

**PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

Report No.: AB1471

Project Name	BR-Low Income Housing TAL
Region	LATIN AMERICA AND CARIBBEAN
Sector	Housing finance and real estate markets (100%)
Project ID	P050761
Borrower(s)	GOVERNMENT OF BRAZIL
Implementing Agency	
Environment Category	<input type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> FI <input type="checkbox"/> TBD (to be determined)
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1. Country and Sector Background

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 is generated in cities. Access to housing and reliable urban services is essential to poverty reduction and growth in Brazil, with housing being a potentially important component of the economy, contributing to job creation (housing investment has a multiplier effect of 1.8), expansion of the finance system and creation of household wealth. In the past, Brazil's performance in this area has been woefully inadequate; outstanding mortgage loans are approximately 3-4% of GDP (compared with 15% in Chile and 65% in the US), the housing "deficit" is estimated at 7.1 million units (equivalent to 28 million people without access to adequate shelter); urban informal settlements are growing 4 times faster than average urban growth; and an estimated 65% of new households formed annually cannot afford the most basic house produced in the formal market (700,000 households per year).

In February 2001, Brazil's Congress passed a constitutional amendment which guarantees the right to adequate housing for all Brazilians. Accomplishing this ambitious goal while maintaining fiscal and political discipline represents a major challenge and defining the role of the public sector in meeting the housing needs of Brazil's poor population requires comprehensive and sustained policy reform and investment, with a focused effort to mobilize financial sector resources and private sector savings. While the issue of housing and the attendant social, economic, environmental, and health issues which stem from the sustainable urban development agenda was priority in the electoral campaign of the President, elected in 2002, progress has been slow in the last two years, in large part as a result of the fiscal restrictions self-imposed by the government and the initiation of administrative and institutional reforms to manage the sector.

The key issues facing the country include:

- The need to rationalize sector institutions and strengthen the capacity of public-sector institutions to design, monitor, and implement housing and urban development policy. The formal housing system in Brazil is a complex web of federal entities, private sector developers, and state and local governments. Over the last fifteen years, responsibility for housing and urban issues has been transferred to a number of ministries and secretariats, resulting in a general mismanagement of the

sector and an obvious lack of policy direction. In the context of the Government's decision to transform the sector and make housing a national priority, efforts are needed 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. While the creation of the Ministry of Cities in [2002] represents an important first step, efforts are needed to (a) articulate the strategic direction for the housing sector; (b) establish a national program for housing finance while avoiding the bottleneck risks of a single-window for transferring sector resources; (c) link federal housing policy and finances to other policy efforts at the local and state level; and (d) significantly strengthen the Ministry of Cities' capacity and policy relevance through a series of institutional reforms.

- The need to create a liquid and efficient formal housing market. The absence of an efficient market for formal housing credit has a direct impact on the lower- and lower-middle income households directly and indirectly. On the one hand, housing finance markets are incomplete and do not serve large segments of the low-income population because the costs and risks to do so are too high. On the other hand, a well functioning mortgage market for higher-income households is critical, in the medium-term, to poorer households as it creates a stock of financed housing to which can "filter" down. While the overall market dynamic is in large part driven by the macroeconomic conditions and public sector debt-related interest rate dynamic, the short-term policy agenda is rich. Simultaneous efforts are needed to (a) provide access to housing finance to households which could afford monthly mortgage payments but which lack a stock of savings for the current high levels of down payment of 30 to 40 percent required; (b) incorporate micro-lenders into the housing finance market by increasing their access to the below-market rate funds to which large financial institutions currently have access; and (c) improve the legal and regulatory framework which governs the formal market, including the management and administration of FGTS resources.
- The absence of a consistent and broad program of subsidies for the poor. Well-targeted subsidies for the poor are an important aspect of any housing market; in the absence of an efficient private market for very basic low income housing (because costs and risks are too high for formal market players to enter) and in order to compensate for the costs imposed by inappropriate regulation and market inefficiencies, subsidies in the short-term can help bridge the wide affordability gap which, in principle, could narrow in the medium-term as unaffordable planning regulations are removed, land management systems improved, and the structure of the housing finance system made more efficient. The key challenge for the Government will be to establish a housing subsidy policy which is both of high impact and efficient, maximizing the impact of limited fiscal resources by leveraging credit from the financial system.
- The high costs – both financial and administrative – of land development, subdivision, and housing creation. The lack of formality in which new settlements for the urban poor emerge is 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, have limited access to legal recourse, etc. It has taken decades for Brazil to recognize that a policy environment which creates incentives for formality is a key pillar of both rational urban development and the overall poverty-reduction and growth agenda. The key challenges for Brazil are to address both the stock and flow of informality through (a) a concerted effort to formalize existing *favelas* and improve their access to basic public services by developing a national slum upgrading strategy and a program of financing for urban upgrading; and (b) reducing the costs of new land development, subdivision, and registration.

The Government's medium-term strategy to improve access to affordable housing for the poor has 4 key tenets:

- Rationalize sector institutions and the legal and regulatory framework for housing and urban development. The Government aims to strengthen the capacity of the Ministry of Cities to formulate, articulate, and implement housing and urban development policy in Brazil. Some of the efforts underway include (a) the creation of a National Housing Plan (NHP) which would identify the targets, priorities, and key sector investment programs; (b) restructuring the Ministry of Cities to establish the needed institutional framework for cogent sector management, including the establishment of an interagency coordinating mechanism to manage sector dialogue across the public sector; (c) the establishment of a National Low Income Housing Fund (FNHIS) to finance the NHP; and (d) initiatives to extend technical assistance to state and municipal governments for the implementation of the many locally managed aspects of housing development policies.
- Support the development of a formal housing finance market. Since the mid-90s, Brazilian authorities have been struggling to restructure the country's housing finance sector and to enhance the role and impact of the market-based housing finance system (SFI) and to improve the existing the savings-linked *Sistema Brasileiro de Poupança e Empréstimo* (SBPE) and (b) the higher-end market based mortgage system, known as the SFI (*Sistema Financeiro Imobiliário*). As regards SBPE, the key efforts in coming months and years will focus on the orderly and phased expansion and deregulation of the SBPE and broaden its reach through changes to the targeting and weighting of loans eligible for financing. For the broader SFI, the Government aims to set the stage for a gradual expansion of market-based finance as market conditions evolve.
- Address affordability of housing through the creation of a comprehensive housing subsidy policy. The Government is implementing a multi-pronged as regards housing subsidies: (a) to dramatically increase the amount of finances in the system; (b) to move away from implicit interest rate subsidies to explicit upfront grants; and (c) to separate credit-linked subsidies from non-credit related grants. The Government has created the *Programa Social de Habitação* (PSH), which 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, and a well conceptualized auction system for participating financial agents. At the same time, the Federal Pension Severance Guarantee Fund (FGTS) has established a similar program for upfront housing subsidies for the poor.
- Reduce the barriers to formality of housing and services for the poor. The Government is supporting efforts to break the cycle of overregulation and informality which has dominated the growth of urban areas in Brazil for the last 30 years and which is most evident in the expanses of urban and peri-urban slums that characterize Brazilian cities. The Government's strategy involves supporting a new law for land subdivision and development which aims to increase the supply of urban land by reducing the administrative requirements for new urban development (e.g. minimum lot sizes, overly onerous requirements for public spaces as a percentage of new development, unrealistic infrastructure dimensioning requirements, etc.); (b) enforcing the existing legal and administrative mechanisms required to regularize existing slums; and (c) extending technical assistance and capacity building to state and, particularly, municipal governments, the latter of which will play the key role as interface between the public sector and developers, financial institutions, and residents.

2. Objectives

Project Development Objective. The development objective of the proposed TAL would be to support the implementation, monitoring, and evaluation of the Government reform program supported by the

Housing Sector Programmatic Development Policy Loan (PDPL). The Second Programmatic Loan for Sustainable and Equitable Growth aims to improve the policy environment for improving the living conditions of the poor and strengthening their access to assets, notably housing and serviced/serviceable land and would be the first in programmatic series of Development Policy Loans (DPLs), presented to the Bank's Board of Executive Directors in conjunction with the proposed TAL. The Second Programmatic Loan for Sustainable and Equitable Growth supports the Government's program to (a) strengthen the sector institutions managing Federal housing and urban development policy and programs; (b) build an efficient market for formal housing finance capable of absorbing long-term savings and which will provide a stock of finished housing for medium-term down-filtering of middle class housing; (c) establish a rational and complementary system for housing subsidies for the poor; and (d) improve the conditions for land and urban development by reducing barriers to formality and improving the affordability of formal land and housing development.

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 (see Annex [3] for the complete list of indicators) are:

Overall Indicators

- PDPL II 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 OGU and off-budget resources (including FGTS).
- Establishment of the subsidy monitoring and evaluation system

Component 4 – Land and Urban Development

- Preparation and dissemination of new PSH and other subsidy program training materials.
- Preparation of toolkits for (a) cadastre and registry development; (b) risk management and definition of ZEIS areas; and (c) progressive infrastructure development and management.

The proposed TAL and accompanying Development Policy Loan (DPL) directly contribute to the Government's poverty reduction and growth agendas. As regards the former, the package of policy reforms and accompanying technical assistance intend to increase the access of Brazil's poor to affordable shelter solutions through increased access and more efficient use of public sector subsidies and through the strengthening of the housing finance system, a critical element in expanding the stock of housing. The operations contribute to growth, both through the financial system reforms and through housing-related investment and consumption.

3. Rationale for Bank Involvement

CAS Linkage. The program is fully consistent with the Brazil CAS approved by the Bank’s Board of Directors on November 2003 as it supports the CAS’ three main pillars of equity, sustainability and competitiveness. Most fundamentally, the operation would support capacity building efforts linked to the Government’s initiatives to improve access to affordable housing and basic services and 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 comprehensive reforms being undertaken by the Government would increase the sustainability and competitiveness of the housing finance sector. Further, the results-based-CAS set the framework for monitoring progress towards achieving the CAS goals. Within that framework, the CAS states specifically that the TAL and proposed housing sector SWAp would contribute to a more sustainable Brazil. [The CAS]¹ identifies as medium-term outcomes which include: (a) that housing programs better targeted to the poorest; and (b) the reform of housing finance and land development regulation.

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 maximize the efficiency of housing market interventions 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.

4. Description

The proposed TAL would channel Bank financial support the four areas of programmatic support being incorporated under the concurrently-prepared series DPLs. 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 [2] identifies the Project components and their associated costs.

Components	Indicative Costs (US\$M)	% of Total	Bank-financing (US\$M)	% Bank-financing
Component 1 – Institutional and Legal Framework Component	1.6	32%	1.6	100%
Component 2 – Housing Finance Market Development Component	0.3	6%	0.3	100%
Component 3 – Housing Subsidies for the Poor Component	2.4	48%	2.4	100%

¹ Note – confirm this is correct.

Component 4 – Land and Urban Development Component	0.7	14%	0.7	100%
Total	5.0	100%	5.0	100%

The four components of the TAL are:

Component 1: Supporting the Institutional and Legal Framework for Housing Policy (US\$ [XX] 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 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\$ [XX] 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 into the market-based 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\$ [XX] 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 OGU, off-budget, 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\$ [XX] 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 própria*,” 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.

Disbursement Category	% Bank Financing	US \$
Category 1 – <i>Institutional and Legal Framework Component</i>	100%	
Category 2 – <i>Housing Finance Market Development Component</i>	100%	
Category 3 – <i>Housing Subsidies for the Poor Component</i>	100%	
Category 4 – <i>Land and Urban Development Component</i>	100%	
	Total	\$ 5,000,000

5. Financing

Source:	(\$m.)
BORROWER	0
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT	5
	Total 5

6. Implementation

Borrower. A Loan of US\$ 5.0 million will be made to the Federative Republic of Brazil.

Project Implementation. The Project has been designed to be implemented based on the existing sector institutions and the evolving arrangements for policy management in the housing sector without creating parallel implementation institutions. The National Housing Secretariat within the Ministry of Cities will be the key implementation agent responsible for day-to-day TAL management in coordination with the Government’s Interministerial Housing Policy Group (IHPG). The IHPG is comprised of representatives of the Central Bank, National Treasury, Ministry of Finance, SEAIN, Ministry of Planning, CEF, and FGTS. The National Housing Secretariat would prepare six-month implementation plans, which would be reviewed by the IHPG. Because of the importance of the finance sector institutions represented on the IHPG in providing technical oversight and guidance for issues related to Component 2 and Component 3 of the Project, the IHPG would review terms of reference and technical outputs for consultancies financed under those components.. This is especially important given the links between the TAL and a number technical reviews already underway and planned in the housing sectors by the National Treasury, Ministry of Finance, and Central Bank, in particular.

7. Lessons Learned from Past Operations in the Country/Sector

² Consistent with the Bank’s new expenditure policies, each disbursement category would finance goods and services related to a Project component.

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 PDPLs 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 t 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 the series of PDPLs 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.

8. Safeguard Policies (including public consultation)

Not applicable.

9. List of Factual Technical Documents

To be completed prior to Negotiations.

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