios para Habitação**

17. Pela primeira vez, o Governo criou um programa de subsídio direto e antecipado. O Programa de Subsídio à Habitação de Interesse Social (PSH) tem sido muito bem sucedido: é um programa transparente de subsídios antecipados; que prevê um sistema de leilão público para a distribuição de recursos do PSH, com o propósito de expandir o universo de instituições financeiras participantes; financiado com recursos do orçamento federal (OGU); e que vem sendo aprimorado ao longo do tempo. As melhoras iniciadas recentemente, entre outros objetivos, visam expandir o universo de instituições financeiras participantes. Estão sendo estudados mecanismos que proporcionem um ambiente mais competitivo para agentes de crédito e produtos alternativos, por meio de: (a) estabelecimento de um sistema de pré-qualificação de agentes financeiros, incluindo companhias do setor público local e (b) melhoria do processo de credenciamento técnico, para eliminar o risco de possíveis práticas desleais ou ilegais.

18. No futuro imediato, o Governo continuará os esforços para racionalizar e coordenar os programas de subsídio. A harmonização de tão diversos programas como os subsídios do FGTS, PAR, PSH e outros, deve contemplar questões relativas a benefícios por faixa de renda e critérios de acesso, entre outras. Como inovação recente, pode-se ressaltar a aprovação da Resolução 460 pelo Conselho Curador do FGTS, que estabeleceu uma nova política de subsídios antecipados, prevendo a alocação de R\$ 1,2 bilhão para 2005, segundo critérios bem definidos para seleção de beneficiários, e contemplando a possibilidade de conceder subsídios para aquisição de imóveis usados.

19. A agenda de curto prazo inclui a harmonização do sistema de subsídios, melhoria de focalização dos programas e a preparação de arcabouço para o sistema de Monitoramento e Avaliação do Programa Habitacional do Governo, com particular atenção aos componentes de subsídios.

### **Redução do Custo da Formalidade e Aumento da Oferta de Solo Urbano**

20. Os obstáculos à uma oferta mais adequada de terra a preços acessíveis para a população de baixa renda continuam a ser um grande problema. Aspectos da própria legislação, bem como de processos de registros, dificultam as ações de promoção da ampliação da oferta de terra pelo mercado formal. O Governo empreendeu um processo de consulta pública e apoiou o delineamento da proposta de nova lei de parcelamento do solo e regularização fundiária para áreas urbanas. Conhecido como "Lei de Responsabilidade Territorial", esse PL pretende promover avanços a partir do arcabouço legal do Estatuto da Cidade, constituindo o novo marco regulatório da produção e regularização de assentamentos humanos no país.

21. Além disso, o Governo lançou um programa de apoio ao desenvolvimento de planos urbanísticos municipais incluindo: (a) o desenvolvimento de um conjunto de ferramentas para preparação de planos diretores, no contexto do Estatuto da Cidade; (b) o desenvolvimento de um banco de dados nacional de consultores qualificados para dar suporte aos municípios, na preparação de planos diretores participativos; e (c) a alocação de verbas do OGU para apoiar o desenvolvimento de planos diretores participativos.

22. No médio prazo, o Governo deverá lançar um programa de integração urbana de assentamentos precários em áreas metropolitanas, onde se encontram 90% dos assentamentos informais. Relativamente à política de desenvolvimento urbano, o Governo deverá incluir no Plano Nacional de Habitação diretrizes de política para estimular a oferta de terra urbana, definindo instrumentos e incentivos aos governos municipais e outros agentes para a redução de custos administrativos de acesso ao mercado e parcelamento de terra urbana.

#### Assistência Financeira

23. A agenda de reformas e iniciativas descritas acima demonstra o forte comprometimento do Governo com o setor da habitação. Nesse contexto, o Governo agradece a participação do Banco no financiamento do programa de reformas descrito acima e o apoio dado através do Empréstimo para Política de Desenvolvimento. Desejamos continuar trabalhando com o Banco em empréstimos programáticos futuros voltados para o crescimento equitativo e sustentável da economia brasileira e para a provisão de moradia adequada e de serviços habitacionais aos brasileiros.

Cordialmente,



Antonio Palocci Filho  
Ministro da Fazenda



Olívio Dutra  
Ministro das Cidades

LETTER OF DEVELOPMENT POLICY  
TRANSLATED FROM ORIGINAL DOCUMENT

Brasilia, May 06, 2005

Mr James Wolfensohn  
President  
World Bank  
Washington D.C.

Dear Mr. President

1. The Government of President Luis Inacio da Silva has been implementing an important program of microeconomic reforms aimed at promoting an increase in economic productivity and equitable growth of the Brazilian economy. In this context, the Brazilian Government has requested from the World Bank a program of Development Policy Loans (DPLs) to support the financing of its housing sector reform. This reform program is part of the activities that the Bank is supporting in the area of Sustainable and Equitable Growth and whose first loan was approved last year.

2. The present administration has given a noticeable importance to the low income housing sector as a result of the impact that shelter has in the daily lives of the lowest income groups, as well as in the creation of jobs and in the promotion of economic activity. Below you will find the most important measures already taken, or to be taken, to address the main issues afflicting the housing sector in Brazil.

3. The Government is aware of the enormous challenges ahead. Brazil's housing deficit is estimated at about 7 million units; 88% of this deficit is concentrated in families earning less than 5 minimum wages. These numbers will not decline if we fail to address the excess of demand for housing services generated by the new households. A significant portion of the households formed every year cannot afford even the least expensive market-built house and turn to the informal housing markets.

4. The Government has identified four areas where measures and reforms are crucial to increase the access of the poor to adequate shelter. First, the Government is working to strengthen the institutions dealing with the sector as well as their capacity of coordination, based on adequate statistics and sound and detailed analysis so as to define a medium term plan with clear priorities and within realistic financial targets. Second, the Government is committed to produce a greater integration of the housing finance sector supported by the consolidation of the macroeconomic stabilization and the structural reforms which will lead to a consistent reduction of the basic interest rates and the financial intermediation spreads. The Government strategy is in the short run to improve the situation of the housing financing system, promoting greater efficiency among financial agents, harmonizing implicit and explicit subsidies, and creating mechanisms of credit insurance that protect both lenders and borrowers. In this way, we will be creating the conditions to reach in the future a greater integration in the housing finance markets. Third, the Government will continue its efforts to modernize the housing finance sector and the capital market instruments in order to increase the volume of resources to the sector and allow a gradual reorientation to the lower income classes. Fourth, the Government is working to improve the supply of formal urbanized land. Many of the challenges are found at the level of state and municipal governments, in particular in the supply of urban land, including formalities in titling and subdivision, construction licenses, urban and environment licensing.

## **Institutional Strengthening**

5. Housing policy and housing finance issues have been the function of several government agencies which require an effective coordination. In this context, the Government has taken important measures, beginning with the creation of the Ministry of Cities and its Housing Secretariat. (Law 10.683, May 28, 2003) and the creation of the National Housing Secretariat as the Federal agency responsible for the development, execution and monitoring of housing sector policy, programs and actions. We have taken further steps to ensure the technical and administrative capacity of the National Housing Secretariat, including, *inter alia*: (a) the creation of a technical unit to design the housing plan and conduct the associated monitoring and evaluation and (b) the contracting of staff/consultants to ensure adequate in-house technical capacity.

6. With the creation of the Ministry of Cities, the Government in collaboration with large groups of civil society has advanced in the preparation of its National Housing Policy, aiming at establishing the coordinates of the Government policy to guarantee the Brazilian population the access to adequate shelter. This effort has led to the publication by the Ministry of Cities of the National Housing Policy document in 2004 defining the main principles and guidelines for the sector as well as the proposals for its implementation. Adjustments will likely take place during the implementation of the housing policy and of its effective consolidation through its law and the multi-year national plan comprising objectives, targets and indicators.

7. In parallel and as a complement to that effort, the National Congress is reviewing a Project Law which creates the National Social Interest Housing Fund (FNHIS) to coordinate transfers, subsidies, financial resources and funding to support the housing policy. The *Projeto de Lei* was approved by the House of Representatives and awaits its approval in the Senate. The creation of this Fund represents an attempt to homogenize the way resources are used for housing policy purposes and to increase synergies between programs financed by the public sector. In the near term, and after the approval by the National Congress, it will be necessary to regulate the functioning of the FNHIS, defining its management structure, and promoting a progressive inclusion of all budget subsidies in this single structure, as defined by the law.

8. To ensure the collaboration and coordination of the program, the Government has created an Inter-ministerial Group to follow the Housing Finance and Subsidy Policy that will follow the market-based and subsidy components of the Housing Policy as well as the work developed under the Bank-financed Technical Assistance Loan for the sector.

9. To strengthen the implementation capacity of these policies, the Government has launched a comprehensive capacity building program aimed at the institutional strengthening of municipalities in the operation of programs and policies of the Ministry of Cities. This action has been accompanied by measures to map and assess the capacity of the sub-national agencies involved with housing planning and policy. Finally, we are strengthening the institutional and training activities in municipalities in metropolitan regions focused on instruments and practices in urban and housing policies.

## **Amplifying Housing Finance**

10. Housing finance is one of the pillars to promote wider access of housing. In Brazil, major reforms have been undertaken in the last years to promote the development of secondary markets and the issuing of securitization papers that can be traded in the market with confidence and profitability. Our experience has been quite successful. Although the housing capital market is still limited, it has great growth potential which will materialize *pari passu* with the consolidation and improvement of the macroeconomic conditions as observed in the last months.

Important measures have been taken so far to channel savings to this sector, such as the approval of Law 10931, which includes (a) the strengthening of *alienação fiduciária* (the trust deed instrument, created in 1997, Law 9514) as an alternative mode of collateralization; (b) the strengthening of credit institutions interested on housing financing, making it possible to regulate real estate credit titles (CRI and LCI); (c) regulation of the *Patrimônio de Afetação* (“affected assets”) at real estate developments; (d) introduction of efficacious means of inspection and making feasible the continuity of the construction works in case of the developers’ bankruptcy; (e) simplification of the tax over the revenues of *Patrimônio de Afetação*, through the creation of the Special Tax Regimen (RET – *Regime Especial de Tributação*); grouping federal taxes in a single tax aliquot; and (f) regulation of the solution of controversial legal disputes.

11. In addition, the Government instituted legal reforms which allow lenders to securitize their housing loans, facilitate the creation of private securitization companies, and establish legal framework for capital market instruments (CRI) for mortgage derivatives. Trust Letters for the repurchase of CRI’s – *Certificados de Crédito Imobiliário* – were created by Res.3155/2003 of the National Monetary Council (CMN), aimed at increasing the liquidity of these titles, improving the security of credit holders, and stimulating the expansion of a secondary mortgage market. Finally, Laws 11.053/04 and 11.033/04 facilitate the development of mortgage securities, including tax incentives for mutual and pension funds to purchase long term securities, in addition to implement income tax exemptions for retail investors holding SFI paper (LH, LCI, and CRI).

12. With the objective of developing and expanding the market, the Government intends to continue improving the regulatory framework, presenting proposals to reduce the judicial risk of the housing credit contracts and promote the establishment of a data bank for consumer protection (positive cadastre) aiming at the housing sector clients. In addition, the Government intends to study the potential to develop risk insurance and to work with the Judiciary to analyze jointly the specific conditions of the housing market and to assess the need to enforce the contracts as a vital measure for the market to flourish.

13. The consolidation of the macroeconomic stability and the microeconomic reforms that have been implemented already contribute and will certainly create an environment more favorable to a larger participation of the private banks in housing finance, making it more interesting for the financial sector to lend for housing related products.

14. During this period of consolidation of reforms in the sector, the long-term housing finance will require adequate regulation and protection.. The two segmented markets that account for more than 75% of the housing market include SPBE and FGTS. The first has been providing around 25% of housing loans. Funded by tax free saving accounts, SBPE system (*Sistema Brasileiro de Poupança e Emprestimo*) has at its disposal a large volume of resources which have been partially oriented for housing loans. Given the relatively lower profitability of such credits, and still limited role of the private banks in that segment, the Monetary Council has determined an increase in the application of funds to housing loans as well as the monitoring mechanisms to ensure that banks follow those rules. We believe that in the medium-term, this system would no longer be needed, when the conditions will allow its integration in the full market system. More recently, Resolution 3.259 of January 2005 has established an adequate degree of allocation to housing finance in line with the sector capacity to produce housing units while defining the incentives to finance low income groups and low housing value.

15. FGTS (*Fundo de Garantia do Tempo de Serviço*) will remain an important source of financing for social housing probably even in a longer horizon. It accounts for more than half of total housing exposure and it is the intention of the Government to focus it to low income populations while maintaining its profitability and security. In the recent past, the FGTS have

improved management procedures, notably by including explicit upfront calculation of the cost and risk to lenders of the FGTS interest rate subsidy program differentiated by income group (Resolution 460, CCFGTS). In addition, it determined that, by 2008, all FGTS resources will benefit households earning less than 10 minimum wages, increasing in 2005 the amount of credit available for households earning less than 6 MW.

16. In the short term the Government will remain committed to ensure an efficient management of the FGTS, in its double role of provident fund and source of housing finance, looking for alternatives that promote the use of these resources by a wider group of financial institutions.

### **Improving the Efficiency of Housing Subsidies**

17. For the first time, the Government has created a program of upfront subsidies. The Social Housing Program (PSH) has been very successful. It is a transparent upfront subsidy program financed from Federal budget resources (OGU) which includes a system of public auction in the allocation of its resources with the objective of expanding the universe of participating financial institutions and which has been improved over time. Improvements recently undertaken include, inter-alia, the expansion of the universe of participating financial institutions. Other mechanisms are being studied to create a more competitive environment for alternative lenders and products by (a) establishing an improved system of pre-qualification of lenders and other agents, including local public sector companies and (b) further improvement of the technical accreditation process to reduce the risk of underbidding and possible unfair/illegal practices.

18. In the very near future, the Government will continue its efforts to rationalize and coordinate subsidy programs. The harmonization of very different programs such as the subsidies of FGTS, PAR, PSH and others should address questions related to benefits by income level, procedures to access subsidy funds, and others. As recent innovation, we mention the approval of Resolution 460 of the Board of Directors of FGTS which established a new policy of FGTS upfront subsidies with an allocation of R\$1.2 billion for 2005 with well-defined criteria for the selection of beneficiaries and inclusion of the subsidy component for existing houses.

19. The near-term agenda includes harmonization of the subsidy framework, improved targeting of both programs and Preparation of a Framework for the Monitoring and Evaluation system of the Housing Program of the Government, with particular attention to the Subsidies component.

### **Reduce the Cost of Formality and Improve Supply of Urban Land**

20. Constraints to an adequate land supply, especially at affordable prices for low income people continue to be a major problem in attempting to provide universal shelter. Aspects of the legislation itself, as well as registry system, impede the action of the Federal and the local governments to provide formal land on-time. The Government has championed the public consultation process and supported the drafting of a new land law, known as the Law of Territorial Responsibility, which aims to promote advances based on the new legal framework of *Estatuto da Cidade*, becoming the new regulatory framework for the production and regulation of urban settlements in Brazil.

21. Moreover, the Government has launched a program to support the development of strategic municipal plans including: (a) the development of a toolkit for the preparation of master

plans within the framework of the City Statute; (b) the development of a national database of qualified consultants for providing support to municipalities in preparing participatory urban strategic plans; and (c) providing budget resources to municipalities for the development of their participatory urban plans.

22. In the medium term, the Government will launch a program of urban integration and upgrading in the metropolitan areas, where there are 90% of the informal settlements. In relation to the urban development policy, the Government will include in the National Housing Plan the policy guidelines to stimulate the use of urban land, defining the instruments and incentives for the municipal governments and other agents to reduce the administrative costs to access the formal housing market and urbanized land.

#### **Financial Assistance Request**

23. The reform agenda and the initiatives described above indicate the strong commitment of the Brazilian Government to the housing sector. In this context, the Government is grateful of the Bank's participation in the financing of the reform program described above and the supported provided through the Development Policy Lending. We wish to continue working with the Bank in future programmatic loans aimed at the sustainable and equitable growth of the Brazilian Economy and the provision of adequate shelter and housing services for most of its inhabitants.

Sincerely,

Antonio Palloci Filho  
Ministro de Estado da Fazenda

Olívio Oliveira Dutra  
Ministro de Estado das Cidades



**ANNEX 2: MATRIX OF OBJECTIVES, KEY ACTIONS AND OUTCOMES**

Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
<b>Policy Area #1. Strengthening the Housing Policy and Government Institutional Framework for the Housing Sector</b>					
<p>1. Strengthen government's hierarchy of housing policy making institutions: MOC, SNH, technical units, Interministerial coordinating entity.</p>	<p>Creation of the Ministry of Cities, of the National Housing Secretariat (SNH) representing the commitment of the Federal Government to treat Housing and Urban Development as State priorities. (Law 10.683, May 28 2003).</p> <p>Legally establish the National Housing Secretariat - SNH (<i>Secretaria Nacional da Habitação</i>) as the federal agency responsible for housing sector policy, programs and actions, including, inter alia: (a) creation of a technical unit to design the housing plan and conduct the associated monitoring and evaluation; and (b) contracting of staff/consultants for producing the Plan and operating the technical unit.</p> <p><b>Preparation of the National Housing Policy</b> document with the participation of a wide array of stakeholders containing the proposals of the Ministry of Cities to the formulation of the National Housing Plan as well as the principles, guidelines and objectives for the sector.</p> <p><b>Agreement to create an inter-ministerial committee</b> to follow up proposals on the market-based and/or subsidy components of the Housing Policy.</p> <p>Creation of a Housing Production Directorate to act as a unit of policy analysis and monitoring actions of housing programs in the Ministry of Cities.</p>	<p><b>Elaboration and dissemination of National Housing Plan</b> and its monitoring with the participation of all relevant actors, defining targets, priorities, and investment levels over the next 20 years.</p> <p>Develop and make operational the monitoring and evaluation system for the National Housing Plan.</p>	<p>Technical assistance to strengthen the managerial, technical and operational capacities within SNH in support of the National Housing Policy. National Housing Plan and its instruments.</p> <p>Technical assistance to support the dissemination, monitoring and evaluation of the National Housing Plan.</p>	<p>Completion and dissemination of the National Housing Plan.</p>	<p>Multi-year development plan with clear targets established at the three levels of government and monitoring indicators to evaluate progress towards the goals to improve access to shelter and deepen the financial market.</p>

Note: Conditions prior to proposed loan and triggers for the subsequent loan are marked in bold

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Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
<p>2. Consolidate financial resources for federal housing subsidies.</p>	<p>Approval by the House of Representatives of Project Law 36/2004 defining the National Social Housing Fund (FNHIS) to coordinate transfers, subsidies and funding structures.</p>	<p>Progressive inclusion of federal subsidies under FNHIS, according to final law text as approved by National Congress.</p> <p><b>After the approval by Congress, the government will have regulated the National Housing Subsidy Fund and addressed</b> within the time established in the final version</p> <ul style="list-style-type: none"> <li>• Definition and agreement among the parties of the final rules for management of FNHIS</li> <li>• Definition of mechanisms to ensure wide access to Fund resources to leverage resources from the private sector, beneficiaries and public in general.</li> <li>• Address potential conflicts of interests in Fund administration and possible solutions</li> <li>• Clarification of the type of subsidy mechanisms and subsidy calculations used by FNHIS; (e.g., upfront subsidies, yearly allocations for interest rate subsidies).</li> </ul> <p>Promote transparency of all off-budget housing subsidies.</p>	<p>Technical assistance to support the <i>regulamentação</i> of the National Housing Fund and the definition of the model, mechanisms and adhesion instruments at sub-national government levels, as well as the participation of other financial agents, promoters and technicians.</p>	<p>Group for managing FNHIS established upon the general approval of the Law.</p> <p>OGU resources for housing included in FNHIS in the medium term as determined in the legislation.</p>	<p>Increase the efficiency of the resources available for low income finance and leverage private sector resources</p> <p>Public sector resources available for low income housing will be managed in an integrated fashion by sector institution in line with the perceived need to address market failures and problems of affordability in a targeted fashion.</p>

Note: Conditions prior to proposed loan and triggers for the subsequent loan are marked in **bold**

**ANNEX 2: MATRIX OF OBJECTIVES, KEY ACTIONS AND OUTCOMES**

<b>Issue / Policy Need</b>	<b>Actions prior to Proposed Loan Growth DPL / Housing</b>	<b>Actions Prior to Subsequent Growth DPL Supporting Housing</b>	<b>Complementary TA Activities</b>	<b>Performance / Outcome Indicators</b>	<b>Medium-term Outlook</b>
<p>3. Strengthen sub-national governments for implementation of the National Housing Policy and Programmatic action.</p>	<p>Preparation and dissemination of the National Program of Cities' Capacity Building with action lines aimed at institutional strengthening of municipalities in operation of programs and policies of Ministry of Cities.</p> <p>Implementation of measures to map and assess the capacity of the sub-national agencies involved with housing planning and policy, including the COHABs, notably the signing of the agreement (convenio) between the Ministry of Cities, CEF and COHAB's aimed to strengthen their institutional and technical capacity.</p> <p>Institutional and training activities of the municipalities in metropolitan regions through the creation and improvement of their instruments and practices in urban and housing policies within the Slum Upgrading program coordinated by the Secretariat of Housing.</p>	<p>Strengthen technical and operational capacities of sub-national planning and housing entities for implementation of the National Housing Plan.</p> <p>Definition of minimum criteria for sub-national entities to access federal housing funds.</p>	<p>Development of tool kits for local planning and housing entities in the functional areas of the Secretariat of Housing.</p>	<p>Number of municipalities with Housing Plans (<i>Planes Directores</i>) prepared and approved.</p> <p>Number of public workers trained by means of the tool kits.</p> <p>Number of municipalities in the metropolitan regions which received training and institutional development actions.</p>	<p>Local governments are able to identify the dynamics of their low income housing market, evaluate the capacity to address the main issues, request assistance from the higher government levels as needed and engage with the community in the development of shared visions to address the shelter problem in a sustainable fashion, anticipating need for further serviced land.</p>

Note: Conditions prior to proposed loan and triggers for the subsequent loan are marked in **bold**

**ANNEX 2: MATRIX OF OBJECTIVES, KEY ACTIONS AND OUTCOMES**

Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
<b>Policy Area #2: Reforms to Increase the Stability and Scale of Housing Finance Market</b>					
<p>1. Improve regulatory and legal environment for housing finance.</p>	<p>Strengthening of alienacao fiduciaria (trust deed created in 1997, Law 9514) as an alternative mode of collateralization (Law 10.931, 2004)</p> <p><b>Approval of improvements in the housing credit regulatory framework (Federal Law 10,931/2004)</b>, that will propitiate the strengthening of credit institutions interested on housing financing, making it possible to:</p> <p>(a) regulate real estate credit titles (CRI and LCI);</p> <p>(b) regulate the <i>Patrimônio de Afetação</i> ("affected assets") at real estate developments, introducing efficacious means of inspection and making feasible the continuity of the construction works in case of the developers' bankruptcy;</p> <p>(c) simplify the taxing of "affected assets" through the institution of the Special Tax Regimen (RET – <i>Regime Especial de Tributação</i>), grouping federal taxes in a single tax aliquot; and</p> <p>(d) regulate the solution of controversial legal disputes.</p>	<p>Complete standardization of mortgage instruments (with ABECEPE).</p> <p><b>Present proposal to reduce the judiciary risk in the housing finance contracts</b> strengthening the borrower and lender rights and obligations.</p> <p><b>Study of potential for the development of credit insurance.</b></p> <p>Conduct workshops and seminars (<i>promover debates</i>) to promote awareness in the judiciary system, NGO community and congressional committees about importance of efficient housing finance contract execution.</p> <p>Preparation of Draft Project of Law to solve legal ambiguity about capitalization of interests applied to existing portfolios (interpretation of 1933 law).</p>	<p>Support outreach and information dissemination for Judiciary, NGO and Congressional committee members.</p>	<p>Number (and aggregate value) of mortgages issued for existing and new housing, (relative to data of houses build in the formal housing market).</p> <p>Record of court cases on housing finance.</p>	<p>Housing Credit and Housing Finance systems grow to the level of comparable countries such as Chile, South Africa or Spain.</p> <p>Regulatory framework is transparent and credit insurance has been launched allowing better pricing for risky clients.</p> <p>Most newly formed households will be able to access formal, market produced housing – either rental or ownership – according to their preferences and income level.</p>

Note: Conditions for proposed loan and triggers for subsequent loan are in bold

**ANNEX 2: MATRIX OF OBJECTIVES, KEY ACTIONS AND OUTCOMES**

Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
<p>I. (cont.) Improve regulatory and legal environment for housing finance.</p>		<p>Improve and consolidate the management information contained in the database on housing loans from the main agents in the market (e.g., CEF, Financial Institutions, BACEN, developers and CVM) making such information available to the public.</p> <ul style="list-style-type: none"> <li>- Review of results of law 10.931 and suggestions for further improvements.</li> <li>- Introduce project of law to regulate the system of <i>cadastro positivo</i> (credit risk information) which will include housing credit information.</li> </ul> <p>Introduce proposal of regulation to allow and expand the use of payroll deductions for housing loans.</p> <p>Improve the legal processes related to the housing rental markets with the objective to expand the alternatives to fill the demand for shelter. (Review of Law n° 8.245/1991).</p>			

**ANNEX 2: MATRIX OF OBJECTIVES, KEY ACTIONS AND OUTCOMES**

Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
<p>2. Strengthen capital market funding systems for housing finance (SFI).</p>	<p>Instituted legal reforms which allow lenders to securitize their housing loans, facilitate the creation of private securitization companies and establish legal framework for capital market instruments (CRI, <i>Certificados de Recebíveis Imobiliários</i>) for mortgage derivatives.</p> <p>Creation of Trust Letters for the rebuying of CRI's - <i>Certificados de Crédito Imobiliário</i> by resolution of the National Monetary Council (Res. 3,155/2003) aiming at increasing the liquidity of these titles, improving the security of credit holders and stimulating the expansion of a secondary mortgage market.</p> <p>Approval of Laws 11,053/04 and 11,033/04 which facilitate development of mortgage securities, including (a) tax incentives for mutual and pension funds to purchase long term securities; and (b) income tax exemptions for retail investors holding SFI paper.</p>	<p>Adopt revisions in the incentives structures for investment in real state securities as deemed appropriate in line with studies to be undertaken by the Ministry of Finance. These studies will consider the impact and equity of current tax incentive schemes for investors and analyze alternative incentives to improve the returns (and liquidity) of mortgage securities (including for down-market social housing loans), taking into account the macro-economic environment and the need for an exit clause when macro-economic conditions improve.</p> <p>Assessment of the impact of the measures taken and their revision and improvement, if deemed necessary.</p>		<p>Number (and aggregate value) of mortgage-backed securities, issued and traded. (CRIs) registered and authorized by the BACEN and CVM.</p>	<p>Substantial increase of housing loans, expansion of secondary markets and securitization.</p>
<p>3. Strengthen and facilitate expansion of alternative lenders for non-collateralized shorter term lending for low and moderate income housing.</p>	<p>Include in the existing working group on Micro-credit, including Ministry of Finance, Central Bank, Casa Civil, Ministry of Labor the issue of collection of information on alternative housing finance agents (e.g. micro-credit and cooperatives).</p>	<p>Improve system to collect information on micro-lenders and cooperatives.</p>	<p>Training for alternative lenders in micro-finance and related lending practices.</p> <p>Diagnosis of performance of alternative housing finance agents and proposal to expand their role in the market, including improving the regulation of those agents.</p>	<p>Number of alternative lending agencies included in the database on housing finance.</p> <p>Improve database on performance of alternative agents.</p>	<p>Expansion of alternative financing system for low income classes including micro-credit and others.</p> <p>Shared and open information/ monitoring systems help alternative agencies to become more relevant in the sector and to reduce exposure of low income clients to dishonest practices.</p>

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**ANNEX 2: MATRIX OF OBJECTIVES, KEY ACTIONS AND OUTCOMES**

Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
<p>4. Reform of SBPE to expand its scope and move it down-market in the intermediate term and to promote its gradual integration in the market.</p>	<p>Passage of:                      Resolution 3,005/2004 of Monetary Council which obliged private banks to increase their housing loans using SBPE funds.                       Resolution 3177/2004 and its subsequent amendments increased the speed at which Banks were obliged to use SBPE funds for mortgage loans and increased penalties for non-compliance.   <b>Progress in SPBE regulations (Resolution 3,259 of January 2005)</b> bringing them in line with the sector capacity and introducing weights in favor of loans to low income households or and to low housing value.</p>	<p>Preparation of proposals aimed at making housing finance accessible to different income levels without discontinuity and considering the characteristics of different sources of funds (e-g. SBPE and FGTS).                       Diagnosis of proposal to improve in the short run the SBPE with the objective of integrating it in the market in the future when the macroeconomic conditions improve and the interest rates go down.</p>	<p>Analysis of performance of SPBE in present housing finance and ongoing regulation; analysis of the impact of an eventual deregulation.                       Study to develop alternative modalities of housing savings, closer to market instruments.                       Diagnosis/legal review to study alternatives to reduce the gap between FGTS and SPBE housing finance systems.                       Identify profile of beneficiaries of SBPE and FGTS housing credit by credit instrument and income level.</p>	<p>Increase in aggregate value and number of SBPE mortgages.                       Deposits retained in BACEN due to lack of adherence to the measures included in Resolution 3529/2005 determining the allocation of SBPE funds.                       Structure of FGTS and SBPE housing lending by income brackets.</p>	<p>Gradual deregulation of SBPE and integration of its funding into the formal capital market, in line with the consolidation of the macroeconomic stability and the development of the housing finance market system (SFI).</p>

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**ANNEX 2: MATRIX OF OBJECTIVES, KEY ACTIONS AND OUTCOMES**

Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
<p>5. Improving the targeting and transparency of the FGTS interest rate subsidy program and extended access to FGTS funds.</p>	<p>FGTS accepted use of trust deed as eligible credit collateral.</p> <p><b>Approval of Resolution of Board of Directors of FGTS (Conselho Curador resolution 460, December 2004) (a) improving the targeting and transparency of the of the FGTS interest rate subsidy program differentiated by income group, (b) ensuring that, by 2008, all FGTS resources will benefit households of less than 10 MW; (c) increased the amount of credit available for households earning less than 6 MW in 2005.</b></p>	<p><b>Implementation of measures to contribute to expand the number of financial institutions that access FGTS.</b></p> <p>Other measures to improve the pricing of FGTS credits as identified from the strategic study of FGTS.</p>	<p>Strategic study to revisit the structure, efficiency, and coherence of FGTS' role and activities, including: the restriction for other agents to be able to operate with the Fund and or to access its funds.</p> <p>Study of interest rate pricing for housing lending according to income and credit risk.</p>	<p>Financial institutions with access to FGTS funding for housing finance purposes.</p> <p>Total amount made available for FGTS interest rate subsidies (both for mortgage loans and material construction).</p> <p>Distribution of housing subsidies by income brackets.</p>	<p>FGTS is improving its performance as a provident fund without sacrificing its role in the financing of low income housing.</p>
<p><b>Policy Area #3: Improve effectiveness and harmonize Federal Housing Subsidies</b></p>					
<p>I. Consolidate and rationalize Federal housing subsidies in order to leverage private funds and local government actions.</p>	<p>Inclusion of the theme of rationalization and coordination of subsidy programs, consistent with the Government housing policy and plan, in the work program of the interministerial working group.</p>	<p>Publication of a plan to <b>rationalize and harmonize subsidy programs</b> (including FGTS interest rate subsidy, FGTS upfront subsidy, PAR and PSH programs and others) in terms of:</p> <ul style="list-style-type: none"> <li>(a) loan to value ratios,</li> <li>(b) maximum house-value to be financed,</li> <li>(c) depth of subsidies across income groups, and</li> <li>(d) Procedures to access subsidy funds. Including improvements to the income verification process and assurance that beneficiaries of loan-linked subsidies be checked for credit performance.</li> </ul>	<p>Consulting services aimed at harmonizing all the housing subsidy programs of the Government.</p> <p>Dissemination of national subsidy programs to improve understanding of federal subsidy schemes at local level.</p>	<p>Preparation and publication of a comprehensive housing subsidy policy as a core component of the National Housing Plan.</p>	<p>Rationalization of subsidy programs with clear criteria of targeting and monitoring.</p> <p>Subsidy system expands the access of credit to low income families, promoting individual savings and encouraging the housing market to answer to the needs of the low income classes as much as possible.</p>

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**ANNEX 2: MATRIX OF OBJECTIVES, KEY ACTIONS AND OUTCOMES**

Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
<p>2. Create a budget financed upfront housing subsidy system for the very low income groups</p>	<p>Establishment of the PSH, with approval of Law 10,008/204, which creates a transparent upfront subsidy program financed from OGU with two distinct schemes: (a) <i>parcelamento</i>, not necessarily linked to credit and (b) <i>financiamento</i>, a credit-linked subsidy.</p> <p>Creation of a transparent auction system for the allocation of PSH resources to expand the universe of participating financial institutions.</p> <p>Creation of a competitive environment for alternative lenders and products by establishing an improved system of pre-qualification of lenders and other agents, including local public sector companies.</p>	<p>Ensure that budgetary resources continue to be made available to finance PSH.</p> <p>Requirement within the PSH <i>parcelamento</i> for equity contributions from beneficiaries through cash, and self-help contributions (except in exceptional circumstances when such contribution is not possible).</p> <p>Enforce sanctions when bidders do not comply with the terms of the contracts and after PSH is consolidated, establishment of sanctions for bidders that do not execute the number of contracts allocated by the "leilao".</p> <p>Improvement of the technical accreditation process to reduce the risk of possible unfair/illegal practices.</p>	<p>Technical assistance to local communities, local governments for structuring and packaging PSH subsidy requests and support the local level to improve transparency and enforcement of targeting of households.</p> <p>Study of how to include municipal contributions in the bid evaluation criteria for the <i>parcelamento</i> program (adjusted according to different levels of human development index across municipalities).</p> <p>Study to assess viability of a program combining <i>parcelamento</i> w/ other programs; in specific municipalities aimed at improving the supply of urbanized land for low income.</p>	<p>Amount of PSH subsidies (both <i>financiamento</i> and <i>parcelamento</i>) in terms of aggregate volume and number of households benefiting.</p> <p>% of PSH subsidies which reach the very poor (below 2 MW) under new verification regime.</p> <p>Number of financial institutions participating in the <i>financiamento</i> program</p> <p>Number of <i>parcelamento</i> agents prequalified / application of sanctions for banks which do not comply with the terms of bids</p> <p>Number of municipalities trained in <i>parcelamento</i> procedures</p>	

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<b>Issue / Policy Need</b>	<b>Actions prior to Proposed Loan Growth DPL / Housing</b>	<b>Actions Prior to Subsequent Growth DPL Supporting Housing</b>	<b>Complementary TA Activities</b>	<b>Performance / Outcome Indicators</b>	<b>Medium-term Outlook</b>
<p>3. Improve the FGTS upfront grant subsidy and its harmonization with PSH</p>	<p>Establishment of a new policy of FGTS upfront subsidies with an allocation of \$R1.2 billion for 2005. (Resolution 460).</p> <p>The establishment of criteria for the selection of beneficiaries.</p> <p>Inclusion of the subsidy component for existing houses.</p> <p>Increase efficiency by increasing owner equity in subsidy formula.</p>	<p>Improve design of FGTS upfront subsidy program, taking into account the results of the study to evaluate all subsidy programs. This would include:</p> <ul style="list-style-type: none"> <li>• Broadenin lending distribution channels to attract more lenders to low income markets.</li> <li>• Harmonizing it with PSH program, including the use of a similar targeting, prioritization and selection system.</li> </ul>	<p>Study of prioritization and verification of households in the upfront subsidy study.</p>	<p>Number of households which receive upfront grants and aggregate volume of subsidies.</p> <p>% of FGTS upfront grants which go to households with &lt;4MW.</p> <p>No. financial institutions participating in FGTS upfront grant system.</p>	

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Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
<p>4. Improve subsidy targeting and monitoring and evaluation of subsidy programs across institutions (particularly FGTS and STN/MOC the PSH administrators).</p>	<p>Both PSH and the FGTS upfront subsidies have included regional allocation criteria and have targeted households below 3MW and below R\$1500 respectively.</p> <p><b>Preparation of a Framework for the Monitoring and Evaluation system of the Housing Program of the Government, with particular attention to the Subsidies component. (For example, Subsidies for Urban and Land Policy, and Housing Finance).</b></p>	<p>Creation of a program to prioritize and select PSH and upfront FGTS subsidies beneficiaries, including eligibility verification based on expected demand excess.</p> <p><b>Develop and implement a comprehensive monitoring and evaluation system which would include among others (a) ensure that program criteria are respected in a random fashion and establish sanctions when criteria are not met; (b) improve household income verification based on successful methods used in other programs; (c) design verification procedures for household eligibility that can be transferred to the municipal agents. Include other means besides self declaration and CADMUT checking, such as <i>Cadastra Unico</i>.</b></p> <p>Potential beneficiaries of credit-linked programs (PSH financiamento and FGTS) will be checked on credit performance.</p>	<p>Technical assistance to design a targeting, prioritization, and M&amp;E system. Review existing household targeting and prioritization used by PSH and FGTS</p> <p>Evaluate performance of past PSH and PAR programs to assist in their adjustment and the design of targeting and monitoring systems.</p>	<p>M&amp;E system is designed and in place. Execute regular audits consistent with Brazilian law.</p> <p>Periodic and long-term monitoring and evaluation.</p> <p>Completion of an evaluation of the PAR program and the first round of PSH subsidies.</p>	<p>M&amp;E in place and used for accountability purposes for local and central decision makers.</p>

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**ANNEX 2: MATRIX OF OBJECTIVES, KEY ACTIONS AND OUTCOMES**

Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary T.A. Activities	Performance / Outcome Indicators	Medium-term Outlook
<p><b>4. Land and Urban Development</b></p> <p>Create a legal framework that would reduce the cost of formality, provide incentives for the regularization of land tenure, and the development of progressive housing and infrastructure.</p>	<p>The Government has championed the public consultation process and supported the drafting of a new land law, known as the Law of Territorial Responsibility, which aims to (a) define new requirements for the development of urban land; (b) establish more flexible procedures for land development projects; (c) reduce the cost of land development; (d) promote the regularization of low income settlements based on the right to shelter.</p> <p>The Government has undertaken a review and diagnosis of the <i>Código Florestal</i> as relates to urban land as an input to the drafting of the new Law of Territorial Responsibility</p> <p>The Government has launched a program to support the development of strategic municipal plans including:</p> <ul style="list-style-type: none"> <li>• The development of a toolkit for the preparation of master plans within the framework of the City Statute.</li> <li>• The development of a national database of qualified consultants for providing support to municipalities in preparing participatory urban strategic plans.</li> <li>• Providing OGU resources to 130 municipalities for the development of their participatory urban plans.</li> </ul>	<p>Efforts to support the revision of the Law of Territorial Responsibility, in the thematic groups of Congress in a process of consultation with wide sectors of the society aiming at generating a common view for new subdivisions and settlements for low income and to the uniformization of processes for housing registration and regularization <i>fundiaria</i>.</p> <p>Wide dissemination of the contents of the law once approved.</p> <p><b>The Government has launched a national Urban Upgrading Program (Programa de <i>integracao urbana de assentamentos precarios</i>) for the major metropolitan areas (which include 90% of the country's informal settlements).</b></p> <p>Providing OGU resources to 250 municipalities for the development of their participative urban plans.</p>	<p>Activities for public discussion for the design of the draft Territorial Responsibility Law and, if passed, for its dissemination.</p> <p>Workshops, studies, case studies, and <b>data collection</b> at local level to disseminate the urban and tax instruments that can be used to improve the supply of urban land for low income population.</p> <p>Activities for the development of a toolkit to local governments for improving permitting and registration processes and for the <i>cartorios to simplify their</i> processes including the establishment of free registration of land regularization (law 10.931).</p>	<p>% of municipalities that had developed master plans, relative to the goal of 1700 cities targeted by the <i>estatuto da cidade</i>.</p> <p>% of families assisted by the national program for precarious settlements, relative to the demand defined by official data available.</p> <p>% of municipalities that had developed local housing plans.</p> <p>% of municipalities that implemented municipal policies of land regularization.</p> <p>% of municipalities that implemented municipal regularization programs in relation to the number of municipalities with problems of irregular settlements.</p>	<p>Budgetary resources are available to leverage other resources to implement an integrated strategy between the different levels of public sector and between private and public sectors.</p> <p>Operational plan outlining plan to address the major upgrading problems in an integrated and sustainable way.</p> <p>Municipalities have the capacity and knowledge to understand level of urgent interventions, the need for pro-active prevention and a combination of all strategies across government levels and private sector.</p>

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Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
<p>1. cont Create a legal framework that would reduce the cost of formality, provide incentives for the regularization of land tenure, and the development of progressive housing and infrastructure.</p>	<p>Prepared/implemented a national policy for sustainable urban land tenure regularization – <i>politica nacional de regularizacao fundiaria sustentavel - Programa Papel Passado</i> aimed at guaranteeing the title of the land to poor people.</p> <p>Provided budget support to 49 municipalities and 17 states for the rollout of land tenure regularization efforts.</p> <p>Presentation to Congress of new Land Subdivision Law (to revise Law 6766). It delegates to municipal governments the role to formulate land policy in terms of land subdivision and establishes the concept of progressive land development and infrastructure, and introduces innovative ways to deal with procedures to regularize informal settlements (especially with regard to property registries) and the regularization of “horizontal condominium.”</p>	<p>The Government has included as part of the National Housing Urban Land Program for increasing urban land, which established the goals, timing, instruments, incentives to local governments and other agents, and concrete policy initiatives for reducing the administrative costs of entry to the market and subdivision of urban land.</p> <p>Establishment of a benchmark system to assess the performance of the municipal governments in the process of land subdivision including licensing and registration of new subdivisions (<i>loteamentos</i>).</p> <p>Establishment of minimal criteria to transfer resources from the Federal Government to municipalities that abide to the national urban, housing and land policy.</p> <p>Implementation of a National Campaign of Sensibilization and Mobilization to implement the <i>Estatuto da Cidade</i> and local municipal City Plans (<i>Plano Diretores</i>) participatory that define, among others, a land policy and a land management system that increases the access of social housing in adequate sites.</p>	<p>Assessment of participative city plans with focus on the experiences focused on the promotion for access to urbanized land for low income people.</p> <p>Technical Assistance to make the diagnosis and definition of a model for the integration of the Irregular Settlements in the metropolitan regions.</p>		

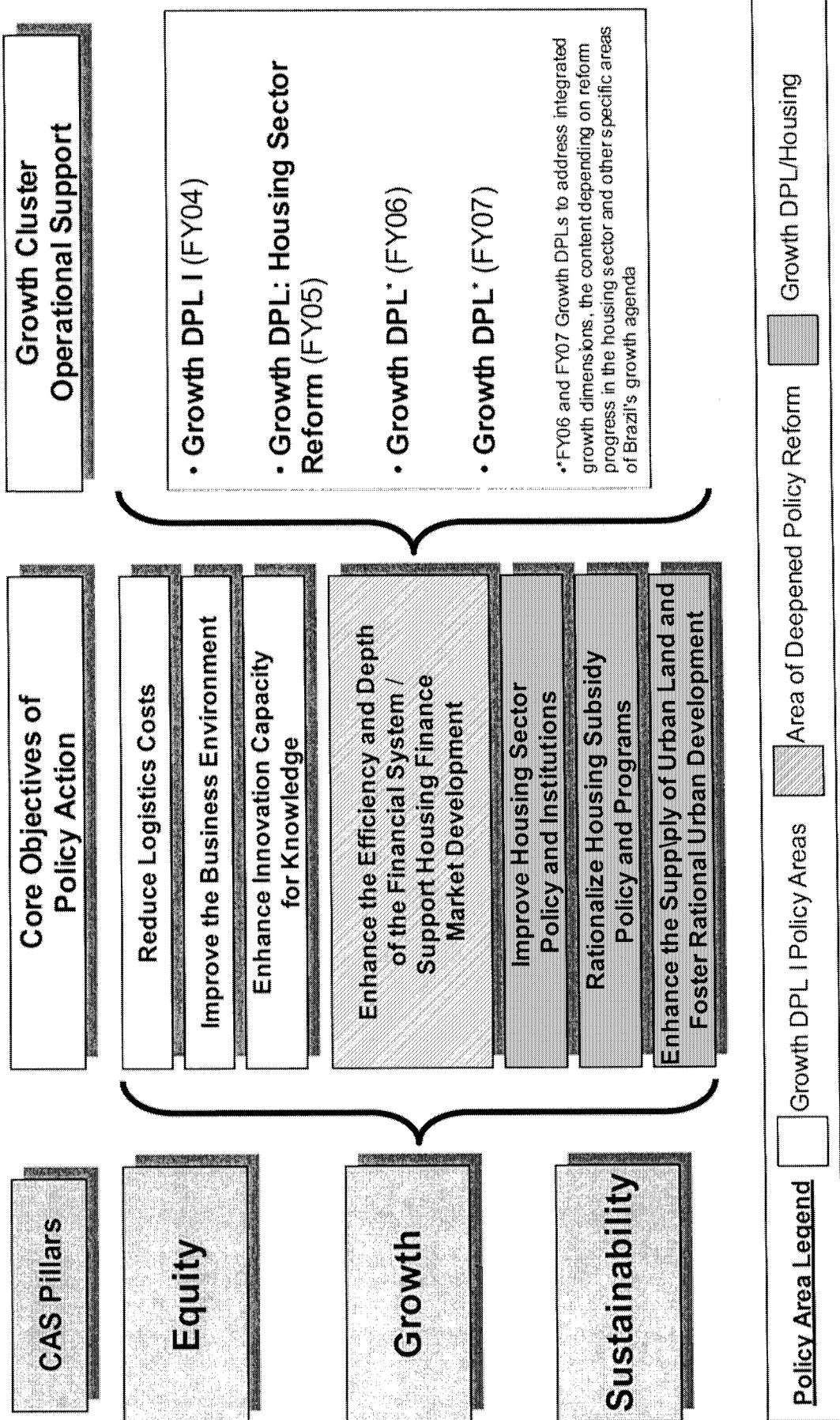
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Issue / Policy Need	Actions prior to Proposed Loan Growth DPL / Housing	Actions Prior to Subsequent Growth DPL Supporting Housing	Complementary TA Activities	Performance / Outcome Indicators	Medium-term Outlook
		<p>Include in all housing and urban plans financed with federal funds the guidelines of the National Policy for Land Regularization as well as the new legal and urban instruments available after the approval of the Estatuto da Cidade.</p> <p>Efforts to reach full recognition and use of legal instruments which guarantee the right and security of land titles,</p>			

Conditions prior to proposed loan and triggers for the subsequent loan are marked in **bold**

### Annex 3: Cluster of Ongoing and Programmed Operations Supporting Brazil's Growth Agenda

The Bank's support to the Government's development approach is built upon three pillars: Growth, Equity, and Sustainability. Bank operational support for the Growth agenda is structured around a cluster of activities which includes Sustainable and Equitable Growth DPLs covering key areas of policy reform. Investment and TA operations complement these policy loans.



## **ANNEX 4: ENVIRONMENTAL AND SOCIAL IMPACT OF THE PROGRAM**

The proposed loan will support Government policy efforts in the areas of: institutional reform and support of the national housing policy; housing finance and market reforms; low-income housing subsidy policy; and land and urban development legal and institutional frameworks. The reforms supported in this program are intended to increase access of poor and moderate income families to formal sector housing – including finished housing, urbanized land, and the upgrading of informal settlements. These are all actions that would have potential substantial positive environmental and social impacts. A rapid environmental and social assessment of the main issues addressed in the PDPL was commissioned in accordance with the new OP8.60. A summary of the findings is presented here.

### **Environmental Legal and Institutional Framework**

Brazil's legal and institutional framework concerning the environment is substantially advanced compared with many other developing countries and is adequate for regulating and reviewing the kind of localized environmental impacts that are associated with urban development and housing policies and programs.

The Federal Constitution establishes the legislative and administrative competencies regarding the natural environment, providing for (i) the Union to legislate general environmental norms of a national interest; (ii) the states to legislate norms of state level interest; and (iii) municipalities to legislate norms of local interest. States and municipalities, therefore, have competency to legislate over environmental matters, provided that such legislation is not in conflict with federal law. The Constitution further requires, in paragraph 1 of Article 225 that any public works or activities that may cause significant environmental degradation must first be subject to a study of the environmental impacts, thus laying the basis for the environmental licensing process.

Federal law 6.938 of August 31, 1981 established the National Environmental Policy (PNMA). The law was regulated by Decree No. 99.274 of June 6, 1990 (altered in 1991 and 2001). Among the preventive instruments established in the policy, and of relevance to the urban and housing sectors, are the establishment of environmental quality parameters, environmental zoning and assessment of environmental impacts. This law also defined the National Environmental System (SISNAMA), together with the institutions responsible for protecting environmental quality:

- Ministry of Environment, responsible for planning, coordinating, supervising and controlling environmental policy at the federal level;
- The Brazilian Institute of Environment and Natural Resources (IBAMA);
- State institutions responsible for controlling and overseeing activities that can cause environmental degradation; and
- Municipal organizations or institutions to control and oversee activities that can cause environmental degradation at the local level.

Environmental licensing is the most relevant instrument for environmental management at the local level. The National Environmental Council (CONAMA) edited resolutions No. 237 of December 19, 1997, altering Resolution No. 001/86, in order to more systematically treat the environmental licensing process. This defines works and activities that are subject to environmental licensing. Among those relevant to the housing and urban development area are:



land subdivision, treatment and disposition of urban solid waste, activities related to water and waste water services. While the institutional and legal frameworks are adequate, in practice there are often conflicts between jurisdictions and capacity, particularly at the local level varies from place to place. These problems are prevalent in the urban realm, particularly in the approval of subdivisions, social housing projects and the regularization of informal settlements. This is an area that requires greater integration and streamlining between the legal and institutional frameworks governing urban development and environmental licensing. While it is not the intent of this lending program to reform environmental legislation, the programs support of a public dialogue on the reform of the land subdivision law, 6.766.79, provide a good vehicle to promote greater integration of environmental and urban development legislation.

### **Identified Potential Social/Environmental Issues**

A brief assessment of the environmental and social impacts of the project identified a number of areas of potential risk and weaknesses in as regards environmental and social impacts. The proposed project addresses these in systematic way.

#### ***Policy Area 1: Housing Policies and Institutions***

*Disarticulation of Programs:* There is an historic disconnect between housing programs and urban development policies and instruments such as territorial planning, municipal zoning and environmental programs. This can result in construction of social housing projects in inadequate areas, such as in environmentally sensitive areas. In addition, it has been identified that there has been an historical disconnect between programs in solid waste management, urban transport, water supply and sanitation and housing. This can result in the development of housing that may prevent low-income beneficiaries of government housing programs from enjoying the full benefits of urban life, with housing often being built far from transport networks and sources of employment, for example. There have been advances, however, to mediate these potential negative social and environmental impacts, several of which are supported by the PDPL. These include: creation of the Ministry of Cities, the promotion of good planning instruments as those identified in the City Statute and technical assistance to municipalities to formulate integrated planning actions through Planos Diretores and Municipal Housing Plans. The Technical Assistance Loan, that is associated with the PDPL envisages actions that would lead to the better integration of the various secretariats within the Ministry of Cities, including transport, water supply and sanitation, housing and urban development. The national housing policy, to be monitored through the National Housing Plan, articulates the need for such improved integration. There is a risk that still exists, however. The Ministry of Cities is a new ministry. Its current structure which segregates housing, urban development, sanitation and transport into separate secretariats does not facilitate the needed integration and the PDPL could take extra effort to better integrate these secretariats, especially in the reformulation of the land subdivision law which has direct impact on the urban development and housing secretariats, in particular.

*Fragmentation between Levels of Government:* Urban and housing policies are generally fragmented between levels of government and there is a need to bring greater harmonization among these various levels. This is partly a legacy of a long period in Brazil's history of not having defined housing and urban development policies at the national level. The lack of integration among levels of government has contributed to the low level of impact of social housing programs in Brazil, and a likely poor allocation of scarce public resources in the sector. The National Housing Policy addresses these issues by attempting to develop synergies between

federal, state and local policies and to develop institutions, such as National Housing Fund, that will attempt to establish an appropriate hierarchy of policies and integration of programs.

*Weakness in Resource Mobilization:* A legacy of the collapse of the Brazilian National Housing Bank (BNH) has been an inability to mobilize resources for social housing and other programs aimed at improving the living conditions of the urban poor. The Government proposes to develop a National Low-Income Housing Fund that would serve as the vehicle to mobilize public (and potentially private) sources of funds for housing and urban development programs at the federal level. The policy calls for a system that would encourage the leveraging of these funds with state and local resources, and would establish clear rules for accessing the resources available in the fund. The PDPL will support that process.

### ***Policy Area 2: Housing Finance Market***

The actions to be supported in the Housing Finance Market are aimed at increasing the availability of housing finance, the effectiveness of housing finance and deepening the market for housing finance, including providing incentives to make existing programs reach lower income groups, the actions supported in the PDPL are expected to have positive social impacts.

### ***Policy Area 3: Housing Subsidies***

*Disarticulation Between Subsidy Programs:* One of the identified deficiencies in the current subsidy environment, is that there is a greater need to integrate housing programs with national income transfer and other social programs such as Bolsa Familia, Bolsa Escola and Fome Zero. The result of this disarticulation is continued social exclusion, as it is implied that housing programs are not well targeted to the poor. This is one of the prime areas to be developed under the PDPL and the accompanying TAL. It is recommend that linking housing programs for the poor with national income transfer programs such as Bolsa Familia, will allow for the better targeting of such programs and ensure that the poorest are benefiting. The program aims to rationalize existing subsidy programs, develop better targeting mechanisms and develop monitoring and evaluation systems for the existing government programs.

*A Lack of Information:* The social assessment indicated that there is a lack of credible information regarding living conditions to determine if housing programs and subsidies will be targeting the geographic areas and families in greatest need. One of the impacts of this is that resources may not be directed to geographic regions with the highest demand for public investment, and thus continue the current trend of informal development in certain regions. Historically, for example, more public housing resources have gone to the south and southeast, at the expense of the northeast where housing deficits are considered highest. Developing proper databases will be important to properly channel public resources to regions of greatest deficits. The development of data bases and monitoring and evaluation systems would be developed under the accompanying TAL.

*Lack of Optimization of Resources:* The assessment also indicated that the National Housing Policy, and its implementation through the National Housing Plan, will be ineffective if scarce public resources (both financing and subsidy) are not better optimized to allow for greater coverage of beneficiaries and to ensure that the poor are properly targeted. Without such optimization, housing deficits would continue and housing programs would not reach the poorest. The assessment suggests instruments such as proper local planning would help to optimize resources for housing programs by ensuring that they are most effectively used at the local level.

The PDPL would support that, and more, by ensuring that subsidy programs are harmonized and that monitoring and evaluation systems would ensure that the proper segments of the market are benefiting from subsidy programs.

***Policy Area 4: Land and Development***

*Minimum Lot Sizes:* The assessment suggests that any debate on Law 6.766/79 will need to balance the elimination of minimum lot sizes, with the constitutional right to dignified housing and the potential impacts of increased density that an elimination of minimum lot sizes could induce. However, this should be viewed against the current situation in which many argue that too onerous of development standards lead to increases in land prices, a lack of developed land for the poor and the resultant process of large-scale informal urban settlements. This is one of many areas of the proposed reforms to the law that will be held to public debate, led by the Ministry of Cities.

*Compatibility between Legislation:* Environmental legislation is considered to be further advanced than the legislation governing land subdivision. It has also been noted that conflicts are inherent in the licensing process of new subdivisions, particularly between state and municipal jurisdictions, which may disagree on what is in the purview of local authorities and what is in the purview of state authorities. This conflict is one of the main reasons for the long time it takes to approve new land subdivisions. This results in unauthorized subdivisions and perpetuates the problem of informality in urban areas. Revision of 6.766/79 will need to resolve these conflicts if it is to be effective. Likewise, any revised law must resolve the conflicts between environmental legislation and the regularization of existing informal settlements, many of which occupy environmentally protected areas. This will require careful analysis and consensus building as the law is debated in the public arena.

## ANNEX 5: UPFRONT CASH SUBSIDIES AND HOUSING ALLOWANCES<sup>39</sup>

The most direct mode of finance-linked housing assistance to consumers is a grant of cash or a regular cash-payment that lowers the capital or recurring cost of housing. Most other housing finance consumer subsidies, such as interest rate subsidies and tax subsidies, involve an indirect process of subsidization, most commonly through subsidizing *borrowing* for housing. In theory, direct grants can be very efficient and non-distorting and can address most of the household constraints that might require subsidies. In practice, however, the implementation of upfront grant subsidies is much more complex.

Subsidizing households through cash grants has several significant advantages over nearly any other form of household subsidy. For central banks and finance ministries the transparency of the subsidy is very important. If the subsidy is a lump-sum, the appropriation is on budget and there are no future or hidden liabilities to government. Whether lump-sum or recurrent, this type of subsidy can also be transparent for consumers. The subsidy benefits are clear and it provides the possibility of greater consumer choice and hence greater efficiency than subsidies through interest rates or taxes. For housing policy makers, the ease and transparency of targeting cash grants is valuable.

For these reasons, most advanced economies have moved from providing subsidies to suppliers of housing and housing finance towards subsidizing consumers directly through cash grants.<sup>40</sup> This shift occurred in advanced economies because housing shortages have mostly been resolved and the lack of affordability of quality housing is the core issue for the lower end of the market, a problem that can, conceivably, be more efficiently addressed by cash grants.<sup>41</sup> Subsidies to the supply side had already come under political pressure in many European countries because of the fiscal burden they posed during the economic down-turn of the 1970s and 80s and their frequent regressiveness.<sup>42</sup> Also, during the same period the US Experimental Housing Allowance Program provided evidence that in cities (countries) with well functioning housing markets, cash allowances that increase the housing demand of beneficiary households were more efficient in stimulating housing consumption and provision than public housing or other supply-side housing subsidies, including subsidizing borrowing.<sup>43</sup>

**Chile**, a country with a fairly well developed housing finance system in the 1970s but poor housing conditions and traditional supply-side housing policies, built on these insights to develop a program that would stimulate demand through cash grants rather than provide housing directly. Its success has made it the envy of many emerging economies, which have tried to emulate its program (particularly in Latin America), often without appreciation of the prerequisites and limitations of its application.

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<sup>39</sup> Prepared by Marja C. Hoek-Smit, 2004

<sup>40</sup> Few countries have gone as far as New Zealand and Australia, where supply side subsidies have completely disappeared (Kemp, 1997). In the UK direct cash grants now comprise more than three-quarters of all housing subsidies after mortgage interest tax relief was phased out in April 2000 (Wilcox, 2000).

<sup>41</sup> In fact it begs the question why a general income transfer would not be more efficient.

<sup>42</sup> However, the current housing cash grants in many European countries are often more or equally costly than the previous supply and demand side subsidies.

<sup>43</sup> The main focus was on *rental housing* solutions rather than home-ownership, however. Also, mortgage Interest Tax Rebates subsidies to beneficiaries were not included in the experiment.

The major vulnerability of upfront grant programs that are linked to credit is that they depend on financial institutions to extend credit to the beneficiaries. This often requires that the state address some of the risks and transaction costs related to down-market lending both for mortgage and consumer or micro-lending, as the case study of Chile will show.

Some upfront grant programs are tied to additional supply-side subsidies for that reason—e.g., assistance with liquidity provisions for small lenders, subsidized finance through non-market lenders (e.g., Mexico, Brazil) or to non-market based contract savings schemes (Germany). Depending on their design these hybrid subsidy programs may be less transparent, efficient and equitable and imbed higher potential future cost than is evident from the demand-side component. The supplemental supply side programs need, therefore, to be evaluated with the same rigor as the main cash grant program.

The various cash grant programs are discussed in some detail below, including the specific targeting and implementation issues that frequently arise.

### **Types of cash grant subsidies**

There are many ways a housing grant can be structured. It can be (i) linked to the financing package, (ii) applied directly to the physical investment. Different types of cash grants for housing are often integrated as part of one subsidy program to reach different types of beneficiaries.

**1. Lumpsum cash grants linked to financing.** The financing package typically comprises a down-payment, upfront costs and a loan, and, increasingly, some provision for mortgage insurance. The cash grant can be applied to any of these components.

- *Grant towards down-payment, upfront costs, or loan amount.* The most common use of cash grants is for it to pay for *part or all of the down-payment for a loan or other upfront costs* such as fees to obtain title and registration of the land or title insurance and mortgage registration. Such a subsidy package is particularly relevant for households that have savings constraints, i.e., first-time home-buyers who have to pay rent and find it difficult to save for the down-payment at the same time. It is one of the most serious hurdles to increase homeownership even in markets where permitted LTV ratios are fairly high.<sup>44</sup>

Lenders like down-payment grants to reduce LTV ratios, in particular for loans made in risky neighborhoods, to make sure there is sufficient equity in the property to stimulate repayment and decrease loss-given-default. In most countries where longitudinal data on default patterns are collected, the information shows that negative equity in the house is one of the main reasons for defaults and losses in case of default.<sup>45</sup>

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<sup>44</sup> For example Wachter 1992 has shown this for the USA, and Rogozhina, et al, 2003, discuss this for Russia and Hungary.

<sup>45</sup> US studies on FHA and regular Freddie Mac and FNMA mortgage data show that approximately 60 percent of delinquencies can be explained by negative equity in the house. Other main reasons are unexpected changes in household conditions such as divorce, loss of job, etc.

Although such grants are especially desirable when beneficiaries have difficulty saving, they are significantly more effective and efficient if the beneficiary is still required to make a contribution for at least part of the equity, e.g., 5 or 10 percent of the house price. This will generally increase a sense of ownership in the property, and further encourage regular loan repayments (see the case of Chile below).

Another variant is to give a *grant to "top up" the loan*. Under this scenario the beneficiary pays a regular down-payment and receives a loan amount on the basis of his or her ability to pay, and the grant is added to the loan to allow the beneficiary to buy a house of a higher price than otherwise possible. Such a subsidy would have a similar effect on reducing monthly payments as an interest rate subsidy (see Chapter 11), but would be more transparent and could more easily address the often regressive nature of subsidies through borrowing.

Yet another type of upfront subsidy is a *grant provided on top of the purchase price of an existing home* to pay for the improvement (or completion). The buyer pays a regular mortgage loan and down-payment to pay for the current market price.<sup>46</sup> Such subsidies have been successfully applied in housing markets where low quality of the existing housing stock rather than the production of new housing is the most important housing constraint, e.g., in urban renewal areas in transition economies, where most lenders are reluctant to make loans for existing poor quality housing units and will not provide credit for future home-improvements. Such a grant will likely increase the value of the house in the sensitive early years of the loan, boost lender confidence and increase transactions in the resale market.<sup>47</sup>

- *Grant towards mortgage/credit insurance.* An upfront cash grant can be applied to pay the premium for private (or public/private) mortgage insurance. This would lower the upfront costs for the borrower, and would at the same time decrease the riskiness of the loan to the lender.

#### **Box 1: The Lithuania Case**

Lithuania implemented a combination of insurance and interest rate subsidy. The state paid for half of the insurance for subsidized loans (for which insurance is mandatory) and for borrowers who meet the general requirements to be eligible for a subsidized loan but were not able to receive one. In practice this meant that most young first-time homeowners were eligible for this insurance grant. In 2002, these subsidized customers were about 75 percent of business of the Lithuania Mortgage Insurance Company, a government-sponsored entity operated on commercial principles. However, the subsidized loan program ended in 2003, when the government opted for a mortgage interest tax deduction instead.

<sup>46</sup> This is in fact a hybrid between a cash grant for investment and a grant linked to the finance package.

<sup>47</sup> The administrative hassles of certifying that these grant are indeed used for home-improvements is a problem unless the subsidy is structured as a general income transfer to first-time home-owners like the German investment grant program (see below).

Mortgage insurance often allows a higher loan-to-value ratio which will increase the loan amount the borrower can obtain, all things being equal, and therefore increase the house price that the beneficiary group can afford. The higher monthly repayments that this will entail, can be compensated by combining the grant for the payment for the MI premium with partial monthly repayment assistance.<sup>48</sup>

There is an interesting alternative method of achieving a similar goal when mortgage insurance is not feasible for a particular segment of the market. A cash grant could provide for *an emergency payment deposit in a blocked account* sufficient to pay for a number, say six, of monthly payments. Such a blocked account can be accessed when unforeseen and short-term problems (e.g., medical expenses, burial costs, temporary drop in income) cause the borrower to miss a payment on the loan.<sup>49</sup> This type of grant mechanism protects both lender and borrower by reducing the risk of default (and possible foreclosure). Moral hazard, the fact that the borrower will be less motivated to make all payments when s/he knows that payments will be made up from the special account, can be decreased by promising borrowers access to the amount left in the account after a specified number of years plus an additional bonus.<sup>50</sup> This type of grant support is suitable for both mortgage and micro-finance or consumer-type lending for housing.<sup>51</sup>

- *Grants towards consumer education.* Another type of cash-grant subsidy, and one that, like payments for mortgage insurance, benefits both consumers and lenders, is the payment for borrower education. Such education could include both the ins and outs of obtaining or choosing and maintaining mortgage credit and home-maintenance for first-time home-owners.<sup>52</sup>

**2. Cash grants towards the physical housing investment.** A second category of cash grants is applied *towards the investment in the house directly and is not linked to debt finance*. For example, Germany pays a cash grant (over eight years) towards the housing investment to all

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<sup>48</sup> One variant of this type of subsidy is the experimental PSP upfront subsidy in Brazil. The cost of increased credit risk is priced out by the lender (on a competitive basis) and included in an upfront cash grant that further includes a down-payment grant to the beneficiary and compensation for the lender's transaction costs and part of the interest rate risk. However, the Brazil example also shows that a self-insurance option for lenders may lead lenders to seek additional guarantees e.g., from municipalities, if the program targets more risky households than provided for in the subsidy amount, making the subsidy package non-transparent.

<sup>49</sup> Experience has shown that it is extremely difficult for a moderate income household to make up missed payments and that the likelihood of loan delinquency increases dramatically once a payment is missed.

<sup>50</sup> For example to improve or extend the house.

<sup>51</sup> A variety of this type of subsidy was successfully used in Indonesia as part of a home-improvement program using small loans. It received funding from a Dutch NGO but was discontinued when program funding stopped. In the US such type of "mortgage insurance" was used as an alternative to conventional mortgage insurance by developers on behalf of their clients.

<sup>52</sup> Experience in countries as diverse as the US and South Africa have shown the benefit of such input for both home-owner and lender (Hirad and Zorn, 2001). The Home Loan Guarantee Corporation of South Africa (discussed in Chapter 4), a non-profit but non-subsidized mortgage guarantor, has developed a very hands-on way of borrower education and immediate counseling upon late-payments, with impressive results on loan performance.

first-time home-owners, irrespective of whether or what type of financing package they have.<sup>53</sup> In emerging economies cash grants are frequently used to pay for the provision of a serviced plot with or without a house, or for the expansion or improvement of the house and related services, with beneficiaries responsible to build or finish the house with their own savings or sweat equity or by acquiring credit (which may be facilitated by having property rights and equity in the property). Experience has shown that it is nearly always inefficient to provide a complete housing package to program beneficiaries without any owner contributions (i.e., beneficiaries do not value the subsidy at its real cost, and the subsidy is often larger than necessary).

This type of subsidy, whether used for upgrading or new housing, makes it possible for those households who do not qualify for a mortgage loan -- because of low income, uncertain employment or high asset risk-- to still benefit from a subsidy. For that reason, it is the most common way of subsidizing housing for the lowest income urban households in most of Africa, Latin America and South Asia. The efficacy of this subsidy is seriously hampered, however, by the lack of appropriate savings and credit options for this type of beneficiary group. As we will see in the cases of Chile and South Africa below, this leads the Government to provide a larger subsidy than necessary, indeed often a complete house.

### **Targeting Cash Grant Subsidies.**

There are many variations in the way cash grant subsidies can be targeted, depending on the objectives of the program and the available budget. Several crucial questions have to be considered:

- i) Are the quality standards of the house set too high relative to the goals of the housing program?
- ii) Is the subsidy that is therefore needed to reach the targeted income group excessive in terms of reducing the number of households that can be reached each year?
- iii) Can households trade off different quality components of the housing bundle within the subsidy amount?
- iv) How much leveraging of household's own resources is induced/required by the program?
- v) How does recipient behavior compare under cash grant subsidy programs with different housing standards (a finished house, a progressive house)?

For many cash grant and allowance programs, the *quality and location standards* to which the house has to comply are set too high relative to the income level of the beneficiary group, which increases the size of the required subsidy and hence the number of households that will be able to participate. Also, deep subsidies often increase the discrepancy between those who are eligible for the subsidy and those who are above the cut-off point. This will often result in households misstating their incomes to gain access to the program and vertical inequities.

On the other hand, if standards are set too low relative to incomes and loan capacity of the targeted group, the subsidy tends to replace the beneficiary's own contribution and much of the subsidy amount effectively increases overall consumption other than housing. Lastly, the locational and quality restrictions or simply the lack of housing choice in such programs may introduce a larger gap between the value to the beneficiary and the cost of the subsidy, discouraging participation in the program.

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<sup>53</sup> In Poland, home-improvement expenditure could be written off completely and directly from income taxes, a close equivalent of a cash grant. This system was however misused and has been discontinued,



The other important issue is whether the program should reach *all or only a proportion of qualifying households*. For example, in Germany the investment grant applies to all first-time homeowners, a truly universal program. Housing allowance programs in Western Europe have traditionally been structured as entitlement programs that benefit all qualifying households below a specific income cut-off.<sup>54</sup> In most emerging economies with a finance-linked cash grant program such as Chile, Costa Rica, and Ecuador, the subsidy is restricted to moderate-income first-time owners and new houses (and frequently to families with children) and the proportion of qualified beneficiaries that will receive a subsidy each year is limited. The criteria used to select beneficiaries often include both need-based indicators and those that show a willingness by the beneficiary to contribute equity (e.g., time on the waiting list, household size, current housing situation, savings amount and characteristics, and other indicators of owner contributions).

Priorities can also be set on a locational basis using criteria such as local government willingness to adjust regulatory requirements to suit moderate-income housing development, existence of neighborhood organizations or neighborhood improvement plans, etcetera.<sup>55</sup>

### **Implementation Issues**

Programs differ in the way the finance-linked cash grants reach the beneficiaries, either directly (as a voucher) or through lenders or developers. A truly demand side subsidy would be provided directly to beneficiaries, allowing them to look for a qualifying house of their choice amongst those offered in the marketplace and then select a participating lender to get a loan. However, such a system can only work when a sufficient supply of housing of the relevant quality is developed in the targeted market (may be as a result of the grant program) and lenders have incentives to make loans to the beneficiaries. Unfortunately, this is often not the case, not even in the efficient housing markets of advanced economies.

So how do “direct demand” cash subsidies in most emerging economies reach the consumer? The subsidies are frequently allocated through lenders who in turn make agreements with developers to build houses of a certain price that pre-qualified households can afford with the subsidy. Alternatively the grant goes directly to the developer, who may be a private or non-governmental entity, and who selects the beneficiaries and often pre-approves them for a loan with a lender with whom they have an agreement. Costa Rica developed an effective network of non-profit developers that organized low-income households to build projects and offered construction finance. Yet another alternative is that NGOs will help organize beneficiary demand and screen applicants before they seek out a lender or developer. Investment grants in the form of serviced plots will naturally go through municipalities or NGO intermediaries who allocate the “grants”.

As a consequence, the size of upfront grants, the income groups to be reached and the quality standards of the house or house-prices are frequently a matter of negotiation between government, and developers and lenders. In effect, the finance-linked grant is transformed into an investment grant to developers and lenders and the allocation process becomes less transparent.

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<sup>54</sup> The US rental housing allowance program is not designed as a universal program and subsidizes only approximately 30 percent of all qualified households. In European countries such programs are more often designed as universal/ entitlement programs.

<sup>55</sup> The allocation of non-finance-linked investment grants applied to serviced plots or core houses are typically done through waiting lists kept by municipalities or by a combination of non-governmental institutions (NGOs) and community-based organizations (CBOs).

Since developers generally do not have to compete for the grants when these subsidies are considered “demand” subsidies to beneficiaries, this system can easily lead to inefficiencies, with much of the subsidy going to intermediaries.<sup>56</sup> Mexico and Ecuador are examples of such targeting systems, while Brazil’s hybrid experimental grant program has a competitive bidding process for lenders who act as allocation agents for the subsidies.<sup>57</sup>

Such allocation systems are usually unavoidable early on in the “direct demand” programs in emerging economies, because developers will simply not produce low-income housing without full upfront subsidy commitments.<sup>58</sup> And even in countries like Chile, that have long-standing cash grant programs, the real consumer driven programs only work for middle income households and break down for low-income groups. The lack of supply elasticity for low-income housing is problematic even in advanced economies (Malpezzi and Green, 1996, 2003).

The possible negatives of allocation systems through suppliers are the same as for any supply-side or product subsidy, i.e., lack of choice for the individual, lack of responsiveness to diverse local housing constraints, non-diverse communities, poor housing quality relative to house price, and often a general increase in house-prices in the targeted segment. . Another frequent outcome is that recipients of the subsidy would have bought the same house without the subsidy had there been a competitive market. Also, such targeting and allocation systems are frequently excluding the lower income sections of the potential beneficiary range.

Ironically, because these cash subsidies are developed and labeled as “demand-side” subsidies, they do not get the scrutiny they would receive if they would be known as what they are, investment grants to developers or lenders directly.

One additional implementation issue is worth mentioning. Since cash grant programs are designed to expand private sector participation in the moderate income housing sector in response to increased demand, the programs need to be sustained for a long time to build sufficient confidence for the private sector to invest in systems to cater to a lower income client. A stop-and-go program will have difficulty doing that. This has fiscal consequences, however.

Below we discuss the experience of Chile with a cash grant program, not only the achievements of these programs but also the hard work required to make them perform effectively.

### **Chile’s: Upfront Grant Program**

In 1978, the government designed a national housing cash grant/voucher program focused entirely on *first time home-owners*, to stimulate economic development, alleviate the economic recession, and improve poor and inequitable housing conditions. The development of the Chilean

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<sup>56</sup> Seldom will developers on their own volition propose to build a “minimum” quality house.

<sup>57</sup> The result is that most lenders bid for the package with the highest upfront subsidy, i.e., for the lowest income brackets, but have considerable freedom to allocate the subsidy to a higher income bracket.

<sup>58</sup> Of course, this would not be a problem if used houses qualified for the program. But then other issues arise, including fraud by sellers and beneficiaries

upfront voucher program provides a unique case of an upfront cash grant scheme since it shows the successes, complexities and hurdles of such a program as it developed over a 25 year period.<sup>59</sup>

### **Description and Discussion**

Chile, a country of 15 million inhabitants which is 85 percent urban, has a long history of government support to the housing sector as the main channel for redistributive or social welfare activities. Before the 1970s, as in most Latin American countries, this support took the form of direct government construction of houses for specific target populations, coupled with a tolerant attitude towards informal land invasions to accommodate the poor.

The military government that took power in 1973 followed a market-oriented approach to economic development, and the housing sector was viewed as an important vehicle to combat the escalating economic recession. Compared to most of its neighboring countries, Chile had a fairly well developed commercial banking system (state and private banks), social security and pension fund system and capital market. The finance sector was considered capable of playing a major role in expanding private housing markets, provided that the government improved the regulatory system and stabilized and reformed the macro-economy. This was the premise of the new housing policy developed in 1977/78.

The government improved urban development procedures and rationalized infrastructure provision and land markets, while also improving property right systems and no longer allowing low-income households to build unauthorized or squatter settlements. The government instituted a demand side subsidy program that provided upfront cash subsidies towards the down-payment for a loan. Households had to contribute their own savings to fulfill part of the down-payment requirement and take out a loan from a private lender to purchase a house from a private developer. It targeted new housing since one of the aims was to stimulate the economy through the construction sector.

The subsidy was designed to be transparent (all inputs calculated on their PV and included on the budget), and, although substantial in order to reach its economic development goal, it was not to create budget deficits. Subsidies were and still are strictly rationed and only about 20 percent of those who are “eligible” are awarded a subsidy in a given year. The formula for establishing priority includes family size, income, current housing condition, and size and term of savings effort.

The original subsidy program set the maximum value of the house that could be financed quite high and applied a “fixed subsidy” amount. While the market responded well to this program, most of the vouchers were utilized by upper middle and higher income households. Since the vouchers were not valid for existing housing, the downward filtering of upper income housing was limited. By the early 1980s it became clear that private developers were not willing to take on the risks and difficulties of developing houses for the low-income segment, nor were lenders interested in making loans to low-income households. As a consequence, the housing situation of the lower income households became untenable and the upfront grant program was revised. The maximum value of the house was lowered, and the government decided to take on a more active role in the provision of low-income housing both on the construction and the finance side. The Ministry of Housing and Urbanism (MINVU) contracted out the construction of low-income

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<sup>59</sup> This experience is well documented by the government and external experts and this case analysis is based on these sources; The Ministry for Housing and Urbanism (MINVU), Rojas, Greene, Pardo, Kusnetzoff and Bromberg and others.

houses (“Basic Housing Program”) and provided supplemental loans to beneficiaries directly. Low-income households were supposed to finish the roughly constructed houses, which were often built far away from the city center on cheap land. This program remained in place during the 1980s and was expanded in 1990 by the first democratically elected government (Kusnetzoff, 1987; Rojas and Greene, 1985; Rojas 1999; Cummings and Dipasquale 1996).

Levels of new construction during the 1980s and 1990s were well above the level of new household formation and the need for replacement of dilapidated structures and resulted in a noticeable improvement of housing conditions of the population.<sup>60</sup> When the need for new construction decreased, the private sector component of the program was opened to existing houses in the mid 1990s (Rojas, 1999).

Many challenges remained, however. In particular, the government construction and loan program for the lowest income households performed dismally. From the outset it was plagued by high defaults on the loans.<sup>61</sup>

In 2002, the government decided to leave the mortgage lending business for *the lower income groups* and transfer these responsibilities to the private sector. To do that successfully, it made several structural changes in the program.

- (i) For the very lowest income groups who cannot save nor carry debt, the government provides an investment grant in the form of a very basic dwelling unit (through local governments).
- (ii) For households who cannot realistically take on mortgage debt, but can contribute a small down-payment, a core house is provided that can be progressively expanded (with a value lower than approximately \$7500).
- (iii) For households who can afford a mortgage loan for a house with a maximum value of approximately \$15,000, a down-payment and loan are required on top of a government cash grant towards the purchasing price (a maximum subsidy of approximately \$3800).

To induce banks to make loans to this last group, the government has made agreements with four (mostly state) banks, providing compensation for transaction costs of catering

to this group of low-income customers and partial credit risk guarantees. It is too early to know how the new low-income lending program works and whether the banks will be successful in limiting loan defaults and foreclosing on defaulting loans.

The Unified Subsidy program for *middle income households* remained the same. In 2001 a lease-purchase scheme was added for households who cannot save for the down-payment (Pardo, 2001). Table 1 gives a summary of all programs.

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<sup>60</sup> Between 1974 and 1989 approximately 76.5 percent of all houses constructed in Chile received a government subsidy (33,000 units per year out of a total of 43,250). During the 1990-98 period both private and public sector house construction increased dramatically (a total of 116,3000 houses were built per year during that period of which 75,000 units received a subsidy)

<sup>61</sup> Numerous attempts were made to restructure household debt and forgive outstanding payments, but none were successful (beneficiaries quickly learned that default was rewarded, not penalized). Rojas (1999) estimates that 60 percent of the 300,000 outstanding government loans were more than 30 days in arrears in 1998.

<b>Table 1: Usage and Cost of Chile's Upfront Grant Subsidy</b>	
<i>Number of beneficiaries</i>	<ul style="list-style-type: none"> <li>• 104,000 households in 2002 and 96,700 in 2003 were allocated a subsidy</li> <li>• 80,450 and 74,300 actually cashed a voucher (MINVU 2003)</li> </ul> Out of a population of 15.8 million (2003) and 3.87 million households (2000) (MIDEPLAN - CASEN 2000).
<i>Cost per beneficiary</i>	<ul style="list-style-type: none"> <li>• Basic Housing Programs: Subsidy = US\$4,860 (159 UF) (Credit = US\$4,584 (150 UF))</li> <li>• Progressive Housing Program: Subsidy = US\$5,960 (195 UF) (Credit = 0) (2003 – MINVU)</li> </ul>
<i>Share of state budget</i>	Approximately 5% of annual government consumption for allocated subsidies and 4% for disbursed vouchers in 2002 and 2003. <sup>62</sup> These figures do not include administrative costs of the program (which are significant).

### **Rationale**

The major impetus to create the housing voucher scheme was to provide incentives for increased activity in the private residential construction sector in order to boost the economy. For that reason the grants were only given for new housing, at least initially.

The second objective was a social redistributive one. The cash grant scheme eliminated the regressive bias of the previous subsidies; notably, the largest grants went to the lowest income groups. It included options for those who do not qualify for a loan to benefit from an investment grant towards the house.

The third objective was to improve the efficiency of the private housing and housing finance market. The cash grant subsidy was chosen to avoid distortions in the broad middle income market which were prevalent under the old system of interest rate subsidies and direct government construction. It was accompanied by a long-term strategy of improving the regulatory environment in the urban planning and financial sectors.

### **Efficiency**

One aspect of the system that is immediately noticeable is its generosity. This reflects the fact that housing is the major social welfare and redistributive program in the country. The side effect of such high levels of subsidy is that they may replace some of the beneficiaries' own spending on housing or increase house price levels. There is also a concern that the high levels of construction stimulated by the subsidy program may have had a negative effect on land prices. No detailed study has been done on this issue yet.

<sup>62</sup> Average allocated subsidy cost in 2002 is US\$ 4,120 x 103,794 = US\$ 427.63 million @23.8 US\$/UF. Average allocated subsidy cost in 2003 is US\$ 5,260 x 96,679 = US\$ 508.53 million @ 33.5 US\$/UF. For state budget and government consumption expenditure we used the national sources in current Chilean pesos converted in US\$ (IMF conversion rates).

The scheme is efficient in its capacity to leverage household savings and expand private sector participation in mortgage lending and residential development. This is only true for the middle income sector subsidy, however. Indeed, the major inefficiencies are related to the higher than anticipated government intervention in the lower income segments of the program. This has created a fairly low quality, monotonous, segmented and inflexible housing supply that is lowly valued by the beneficiaries and the market and decreases the mobility of the lowest-income families.

The inefficiencies of direct government lending which resulted in high unforeseen loan losses, is now being addressed. This does not necessarily solve the problems, however. Since most of the banks involved in the low-income scheme are state banks, the hidden cost of government guarantees may turn out to be considerable.

### **Equity**

The upfront subsidy program, after its first targeting readjustment, is equitable, both horizontally (a large proportion of low and moderate income households received the subsidy over the years) and vertically (the subsidy increases as the cost of the house decreases and focuses on the below median income groups).

On the other hand, the side-effects of the government lending scheme make the subsidy less equitable, i.e., defaults in MINVU loans become a de-facto subsidy, which is highly regressive since those with a loan end up receiving a subsidy that is 50 percent higher than that received by Progressive Housing beneficiaries, who have no loans and lower incomes (Rojas 1999).

### **Transparency**

The Chilean system is recognized as one of the first to emphasize transparency in budgeting and in allocation. However, it is not a perfect system, even in this regard, because, in practice, it utilized hidden and unbudgeted loan subsidies. Government provided subsidized finance and hidden subsidies related to the refusal to pursue foreclosure, even when the majority of households defaulted on their loans. Whether the new system of paying for the risks and costs of lending will solve the problem entirely remains an area of concern.

The allocation and selection of beneficiaries is considered to be reliable and transparent, based on a national list of applicants and a formula-based scoring mechanism (Rojas and Greene 1995, Rojas 1999).

### **Implementation:**

For the middle income households, the voucher program works as a true demand-driven program. After households prove their housing needs and income levels<sup>63</sup> and complete a savings plan, they receive a voucher directly, which they can use for a qualifying house of their choice, either a used one or one built by competing private builders. Housing options under the low-income programs, on the other hand, are allocated through the government and consumer choice is limited (Rojas and Greene 1995, Rojas 1999, Pardo 2001).

### **Lessons**

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<sup>63</sup> Households have to fill out a Social Stratification Survey (*Ficha CAS*).

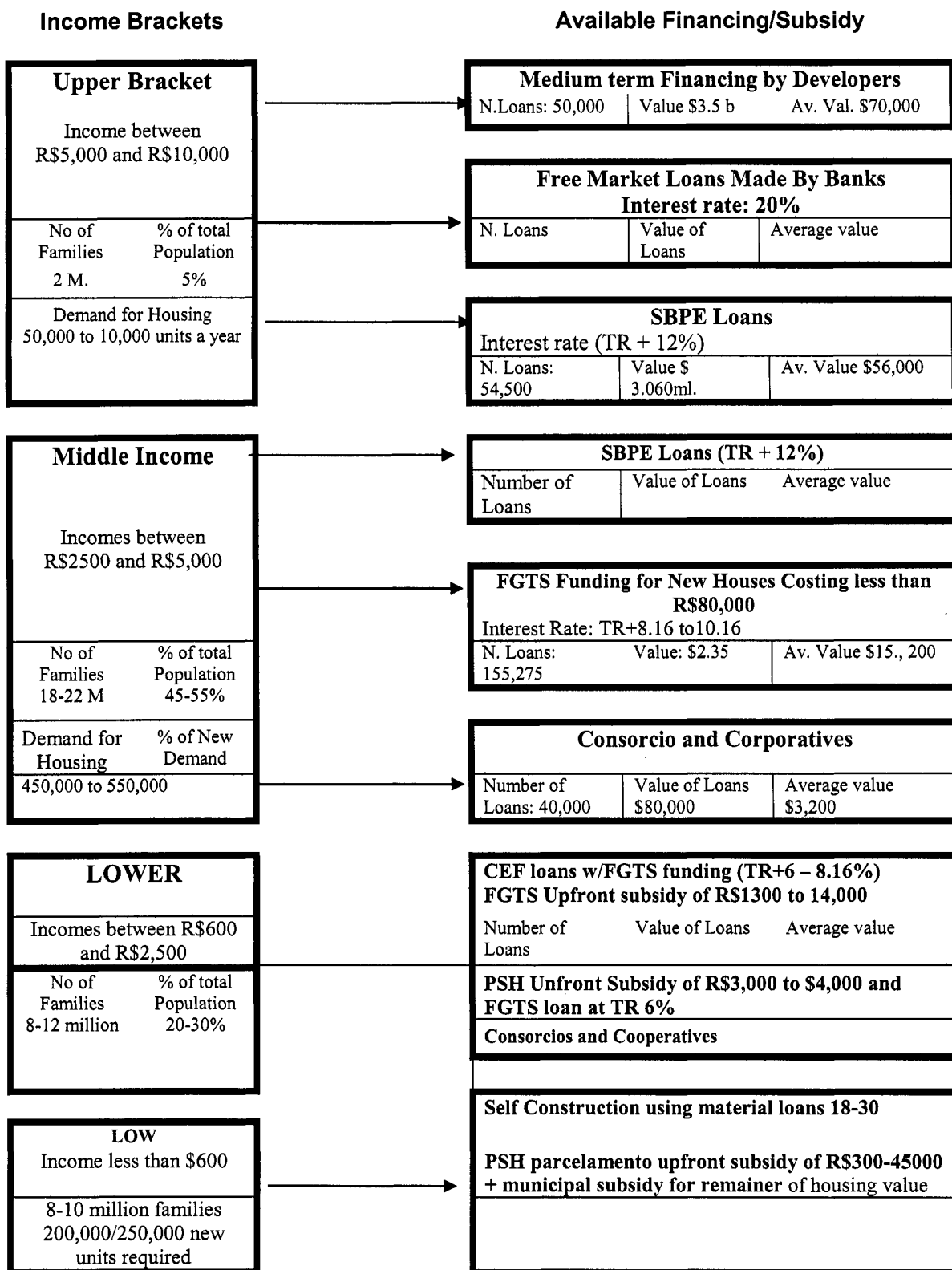
The premise of the Chilean upfront grant program was its confidence in the power of markets, i.e., its presumed ability to trigger a response in the residential development and mortgage sector by increasing consumer demand for housing. The policy was realistic in that it understood that regulatory change in the land management and mortgage finance sector had to accompany such a program. It also was designed to be long-term to give it credibility with the private sector, and it was fully transparent in its allocation system. It gradually included more housing options beyond new construction when the main housing shortage had been addressed. And indeed the package worked well for the middle income groups, albeit that most lending was done through the largest state owned bank.<sup>64</sup>

However, the original policy was overly optimistic in its assumption that such a model could be effective for the low-income segment of the market. And many countries that followed Chile's example, with less developed financial institutions, learned this same lesson the hard way. By the time it was realized that the private markets failed to respond to the voucher incentives for moderate and low-income households, the political and economic situation in the country required immediate and positive action to correct that. Government took over and predictably, the housing products were disliked and loans were poorly repaid. Little innovation took place in housing design and production and schemes to provide alternative types of credit to lower income households were never developed. Also, hidden, non-transparent subsidies increased program costs. Only 20 years later are these being addressed again. But, after the long history of poor loan performance by that target group, state credit guarantees are demanded by the (state) banks to take over this portfolio. When the banks gain experience with this type of borrower, the government can gradually decrease its role.

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<sup>64</sup> As in most cases when state banks are involved, it is difficult to tell if the dominant role of these banks in this part of the market was necessary or if the private banks would have eventually come in if the state had stayed out. The evidence is that at least some parts of this market would be served privately without state involvement.

## ANNEX 6: HOUSING FINANCE AND SUBSIDIES IN BRAZIL





## ANNEX 7: LAND ISSUES IN BRAZIL

Available data on housing and land markets suggest that Brazil's urban land and housing markets have not been able to keep pace with demand. During the decades of the 1950s, 60s, 70s and 1980s, urban population growth was rapid, exceeding 5 percent during the 1950s and 1960s, 4 percent in the 1970s, and over 3 percent in the 1980s. Only during the 1990s did urban population growth decrease to less than 3 percent. While the supply of housing in cities across the country has increased dramatically, much of the production is not affordable to low and moderate income households. Formal sector housing (averaging 35 square meters) sells for approximately R\$20,000 and is affordable to households earning more than four minimum wages—less than 50 percent of the Brazilian population [World Bank, 2001].

As a consequence, low- and moderate-income households are forced to seek housing in the informal sector. Some analysts estimate that more than 80 percent of the housing constructed over the last 20 years has been informally constructed [IBRD, 2001, page 82]. The causes of the land and housing markets dysfunction are manifold and complex, but unfortunately there has been little empirical research to draw on.

Based on the poor performance of urban land and housing markets, one would expect that economists and policy analysts would be carefully assessing Brazil's housing market problems and debating various forms of public policy intervention. In meetings with housing and urban planning specialists one finds little awareness of the role that land and housing markets play in shaping housing outcomes. No comprehensive economic assessment of the current flows of formal and informal urban housing supply has been conducted, nor has any microeconomic-based policy research on the urban housing sector in Brazil systematically addresses housing and land market performance. Effective policy dialog must be based on empirical and systematic assessments of urban land and housing markets.

The lack of understanding of the urban land and housing market is a serious impediment to sector reform. Despite the lack of substantial research, anecdotal evidence points to a series of factors that impede affordable housing production:

- Constrained supply of vacant developable land
- Lack of adequate infrastructure networks to serve vacant land
- Inefficient land and property titling and registration
- Poorly developed and restrictive master plans for urban areas
- Inappropriate zoning and subdivision standards
- Inadequate financial mechanisms for infrastructure investment
- Lack of competition in the low and middle income housing development sector

“Vicious cycle” is an apt way of describing how these factors interact to thwart affordable housing production. In some ways the problem starts with poorly conceived and restrictive master plans for urban areas. Federal laws 6766 (1979) and 9785 (1999) established the authority and process for land subdivision and master plans. These laws constrain the supply of land that can be legally developed, and they make it difficult for developers to produce affordable land subdivisions. A major impediment is the requirement that municipalities establish urban development perimeters beyond which residential development is prohibited. This effectively constraints the supply of residential land within cities and metropolitan areas. Furthermore residential development is limited to those areas with infrastructure. This catch-22 makes progressive or incremental residential development illegal.

Subdivision standards and zoning restrictions make it difficult to build affordable housing. Restrictions on minimum plot sizes, frontage, and setbacks drive up housing costs. So do excessive dedication requirements for rights-of-way and public facilities.

Another problem restraining land development is the fragmented process of land titling and registration. It is difficult for owners and developers to secure legal title to land and therefore encourages illegal subdivision and property transfers.

The process of infrastructure provision and financing is not sustainable. Developers are required to front end the financing of residential infrastructure even before they start development. Little attention is given to recovering the costs of infrastructure investments. As a result, infrastructure costs are not recovered from users and this makes it very difficult for the developer or the government to finance community facilities.

A final problem is the lack of a vibrant low and middle income housing industry. We found few examples of low income housing developers. Apparently, most concentrate on the upper end of the income distribution. However, if the GOB begins to allocate credit to low- and moderate-income households, the private sector will likely seize the opportunity to produce housing for the low and middle income groups. The transformation of the Bangkok housing market is a case in point [Dowall, 1992].

Based on this assessment, three conclusions can be advanced about Brazil's land and housing market policy environment:

- ***Brazil's urban land and housing policy is undeveloped and asymmetric:*** It focuses on housing finance and demand side subsidies, and on the supply side it exclusively focuses on slum upgrading and regularization. Current policy overlooks the design and implementation of strategies to increase low-income land and housing supply. Ongoing policy dialogue needs to be grounded in a strong analytical framework. The policy perspective should be more "macro" in orientation—it needs to be based on an overall urban development strategy, one that considers not just housing but also urban economic development and employment creation, environmental and social quality of life as well as housing. Policy interventions should focus on strategies to increase land and housing supply, upgrading of existing housing and neighborhoods, as well as demand side interventions targeted on the poor.
- ***Urban land management reform needs to precede housing finance reform:*** Because of the profound constraints in the land and housing market, efforts to increase housing credit must be preceded by land and housing market liberalization reforms. To be effective, such reforms must be preceded by a comprehensive empirical assessment of urban land and housing markets.
- ***The existing approach to master planning and land subdivision and zoning regulations do not foster the provision of affordable housing:*** Despite the long experience with urban master plans, subdivision regulations and zoning ordinances, most Brazilian cities do not have urban land development policies that are conducive to the production of low and moderate income housing. The

policies ignore the cost impact of standards and regulations. Little thought is given to the importance of linking land management policies with the provision of land supply for urban poor.

- ***Current land and housing policies ignore cost recovery:*** Most current government policies on housing for the poor are based on the provision of substantial subsidies to households. Little consideration is given to cost recovery especially for infrastructure service provision. Several projects we visited did not include a land titling and registration component to link occupancy and ownership.

## ANNEX 8: PROGRAM MONITORING AND EVALUATION EFFORTS

Objectives. The Government is launching a program for comprehensive monitoring and evaluation of the National Housing Policy to be supported by the TAL which accompanies the proposed DPL. The monitoring and evaluation activities seek to support the National Housing Policy of Brazil (*Política Nacional de Habitação*, or PNH) in designing and implementing a results based monitoring and evaluations system aimed at: (i) *assessing housing needs* at the intra municipal level to facilitate the identification of the target population in each municipality, (ii) *monitoring implementation and service delivery of PNH's various programs*, for quality control, accountability and legitimacy purposes, and (iii) *assessing of program effectiveness and efficiency* via impact assessment and cost effectiveness studies.

The Monitoring and Evaluation System of Brazil's National Housing Policy. The monitoring and evaluation system proposed includes four main activities:

- (a) Intra-Municipal Level Housing Needs Mapping to improve the targeting of PNH's programs at the municipal level;
- (b) a Management Information System to improve effectiveness of program delivery;
- (c) Processes Monitoring and Quality Control to ensure accountability and legitimacy;
- and
- (d) Impact Assessment and Cost Effectiveness studies.

### ***Intra-Municipal Level Housing Needs Mapping***

The objective of this subcomponent is to provide a tool to municipal authorities to identify areas within municipalities that are priority for the implementation of PNH's programs (PSH, etc.). The proposal is to combine census and national household surveys to estimate housing deficits at the census segment level. This would serve two purposes: First, it would help municipal governments in prioritizing the implementation of PNH's programs by targeting geographic areas in which poor eligible beneficiaries currently reside. Second, by comparing the housing needs map to the map of the incidence of the PNH programs, the federal government would be able to monitor the targeting performance of these locally implemented PNH programs. That is, inconsistencies found between the housing needs map and the actual programs' incidence map will alert the federal government to inadequate targeting of the intended beneficiary population by municipal governments.

Specific activities for this subcomponent include: (i) hiring of consultants to elaborate the housing needs map; (ii) workshop and publications to disseminate results the housing needs map; and (iii) hiring of consultants to develop web page to make maps available.

### ***Management Information System***

The objective of this subcomponent is to assist the Ministries responsible for the PNH programs in developing a MIS to gather and process real time information that is crucial for program management and implementation supervision. Once in place, the system will be able to instantaneously supply information about various implementation indicators to the program management teams and policy makers alike. The MIS will be designed to ensure proper resource use, to facilitate quality control, and to ensure public accountability. It entails the systematic documentation of key aspects of program performance that are indicative of whether the program

is functioning as intended or according to some appropriate standard. Thus, the MIS will be designed to answer questions as, for example:

- How many individuals (or families) are directly benefiting from the program?
- Total number of families that have applied to the program to date?
- Total number of beneficiaries receiving program benefits?
- Amounts transferred per month and per municipality?
- Average time elapsed between beneficiary application and selection into the program?
- Average time elapsed between beneficiary selection into the program and receipt of benefit?
- Socio-economic profile of beneficiary households?

The MIS developed under this subcomponent will gather and process information held by municipal governments and the financial agencies implementing the various programs under the PNH. Regular newsletters and reports with detailed information on program delivery information will be prepared and sent to key policy makers at federal, state and municipal levels. A web site will also be developed to provide real time information on program delivery and outreach status.

This subcomponent would support the following activities for the setting up of PNH's MIS: (a) the design, training of staff and implementation of the MIS system; (b) MIS software and hardware equipment; (c) system maintenance and updating; (d) operational costs for the first 2 and ½ years of the program; (e) training and dissemination workshops for MIS users (including federal, state and municipal government staff and policy makers).

### ***Processes Monitoring and Quality Control***

This subcomponent seeks to strengthen PNH's efficacy by supporting its programs in the area of quality control audits and the monitoring of downstream processes to ensure accountability, legitimacy and transparency of program execution by establishing effective incentive mechanisms for decentralized implementation. Therefore, this subcomponent will support the design and execution of random audits at the municipal level to check whether beneficiary selection procedures follow program guidelines, and if beneficiaries are receiving adequate services. A random sample of municipalities will be drawn each year. From each municipality, a further random sample of beneficiary families will be selected to verify the truthfulness of their reported eligibility, and the quality of the services delivered. The following questions will be addressed:

- Are those benefited the intended target?
- Are members of the targeted population aware of the program, and of program rules?
- Are necessary program functions being performed adequately?
- Are beneficiaries receiving the proper amounts, type and quality of service?
- Are there eligible targets that are not receiving services?
- Are program resources used effectively and efficiently?
- Are costs per service unit delivered reasonable?
- Are municipal projects in compliance with requirements imposed by the PNH?
- Are participants satisfied with the services they receive?

Specific activities for this subcomponent include: (i) hiring of consultants to design survey instruments, sampling strategy, and to implement periodic field surveys in municipalities randomly selected each year; (ii) workshop and publications to disseminate results of the quality

control survey; and (iii) hiring of consultants to develop program re-design strategies to address implementation issues identified by the quality control survey.

### ***Impact Assessment and Cost Effectiveness studies***

An assessment of program effectiveness and efficiency will be conducted to examine the degree to which the desired outcomes are generated by the program, and if such outcomes are produced with the lowest possible costs. Impact assessments cannot be made with certainty but only with varying degrees of plausibility. Typically, evaluation studies assess the effects of social programs by comparing information about the outcomes for participants and non-participants. The main objective of an impact assessment is to produce estimates of the net effects of an intervention, that is the impact uncontaminated by the influence of other processes and events that also may affect outcome indicators.

The main objective of an efficiency assessment is to provide a framework to compare program costs to outcomes. There are usually two types of efficiency analysis: (i) cost-benefit analysis, and (ii) cost-effectiveness analysis. Cost-benefit analysis requires that program costs and outcomes be known and valued by a common measurement unit (usually monetary units). When outcomes cannot be converted to monetary units, cost-effectiveness analysis permits interventions with similar goals to be compared in terms of their relative efficiency. To be feasible, cost-effectiveness analysis requires that several programs (or interventions) are evaluated for impact. While most administrative costs are captured by the monitoring systems of the programs themselves, some non-administrative costs (private or community costs) need to be assessed through primary data collections.

This sub-component will support PNH's monitoring of outcomes and assessment of program impacts. At a more aggregate level, the project will support monitoring and impact evaluation of economic and social indicators, as well as social capital indicators and indicators to measure municipal level supply of public services that might constrain program effectiveness. The monitoring and evaluation of outcomes at the municipal level will utilize existing and newly collected data at the municipal level. Existing data sources including the national population census, and sample data from large national surveys (e.g., PNAD, POF, PNDS, etc.). These latter will be used to estimate key municipal indicators through out of sample imputation methods, such as the methods develop applied in Lanjouw et al. . The use of imputation methods will allow for the spatial analysis of poverty and inequality outcomes at the municipal level before and after program implementation.

At the household level, this subcomponent will support baseline data collection from a sample of program participants as well as non-participant households. Program participants included in the sample will be interviewed right after being selected in to any of the PNH programs. This will ensure that sample beneficiary households will be more likely to provide truthful information when answering the baseline survey, since the probability of their receiving the program will not be affected by their answers to the survey. Comparable non-participant households will also be interviewed.

The data gathered during this exercise will provide baseline information for the relevant impact indicators. This subcomponent will also support follow up surveys. If possible, the sample of non-participant households should be selected from the pool of applicant households that were registered, but that were not selected into the program because they did not meet the eligibility criteria. Surveying these excluded households will allow for two valuable types of analysis: (i) an

assessment of the efficacy of the beneficiary selection process, by verifying if excluded households are in fact less deprived than beneficiaries, and (ii) an assessment of the impact of the program on household level socio-economic indicators via the method of regression discontinuity design (see Hahn, Todd and Van der Klaauw, 2001).

Specific activities for this subcomponent include: (i) organization of a Log-Frame workshop to identify program outcome indicators to be monitored and for which impact will be estimated, (ii) hiring of consultants to develop the monitoring and impact assessment methodologies, including the design of survey instruments and sampling strategy, and (iii) workshop and publications to disseminate results of the impact assessment and monitoring studies.

## ANNEX 9: PROPOSED HOUSING SECTOR TECHNICAL ASSISTANCE LOAN

To accompany the DPL, the Government has requested Bank support for a Technical Assistance Loan (TAL) which is expected to be presented to the World Bank's Board of Directors in early FY06. The proposed TAL would support the implementation, monitoring, and evaluation of the Government reform program supported by the Programmatic Loan for Sustainable and Equitable Growth: Housing Sector Reform. The TAL is expected to be in the amount of US\$5.05 million.

Project components. The proposed TAL would channel Bank financial support to the four areas of programmatic support being incorporated under the DPL. The TAL would aim to support the overall policy reform agenda and, concretely, establish the necessary conditions under which the Bank could provide investment-linked support to the housing subsidy programs through a sector investment loan under the Sector Wide Approach (SWAp) beginning in 2006. The TAL would be designed to allow for a large amount of implementation flexibility to account for the likely evolution of the financial sector linked inimitably to Brazil's macroeconomic conditions. Table 1 identifies the anticipated Project components and their associated costs.

Components	Indicative Costs (US\$M)	% of Total	Bank- financing (US\$M)	% Bank- financing
<b>Component 1 – Institutional and Legal Framework Component</b>	1.6	32%	1.6	100%
<b>Component 2 – Housing Finance Market Development Component</b>	0.3	6%	0.3	100%
<b>Component 3 – Housing Subsidies for the Poor Component</b>	2.4	48%	2.4	100%
<b>Component 4 – Land and Urban Development Component</b>	0.7	14%	0.7	100%
<b>Subtotal</b>	<b>5.0</b>	100%	<b>5.0</b>	100%
<b>Front-end Fee<sup>65</sup></b>	<b>0.05</b>	0.5%	-	100%
<b>Total</b>	<b>5.05</b>		<b>5.0</b>	

The four components of the TAL are:

*Component 1: Supporting the Institutional and Legal Framework for Housing Policy (US\$ 1.6 million).* The TAL would include resources to support the Ministry of Cities in its internal reorganization, including the consolidation of the National Housing Secretariat as the key technical and policy entity for managing coordinate policy design across the many public sector actors. The component would finance technical assistance related to the establishment of the FNHIS and, critically, to implement a broad program of capacity building and training for local officials at the municipal and state level. Because municipalities will be taking on greater

<sup>65</sup> The amount of the front-end fee, which is financed under the Loan and has been calculated at an amount equal to 1% of the Loan amount as presentation is expected in early FY06. However, if the Bank's Executive Directors approve a front-end fee waiver that applies after July 1, 2005, the Loan amount will be reduced to reflect the amount of any such waiver.



responsibilities in the context of the evolving legal framework, efforts are urgently needed to strengthen the ability of local governments to recover costs and manage the basic fiduciary and technical aspects of urban development.

*Component 2: Housing Finance Market Development (US\$0.3 million).* The TAL would include resources to support the improvement of the legal and regulatory framework for housing loans, including incremental reforms to the existing housing finance system, the further deregulation of the SBPE, and overall strengthening of the market-based Housing Finance System (SFI). While the reform agenda is broad and complex, and the sector actors have initiated a number of studies and technical reviews, the Government has requested that the TAL activities be highly focused on (a) efforts to disseminate information about the importance of a credible regulatory and legal framework for housing finance among a broad audience which would include the judiciary and members of Congress; (b) a technical review of the issues related to the development of a functioning credit insurance market; and (c) a strategic study, by independent consultants, of the medium-term future of FGTS. The TAL activities would complement other Government technical work on a number of issues, including: (a) the development of new legal and financial instruments for promoting greater primary and secondary market development; (b) the transition and future deregulation of SBPE, and (c) efforts to support the drafting of housing-specific consumer protection legislation, including a short study tour to the United States and/or Western Europe where such efforts are also underway.

*Component 3: Housing Subsidies for the Poor (US\$ 2.4 million).* The focus of technical assistance activities as relates to housing subsidy policy would be the rationalization of the Government's various subsidy programs and the establishment of effective targeting, monitoring, and evaluation mechanisms. Activities to be supported include (a) technical assistance for subsidy harmonization and regularization across the various subsidy programs (including Federal budget or OGU resources, off-budget financing, and FGTS programs); (b) the establishment of a tiered system of monitoring and evaluation, including regular monitoring of subsidy programs as regards targeting, impact, unit costs, the performance and compliance of financial intermediaries, and which would address both real-time needs and medium-term living standards impact; (c) demand-side technical assistance to local communities/local governments for structuring and packaging requests to the PSH; (d) a series of outreach and dissemination activities as regard national subsidy programs to improve understanding at the local level; and (e) technical assistance to improve the targeting of subsidies, including studies and analysis for the establishment of a system for poverty categorization that is more reliable than the current system of self-declaration and is consistent with Bank and Government experience.

*Component 4: Land and Urban Development (US\$ 0.7 million).* Technical assistance under this Component would be aimed at (a) federal-level research, monitoring, and evaluation of the remaining policy and regulatory efforts for urban development and land subdivision; (b) support for the Ministry of Cities' program to strengthen local governments in their efforts to achieve "gestão plena," the accreditation of their institutional capacity which allows them to take the lead in local urban development policy setting and implementation; and (c) the development of a series of toolkits to facilitate the implementation of the policy innovations supported by the DPL, including toolkits for progressive housing development, the preparation of *Planes Diretores* (local master plans), and demand-side organization for housing subsidy programs.

**Key Indicators.** The key indicators of TAL implementation are directly related to (a) the implementation of capacity building; (b) the Government's overall policy trajectory; and (c) the

use of information and knowledge generated by the TAL in redesigning and refocusing the Government's policy initiatives. Among the key indicators are:

***Overall Indicators***

- Subsequent Housing DPL triggers are met (as far as they are supported by the TAL)
- Program implementation, monitoring, and evaluation based on the results of the analytical and technical work of the TAL

**Component 1 – *Institutional and Legal Framework***

- Preparation of a draft law for the National Housing Policy
- Finalization of the National Housing Plan
- Preparation of the comprehensive regulations for operation of the FNHIS

**Component 2 – *Housing Finance Market Development***

- Workshops held to discuss housing market credibility with judiciary and legislators
- Strategic study on the future of FGTS completed

**Component 3 – *Housing Subsidies for the Poor***

- The Government has prepared a program for the harmonization of subsidies, including federal budget and off-budget resources (including FGTS).
- Establishment of the subsidy monitoring and evaluation system

**Component 4 – *Land and Urban Development***

- Preparation of toolkits for cadastre and registry development

**Lessons learned and reflected in the project design**

The experience of the World Bank and other donors in housing and urban development, and in TA projects, generally, suggests a number of key lessons incorporated in program design of the TAL:

- First and foremost, the synthetic nature of the housing and urban sectors requires joining reform in a range of areas to be effective, including credit and household savings, subsidies, and the broad urban development agenda. At the same time, selectivity is important, and both the TAL and DPLs focus on what the Government and Bank team consider to be the most important issues in developing a robust housing system. For example, despite the complexities of urban land development issues in Brazil, the Government's approach to focus on reducing the cost of formality for the poor and improving land subdivision, regularization, and infrastructure development is a critical area of reform with the necessary political support to take immediate action.
- Second, the decision by the Government to pair housing-related DPLs with targeted technical assistance reflects both the commitment of the Government to support the strengthening of the housing sector institutions – and particularly the Ministry of Cities National Secretariat for Housing – and the interest in maintaining Bank involvement through hands-on technical assistance.
- Third, housing subsidies function best in the form of grants made under a unified subsidy system that meets criteria for efficiency and equity, and the Government's reforms in this area have made major strides in achieving this. When markets function, these grants best take the form of portable vouchers that households join with their own down payment and a market-rate loan to buy the home of their choice. When distortions disrupt markets

- the case of low-income households, in general, and many moderate-income households
  - reforms that facilitate supply (e.g. organizing households into groups for projects, making available serviced lots, and strengthening property rights) are just as important and a pre-requisite for the effective functioning of subsidy programs.
- Finally, in technical assistance operations, it is important to have flexibility in the allocation of funds. To this end, the TAL has been designed to offer the sector actors flexibility during implementation.

## ANNEX 10: IMF RELATIONS NOTE

Press Release No. 05/67

March 28, 2005

International Monetary Fund  
700 19th Street, NW  
Washington, D.C. 20431 USA

### 1. STATEMENT BY IMF MANAGING DIRECTOR RODRIGO DE RATO ON BRAZIL

Mr. Rodrigo de Rato, Managing Director of the International Monetary Fund (IMF), made the following statement today:

"On March 21 the Executive Board of the IMF completed the tenth and final review of Brazil's performance under the SDR27.4 billion (about US\$41.8 billion) stand-by arrangement, which was originally approved in September 2002 (see Press Release No. 05/64) and is scheduled to expire at end-March 2005. The Brazilian authorities and Fund staff and management have jointly considered the future form of relations between Brazil and the IMF. In light of the sound macroeconomic and institutional framework in place, the government's commitment to pursuing further reforms, and a balance of payments position much stronger than earlier anticipated, the Brazilian authorities have decided not to request Fund support under a successor arrangement. The IMF staff and management fully support the authorities' decision.

"The decision by the authorities reflects the impressive results, generally ahead of expectations, of Brazil's macroeconomic stabilization and reform policies that have been supported by the current arrangement. Underpinned by these policies and a favorable global environment, economic activity has rebounded strongly in 2004, led by robust growth in private consumption and a sharp recovery in investment, bringing real GDP growth to over 5 percent-its highest level since 1994. External performance has been remarkable, with the trade and current account balances close to record surpluses at present, and net international reserves rising to more comfortable levels. Moreover, inflation is being reduced steadily under the inflation targeting framework. A consistently strong fiscal performance has contributed to reducing the level and improving the structure of public debt and has greatly assisted in preserving macroeconomic stability, while private sector efforts to strengthen balance sheets have led to a marked decline in external indebtedness. These developments have significantly lessened economic vulnerabilities and bolstered confidence in the economy. The authorities are committed to continuing with their reform agenda, and further steps to strengthen public finances, through reforms on the social security system, have just been announced and are welcomed by IMF staff and management.

"The Brazilian authorities and the staff and management of the IMF look forward to continuing with the close and cooperative policy dialogue between Brazil and the IMF through the usual channels of surveillance and post-program monitoring."

Public Information Notice (PIN) No. 05/41

March 25, 2005

International Monetary Fund  
700 19th Street, NW  
Washington, D.C. 20431 USA

## **2. IMF EXECUTIVE BOARD CONCLUDES 2005 ARTICLE IV CONSULTATION WITH BRAZIL**

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

On March 21, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Brazil.<sup>66</sup>

### **BACKGROUND**

Since the 2002 crisis, and in the context of a favorable external environment, strong macroeconomic policies and the pursuit of ambitious structural reforms have restored macroeconomic stability and fostered favorable conditions for growth. High primary surpluses—reaching 4.6 percent of GDP in 2004—have helped to improve debt sustainability. The ratio of net public debt to GDP fell from 65.5 percent at end-2002 to 54.5 at end-2004, while the structure of the debt has improved, with a marked reduction in the share of foreign-currency-linked debt. Cautious monetary policy kept inflation within the target band in 2004 despite supply shocks, and inflation is set to continue on a declining path this year. The passage of several important reforms—including tax and pension reforms and bankruptcy legislation—has strengthened confidence and improved the business climate.

The resulting decline in vulnerabilities and rising confidence have helped to fuel a strong economic recovery. GDP growth was 5.2 percent in 2004, and employment grew by 3.2 percent. The recovery has been aided by a very strong export performance, which has led to a record current account surplus of almost 2 percent of GDP. However, domestic demand also rebounded significantly during 2004, helped by declining real interest rates from mid-2003 and reforms facilitating access to credit. With capacity utilization close to peak levels and rising business confidence, investment rose by 11 percent in 2004.

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<sup>66</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Financial market conditions are currently the best in many years. Sovereign spreads have fallen to around 400 basis points, the real has been appreciating, and strong capital flows have allowed the central bank to rebuild international reserves. The government has already funded about three quarters of its US\$6 billion external issuance requirements for 2005.

The health of the banking system has continued to improve over recent years and progress has been made in strengthening financial sector supervision. Overall, banks are well capitalized and profitable and capital adequacy ratios are high by international standards, although financial institutions remain significantly exposed to the public sector. The system withstood the pressures stemming from the intervention of Banco Santos in November well, partly aided by the prompt actions taken by the central bank.

## **EXECUTIVE BOARD ASSESSMENT**

Directors welcomed Brazil's impressive economic achievements over the last two years, and the remarkable track record of performance under the Stand-By Arrangement, which reflected the authorities' continued pursuit of strong macroeconomic policies and steady progress with structural reforms. Helped by a generally supportive external environment, these policies have led to a significant transformation of the economy, which has resulted in a strong economic recovery, income and employment gains, a declining public debt burden, and rising international reserves.

Directors pointed out that despite these successes, vulnerabilities and challenges remain. They noted that public debt was still high and sensitive to global financial conditions. Moreover, Directors stressed the need to persevere with structural reforms in order to boost long-term growth prospects, critical to addressing persistent poverty and inequality.

Directors observed that the inflation targeting and flexible exchange rate regimes had worked well in recent years and commended the authorities for their skillful conduct of monetary policy. They considered that, in light of the supply-side shocks faced by Brazil over the past year, the reduction of inflation to within the target band in 2004 was a substantial achievement. Directors supported the central bank's emphasis on keeping inflation on a downward path, and its cautious approach in the face of sticky inflation expectations and persistently high core inflation. They observed that the challenge for the central bank is to bring inflation down further while minimizing the impact on growth. In this regard, they noted that the recent appreciation of the real together with rising interest rates and the moderating pace of activity should contribute to slowing inflation in the coming months. Directors generally shared the view that the effectiveness of monetary policy would be enhanced by the passage of legislation to provide the central bank with full operational autonomy.

Directors supported the recent resumption of foreign exchange purchases by the central bank. They noted that continuing capital inflows could provide opportunities for further reserve accumulation, although a deterioration in external conditions could lead to some unwinding of the recent build up in real positions. They supported the authorities' continued commitment to a floating exchange rate regime, and stressed the importance of allowing the rate to move in the face of market forces, while continuing to take advantage of opportunities to build reserves. Directors welcomed the recent announcement of measures to streamline foreign exchange regulations, noting that carefully sequenced reforms in this area should help to strengthen integration with the global economy, promote trade openness, and enhance the efficiency of capital markets.

Directors congratulated the authorities for consistently achieving high primary fiscal surpluses. A number of Directors saw merit in a further moderate tightening, which would accelerate debt reduction while supporting monetary policy and helping to reduce pressures for appreciation of the real by lessening incentives for capital inflows. However, other Directors considered that the fiscal target for 2005 and beyond appeared prudent, while providing room for infrastructure and social spending. Directors commended the cautious approach taken in the first budget execution decree for 2005, given that determined efforts would be needed to contain nonpriority current spending so as to create room for additional spending on infrastructure. In this context, Directors welcomed the progress made under the pilot project to strengthen mechanisms for selecting, implementing and monitoring public investment, and the recent advances in establishing the framework for public-private partnerships. A key aspect of the pilot program will be maintaining full transparency in the context of the budget.

Directors stressed the importance over the medium term of fiscal reforms to increase budget flexibility, so as to provide more room for priority programs. Raising the flexibility of both revenue and expenditure and containing entitlement spending would allow for an expansion of targeted social spending, facilitate further tax reforms, and reduce vulnerabilities.

Directors welcomed improvements in the debt structure and agreed with the authorities' focus on lengthening maturities and reducing the share of exchange-rate and short-term interest rate linked debt. Directors also highlighted the need to develop the domestic debt markets further, including by continuing the dialogue with large institutional investors and reducing impediments to participation by foreign investors.

Directors pointed to the considerable strengthening of Brazil's banking system in recent years, observing that the system had coped well with the failure of a mid-sized bank in late 2004. They considered that further steps to strengthen the prudential framework would help the central bank to deal even more effectively with banking distress, thereby limiting the likelihood of contagion from problems in individual banks to the system as a whole. Directors encouraged the authorities to promote financial intermediation by gradually reducing directed lending requirements, and the distortionary taxation of financial intermediation. Directors also encouraged the authorities to implement the remaining recommendations of the FSSA, and welcomed their intention to explore an FSAP update.

Directors emphasized that the current environment provides a favorable opportunity to address structural weaknesses in the Brazilian economy and reduce poverty and inequality. Substantial progress has been made in recent years, although structural rigidities and bottlenecks continue to constrain Brazil's growth potential. Looking ahead, the authorities' reform agenda—including central bank autonomy, reform of the state-level VAT, and further measures to enhance the business environment—covers important areas. Other critical reforms would include measures to increase budget flexibility, address the large remaining imbalances in the pensions system, promote financial intermediation, and reduce labor market informality through reforms of the labor code, so as to substantially increase flexibility in labor contracts. In this regard, Directors emphasized the importance of careful sequencing of reforms and building consensus around them.

**Brazil: Selected Economic Indicators**

	2000	2001	2002	2003	2004
	(annual percentage change)				
<b><i>Domestic economy</i></b>					
Real GDP growth	4.4	1.3	1.9	0.5	5.2
Inflation (IPCA, end-of period)	6.0	7.7	12.5	9.3	7.6
	(in billions of U.S. dollars)				
<b>Balance of payments</b>					
Exports, f.o.b.	55.1	58.2	60.4	73.1	96.5
Imports, f.o.b.	-55.8	-55.6	-47.2	-48.3	-62.8
Current account balance	-24.2	-23.2	-7.6	4.2	11.7
Capital and financial account	19.3	27.0	8.0	5.1	-7.3
o/w Foreign direct investment	32.8	22.5	16.6	10.1	18.2
Current account balance (in percent of GDP)	-4.0	-4.5	-1.6	0.8	1.9
Gross reserves to short-term external debt 1/	52.6	56.6	59.7	85.3	94.8
	(in percent of nominal GDP)				
<b>Public finances</b>					
Public sector net debt	51.1	55.1	65.5	58.7	54.5
Public sector primary balance	3.5	3.6	3.9	4.3	4.6
Public sector overall balance	-3.6	-3.6	-4.6	-5.1	-2.7
<b>Money and credit</b>					
Change in base money (in percent)	-1.5	11.7	37.7	-0.1	21.2
Change in broad money (M2) (in percent)	3.3	13.3	23.6	3.7	19.3
Average overnight interest rate (in percent)	17.4	17.3	19.1	23.2	16.2

Sources: Brazilian authorities and IMF Staff estimates.

1/ On a residual maturity basis, in percent.



## ANNEX 11 STATUS OF BANK GROUP OPERATIONS

Project ID	FY	Purpose	Original Amount in US\$ Millions					Difference between expected and actual disbursements		
			IBRD	IDA	SF	GEF	Cancel.	Undisb.	Orig.	Frm. Rev'd
P082328	2005	BR-Integ.Munic.Proj.-Betim Municipality	24.07	0.00	0.00	0.00	0.00	24.08	0.00	0.00
P083533	2005	BR TA-Sustain. & Equit Growth	12.12	0.00	0.00	0.00	0.00	12.12	0.00	0.00
P087711	2005	BR Espirito Santo Wtr & Coastal Pollu	36.00	0.00	0.00	0.00	0.00	36.00	0.73	0.00
P069934	2005	BR-PERNAMBUCO INTEG DEVT: EDUC QUAL IMPR	31.50	0.00	0.00	0.00	0.00	31.50	0.79	0.00
P060573	2004	BR Tocantins Sustainable Regional Dev	60.00	0.00	0.00	0.00	0.00	60.00	7.00	0.00
P080830	2004	BR Maranhao Integrated: Rural Dev	30.00	0.00	0.00	0.00	0.00	30.00	1.92	0.00
P083013	2004	BR Disease Surveillance & Control APL 2	100.00	0.00	0.00	0.00	0.00	99.50	0.00	0.00
P087713	2004	BR (CRL1) Bolsa Familia 1st APL	572.20	0.00	0.00	0.00	0.00	572.20	0.00	0.00
P070827	2003	BR-2nd APL BAHIA DEV. EDUCATION PROJECT	60.00	0.00	0.00	0.00	0.00	42.19	20.68	0.00
P049265	2003	BR-RECIFE URBAN UPGRADING PROJECT	46.00	0.00	0.00	0.00	0.00	44.99	6.25	0.00
P058503	2003	GEF BR Amazon Region Prot Areas (ARPA)	0.00	0.00	0.00	30.00	0.00	26.31	0.00	0.00
P054119	2003	BR BAHIA DEVT (HEALTH )	30.00	0.00	0.00	0.00	0.00	28.27	6.27	0.00
P080400	2003	BR-AIDS & STD Control 3	100.00	0.00	0.00	0.00	0.00	91.85	17.15	0.00
P076977	2003	BR-Energy Sector TA Project	12.12	0.00	0.00	0.00	0.00	12.12	4.02	0.00
P074777	2003	BR-Municipal Pension Reform TAL	5.00	0.00	0.00	0.00	0.00	4.90	4.30	0.00
P051696	2002	BR SÃO PAULO METRO LINE 4 PROJECT	209.00	0.00	0.00	0.00	0.00	163.48	126.58	0.00
P073192	2002	BR TA Financial Sector	14.50	0.00	0.00	0.00	0.00	9.30	6.48	0.00
P055954	2002	BR GOIÁS STATE HIGHWAY MANAGEMENT	65.00	0.00	0.00	0.00	0.00	34.46	34.12	0.00
P057653	2002	BR- FUNDESCOLA HIA	160.00	0.00	0.00	0.00	0.00	209.31	-22.78	0.00
P057665	2002	BR-FAMILY HEALTH EXTENSION PROJECT	68.00	0.00	0.00	0.00	0.00	50.81	38.67	0.00
P070552	2002	GEF BR PARANA BIODIVERSITY PROJECT	0.00	0.00	0.00	8.00	0.00	8.59	5.99	0.00
P074085	2002	BR Sergipe Rural Poverty Reduction	20.80	0.00	0.00	0.00	0.00	3.13	-1.96	0.00
P060221	2002	BR FORTALEZA METROPOLITAN TRANSPORT PROJ	85.00	0.00	0.00	0.00	0.00	111.47	57.35	0.00
P066170	2002	BR-RGN 2ND Rural Poverty Reduction	22.50	0.00	0.00	0.00	0.00	13.68	6.48	0.00
P043869	2002	BR SANTA CATARINA NATURAL RESOURC & POV.	62.80	0.00	0.00	0.00	0.00	59.96	19.11	0.00
P073294	2001	BR Fiscal & Fin. Mgmt. TAL	8.88	0.00	0.00	0.00	0.00	6.74	5.78	0.00
P050881	2001	BR PIAUI RURAL POVERTY REDUCTION PROJECT	22.50	0.00	0.00	0.00	0.00	8.78	7.45	0.00
P059566	2001	BR- CEARA BASIC EDUCATION	90.00	0.00	0.00	0.00	0.00	71.32	-18.68	0.00
P050772	2001	BR LAND-BASED POVRTY ALLEVIATION I (SIM)	202.10	0.00	0.00	0.00	58.13	151.01	152.74	0.00
P050880	2001	BR Pernambuco Rural Poverty Reduction	30.10	0.00	0.00	0.00	0.00	16.65	12.92	0.00
P057649	2001	BR Bahia Rural Poverty Reduction Project	54.35	0.00	0.00	0.00	0.00	5.02	-1.77	0.00

Project ID	FY	Purpose	Original Amount in US\$ Millions				Cancel.	Undisb.	Difference between expected and actual disbursements	
			IBRD	IDA	SF	GEF			Orig.	Frm. Rev'd
P050875	2001	BR Ceara Rural Poverty Reduction Project	37.50	0.00	0.00	0.00	0.00	7.26	2.01	0.00
P050776	2000	BR NE Microfinance Development	50.00	0.00	0.00	0.00	0.00	30.15	-19.85	0.00
P047309	2000	BR ENERGY EFFICIENCY (GEF)	0.00	0.00	0.00	15.00	3.29	9.39	11.17	6.25
P039199	2000	BR PROSANEAR 2	30.30	0.00	0.00	0.00	6.40	22.29	28.69	22.29
P006449	2000	BR CEARA WTR MGT PROGERIRH SIM	136.00	0.00	0.00	0.00	0.00	67.27	47.14	4.00
P035741	2000	BR NATL ENV 2	15.00	0.00	0.00	0.00	2.32	5.61	7.93	2.29
P048869	1999	BR SALVADOR URBAN TRANS	150.00	0.00	0.00	0.00	0.00	85.95	85.95	0.00
P050763	1999	BR- Fundescola 2	202.00	0.00	0.00	0.00	0.00	17.29	17.29	0.00
P058129	1999	BR EMER. FIRE PREVENTION (ERL)	15.00	0.00	0.00	0.00	0.00	5.46	5.46	0.18
P042565	1998	BR PARAIBA R.POVERTY	60.00	0.00	0.00	0.00	0.00	11.16	11.16	0.00
P035728	1998	BR BAHIA WTR RESOURCES	51.00	0.00	0.00	0.00	0.00	4.03	4.03	0.03
P006559	1998	BR (BF-R)SP.TSP	45.00	0.00	0.00	0.00	0.00	0.02	0.02	0.00
P006474	1998	BR LAND MGT 3 (SAO PAULO)	55.00	0.00	0.00	0.00	10.00	36.98	46.98	21.63
P038895	1998	BR FED.WTR MGT	198.00	0.00	0.00	0.00	40.00	54.67	94.67	26.23
P043421	1998	BR RJ M.TRANSIT PRJ.	186.00	0.00	0.00	0.00	27.78	92.74	120.52	0.00
P057910	1998	BR PENSION REFORM LIL	5.00	0.00	0.00	0.00	0.50	1.48	1.98	1.28
P043420	1998	BR WATER S.MOD.2	150.00	0.00	0.00	0.00	125.00	19.33	144.30	3.78
P006532	1997	BR FED HWY DECENTR	300.00	0.00	0.00	0.00	50.00	61.51	111.51	111.51
P043873	1997	BR AG TECH DEV.	60.00	0.00	0.00	0.00	0.00	15.24	15.24	15.24
P043868	1997	BR RGS LAND MGT/POVERTY	100.00	0.00	0.00	0.00	0.00	8.79	8.79	8.79
P034578	1997	BR RGS Highway MGT	70.00	0.00	0.00	0.00	0.00	30.09	30.09	30.09
P037828	1996	BR (PR)R.POVERTY	175.00	0.00	0.00	0.00	10.00	38.36	48.36	48.36
P006210	1996	GEF BR-NAT'L BIODIVERSITY	0.00	0.00	0.00	10.00	0.00	1.87	2.59	1.30
Total:			4,325.34	0.00	0.00	63.00	333.42	2,666.68	1,323.62	303.25

## ANNEX 12: STATEMENT OF IFC'S HELD AND DISBURSED PORTFOLIO

Approval Fiscal Year	Institution Short Name	Loan Cmtd-IFC	Equity Cmtd-IFC	QL+QE Cmtd-IFC	All Cmtd-Part	Loan Out-IFC	Equity Out-IFC	QL+QE Out-IFC	All Out-Part
2001	AG Concession	0.00	15.00	15.00	0.00	0.00	14.07	0.00	0.00
2002/2005	Amaggi	55.71	0.00	0.00	0.00	40.71	0.00	0.00	0.00
2002	Andrade G. SA	27.50	0.00	10.00	16.67	27.50	0.00	10.00	16.67
2001	Apolo	7.21	0.00	0.00	0.00	4.71	0.00	0.00	0.00
2005	Aracruz	50.00	0.00	0.00	0.00	50.00	0.00	0.00	0.00
1998	Arteb	20.00	7.00	0.00	18.33	20.00	7.00	0.00	18.33
1999	AutoBAN	22.73	0.00	0.00	17.25	22.73	0.00	0.00	17.25
1998	BSC	1.24	0.00	0.00	0.66	1.24	0.00	0.00	0.66
1996/2003	Banco Bradesco	1.19	0.00	0.00	1.75	1.19	0.00	0.00	1.75
2001	Brazil CGFund	0.00	20.00	0.00	0.00	0.00	1.60	0.00	0.00
1994/1996	CHAPECO	11.78	0.00	0.00	5.26	11.78	0.00	0.00	5.26
2002/2004	CN Odebrecht	29.04	0.00	20.00	31.59	29.04	0.00	20.00	31.59
1973 / 1978 / 1983	CODEMIN	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2003	CPFL Energia	0.00	0.00	40.00	0.00	0.00	0.00	40.00	0.00
1992	CRP-Caderi	0.00	0.32	0.00	0.00	0.00	0.32	0.00	0.00
1996 / 1997	CTBC Telecom	11.50	18.17	0.00	0.00	11.50	18.17	0.00	0.00
2004	Comgas	45.00	0.00	0.00	45.00	12.50	0.00	0.00	12.50
1997 / 2000	Coteminas	4.69	5.43	0.00	0.00	4.69	5.43	0.00	0.00
1980 / 1992 / 1993	DENPASA	0.00	1.12	0.00	0.00	0.00	1.08	0.00	0.00
1998	Dixie Toga	0.00	14.90	0.00	0.00	0.00	14.90	0.00	0.00
1987 / 1996 / 1997	Duratex	6.76	0.00	0.00	3.95	6.76	0.00	0.00	3.95
1999	Eliane	19.20	0.00	13.00	0.00	19.20	0.00	13.00	0.00
1998	Empesca	5.00	0.00	10.00	0.00	5.00	0.00	10.00	0.00
2000 / 2004	Fleury	25.79	0.00	6.00	0.00	5.79	0.00	6.00	0.00
1998	Fosfertil	5.30	0.00	0.00	21.36	5.30	0.00	0.00	21.36
1998	Fras-le	6.00	0.00	10.00	0.00	6.00	0.00	6.70	0.00
1994	GAVEA	0.94	0.00	5.50	0.00	0.94	0.00	5.50	0.00
2002	GP Cptl Rstrctd	0.00	8.70	0.00	0.00	0.00	8.62	0.00	0.00
2001	GPC	9.00	0.00	0.00	0.00	9.00	0.00	0.00	0.00
1997 / 1998	Guilman-Amorim	20.99	0.00	0.00	28.74	20.99	0.00	0.00	28.74
1998	Icatu Equity	0.00	14.00	0.00	0.00	0.00	12.62	0.00	0.00
1999	Innova SA	12.50	5.00	0.00	30.00	12.50	5.00	0.00	30.00
1980 / 1987 / 1997	Ipiranga	23.62	6.32	0.00	39.75	23.62	6.32	0.00	39.75
1999	Itaberaba	0.00	5.34	0.00	0.00	0.00	5.34	0.00	0.00
2000 / 2002 / 2003	Itau-BBA	99.29	0.00	0.00	0.00	71.69	0.00	0.00	0.00
1999	JOSAPAR	7.57	0.00	7.00	0.00	2.57	0.00	7.00	0.00
1995	Lojas Americana	2.00	0.00	0.00	0.00	2.00	0.00	0.00	0.00
1987 / 1992 / 1999	MBR	12.50	0.00	10.00	0.00	12.50	0.00	10.00	0.00
2002	Macaee	45.25	0.00	10.00	37.50	45.25	0.00	10.00	37.50
2002	Microinvest	0.00	1.25	0.00	0.00	0.00	0.42	0.00	0.00
2002 / 2003	Net Servicos	0.00	36.39	0.00	0.00	0.00	36.39	0.00	0.00
1994	Para Pigmentos	8.60	0.00	9.00	0.00	8.60	0.00	9.00	0.00
1987 / 1996	Perdigao	2.19	0.00	0.00	0.00	2.19	0.00	0.00	0.00
1994/2000/2002	Portobello	12.52	6.15	0.00	0.00	12.52	6.15	0.00	0.00
2000	Puras	2.67	0.00	0.00	0.00	2.67	0.00	0.00	0.00
2003 / 2004	Queiroz Galvao	30.00	0.00	10.00	0.00	5.00	0.00	5.00	0.00
2004	Randon Impl Part	3.73	0.00	3.00	0.00	3.73	0.00	3.00	0.00
1987 / 1997 / 2003	SP Alpargatas	36.67	0.00	0.00	0.00	21.67	0.00	0.00	0.00
1994/1995/1997	Sadia	6.11	0.00	3.83	38.74	6.11	0.00	3.83	38.74
1997	Samarco	6.30	0.00	0.00	0.00	6.30	0.00	0.00	0.00

Approval Fiscal Year	Institution Short Name	Loan Cmtd-IFC	Equity Cmtd-IFC	QL+QE Cmtd-IFC	All Cmtd-Part	Loan Out-IFC	Equity Out-IFC	QL+QE Out-IFC	All Out-Part
1998	Saraiva	3.46	3.00	0.00	0.00	3.46	3.00	0.00	0.00
2003	Satipel	12.86	0.00	10.00	0.00	12.86	0.00	10.00	0.00
2000	Sepetiba	26.85	0.00	5.00	0.00	11.85	0.00	5.00	0.00
1999	Sudamerica	0.00	15.00	0.00	0.00	0.00	15.00	0.00	0.00
2001	Synteko	15.43	0.00	0.00	0.00	15.43	0.00	0.00	0.00
1996	TIGRE	1.92	0.00	0.00	0.00	1.92	0.00	0.00	0.00
1998 / 2004	Tecon Rio Grande	12.80	0.00	5.50	15.52	4.70	0.00	5.50	7.42
2001 / 2003	Tecon Salvador	3.30	1.56	0.00	4.15	3.30	1.32	0.00	4.15
2004	TriBanco	10.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1981 / 1987	Triunfo	0.00	-0.00	0.00	0.00	0.00	0.00	0.00	0.00
2002 / 2003	UP Offshore	11.60	10.00	0.00	30.00	0.00	3.00	0.00	0.00
1988/ 1994/ 1996/ 2002 / 2003 / 2004	Unibanco	57.18	0.00	0.00	0.00	57.18	0.00	0.00	0.00
1999	Wiest	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
<b>Total Portfolio:</b>		<b>853.48</b>	<b>194.64</b>	<b>202.83</b>	<b>386.23</b>	<b>666.18</b>	<b>165.74</b>	<b>179.53</b>	<b>315.63</b>

## ANNEX 13: BRAZIL AT A GLANCE

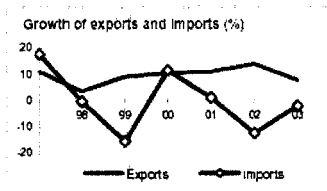
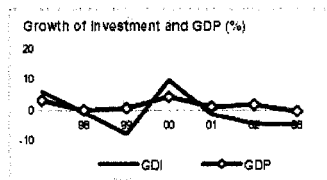
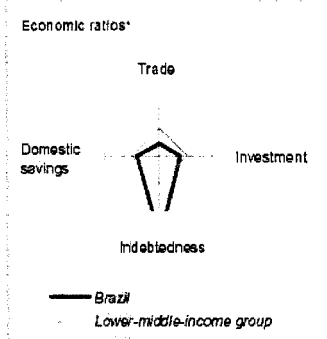
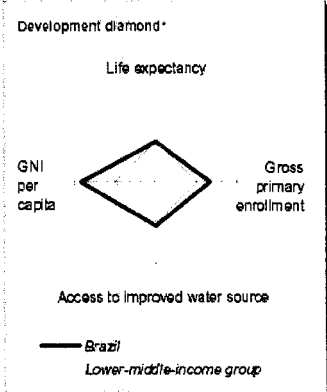
### Brazil at a glance

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POVERTY and SOCIAL	Brazil	Latin America & Carib.	Lower-middle-income		
<b>2003</b>					
Population, mid-year (millions)	176.6	534	2,655		
GNI per capita (Atlas method, US\$)	2,720	3,260	1,480		
GNI (Atlas method, US\$ billions)	479.5	1,741	3,934		
<b>Average annual growth, 1997-03</b>					
Population (%)	1.3	1.5	0.9		
Labor force (%)	1.6	2.1	1.2		
<b>Most recent estimate (latest year available, 1997-03)</b>					
Poverty (% of population below national poverty line)	22	..	..		
Urban population (% of total population)	83	77	50		
Life expectancy at birth (years)	69	71	69		
Infant mortality (per 1,000 live births)	33	28	32		
Child malnutrition (% of children under 5)	6	..	11		
Access to an improved water source (% of population)	87	86	81		
Illiteracy (% of population age 15+)	14	11	10		
Gross primary enrollment (% of school-age population)	148	129	112		
Male	153	131	113		
Female	144	126	111		
<b>KEY ECONOMIC RATIOS and LONG-TERM TRENDS</b>					
	1983	1993	2002	2003	
GDP (US\$ billions)	203.3	438.3	460.8	492.3	
Gross domestic investment/GDP	16.7	20.8	19.8	20.1	
Exports of goods and services/GDP	11.4	10.5	15.5	16.9	
Gross domestic savings/GDP	19.1	22.3	21.8	23.6	
Gross national savings/GDP	..	20.2	18.5	20.7	
Current account balance/GDP	-3.4	-0.1	-1.6	0.8	
Interest payments/GDP	3.9	0.6	2.9	2.7	
Total debt/GDP	48.5	32.9	49.6	48.0	
Total debt service(exports)	54.7	24.4	70.3	65.1	
Present value of debt/GDP	..	..	52.6	..	
Present value of debt(exports)	..	..	329.6	..	
	1983-93	1993-03	2002	2003	2003-07
(average annual growth)					
GDP	2.4	2.3	1.9	-0.2	3.6
GDP per capita	0.6	1.0	0.7	-1.4	2.9
Exports of goods and services	6.3	7.5	14.2	7.9	1.6

STRUCTURE of the ECONOMY		1983	1993	2002	2003
<i>(% of GDP)</i>					
Agriculture		10.9	7.6	5.8	5.8
Industry		44.0	41.6	20.6	19.1
Manufacturing		33.2	25.0	12.4	11.4
Services		45.1	50.8	73.5	75.1
Private consumption		71.2	60.1	58.1	56.9
General government consumption		9.7	17.7	20.1	19.3
Imports of goods and services		9.0	9.1	13.4	13.1
<i>(average annual growth)</i>					
Agriculture		2.4	3.9	5.0	5.5
Industry		1.2	1.8	2.6	-1.0
Manufacturing		0.0	1.4	1.4	2.7
Services		3.0	2.5	1.6	-0.2
Private consumption		0.8	1.9	-0.4	-3.3
General government consumption		6.4	2.0	1.0	11.6
Gross domestic investment		4.9	1.2	-4.3	-4.5
Imports of goods and services		5.9	4.0	-12.3	-1.9

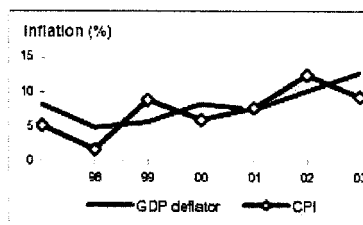


Note: 2003 data are preliminary estimates.

\* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

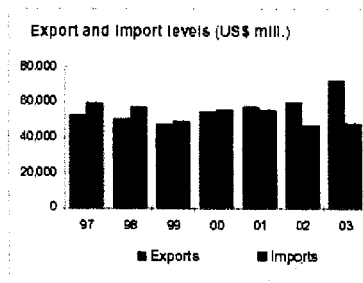
## PRICES and GOVERNMENT FINANCE

	1983	1993	2002	2003
<b>Domestic prices</b>				
(% change)				
Consumer prices	135.0	1,928.0	12.5	9.3
Implicit GDP deflator	140.2	1,996.6	10.2	12.8
<b>Government finance</b>				
(% of GDP, includes current grants)				
Current revenue	..	..	23.9	23.7
Current budget balance	..	..	2.8	3.0
Overall surplus/deficit	..	..	..	..



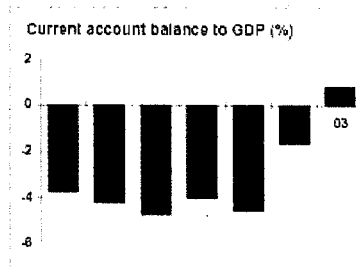
## TRADE

	1983	1993	2002	2003
<b>(US\$ millions)</b>				
Total exports (fob)	..	38,563	60,362	73,084
Coffee	..	2,466	3,049	3,456
Soybeans	..	3,074	3,032	4,290
Manufactures	..	25,935	33,000	39,653
Total imports (cif)	..	25,256	47,237	48,260
Food	..	1,089	1,085	924
Fuel and energy	..	2,139	6,240	6,577
Capital goods	..	8,369	11,643	10,348
Export price index (1995=100)	80	91	88	95
Import price index (1995=100)	57	67	91	90
Terms of trade (1995=100)	140	136	97	105



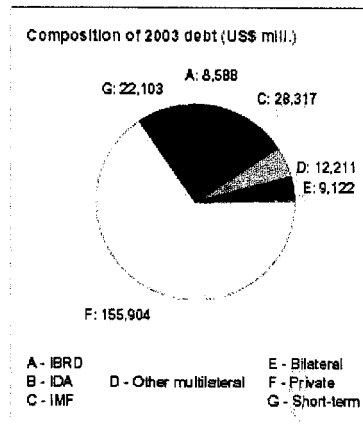
## BALANCE of PAYMENTS

	1983	1993	2002	2003
<b>(US\$ millions)</b>				
Exports of goods and services	23,611	41,616	69,913	83,567
Imports of goods and services	19,534	31,795	61,709	63,819
Resource balance	4,077	9,821	8,204	19,748
Net income	-11,022	-12,099	-18,191	-18,552
Net current transfers	108	1,686	2,390	2,867
Current account balance	-6,837	-592	-7,597	4,063
Financing items (net)	4,946	9,805	-6,003	-963
Changes in net reserves	1,891	-9,213	13,600	-3,100
<b>Memo:</b>				
Reserves including gold (US\$ millions)	4,563	32,211	37,823	49,296
Conversion rate (DEC, local/US\$)	2.10E-10	3.22E-2	2.9	3.1



## EXTERNAL DEBT and RESOURCE FLOWS

	1983	1993	2002	2003
<b>(US\$ millions)</b>				
Total debt outstanding and disbursed	98,525	144,104	228,662	236,245
IBRD	3,628	6,575	8,585	8,588
IDA	0	0	0	0
Total debt service	13,304	10,883	51,636	56,793
IBRD	507	1,858	1,518	2,010
IDA	0	0	0	0
<b>Composition of net resource flows</b>				
Official grants	16	59	0	..
Official creditors	1,576	-1,033	916	..
Private creditors	2,859	10,073	-9,541	233
Foreign direct investment	1,609	1,292	0	..
Portfolio equity	0	6,570	0	..
<b>World Bank program</b>				
Commitments	2,067	636	1,276	1,217
Disbursements	1,204	471	1,384	1,291
Principal repayments	270	1,279	1,063	1,633
Net flows	934	-808	322	-342
Interest payments	237	579	456	377
Net transfers	698	-1,387	-134	-719



The World Bank Group: This table was prepared by country unit staff; figures may differ from other World Bank published data.

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# BRAZIL

- STATE CAPITALS
- ⊕ NATIONAL CAPITAL
- ~ RIVERS
- MAIN ROADS
- RAILROADS
- STATE BOUNDARIES
- - - INTERNATIONAL BOUNDARIES

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