HOUSING PROGRAM

(ES-0087)

EXECUTIVE SUMMARY

Borrower: Republic of El Salvador

Executing agency: Ministry of Public Works, Transport, Housing, and Urban Development, through the Vice Ministry of Housing and Urban Development (VMVDU).

Amount and source:

(in US$ millions)

	Phase one	Phase two	Total
IDB	US$70,0	US$25,5	US$95,5
OC:	US$37,6	US$25,5	US$63,1
OC/IFF:	US$32,4		US$32,4
Local:	US$24,1	US$23,1	US$47,2
Total:	US$94,1	US$48,6	US$142,7

Financial terms and conditions:

Amortization period:	25 years
Grace period:	4 years
Disbursement period:	4 years
Interest rate:	variable
Inspection and supervision:	1.00%
Credit fee:	0.75%
Currency:	U.S. dollar; under the Single Currency Facility

Objectives: The objective of this program is to support the Government of El Salvador in developing and introducing a set of sustainable housing policy instruments. These instruments will improve the housing sector's capacity to provide an efficient and equitable response to the demand for housing among the various income groups in the urban population.

Description:

A. Phase 1

Phase one of the program is divided into three subprograms: (i) the formal housing market; (ii) the informal housing market; and (iii) the Municipality of San Salvador.

Subprogram I: Formal market

1. Strengthening the mortgage market (US$500,000)

The objective of this component is to introduce new financial instruments and to develop a legal framework capable of channeling long-term resources to formal institutions that finance housing. This component will finance the Action Plan for development of the secondary mortgage market. Under this component studies will be

conducted and consultants hired to draft viable and easily implementable proposals to improve primary and secondary mortgage market operations. This component will be carried out by the Multisector Investment Bank (BMI).

2. Institutional and financial strengthening of the Fondo Social para la Vivienda – FSV (US$3.8 million)

The FSV is a first-tier financial institution that serves the middle-income population with mortgage lending for home buying. The objective of this component is to ensure the medium-term sustainability of the FSV by introducing policy and management system reforms that will increase efficiency and improve the risk profile of its portfolio. A modernization plan has been designed and agreed upon with the FSV's senior management: (i) to strengthen its management procedures and systems; (ii) to reform its credit policy and administration; and (iii) to strengthen its management structure. This component will finance the cost of implementing the plan, and activities in support of these reforms. This component will be carried out by the FSV.

Subprogram II. Informal market

1. Subsidies for upgrading marginal neighborhoods (US$40 million)

The objective of this component is to introduce a system of direct subsidies to provide basic services to the low-income neighborhoods and to strengthen the municipal housing programs. This component will finance (a) collective subsidies for neighborhood upgrading projects; and (b) institutional strengthening activities in participating municipalities. The participating municipalities will carry out improvement projects, for which they will receive technical assistance. The maximum amount of the subsidy is US$2,000 per household, with 2,000 families benefiting from this component, which will be carried out by the Vice Ministry of Housing and Urban Development and the National Low-Income Housing Fund (FONAVIPO).

2. Reconstruction subsidies (US$20 million)

The objective of this component is to channel subsidies to a permanent housing solution for low-income families left homeless by the two most recent earthquakes. These resources will be used to build housing at existing sites and in new settlements. The maximum value of an individual subsidy is US$2500, with 8,000 families from this component, which will be carried out by the Vice Ministry of Housing and Urban Development and the National Low-Income Housing Fund (FONAVIPO).

3. Land legalization (US$4 million)

The objective of this component is to expand the scale and efficiency of land legalization programs, in order to reduce illegal land tenure in low-income urban neighborhoods. This component will finance the legalization and registration of 20,000 individual titles in illegal marginal settlements created prior to 1995, at an average estimated cost of US$200 per lot. This component will be carried out by Instituto Libertad y Progreso (ILP).

4. Progressive development of subdivision market (US$1 million)

The objective of this component is to implement a set of standards and procedures to improve the progressive development of a subdivision market in terms of performance. This component will finance three main activities: (i) introduction of a certification process for developers; (ii) dissemination of information on the sector; and (iii) proposed review of regulations applicable to progressive development of residential subdivisions. This component will be carried out by the Vice Ministry of Housing and Urban Development.

5. Modernization of the Vice Ministry of Housing and Urban Development (US$5.6 million)

The objective of this component is to improve the efficiency of the VMVDU in performing its duties of regulating and promoting the housing sector, and analyzing and disseminating information. This component will finance the cost of implementing the action plan for institutional modernization of the VMVDU and the administrative costs of the program. This component will be carried out by the Vice Ministry of Housing and Urban Development.

Subprogram III. Municipality of San Salvador program (US$11.1million)

The objective of this subprogram is to finance direct subsidies to improve the housing conditions of low-income groups in the Municipality of San Salvador. With some minor differences, this subprogram will follow the general outlines of the component providing subsidies for upgrading marginal neighborhoods (Subprogram II) 3,000 families will benefit from it, and will also finance technical assistance for the Municipality of San Salvador, which will carry out the components of this subprogram.

B. Phase 2

The program has been divided into two phases to accommodate the complex reforms that are needed to ensure the sustainability of the FSV. In phase one, the FSV modernization plan will be implementing, thus consolidating the processes and systems that are required to enhance financial management. In addition, a series of dissemination activities will be pursued to provide public information on the new subsidy policy.

In phase two, financing will be provided for direct subsidies to the FSV's target population. FSV management will replace the subsidized interest rate system with one based on direct subsidies - a system that is efficient, targeted, and sustainable. This policy will ensure that the Fund's target population has access to housing loans on market conditions. The Bank will use the funding for phase two to help finance the new subsidy policy. The Bank will consider approving phase two upon fulfillment of the performance indicators (section F of chapter II) agreed on between the Salvadoran government and the Bank.

The Bank's country and sector strategy:

The program will support the Bank's strategy in El Salvador through its intervention in the following areas: (a) development of the financial system; (b) strengthening of social policies to reduce poverty; (c) modernization of the public sector; and (d) strengthening environmental management at the local level.

The Salvadoran government drew up a reconstruction plan that was presented to Consultative Group in Madrid in mid-March 2001. The plan is to be implemented in three phases: (a) emergency, (b) rehabilitation, and (c) reconstruction in three principal areas: the social sectors (housing, education, and health), production, and infrastructure. The Bank has offered to provide financial and technical assistance for each phase and sector involved in the plan, coordinating its efforts with other international donors. The emergency loans (ES-0148 and ES-0150) supported the second stage of the reconstruction plan, with financing to mitigate risks, remove rubble, and build temporary housing. The recently approved loan for FISDL (ES-0120) and the present program are funding the third phase of the reconstruction plan, with supplementary financing for the sectors receiving support: the FISDL loan will finance reconstruction of all sectors covered in the reconstruction phase (education, health, infrastructure, and production) with the exception of permanent housing which will be supported under the present program (chapter I, section F).

Environmental and social review:

The program will address environmental vulnerability issues, particularly in low-income settlements, through two main activities: certification of low-cost construction technologies capable of withstanding earthquakes, and the introduction of municipal environmental risk maps.

Studies conducted during program preparation reviewed the institutional and legal environmental framework in El Salvador, and concluded that the VMVDU and the municipal governments are the key institutions for ensuring compliance with environmental features. The lack of risk maps to guide urban planning was identified as a critical operational problem.

The Operating Regulations and profiles of the neighborhood upgrading, reconstruction, legalization, and certification programs include environmental criteria and procedures. The Committee on Environment and Social Impact will review the draft Operating Regulations (chapter III, section G).

Benefits:

Subprogram I will strengthen the formal housing market by: (a) developing the mortgage market, which will help increase the commercial banks' capacity to originate mortgage loans and lower the cost of those loans to the buyer; and (b) ensuring the FSV's capacity to provide services to its target population, by improving its financial position and targeting its subsidies.

Subprogram II will strengthen the informal housing market by (a) implementing a sustainable subsidy program to address the problems of existing low-income neighborhoods, that will increase public investment in basic services infrastructure in the poorest neighborhoods; (b) expanding a program to promote investments in housing by families through legalization of land in irregular settlements; and (c) creating a program that responds to the problems faced by developers of new neighborhoods for low-income groups, to give buyers of lots the information that is needed for more informed decisions through a process of evaluating each developer's performance.

Subprogram III will produce benefits very similar to those described under Subprogram II, in low-income neighborhoods in the Municipality of San Salvador.

Response to natural disasters. The program will support the government's efforts to respond to natural disasters by: (a) allocating US$20 million to help finance a reconstruction program in areas damaged by the recent earthquakes; and (b) supporting efforts to minimize the impact of future natural disasters by developing local risk maps in municipalities that participate in the program. Municipal staff will be trained in using these maps to improve their capacity to evaluate permit applications for new urban developments.

Risks:

Subprogram I faces two main risks:

Financial failure. A failure to bring its costs under control, to improve the quality of its portfolio, and to implement new lending policies will erode the FSV's financial viability. To reduce this risk, a modernization plan has been developed with a selected set of indicators to monitor its financial progress. The process of designing the plan and agreeing on the indicators has been supervised by the FSV's senior management team and has their support. Moreover, the plan includes funding for dialogue, communications, and promotion to build a consensus amongst broad sectors of government and society on the FSV reforms introducing market interest rates and direct subsidies. Nonetheless, the ability of the FSV's senior management to provide leadership for this process of modernization will be critical to its success.

Political intervention. A series of recent events has demonstrated the FSV's vulnerability to political pressures that have contributed to its financial deterioration. Pressure from the construction industry and from monetary integration have contributed to this deterioration. The proposed changes to FSV's charter will strengthen its autonomy, but these measures have limitations. In the short and medium term, the FSV remains vulnerable to this risk.

Subprogram II faces one main risk:

Budgetary sustainability of the neighborhood upgrading subsidies. The main risk associated with a direct subsidy program is its budgetary sustainability. The program will support the government to shift its priorities in the area of housing policy and to use funding for the housing sector more efficiently, with ensuing savings for the housing policy budget. Furthermore, the design of the local counterpart will ensure that the amount of resources from the Government of El Salvador increases in each year of the program. Accordingly, the process for allocating substantial fiscal resources for these activities will be firmly established by the time the operation with the Bank is completed. Secondly, this component will place resources in the hands of municipalities where political parties other than that of the central government are in the majority. Multiparty support for these actions will help lower the risk of program termination.

Special contractual clauses:

1. **Conditions precedent to the first disbursement for each component of the housing program**

a. Submission of an execution agreement between the executing agency and the respective co-executing agency and an annual work plan for year one of the program. These agreements must contain at least the terms specified in paragraph 3.3. (paragraphs 3.4, 3.9, 3.11, 3.17, 3.24, 3.30, 3.38, and 3.42). Only the VMVDU modernization component and the component for

progressive development of a subdivision market are exempted from this condition.

b. Submission of the corresponding Operating Regulations is an additional condition precedent for components offering direct subsidies (neighborhood upgrading subsidies, Municipality of San Salvador neighborhood reconstruction and upgrading subsidies) (paragraphs 3.5, 3.17, 3.24, 3.38).

2. Special execution conditions

a. After the first disbursement for the neighborhood upgrading subsidy component (Subprogram II), it must be demonstrated each disbursement request that the local counterpart funding required in accordance with table 2.1 is available (paragraph 2.19).

b. The borrower shall ensure that FONAVIPO does not undertake any new credit operations during program execution with the exception of contracts signed prior to 15 November 2001 until such time as an action plan has been agreed upon with the Bank for managing housing credit programs that satisfy at least the criteria indicated in paragraph 3.16. In each annual report, VMVDU will report to the Bank on the extent to which this condition has been fulfilled (paragraphs 3.16 and 3.58).

Poverty-targeting and social sector classification: This operation qualifies as a social equity-enhancing program, as described in the indicative targets mandated by the Bank's Eighth General Increase in Resources (document AB-1704).

Furthermore, this operation also qualifies as a poverty-targeted investment. The rationale for PTI classification is that more than 50% of the potential beneficiaries are below El Salvador's official poverty line (paragraph 4.18ff.).

Exceptions to Bank policy: None.

Procurement of goods and services: The standards and criteria of the Bank will apply to all contracting for goods and services. International competitive bidding procedures will be followed for construction contracts for amounts greater than US$1,000,000, and for procurement of goods and consulting services for amounts greater than US$200,000. Contracting for goods, construction, and consulting services for less than these amounts will be governed by national law provided that the law does not contravene the Bank's principles on this issue (paragraph 3.55).

Recognition of expenditures: Up to US$1,1 million in expenditures incurred since 31 March 2001 may be charged to the Bank financing, provided that procurement procedures substantially similar to those of the Bank have been followed. Of the total amount, expenses will be recognized as follows: up to US$100,000 incurred by FSV to hire consultants for the FSV institutional and financial strengthening component; up to US$400,000 in expenses incurred by VMVDU to hire consultants for the modernization of the Vice Ministry component; and up to US$600,000 in expenses incurred by Municipality of San Salvador to hire consultants for the Municipality of San Salvador institutional strengthening component and for investments in the Municipality of San Salvador neighborhood upgrading component (paragraph 3.56).

I. BACKGROUND

A. Introduction

1.1 This operation will help the government introduce an extensive set of policies to allow for efficient and equitable operation of the housing market. The demand for housing among the various income groups within the urban population is quite varied, and the analysis presented in this chapter will identify the key strengths and weaknesses of the various segments of the housing market. The chapter concludes with a broad overview of the reform strategy. Although the program will support significant measures for improving the performance of the housing market with respect to middle-income sectors, most of its activities and resources aim to improve access to better housing for the low-income population, through a sustainable system of transparent and appropriately focused subsidies.

1.2 However, recent reports indicate that 25% of El Salvador's housing stock was destroyed or damaged by the earthquakes in early 2001, and that the low-income segment was the hardest hit. The program provides subsidies to low-income households for rebuilding or improving the houses that were affected. Additionally, the program will support measures to prevent environmental risks to human settlements.

B. Housing sector

1.3 The sustained demand for new housing in urban areas of El Salvador amounts to 32,800 units per year. The population's income distribution and institutional arrangements to finance housing determine the corresponding supply. In general terms, each year approximately 5,000 units are financed by commercial banks (15% of annual demand); 11,400 units (35%) are financed by the Fondo Social para la Vivienda (FSV); and approximately 16,400 units (50%) are produced and financed each year within the informal sector.

Table 1.1

Annual Production of Urban Housing: Average 1993-2000

	Number of Houses	Average Unit Cost	Average Monthly Income
FORMAL SECTOR	**16,400**		
Banks	5,000	US$17,000	US$ 1,300
FSV	11,400	US$ 8,000	US$ 430
INFORMAL SECTOR	**16,400**		
Progressive Subdivisions	6,600	US$ 1,600	
Shantytowns and Tenements	6,600		< US$ 290
FONAVIPO/NAOs	3,200	US$ 1,600	
TOTAL ANNUAL PRODUCTION	**32,800**		

Sources: FONAVIPO, 1994 and 1998, 1999; IPC, 1999; SILVA, 1996 and 1998, EHPM, 1999, 1993.

C. Formal housing market

1.4 The expansive cycle in El Salvador's construction industry has been peaking as demand for housing becomes saturated, including the low-income segment. Pent-up demand from the war years began to be met at an accelerated pace starting in 1992. However, developers have built projects targeting middle-income segments of the population, offering housing at a cost of 2.8 times average annual income. This accessibility indicator is relatively satisfactory in comparison to indicators for Latin America (3.4) and Venezuela (6.7), though it falls short of Panama's market penetration in the lowest income segments (1.7).

1.5 Commercial banks and the Social Fund for Housing (FSV) offer ample sources of financing for the purchase of homes produced by the formal sector. Commercial banks generally serve clients with monthly income greater than US$580, while the Fund serves workers with incomes ranging from US$290 to US$580 per month. The total amount of mortgage loans in El Salvador is US$1.3 billion, approximately US$700 million of which is with commercial banks and US$600 million with the FSV. The total amount of new lending is US$235 million per year on average.

1. Commercial banks

1.6 **Banking system.** In the early 1990s, the Government of El Salvador began an ambitious program of economic structural reforms that gave rise to privatization of the banking system, which had been nationalized during the armed conflict. With the Bank's assistance, the regulatory framework was created for conducting financial activity that led to the rapid development of one of the region's most dynamic and competitive banking systems, which has achieved a significant level of consolidation in the local market and has recently begun the process of expanding to neighboring countries.

1.7 **Mortgage market**. An active primary mortgage market with a performance that compares favorably to those in other countries in the region has developed owing to the vitality of the banking system. In El Salvador, some 15% of households have access to commercial financing, as compared with 10% in Mexico and 12% in Guatemala. The value of these mortgages is 11% of GDP, and while this figure falls short of rates in industrialized countries (55% in the United States, for example), it compares favorably with rates in such countries as Colombia (12%) and Mexico (7%).

1.8 The foremost mortgage-lending tool is the 15- to 20-year adjustable-rate mortgage with down payments of at least 10%. Most mortgages are issued by four banks that compete fiercely with one another. Until late 2000, the structure of interest rates in El Salvador was characterized by high real interest rates demanded by depositors. Real rates for 90 and 180-day bank deposits hovered between 7% and 8%. The lending rate spread was comparatively low, at 5% to 6%. This meant that mortgage lending rates stood at around 15%. At the end of 2000, the government launched the monetary integration program, as a result of which all financial transactions are now denominated in dollars. Although it is still too soon to discern long-term

trends, rates on bank deposits and loans in general appear to have come down. Mortgage interest rates now stand at approximately 11%, a significant reduction in existing real interest rates. In this context, there is good potential for commercial banks to expand their coverage to families with lower monthly incomes who, until now, have been served by the FSV through loans with subsidized interest rates.

1.9 **Long-term access to resources**. Despite this development in the primary market, banks continue to face strong disparities between assets and liabilities. In the context of monetary integration, particularly given the disappearance of their role as the ultimate lending institutions, the risks to the banks of maintaining these disparities will be increased substantially. The Bank Examiner's Office has begun to regulate this issue, which will force the banks to seek ways of reducing their exposure to these risks. However, the banks are also subject to stricter capitalization rules, which will encourage them to try to clear some of these loans from their accounts. In this context, new and more effective instruments must be put in place to enable banks to gain access to long-term savings inside and outside the country.

1.10 Pension Fund Management Agencies (AFPs) were created during the 1998 pension system reform. Since they began, the AFPs have amassed substantial resources estimated at approximately US$640 million at the end of 2000. Flows of resources to the AFPs are expected to continue their growth at approximately US$240 million per year, a figure that will reach US$440 million per year in 2005. The FSV has been one of the largest users of long-term savings that are channeled through issues of bonds of up to 20 years. The system's banks that participate in the mortgage market have been less dynamic in channeling resources of the pension system (in most cases, the bonds are issued for a period of five years or less), for lack of adequate financial instruments, among other reasons.

1.11 The underpinnings for an eventual secondary market are just beginning to emerge, and the primary market is characterized by weaknesses such as a lack of standards for streamlining lending criteria and the absence of databases with the information needed to assess and provide statistical monitoring of this portfolio. Nonetheless, monetary integration offers an excellent opportunity to promote the development of financial markets, particularly the mortgage market.

1.12 In summary, the primary mortgage lending market exhibits significant strengths, but measures must be introduced to facilitate the long-term flow of local and international resources to financial agents and to lay the groundwork for the rise of a secondary market. This will require a concerted effort by government authorities, financial agents, risk assessors, and local and international institutional investors.

2. Fondo Social para la Vivienda (FSV)

1.13 The FSV has operated for over 30 years as the main provider of mortgage financing for public and private sector workers earning from US$290 to US$580 per month. On average over the past eight years, the FSV has issued approximately 11,400 new

mortgages per year. The average value of these loans is approximately US$7,000. Until December 2000, the Fund's (fixed) interest rates were in the range of 9% for loans of less than US$9,700 and 11% for loans above that amount to US$14,000 (the upper limit for its loans). In both cases, these rates were far below market rates, which fluctuated between 15% and 18%. In most instances, the FSV does not require a down payment.

1.14 The FSV's portfolio now stands at approximately US$600 million, financed mainly from its corporate assets and long-term deposits from retirees. In each year of its existence the FSV has generated profits, all of which have been reinvested, resulting in a capitalization rate of 20%. The Fund issues nearly twice as many mortgages as the private sector, and in terms of total value, it holds approximately 50% of the market. The FSV has gained considerable experience in the market segments it serves. Its stable management team and the relative degree of independence that it has maintained in the past when making its lending decisions have made the FSV one of the few public banks in Latin America that have remained financially viable without requiring government assistance from the start.

1.15 Despite its relatively satisfactory historical performance, the FSV is facing rapidly changing economic conditions, and structural problems have brought about a troubling deterioration in its financial position. FSV's asset profitability has been decreasing since 1995, and its loan delinquency rate has been increasing in a worrying manner.

1.16 **Impact of the 1998 pension system reform**. As a result of the pension system reform, the FSV stopped receiving a share of the contributions to the pension system. This did not result in an immediate reduction in available resources since the FSV was allowed to keep the balances in accounts that existed at the time the reform was implemented (approximately 1.2 million captive accounts of contributors to the former system, with a deposit balance of approximately US$354 million at an average rate of 2%). However, it did involve a substantial change in the cost of its sources of funding, since portfolio growth can be financed only with resources at the market rate. To offset this loss, the Pension Act allows the AFPs to invest up to 40% of their resources in mortgage securities and requires that they invest a significant percentage of their deposits in FSV securities (the percentage will decrease from 30% in 1999 to 10% in 2014). The rate of interest on these instruments is set by law, and stands at 1% over the average deposit rate.

1.17 The Fund's financial projections show that, given the limitations outlined above, the resources attracted exclusively from the AFPs will be insufficient to finance the reduction of its other liabilities (returning pension system contributors' deposits) and the growth of its portfolio. The changes in the mix of financial resources and therefore in their costs will become more pronounced over time, and will clearly render the system of interest rate subsidies that the Fund was financing unsustainable. However asset and liability management, which until quite recently was not especially problematical, will now require a sophisticated approach to financial management, since the FSV has begun to take on risks of a term mismatch

between assets and liabilities, as well as interest rate risks. The FSV does not presently have the ability to detect, measure, control, and manage these risks.

1.18 **High-risk products**. The use of high-risk products is a second area where the FSV has been exposed to increased financial weakness. In 1993, the Fund introduced an adjustable-rate loan consisting essentially of a double-indexed mortgage that uses fluctuations in wages and annual inflation as indices to determine the installments due. Consequently, these loans show negative repayment during the first 15 years of the life of the loan. In addition to being complex to administer, this repayment system is the greatest contributing factor in the deterioration of the FSV's portfolio, accounting for 63% of delinquencies.

1.19 **Growth and portfolio quality.** In the last three years, the FSV has increased the number of loans granted by 50% over the average of previous years. From 1993 to 1997, the FSV financed an average of 9,700 houses per year, while from 1998 to 2000 it financed an average of 14,200 houses. In addition to rapid portfolio growth and the adjustable amortization system were other weaknesses such as the absence of a rigorous credit analysis process, weakness in lending policies (the waiving of a down payment, for example), and inadequate monitoring of loans and collections. As a result, the total portfolio has been expanding at an annual rate of 19% since 1994, whereas the portfolio past due (delinquent for more than 90 days) was up 26%. The most recent figures (September 2001) indicate that the portfolio now in arrears represents 31% of the total portfolio. Adequate reserves have not been set up to cover the deterioration in the portfolio. Portfolio clean-up reserves covered 49% of the contaminated portfolio in 1994, but only 27% in 1999.

1.20 **Governance structure, organization, and operating procedures.** The FSV has gradually taken on the character of a financial institution. The law establishing the Fund poses a number of difficulties for the institution, the most significant of which is the requirement that its accounting records be kept under government accounting, which makes it impossible, for example, to suspend the accrual of interest on delinquent operations or to make portfolio and interest write-offs as appropriate. Additionally, the structure of the Fund's governance is not without conflicts of interest—particularly among the members of the Board of Directors—which have had negative impacts on Fund policies. For example, the recent rapid growth in the Fund's portfolio is partly the result of pressure from the construction sector.

1.21 **Subsidies granted by the FSV**. The interest-rate subsidies granted by the FSV have not been adequately focused (they are not directed to the families who need them most, and households capable of handling the costs of a mortgage loan under market conditions are receiving subsidies), are regressive (the amount of the subsidy depends on the amount of the loan, so that higher-income families receive a larger subsidy), and are very expensive (some households may receive subsidies of up to US$3,500). Additionally, the existing arrangements do not provide any incentives for developers to build lower-cost housing, and act as a disincentive to banks serving the higher end of the market served by the FSV. Finally, this subsidy

structure is unsustainable over time, and keeping it in place will generate increasing losses for the Fund.

1.22 **The effect of the monetary integration program.** In the context of the decisions following the launch of the monetary integration program, implemented in late 2000, a new element has had an impact on the FSV's financial sustainability. In support of the integration process, FSV management (jointly with all the public banks) decided to reduce interest rates across the board by three percentage points. This decision generated immediate costs for the FSV, since its liabilities will be adjusted downward only over time. In the medium term, the resulting lower revenues introduce an imbalance in the FSV's financial structure, rendering it unsustainable.

1.23 To correct this situation, the government proposes to implement a two-phase plan to safeguard the FSV's financial viability: (i) during the first quarter of 2002 interest rates on all FSV loan will be raised. For loans over US$9,700, the rate will be set at 4% over the average deposit rate, thus eliminating the rate subsidy. The rates on loans over this threshold will continue to be subsidized, but at a lower cost to the FSV. In addition, pensioner deposits which paid an average rate of 2% will be reduced by 0.5%; (ii) some time in 2002, but certainly before year-end, an up-front subsidy system will be introduced for loans under US$9,700 and the interest-rate subsidy will be eliminated.

1.24 The authorities have taken other steps to strengthen FSV, including (i) adopting the loan reserve level of US$48 million recommended by the Superintendency of the Financial System, and (ii) limiting the number of loans that are expected to be granted each year in order to avoid adverse effects on the FSV portfolio quality.

1.25 Detailed FSV financial projections show that, with the introduction of these adjustments in phase one, the FSV could operate for up to two years without irreversible setbacks to its financial situation. However, if second phase of the adjustments to modify the subsidy system and to introduce market interest rates are not implemented in the short term and if the portfolio default rate does not improve in the short term, the institution's financial health could be steadily undermined.

1.26 In conclusion, the FSV plays a fundamental role in the mortgage market, where it has done outstanding and vital work for society in recent years. Still, internal and external factors suggest that major reforms may need to be made to the subsidy system and the way it functions in order to ensure financial viability in the medium term. The national authorities and FSV's management are aware of this situation and are committed to making a number of significant reforms, particularly with regard to its management systems, lending policies, governance structure, and subsidy policies.

D. Informal housing market

1.27 Low-income families (with a monthly income of less than two minimum salaries, or US$290) who are not in a position to access mortgage financing use the informal

market to obtain housing. Once the new unit is purchased, the family then focuses on investing gradually in upgrading the quality of the house. Accordingly, the informal sector can be analyzed in terms of a market for purchasing new units and a market for upgrading those units.

1. Market for new housing

1.28 **Progressive subdivisions**. For low-income households, access to land is the most critical factor in the home-buying process. El Salvador is unique in the region in that it has a national industry of legal low-cost subdivision companies. This situation is unique in three ways: (i) its scale, (ii) its legal status, and (iii) its supply of financing. Regarding the scale of their operations, these companies are responsible for producing some 5,000 to 7,000 units per year, accounting for 40% of the annual creation of low-income homes. The industry is comprised of some 200 companies, many with activities limited to a single location. However, three companies that have been operating for over 20 years produce 40-60% of the total at the national scale.

1.29 With regard to the legality of their operations, in contrast to other countries urban development regulations in El Salvador include a category of "progressive development" subdivisions. This enables subdivisions to be approved officially before investments are made in infrastructure. Consequently, there is a legal market for lots costing from US$1,000 to US$2,000, particularly in medium-sized cities. Finally, the development companies offer installment financing with monthly payments of US$15-25 and payback periods of 8-12 years, which significantly broadens the market for this product.

1.30 As a result, squatting is a minor problem in El Salvador. However, from the buyers' perspective, the industry offers significant disadvantages. The first problem relates to the title to the property. It is difficult to verify whether the land title is duly registered and is free of encumbrances or lawsuits. Therefore, when the purchase period ends, there are no assurances concerning transfer of the land title for the individual lot. The second problem relates to the companies' financial practices. The companies use the "lease with promise to sell" concept, and the real financial terms of the deal are rarely explained to the buyer, who is vulnerable to exploitation and financial loss. The third problem relates to environmental risk. The authorities that approve these urban development projects lack information to ensure that projects are not located in risk areas.

2. The upgrading market

1.31 The quality of the housing stock in El Salvador has improved in recent years. Table 1.2 shows the profile of the market from 1994 to 1999. Water and sewer

coverage, the quality of the physical housing structures, and access to registered land[1] have all improved significantly.

1.32 However, El Salvador is behind in this area in comparison to regional averages. In the region, 91% of urban homes have water service, while the figure stands at 74% in El Salvador; permanent structures account for 90% of urban housing in the region, and 80% in El Salvador; properties with registered titles constitute 70% of the total for the region, but only 64% in El Salvador.

Table 1.2

Improvement in Urban Housing 1994-1999					Annual growth rate	Number per year
	1994	%	1999	%	94-99	94-99
Urban population	2,944,415		3,577,523		3.97%	126,622
Number of urban households	679,836		860,082		4.82%	36,049
Average household size	4.33		4.16			
Number of urban houses	658,326	100%	832,339	100%	4.80%	34,803
Urban houses with piped-in water	466,719	71%	613,099	74%	5.61%	29,276
Urban houses with private sewer systems	360,731	55%	499,003	60%	6.70%	27,654
Urban houses with electricity	619,502	94%	780,009	94%	4.72%	32,101
Urban houses with permanent walls	486,034	74%	666,492	80%	6.52%	36,092

Source: Multi-Purpose Household Survey, 1994, 1999.

1.33 The proper functioning of the upgrading market depends on the performance of three key services: the provision of primary and secondary infrastructure by local governments, the availability of microcredit financial services for home upgrading, and the availability of real property registration services.

a. Supply of local public services

1.34 **Social Investment Fund for Local Development (FISDL).** The low rate of infrastructure services coverage is due to the lack of financial and institutional capacity on the part of local governments, among other reasons. To address this weakness, the FISDL was created to assist very small municipalities located mainly in rural areas with investment in urban infrastructure in low-income communities.

1.35 **Municipality of San Salvador.** The Municipality of San Salvador is the largest municipio in San Salvador, with a population of over 500,000 and, together with the 14 municipios that form the Metropolitan Area of San Salvador, is home to 25% of the country's population. In 1997, the Municipality of San Salvador began an extensive reform process supported by the Bank through technical cooperation resources to improve its administrative structure and information systems, and to strengthen two programs in which the Municipality has initiated significant actions: a neighborhood upgrading program, and a land legalization program. The

[1] Although the household surveys do not include land ownership information, sector studies indicate that formal urban housing accounted for 40% of the total in 1970, and 64% in 1992-93 (SILVA, 1998).

Municipality has executed some 70 upgrading projects per year, investing approximately US$1.2 million of its own resources. This experience shows that the Municipality of San Salvador has the technical ability and experience to carry out a decentralized neighborhood-upgrading program, consolidate the experience in El Salvador, and pass this experience on to other municipalities.

b. Supply of financial services

1.36 In many countries, the limited formal market for providing financial services to low-income households may block their ability to invest in upgrading housing. Savings and loan services are significant factors in their ability to mobilize investment resources. El Salvador, by contrast, has an active and competitive industry that provides these services. A study conducted during program preparation identified some 50 institutions (savings and loan cooperatives, banks, and NGOs) that offer financial services to some 100,000 households, with an overall loan portfolio US$124 million. It is estimated that approximately 30% of loans to microenterprises are directed toward the housing sector.

c. Real property register and normalization of marginal land

1.37 Since 1991, the Government of El Salvador has put considerable effort into modernizing the real property and official land registers, and the computer technology that supports them. A radical institutional restructuring process was completed in 1995 with the creation of the National Registry Center (CNR), which brings together registers that were previously scattered. From 1991 to 1999, the new system registered three times more registration applications than the former system, and procedures have been streamlined so that, in the simplest cases, it takes only a few days rather than months to award a land title. The World Bank has supported this process with a loan since 1994.

1.38 Programs to improve access by the low-income population to legal and registered property were undertaken in tandem with the systems modernization process. A new urban planning and construction act was passed in 1991 that included a special regulation authorizing progressive development subdivisions, an office was set up within the VMVDU to approve subdivisions of social interest, and decrees were issued to expedite the process of normalizing illegal settlements. Finally, the Instituto Libertad y Progreso [Freedom and Progress Institute] (ILP) was created as an autonomous public institution attached to the Office of the President of the Republic, to help low-income families living in informal settlements to normalize the status of their property ownership.

1.39 The ILP has been efficient and has achieved good results in legalizing low-income illegal settlements. The Institute legalizes an average of 3,000 lots in informal settlements per year, at an average cost of US$200 each. It operates with a small staff (28 in all) and 50% of its budget is used to outsource legalization projects to private companies. The titling process has been streamlined, decreasing from an

average of 1,325 days in 1992 to 405 days in 1997. Despite these accomplishments, bottlenecks have been identified that could be improved substantially, such as the time required for titling—which could be reduced to 57 days—and information on demand. However, the program has the potential to double its targets using the present capacity at ILP, if resources were available.

E. The Viceministerio de Vivienda y Desarrollo Urbano [Vice Ministry of Housing and Urban Development] (VMVDU)

1.40 As the lead agency in the housing sector, the VMVDU exercises policy-setting and regulatory functions. Additionally, through its executing arm for the low-income segment, the Fondo Nacional de Vivienda Popular [National Public Housing Fund] (FONAVIPO), the Vice Ministry has managed two programs aimed at the low-income population: one lending program, and one program of subsidies.

1.41 **The lending program** offered microcredits to low-income households for home upgrading. The program's design included a number of positive features that enabled it to serve approximately 51,000 households were served from 1992 to 2000, and provide benefits to the program's target population: households with incomes of less than two minimum salaries.

1.42 However, administration of the program required specialized knowledge and independence in selecting the participating agencies, monitoring the portfolio, and managing risks. FONAVIPO experienced significant failures in these areas. Agency selection was hampered by conflicts of interest; procedures were not introduced to detect problems in the portfolio and to make the necessary financial provisions, and the loan portfolio concentrated on a limited number of agencies. In 1999, two of the intermediaries that went bankrupt (a bank and an NGO) held over 40% of FONAVIPO's portfolio.

1.43 **The subsidy program** has also had fairly positive outcomes. Most of the program's resources financed new settlements to relocate households living in risk areas or right of ways. In seven years, some 22,400 households benefited at an average cost of US$1,600. Most of the resources were managed by NGOs with experience in community involvement and housing. In a typical arrangement, FONAVIPO subsidies came to US$1,600, the beneficiaries' contribution was US$100, and the NGOs provided a loan of US$500 to US$900. FONAVIPO required that participating agencies give each beneficiary a registered real property title. In summary, the Vice Ministry has been successfully managing a housing investment program that accounts for approximately 2% of overall government outlays, as compared to a regional average of 2-5%.

1.44 Despite the excellent performance of the subsidy program, there is still room for improvement. First, in making investments, priority should be accorded to infrastructure services that require collective action, and not to purchase of land and housing construction. Second, a more transparent process should be used to select the beneficiaries. Third, priority should be given to investment in urban areas with the highest growth rates. Lastly, every effort should be made to ensure a reliable

and predictable source of funds to guarantee the long-term continuity of the program.

1.45 **Administration and regulation**. The process of restructuring the Vice Ministry, part of the institutional modernization plan, was completed in May 2000. To support the process, the Bank hired an international consulting firm specializing in institutional management to conduct a detailed analysis of VMVDU administration and to make recommendations to improve its efficiency.

F. Impact of the earthquakes and the reconstruction plan

1.46 The development of urban settlements in Central America, and in El Salvador in particular, has occurred without taking into account the risk situations that are especially serious in the region, owing to its geographical location. The main problem is that local authorities do not have environmental risk maps and instruments to guide urban development in general, and informal settlements in particular.

1.47 The vulnerability of El Salvador's population to the environment was made tragically clear by the earthquakes that struck the country in January and February 2001, which showed that the low-income segment of the population is most vulnerable. The earthquakes adversely affected 335,000 homes, of which 185,000 were damaged and 150,000 destroyed, accounting for approximately 25% of the country's entire housing stock. The damage is estimated at over US$260 million. The most affected departments were Usulután (74%), San Vicente (69%), and La Paz (64%). In general, smaller municipalities with fewer than 20,000 inhabitants were the hardest hit. Initial data indicate that 60% of the affected homes were those of households with income of less than two minimum salaries.

1.48 The Salvadoran government prepared a reconstruction plan for the meeting of the Consultative Group in Madrid in mid-March 2001. The plan is to be implemented in three phases: (a) an emergency stage entailing actions to rescue, shelter, and provide assistance to victims and to distribute medicine and food throughout the country; (b) a rehabilitation stage, which sought to mitigate the immediate risks, remove rubble, and provide basic housing to those who lost their homes; and (c) a reconstruction stage which begins immediately with the construction of permanent housing for the sectors seriously affected by the earthquake (housing, education, and health), production, and infrastructure. The estimated cost of the plan is US$1.5 billion, of which the US$375 million will go on housing.

1.49 During the meeting of the Consultative Group for the Reconstruction of El Salvador, the government managed to secure commitments of over US$1.3 billion in grants and loans from the international community, of which US$190 million could be used to finance permanent housing, including US$20 million to be

provided under the present program[2]. The government has set up a committee to coordinate the reconstruction activities and the Vice Ministry of Housing has organized a database to coordinate activities in the housing sector, which will include IDB actions and those of other donor agencies.

1.50 The Bank has offered to provide financial and technical assistance for each phase and sector involved in the plan, coordinating its efforts with other international donors. The emergency loans (ES-0148 and ES-0150) supported the second stage of the reconstruction plan, with financing to mitigate risks, remove rubble, and build temporary housing. The recently approved loan for FISDL (ES-0120) and the present program are funding the third phase of the reconstruction plan, with supplementary financing for the sectors receiving support: the FISDL loan will finance reconstruction of all sectors covered in the reconstruction phase (education, health, infrastructure, and production) with the exception of permanent housing which will be supported under the present program.

G. Strategy of the country, the Bank, and other international agencies

1.51 The program activities help the Government of El Salvador implement its Salvadorian Housing Policy, and are consistent with the Bank's housing policy (OP-751). The program will support the Bank's strategy in El Salvador through its intervention in the following areas: (a) development of the financial system, (b) strengthening of poverty-targeting social policies, (c) modernization of public administration, and (d) strengthening environmental management at the local level.

H. Reform strategy: conclusions

1.52 The program has been divided into two phases to accommodate the complex reforms that are needed to ensure the sustainability of the FSV.

1.53 In phase one, the FSV modernization plan will be implemented. The plan encompasses such as aspects as lending policy, administration of mortgage loan origination, risk management, and internal control procedures. In addition, a series of dissemination activities will be pursued to provide public information on the new subsidy policy.

1.54 In phase two, financing will be provided for an up-front subsidy policy for FSV. The Bank will consider approving phase two upon fulfillment of the performance indicators (section F of chapter II) agreed on between the Salvadoran government and the Bank.

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[2] The principal agencies preparing operations to finance permanent housing are given below: the IDB (US$20 million), USAID (US$59 million), Cooperación Española (US$53 million), the European Community (US$20 million), CABEI (a loan of US$35 million already approved), and the Canadian Cooperation Programme (US$3 million), and the Swedish International Development Agency (US$2 million). Although the World Bank has been helping the government to establish a strategy for reconstruction, it has not provided any financing for reconstruction of permanent dwellings.

1.55 As described in greater detail in the following chapter, the policy reforms and the introduction of the instruments needed to improve performance of other segments of the housing market will be implemented with the help of the Bank during phase one of the program. These reforms are summarized in table 1.3 below.

Table 1.3

Housing Program: Summary of the Reform Strategy			
Market Problem	**Component**	**Executing Agency**	**Reform Strategy**
Subprogram I: Formal Market			
Term mismatch between bank assets and liabilities; lack of instruments for institutional investors to invest in mortgages	**Development of the Mortgage Market** For mortgages issued by commercial banks	**BMI** *Banco Multisectorial de Inversión* 2nd-tier public development bank	• To facilitate the coordination of institutional investors, credit-rating agencies, banks, and financial authorities with regard to standards and instruments suitable for the Salvadorian market
FSV financial model is unsustainable; will not be able to continue serving the target population	**Strengthening the FSV** Household income $430 - $215/month	**FSV** *Fondo Social de la Vivienda* 1st-tier public mortgage lending institution	**PHASE I** • Lending policies: introduce lending rates that cover marginal costs (partial coverage) • Institutional strengthening: improve internal control procedures, technology, and systems • Governance: eliminate conflicts of interest; amend the FSV charter • Consensus-building: achieve broad support for introduction of policy reforms • Conditionality: progress in strengthening the FSV will determine access to subsidy resources
Subsidies offered by the FSV are inefficient and need to be better focused	**Formal Market Subsidies** Serves households with income from US$430 to US$215/month	**FSV** *Fondo Social de Vivienda* (Social Housing Fund)	**PHASE II** • Increase in lending rates completed. • Introduce a sustainable and transparent system of direct, targeted subsidies that leverage private resources. • Adjust the "boundary" between the FSV's target market and commercial banks, to prevent them from being crowded out.
Subprogram II: Informal Market			
Low quality of housing in marginal urban neighborhoods	**Neighborhood Upgrading Subsidies** Serves households with income under US$290/ month	**FONAVIPO** *Fondo Nacional de Vivienda Popular* and municipalities Autonomous government institution	• Reorient existing subsidies through a sustainable system of upgrading subsidies that is transparent, focused, and leverages additional resources • Introduce municipal risk mapping • Phase out FONAVIPO public lending programs
Homes destroyed by the earthquakes	**Reconstruction Subsidies**	**FONAVIPO**	• Use of standards and procedures agreed upon with the Bank
Existence of marginal neighborhoods lacking registered titles inhibits investment in housing	**Land Legalization** Serves households with income under US$290/ month	**ILP** *Instituto de Libertad y Progreso* Autonomous public institution	• Expand the scope of the present system • Introduce results-based contracts for the ILP
Unpredictable quality of service in subdivision supply	**Progressive Subdivision Market**	**VMVDU** *Vice Ministerio de Vivienda y Desarrollo Urbano* (Vice Ministry of Urban Housing and Development)	• Certification process: improve quality • Program to disseminate comparative information about subdivisions
Modest institutional capacity at the VMVDU	**Modernization of the VMVDU**	**VMVDU**	• Hire an expert project manager to start the program • Introduce concurrent audits to identify execution problems • Support for modernization of the VMVDU
Subprogram III: Municipality of San Salvador			
Low quality of housing in the marginal neighborhoods of San Salvador	**Neighborhood Upgrading** Serves households with income under US$290/ month	**AMSS** *Municipality of San Salvador*	• Use of national program parameters • Greater autonomy of execution for the municipality, with increased technical and policy capacity.

II. THE PROGRAM

A. General objective

2.1 The objective of this program is to help the Government of El Salvador develop and implement a set of sustainable housing policy instruments. These instruments will improve the housing sector's capacity to provide an efficient and equitable response to the demand for housing among the various income groups in the urban population. Phase one of the program comprises three subprograms: (i) the formal housing market; (ii) the informal housing market; and (iii) the program for the Municipality of San Salvador.

B. Subprogram I. Formal market (US$4.3 million)

2.2 The formal market activity has two components: (i) technical assistance to strengthen the mortgage market; and (ii) technical assistance to support the process of reforming and modernization of the FSV.

1. Component 1. Strengthening the mortgage market (US$500,000)

2.3 The objective of this component is to introduce new financial instruments and to develop an adequate legal framework to promote channeling of long-term resources to formal institutions that finance housing. This component will finance the "Action Plan for Development of the Secondary Mortgage Market", previously agreed on with the Bank. As part of this plan, studies will be conducted and consultants hired to develop viable and easily implementable proposals to improve the functioning of primary and secondary mortgage market operations.

2. Component 2. Institutional and financial strengthening of the FSV (US$3.8 million)

2.4 The objective of this component is to ensure the medium-term sustainability of the FSV by introducing reforms in its policies and management systems that produce greater efficiency and an improved risk profile for its portfolio.

2.5 To correct weaknesses detected during program preparation, a modernization plan has been designed and agreed upon with the FSV's senior management to: (i) strengthen its management procedures and systems; (ii) reform its credit policy and administration; and (iii) strengthen its governance structure. The modernization plan comprises a detailed work plan with a schedule of implementation and a set of critical performance indicators (for further details, see the supporting documentation in the program's technical file). An FSV project team supported by a project manager and international consultants with expertise in bank management will be responsible for implementation of the modernization plan. This component will finance implementation of the modernization plan and the activities of

dialogue, communications, and promotion to build a consensus on the need for reforms (seminars, dissemination campaigns, etc.) The FSV will reimburse the Government of El Salvador for the resources of this component under the same financial conditions provided in this operation.

C. Subprogram II. Informal market (US$70.6 million)

2.6 Subprogram II includes the following components: (i) financing of subsidies to upgrade marginal neighborhoods; (ii) financing of subsidies to support households affected by the earthquakes; (iii) technical assistance for improving the progressive subdivisions market; (iv) technical assistance for land legalization; and (v) technical assistance for modernizing the Vice Ministry of Housing and Urban Development.

1. Component 1. Subsidies for upgrading marginal neighborhoods (US$40 million)

2.7 The objective of this component is to introduce a system of subsidies to improve access of marginal urban neighborhoods to basic services and to strengthen municipalities in their ability to carry out housing programs. This component will finance (a) collective subsidies for neighborhood improvement projects, and (b) institutional strengthening activities in participating municipalities. Municipalities with over 20,000 inhabitants may take part in annual project competitions and municipalities selected will carry out the improvement projects. The program resources will finance up to 70% of the total cost of improvement projects. The municipalities will supply 20% of the cost, and the beneficiaries will contribute the remaining 10%. This component will benefit 20,000 families at a maximum subsidized cost of US$2,000 per beneficiary.

2. Component 2. Reconstruction subsidies (US$20 million)

2.8 The objective of this component is to channel subsidies to provide permanent housing solutions for low-income families affected by the earthquakes in January and February 2001. These subsidies will be directed toward families with a monthly income of less than two minimum salaries, and may be used to earthquake-resistant build housing in new settlements and at existing locations. This component will be guided by the following criteria:

a. Transparency in identifying beneficiaries and allocating subsidies,
b. Decentralized implementation plan,
c. Technical standards: minimum services, satisfactory land purchase process, appropriate unit costs,
d. Preventive measures: proper construction methods and risk maps,
e. Mechanisms for coordinating efforts with other donors.

2.9 The subsidies will benefit some 8,000 families at a maximum average subsidized cost of US$2,500 each.

3. Component 3. Land legalization (US$4 million)

2.10 The objective of this component is to broaden the scale and effectiveness of legalization programs to reduce illegal possession of land in marginal urban neighborhoods. This component will finance the legalization and registration of individual titles to 20,000 lots in illegal settlements created prior to 1995, at an average cost of US$200 per lot. Preliminary studies indicate that 40-50% of such legalization will occur in privately-held subdivisions where land ownership is not fully normalized, and 60-50% in shantytowns on publicly-held land. Studies indicate that in both cases, the average household income is less than two minimum salaries.

4. Component 4. Progressive subdivisions market (US$1 million)

2.11 The objective of this component is to implement a set of regulations and procedures to improve the performance of the progressive subdivisions market. This component will finance consulting services for three main activities: (i) introduction of a developer certification process; (ii) dissemination of information about the sector; and (iii) proposed revisions in regulations concerning progressive residential subdivisions. Accordingly, the program is expected to benefit some 2,500-3,500 households that access this market each year, 70% of which have incomes of less than US$240.

5. Component 5. Modernization of the VMVDU (US$5.6 million)

2.12 The objective of this component is to improve the efficiency of the VMVDU in carrying out its regulatory duties and promoting the housing sector, and analyzing and disseminating information. This component will finance the cost of implementing the action plan for institutional modernization of the VMVDU, which was designed with the support of international consultants during program preparation, and the costs of administering the program.

D. Subprogram III. Subsidy program for the Municipality of San Salvador (AMSS) (US$11.1 million)

2.13 The objective of this subprogram is to finance direct subsidies to improve the housing conditions of the low-income population within the Municipality of San Salvador. With some minor differences, this subprogram will follow the general outlines of the subsidy fund for upgrading marginal neighborhoods (Subprogram II), and will also broaden the scale of the VMVDU's neighborhood upgrading program. The subprogram has two components:

1. **Component 1. Subsidies for upgrading marginal neighborhoods (US$9.9 million)**

2.14 This component will finance the same activities as those financed by the VMVDU's urban upgrading program. In four years of execution, 3,100 families will benefit at an average cost of US$3,300.

2. **Component 2. Institutional strengthening of the AMSS (US$1.2 million)**

2.15 This component will finance: (a) the creation of an executing unit within the AMSS, (b) hardware, (c) studies, (d) training, and (e) the support services of a company to carry out the neighborhood upgrading program.

E. Sustainability and counterpart resources

2.16 Ensuring the sustainability of the subsidy programs was a critical element in determining the size of the operation. To that end, the level of financial support that may be expected from public sources following completion of the operation with the Bank was determined in consultation with the relevant government authorities. Once that level was established, as a general principle it was agreed that the Bank's financing would account for a decreasing proportion of funding over time. This will ensure that the fiscal impact of the new subsidy policies may be absorbed gradually.

Table 2.1

SUSTAINABILITY MATRIX Local counterpart funding INFORMAL MARKET				
Year	**Year 1**	**Year 2**	**Year 3**	**Year 4**
Disbursement plan	The following matrix applies for disbursements of up to US$6 million	The following matrix applies for disbursements over US$6 million and up to US$14.6 million	The following matrix applies for disbursements over US$14.6 million and up to US$20.2 million	The following matrix applies for disbursements over US$20.2 million
GOES	**0**	**20%**	**50%**	**60%**
IDB	**100%**	**80%**	**50%**	**40%**

2.17 With regard to informal market subsidies, it was agreed that the Bank's participation might amount to 100% in the first year of the operation, gradually decreasing to 40% in the fourth year.

2.18 With regard to the component providing subsidies for reconstruction of homes damaged by the earthquakes, it was agreed that the sustainability principle would not apply, and that the Bank would finance 100% of these costs.

2.19 Based on the principles outlined above, estimates were made of the local counterpart resource requirements for the subsidy component for neighborhood improvement. The increasing amounts of the counterpart contributions required in each year of program implementation, therefore, represent a critical element for ensuring that the program will achieve its objectives. *Consequently, after the first*

disbursement of the neighborhood upgrading subsidies component (Subprogram II), each disbursement request will include evidence that the local counterpart contribution required according to Table 2.1 is available.

F. Phase two of the Program

2.20 The program has been divided into two phases for the FSV component: (i) o ensure that the FSV has made satisfactory progress in implementing its modernization plan, and (ii) to allow the FSV and the government to build the broadest possible consensus on reforms to subsidy policy that the institution needs to introduce. Although a sound technical agreement has been established and a strong political commitment in support of reform of the leading institutions in the sector (VMVDU, FSV, Technical Secretariat of the Office of the President) has been given in policy letters signed by the country's highest authorities, implementing a new subsidy policy in FSV calls for further dialogue and consensus. According to the FSV's assessment, such a consensus could be reached within one year after approval of the present operation.

2.21 The general objective of phase two will be to assist the Salvadoran government in completing the reforms that are needed to ensure the sustainability of the FSV.

2.22 Phase two of the program will provide financing for direct subsidies to the FSV target population. The FSV management will replace the subsidized interest rate system with one based on direct subsidies - a system which is efficient, targeted, and sustainable, and which offers the target population access to housing loans on market conditions. The subsidies will be given up-front and will supplement the savings of eligible beneficiaries. The percentage of the funding coming from Bank financing will decline over time such that in the medium term it is expected that the subsidies will be funded from the FSV's and the government's own resources. The following indicators will need to be satisfied in phase one for the Bank to consider approval of phase two:

a. Approval by FSV of the new lending and subsidy policy that satisfies the following criteria:

   i) *Subsidy plan*: must be direct, progressive, not more than 14 minimum salaries, directed to families with up to 3 minimum salaries;

   ii) *Portable subsidies*: evidence of a commitment to gradually introduce portable subsidies commencing with 10% of the total subsidy in year two and amounting to as much as 18% by year four;

   iii) *Lending policy*: minimum prime of 5%, variable interest rate of 4% over the average deposit rate for all new loans.

iv) *Sustainability*: the FSV/Salvadoran government finances 50% of the total cost of the subsidy component for formal market and in final year at least 80% of the annual cost of the subsidies.

b. Disbursement of at least 75% of the FSV financial and institutional strengthening component.

c. Default rate[3] on the new portfolio, understood to be the loan portfolio committed after 1 July 2002, must be equal to or less than 5%. For the loan portfolio committed between 1 January and 30 June 2002, the default rate must be equal to or less than 7.5%.

d. As to the old portfolio, understood to be the portfolio committed prior to 31 December 2001: (i) the findings of a study prepared in accordance with the terms of reference agreed on with the Bank indicating the estimated write-offs of the portfolio in default of loans granted prior to 31 December 2001, must have been submitted; and (ii) the FSV shall have set up reserves in accordance with the findings of the aforesaid study to cover the full amount of the anticipated write off.

e. Loan reserves are maintained in accordance with Superintendency of the Financial System regulations (NCB-003 and NCB-005).

f. There is a new structure of governance to reduce conflicts of interest and political interference in FSV.

G. Scaling of the program

2.23 Three factors were taken into consideration in determining the size of the program: (a) the long-term financial sustainability for the subsidy programs; (b) the execution capacity of the participating institutions, and (c) the costs of the subsidies and the sector's needs (additional information is available in the program technical files).

2.24 **Financial sustainability**. The use of sustainability matrices to ensure the long-term financial sustainability of the subsidy program was agreed upon with the government and the FSV. Also, the program guarantees that the annual cost of the housing programs with the new policies will be less than the average annual cost in previous years (see section E, chapter II, and section B(2), chapter IV).

2.25 **Execution capacity of the sector's institutions.** This was one of the main analyses that limited the scope of the programs for the informal sector, in addition to the analysis of the sector's financing capacity. To ensure that no problems occur with the subsidy programs, its targets will be limited to levels at or under the levels of previous years. For instance, FONAVIPO, which granted 6,000 subsidies a year between 1995 and 1997 and 12,000 in 1993, will have annual targets of 6,000 to

[3] The portfolio default rate will be defined as the outstanding principal more than 90 days in arrears plus post maturity interest and insurance as a percentage of the total portfolio.

8,000 targets during the present program for both the upgrading and reconstruction components combined.

2.26 **Unit costs of the subsidies.** For the informal market, a study was made of construction costs in El Salvador, the costs of the neighborhood upgrading programs, and the characteristics of the country's marginal settlements, as well as the capacity of municipalities and beneficiaries to contribute, in order to determine the cost of the housing solutions and the form of their financing.

H. Cost and financing

2.27 The total cost of phase one of the program is US$94.1 million, of which US$70 million will be financed from the Bank's ordinary capital resources and US$24.1 million under the local counterpart contribution, from the Government of El Salvador, including the contributions of the FSV and the Municipality of San Salvador. As part of the Bank loan, US$32.4 million will be financed under the Intermediate Financing Facility (IFF). Table 2.2 presents a breakdown of costs.

Table 2.2

PROGRAM COSTS
(Equivalent US$000)

SUBPROGRAMS AND COMPONENTS	IDB OC	Local	TOTAL	% TOTAL
1. FORMAL MARKET	**2,400**	**1,900**	**3,900**	**4.6%**
1.1. Mortgage Market	500	0	500	0.5%
1.2. Strengthening the FSV	1,900	1,900	3,800	4.1%
2. INFORMAL MARKET	**51,740**	**18,860**	**70,600**	**75.1%**
2.1. Upgrading Subsidies	24,600	15,400	40,000	42.5%
2.2. Reconstruction Subsidies	20,000	0	20,000	21.3%
2.3. Legalization	2,600	1,400	4,000	4.2%
2.4. Certification	740	260	1,000	1.1%
2.5. Modernization of the VMVDU	3,800	1,800	5,600	6.0%
Modernization of VMVDU	2,940	980	3,920	4.2%
Program administration	860	820	1,680	1.8%
3. MUNICIPALITY OF SAN SALVADOR	**8,780**	**2,350**	**11,130**	**11.8%**
3.1. Upgrading Subsidies	7,990	1,910	9,900	10.5%
3.2. Strengthening the AMSS	790	440	1,230	1.3%
SUBTOTAL	**62,920**	**23,110**	**86,030**	**91.5%**
4. CONTINGENCIES	**607**	**0**	**607**	**0.6%**
5. FINANCIAL COSTS	**6,473**	**945**	**7,418**	**7.9%**
5.1. Interest	5,773	0	5,773	6.2%
5.2. Credit Fee	0	945	945	1.0%
5.3. Inspection and supervision	700	0	700	0.7%
TOTAL	**70,000**	**24,055**	**94,055**	**100.0%**
Percentage by source of funding	**74%**	**26%**	**100.0%**	

2.28 The combined cost of the two phases of the program will be US$142.7 million, of which US$95.5 million will come from the Ordinary Capital resources and US$47.2 million will be in the form of local counterpart funding from the Salvadoran government.

I. Conditions of Bank financing

2.29 The conditions of the loan are presented in the following table:

Table 2.3

Amortization period	25 years
Grace period	4 years
Disbursement period	4 years
Interest rate	Variable
Inspection and supervision	1%
Credit fee	0.75% per year on the undisbursed balance
Currency	U.S. dollars under the Single Currency Facility

III. PROGRAM EXECUTION

A. Program Principles

3.1 Program execution is based on five principles:

a. Using the sector's institutions (FSV, BMI, AMSS, ILP, and FONAVIPO) to execute certain program components directly and autonomously.

b. Streamlining execution by disbursing resources directly to the co-executing agencies.

c. Coordinating program execution through the VMVDU, which will process all requests for disbursements and will consolidate reports for submission to the Bank.

d. Maintaining an efficient system for monitoring the accounts of each coexecuting agency, by means of quarterly operating and financial audits.

e. Permitting each component to be executed independently, so that slowdowns in one component will not delay the others.

B. Institutional framework

1. Borrower and executing agency

3.2 The borrower is the Republic of El Salvador. The executing agency is the Ministry of Public Works, Housing, and Urban Development, through the Vice Ministry of Housing and Urban Development. The Vice Ministry will set up a project coordinating unit (PCU) that will be responsible for: (a) coordinating the execution of the overall housing program, (b) supporting the co-executing agencies in carrying out their components, (c) consolidating reports to the Bank, and (d) consolidating and submitting disbursement requests to the Bank, with the exception of those for subprogram III, which will be submitted by the Municipality of San Salvador to the Bank, with a copy to the PCU. A general coordinator, a private-sector project manager, will be hired for a two-year period through an international competitive bidding process to support the start of program execution, and implementation of the VMVDU's modernization plan. Starting in the third year, the coordinator will be replaced by the sub-coordinator, who will be drawn from the professional staff of the VMVDU.

3.3 The co-executing agencies will be the Fondo Social para la Vivienda, the Municipality of San Salvador, the Banco Multisectorial de Inversiones, the Instituto Libertad y Progreso, and the Fondo Nacional de Vivienda Popular, with which the Vice Ministry will sign execution agreements. At a minimum, these execution agreements will contain the following terms:

a. The responsibilities of the co-executing agency, which will include the appointment of a coordinator or a unit as an executive counterpart at the agency level, the opening of separate accounts and books for the resources that it will administer, and the transfer of the counterpart resources for the agreements with the FSV and the Municipality of San Salvador;

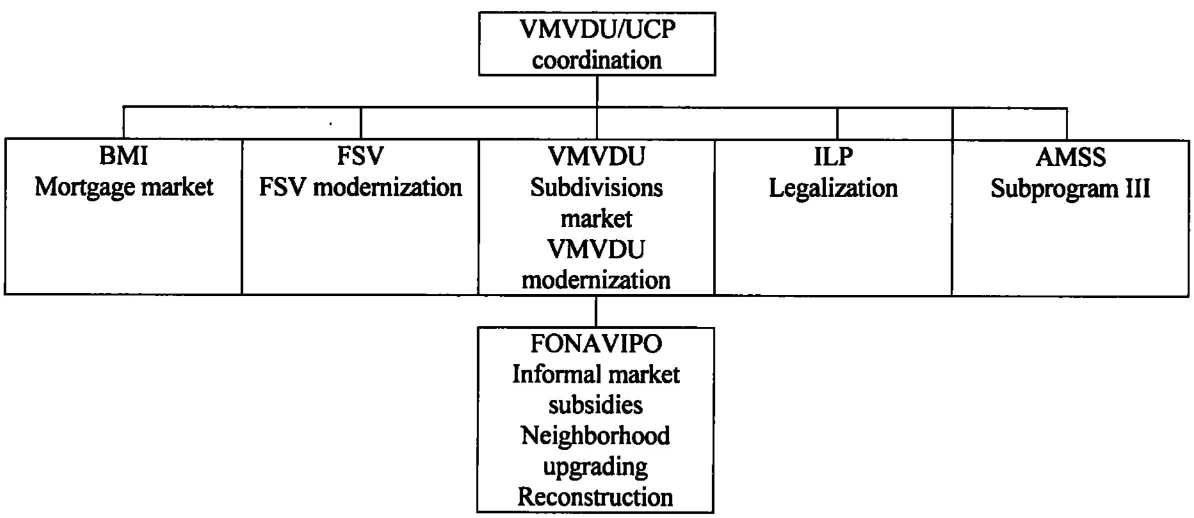
b. The responsibilities of the executing agency;

c. The conditions on which the executing agency will transfer the financial resources, specifying whether these resources are reimbursable or nonreimbursable; and

d. The condition that a work plan for year one and the Operating Regulations for the subsidy programs be approved.

3.4 *Prior to the first disbursement of each component, an execution agreement between the executing agency and the corresponding co-executing agency and an annual work plan for year one will be presented. At a minimum, these agreements will include the terms specified in paragraph 3.3. Only the Modernization of the VMVDU component and Progressive Subdivision Market component are exempted from this requirement.*

3.5 *For components that offer direct subsidies (neighborhood upgrading, reconstruction and AMSS neighborhood upgrading), submission of the relevant Operating Regulations will be an additional prior condition.*



C. Program implementation

3.6 Each of the co-executing agencies and units of the Vice Ministry will appoint a coordinator, who will be responsible for carrying out the components assigned. The coordinators of each component will submit a detailed annual plan of operations to the PCU, which will contain the following at a minimum: (i) the objectives to be achieved during the period (these objectives must be defined specifically and must

be verifiable); (ii) a financial plan for the period; and (iii) a schedule of contracting and procurement. The PCU will consolidate the annual plans and progress reports of each component for submission to the Bank.

3.7 Each of the co-executing agencies will keep accounting records of the resources transferred to it, conduct procurement processes, administer the resources, and prepare the information that the program requires, which will be processed through the VMVDU's project coordinating unit, in accordance with the program's Operating Regulations.

3.8 **Inter-agency coordination.** An Inter-Institutional Coordinating Committee will be formally created to monitor programs I and II. Upon completion of the two phases of the program, the Committee will be responsible for directing national policies on the integrated housing subsidy system, thus ensuring that the different programs and sector agencies are consistent with one another. The Committee will be composed of representatives from all entities involved in the housing sector, including: the Technical Secretariat of the Office of the President, the Ministry of Economic Affairs, the Ministry of Finance, the FSV, the VMVDU, FONAVIPO, the Banco Multisectorial de Inversiones, and the Banco Central.

D. Subprogram I. Formal market

1. Component 1. Strengthening the mortgage market

3.9 The Banco Multisectorial de Inversiones will be responsible for executing this component, because as a second-tier financial institution it has the clout to call meetings to coordinate activities to promote a secondary market. *Signature of an execution agreement between the VMVDU and the BMI is a condition precedent to disbursement of the mortgage market-strengthening component. At a minimum, the agreement will include the terms specified in paragraph 3.3, and will indicate the nonreimbursable nature of the transfer of resources for this component.*

3.10 The BMI will assign a qualified expert to fulfill this function, and must receive the Bank's non-objection. In performing the activities of this component, the BMI will be assisted by a working group (Mortgage Market Working Group) including representatives of the banking industry (bankers association), risk assessors, institutional investors, the Financial Supervisory Board, the Stock Market Supervisory Board, and the FSV. This working group will serve as a means for coordinating the analysis and preparation of specific proposals including draft regulations on key aspects of the development of the mortgage market. Upon the conclusion of program execution, the BMI will submit to the Bank a report specifying the actions undertaken, the accomplishments realized, and the specific outcomes of this component.

2. Component 2. Institutional and financial strengthening of the FSV

3.11 The FSV will be responsible for executing this component since it is the institution with the autonomy and capacity to carry it out. *Signature of an execution agreement between the borrower (Ministry of Finance), VMVDU, and the FSV is a condition precedent to disbursement of the component concerning institutional and financial strengthening of the FSV. At a minimum, the agreement will include the terms specified in paragraph 3.3, and will mention the reimbursable nature of the transfer of resources as well as the FSV's obligation to contribute the counterpart resources for this component.*

3.12 The Fund's senior management will select a group of professionals broadly representative of the institution who will work full time on execution of the modernization plan. This group will work under the leadership of a project manager, who will be hired using program resources. This team will report directly to the executive director of the FSV. The Bank's non-objection is required for the composition of the working group and for the appointment of the project manager. To implement the plan, the working group will be assisted by international consultants in financial institution management. The modernization plan will include activities in the following areas:

a. **Modernization of management procedures and systems,** which includes: (i) strengthening financial management, (ii) restructuring the loan operations area; (iii) improving other operational areas, (iv) strengthening internal controls, (v) restructuring the technology and systems, (vi) hardware and software procurement, and (vii) strategic planning and organizational restructuring.

b. **Reforms in credit policy and administration** include actions to review and strengthen: (i) the credit manual; (ii) the credit area; (iii) credit culture and regulations; (iv) product planning; (v) credit initiation; (vi) account maintenance; (vii) collections; (viii) administration of assets received; and (ix) management information systems.

3.13 **Governance structure**. As part of the reforms discussed during program preparation, by the end of 2001 the FSV will submit to the Assembly a draft text for amending its charter. This bill will provide for: (a) transforming the FSV into a financial institution (without the ability to receive deposits from the public), subject to the same prudential regulations as commercial banks, (b) reform of the governing bodies of the FSV (Governors Meeting and Board of Directors) to ensure its independence and to avoid conflicts of interest, and (c) allowing the informal sector access to FSV loans provided that their income levels qualify them as part of the Fund's target population.

3.14 **Consensus on reforms**. The modernization plan includes funds to finance the activities for dialogue, communications, and promotion of the reforms with the FSV. The FSV will be in charge of carrying out these activities and will organize workshops, seminars, and press releases in an effort to broaden the dialogue and

build a consensus on the new housing subsidy policies. To accomplish this aim, the FSV will have the support of the Inter-agency Coordination Committee.

E. Subprogram II. Informal market

3.15 **Informal market subsidies fund**. FONAVIPO will be responsible for administering the subsidy fund for the informal market, because of its position as the institution authorized by law to grant low-income subsidies for housing and because of its successful experience with managing subsidy programs in the past. The VMVDU will be responsible for promotion, monitoring, and supervision of the execution of programs for which subsidies are allocated, through the Office of Human Settlements (OFAH), since it is an institution with staff in the legal, social, and technical areas who have the skills to perform these functions and also because this division of functions between FONAVIPO and VMVDU was successful in implementing previous subsidy programs.

3.16 In spite of FONAVIPO's excellent track record in administering subsidies, the institution was overly successful in administering the credit program. That is why it was agreed with the government that FONAVIPO would not undertake any credit operation while the program is under way except for loans signed prior to 15 November 2001 until such time as an action plan has been agreed upon with the Bank for managing housing credit programs that satisfy at least the following criteria:

a. FONAVIPO shall act solely as a second-tier intermediary and will not offer credit directly to the beneficiaries of its programs.

b. All of the operations shall be carried out at market rates that are high enough to cover FONAVIPO's costs including the cost of funding, operating costs, cost of principal, and costs associated with setting up reserves for nonperforming loans. This procedure will apply to all lending programs.

c. It must have a methodology to evaluate potential intermediaries in terms of their financial soundness and operating capacity to engage in safe and prudent lending. Such a methodology should be tested in terms of its efficiency with other similar institutions.

d. It has the operating systems to initiate and monitor the credit operations.

e. Administration of this activity is left in the hands of professionals with more than five years' experience with similar programs.

f. The staff assigned to the credit program have been properly trained.

g. The intermediaries taking part in the program are financially sound and have more than five years' experience with microcredit home financing.

h. The monitoring indicators and mechanism in connection with implementation of the plan have been established.

1. Component 1. Subsidies for upgrading marginal neighborhoods

3.17 The VMVDU, which will act through the Office of Human Settlements (OFAH), will be responsible for the management, promotion, supervision, and control of this component. FONAVIPO will administer the subsidies, and will be responsible for disbursing resources to the municipalities when they comply with the eligibility requirements established in the Operating Regulations of this component and once the corresponding contracts have been entered into between FONAVIPO and the municipalities. *Signature of an execution agreement between the VMVDU and FONAVIPO and approval of the program's Operating Regulations are preconditions for the disbursement of the neighborhood upgrading subsidy component. At a minimum, the agreement will include the terms specified in paragraph 3.3, and will indicate the nonreimbursable nature of the transfer of resources as well as the VMVDU's obligation to transfer the counterpart resources for this component.*

3.18 The participating municipalities will be selected in competition organized by VMVDU. The component will be divided up to conform to the different types of municipalities according to size and execution capacity. A ceiling will be placed on the resources available to each municipality based on the capacity it has demonstrated in the past in carrying out investment projects. Under each category, priority will be given to municipalities that contribute additional funding to the minimum 20% requirement.

3.19 The municipalities will be responsible for contracting for the goods and services needed to execute the upgrading construction work, and the institutional strengthening activities. To that end, FONAVIPO and the participating municipalities will sign execution agreements establishing the functions of these agencies and the conditions under which FONAVIPO will transfer resources to the municipalities. The VMVDU will take such steps as are necessary to ensure that rates for water and sanitation service in systems specifically linked to the present program are based on the principle of investment, maintenance, management, and operating cost recovery.

3.20 Program resources may be used for: (a) community organization; (b) studies and technical designs; (c) titling; (d) construction work to bring in water lines, sewers, drainage, road infrastructure, risk alleviation, and to habilitate communal spaces; (e) preparation or updating of local environmental risk maps; (f) studies of informal settlements; (g) training for municipal staff; (h) purchasing hardware; and (i) supervision.

3.21 To ensure that the resource allocation system is transparent and that resources are targeted, eligibility and prioritization criteria have been established, including: (a) publication of rules ands requirements for competitions; (b) an eligibility system for informal settlements that takes family socioeconomic position into account, as well as the lack of basic services and the feasibility of the projects; and (c) a system for prioritizing settlements that takes the lack of water and sewer systems and the instability of roofs into consideration. Beneficiary settlements will be those in which at least 70% of the families have income of less than two minimum salaries. Prioritization criteria that take into consideration earthquake reconstruction needs may not be included in this component.

3.22 To ensure proper execution and to provide local governments with the necessary capacity, the VMVDU will hire private consulting firms and NGOs to function as municipal support institutions. The functions of the latter include: (a) promoting the program at the local level, (b) training municipal staff, and (c) supporting the municipalities in preparing profiles, carrying out works and institutional strengthening activities, and administering program resources.

3.23 The project cycle of this component has four stages:

a. **Promotion and identification**. The VMVDU will hire a municipal support institution to promote the program among eligible municipalities, and to support them in submitting applications.

b. **Pre-investment**. The municipalities will receive the first disbursement of resources and will carry out the institutional strengthening operations, contract the pre-investment studies, initiate public promotion by formalizing agreements between the beneficiary community that represents the marginal neighborhoods and the municipalities, and approve the development projects.

c. **Execution**. The municipalities will tender and contract for the development construction work, and the public promotion for organizing the community work. With the delivery of the construction work, the municipalities may seek the VMVDU's authorization and receive the third disbursement of resources.

d. **Operation and maintenance**. The municipalities will carry out community training, visits, verification, and acceptance of operations and maintenance, and the settlement and final evaluation of the construction work.

2. Component 2. Reconstruction subsidies

3.24 The VMVDU will manage, promote, and supervise this component through the Office of Human Settlements (OFAH), and FONAVIPO will administer the use of the subsidies. *Signature of an execution agreement between the VMVDU and FONAVIPO and approval of the program's Operating Regulations are prior conditions for disbursement of the reconstruction subsidy component. At a minimum, the agreement will include the terms specified in paragraph 3.3, and will*

indicate the nonreimbursable nature of the transfer of resources as well as the VMVDU's obligation to transfer the counterpart resources for this component.

3.25 The process of identifying beneficiaries and allocating subsidies will be transparent. For distribution of resources to the municipalities, the VMVDU has set up a reconstruction board that reports the earthquake damage in each locality and the institutions and donors financing projects. This record will need to be updated on a regular basis and broadly disseminated. While the program was being prepared, the Bank, the VMVDU, and the donor agencies held meetings on initiating coordination on actions and to ensure that investment is subject to the same technical criteria.

3.26 Program resources will be directed mainly to municipalities with the most serious damage in which less investment had been made by other institutions. In selecting beneficiaries, criteria to be used in determining priority will include vulnerability (women heads of household and the disabled). FONAVIPO will work with local participation committees to establish local decision-making authorities. The database managed by FONAVIPO for its program subsidies will be used to ensure that each family receives the subsidy only once.

3.27 Approximately 50% of component resources will be used to finance new organized settlements and 50% the construction at existing sites. Eligible investments will be the leasing of a lot for a one-year period[4], construction of a small permanent home, delivery of basic services (water and sanitation) and technical assistance for the municipalities and communities.

3.28 The municipalities most affected by the earthquakes will identify eligible communities and priority projects and will draw up plans for reconstruction with technical assistance from NGOs. The projects will need to be eligible from a legal, environmental, and technical standpoint. The ILP will rank the sites in terms of their legal status and will draft an environmental report for each project on the basis of the model that is now being adopted in the country with the backing of the Ministry of Agriculture and Natural Resources. Furthermore, the subsidies may only be used to finance housing with an environmental risk map. To facilitate this rule, the VMVDU institutional strengthening component will include resources for environmental risk maps in earthquake-affected municipalities.

3.29 From a technical standpoint, the earthquake resistant structures will be certified by the VMVDU[5] and the municipalities and communities will need to decide on one of these systems. Once the construction system has been selected, the project will be

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[4] If the beneficiary decides not to exercise his option to purchase or refrains from leasing, the subsidized portion of the home will be transferred to another eligible beneficiary so that the program resources are definitely used for acquisition of a home.

[5] The VMVDU has now certified five earthquake-resistant structures that meet the maximum cost criteria of US$2,500. A Canadian consulting firm that specializes in this type of design has helped the government to identify other systems and the Colombian Seismic Engineer Association is also in contact with the VMVDU concerning the transfer of the suitable technologies.

put out to tender amongst construction companies and certified NGOs. Homes must be from 25 to 42 m^2 in size and the lots from 50 to 200 m^2. The total cost of a home must not exceed US$2,500. The VMVDU will ensure that there is at least one standpipe for each 25 homes and one privy per home.

3. Component 3. Land legalization

3.30 This component will be carried out by Instituto Libertad y Progreso (ILP), because it is an autonomous public institution that has successfully carried out other land legalization programs for the government in the last 10 years. *Signature of an execution agreement between the VMVDU and the ILP is a prior condition for disbursement of the land legalization component. At a minimum, the agreement will include the terms specified in paragraph 3.3 and will indicate the nonreimbursable nature of the transfer of resources as well as the VMVDU's obligation to transfer the counterpart resources for this component.*

3.31 The Institute will perform an average of 5,000 legalizations per year. It will receive an advance to legalize 2,000 lots, and thereafter will receive payments for every 2,000 titles registered, submitting the documentation agreed upon with the VMVDU to verify expenditures. To commence the program, the ILP will engage consulting services for the following activities: (a) a diagnostic assessment of the universe of illegal land holding situations in the country; (b) a review of community prioritization and eligibility criteria; (c) diagnostic assessment and proposals to shorten the time needed for land legalization; and (d) training for ILP staff in incorporating the new procedures.

3.32 The ILP will be responsible for carrying out, directly or through the use of contracted services, the entire project cycle for legalizing and registering titles, including the following stages and activities: (a) pre-identification (pre-selection of communities, preliminary technical and legal analysis, census, prioritization and selection of communities, PHDP qualification by the VMVDU); (b) identification (technical environmental and legal analysis and social-interest qualification by the ILP); (c) design (topographical elevation, design of development projects, approval of development projects); (d) execution (registration, filing of documentation with the RSI/CNR); (e) monitoring and supervision; and (f) evaluation. The concurrent auditing contracted by the PCU using program resources will audit a sample of spending and the results achieved through the legalizations undertaken by the ILP.

4. Component 4. Progressive subdivisions market

3.33 The VMVDU will carry out the progressive subdivisions market component through the Office of Strategic Planning (OPES) in coordination with CONACYT [National Science and Technology Council], El Salvador's leading standardization institute. The main stages of the project cycle include: (a) development of standards and procedures for certification; (b) review of the regulations for PHDP; (c) coordination of standards with the sector and the institutions involved;

(d) program promotion; (e) training subdivision firms to comply with the standards; (f) evaluation of compliance; (g) issuance of quality seals; and (h) dissemination of information about the sector. The standards for the certification process will be coordinated with the major companies in the sector, and will include the legal, technical, and financial areas at a minimum. With regard to the legal area, among other measures the company must guarantee the regularity of documentation concerning title to the property it owns, and must include the clauses agreed upon with the VMVDU in the lease contracts with promise to sell, to protect the consumer and to guarantee that title can be obtained at the conclusion of the process. With regard to technical concerns, developers must show that the land is not located in a high-risk area and that the project's plans have been approved or are in the approval process. Finally, developers must make the financial conditions of the contract transparent.

3.34 The target of the program is to certify at least three of the major subdivision companies, which, at the end of the four years of program execution, will have an impact on 40-50% of the progressive residential subdivision market.

3.35 International companies specializing in standardization will develop standards, train businesses to comply with those standards, and evaluate compliance to ensure that companies are acting in accordance with the standards. The certification process will ensure that different firms provide training and compliance assessment, or at least that a firm that carries out both activities demonstrates total separation between these functions, to eliminate any conflict of interest. Once companies have been evaluated for compliance, the VMVDU and CONACYT will issue quality seals, the validity of which will be extended with each new certification process. For further details concerning the profile of the certification program, see the supporting documentation in the program's technical file.

5. Component 5. Modernization of the VMVDU

3.36 The VMVDU will execute this component. The modernization plan has been agreed upon with the senior management of the VMVDU, and includes the following activities: (a) restructuring and institutional change of the VMVDU, (b) decentralization and municipal strengthening, (c) human resources, (d) procedures and performance indicators, (e) information system, (f) computer infrastructure, (g) housing sector studies, and (h) risk prevention (municipal environmental maps and studies on natural disaster-resistant construction technologies) For a detailed description of the plan, see the supporting documentation in the program's technical file.

3.37 As part of the VMVDU modernization component, financing will provided for the following activities to support administration of the program: (i) establishment and functioning of the PCU; (ii) promotion and dissemination of the programs financed with Bank resources; (iii) operating and financial audits of the program; and (iv) impact evaluations.

F. Subprogram III. Municipality of San Salvador subsidy program

1. Component 1. Subsidies to upgrade marginal neighborhoods in the Municipality of San Salvador

3.38 The Municipality of San Salvador will execute this component because it is a local government with considerable technical and political capacity to carry out a program of this kind. *Signature of an execution agreement between the borrower (Minister of Finance), VMVDU and the AMSS and the approval of the program's Operating Regulations are prior conditions for disbursement of the component concerning upgrading of marginal neighborhoods in the AMSS. At a minimum, the agreement will include the terms specified in paragraph 3.3 and will indicate the reimbursable nature of the transfer of resources as well as the AMSS's obligation to contribute the counterpart resources for this component.*

3.39 This component will be carried out by the Municipality of San Salvador through the Coordinating Unit for Subprogram III. The members of the Unit will be a general coordinator, a technical coordinator (responsible for awarding contracts for and supervising the neighborhood upgrading projects and institutional strengthening activities), and an administrative coordinator (responsible for subprogram finances and its accounting). The Unit will coordinate the actions to be carried out by the different offices and units within the municipality (General Management, District Management, Public Services Management, Financial and Administrative Management, and the Legal and Communications Departments). It will forward through the PCU all official communications, disbursement requests, justifications, and reports agreed on with the country, and will provide such information as the Bank, the PCU, and/or the program financial and operating audits may require.

3.40 An Advisory Committee consisting of members of the Municipal Council, the General Manager of the municipality, and independent professionals, will monitor subprogram III. The establishment of this Committee has been approved by the Municipal Council.

3.41 The Operating Regulations of the neighborhood-upgrading program were designed jointly by the VMVDU and the Municipality, and will follow criteria and procedures similar to those of the VMVDU upgrading program.

2. Component 2. Institutional strengthening of the AMSS

3.42 The Municipality of San Salvador will execute this component. *Signature of an execution agreement between the borrower (Minister of Finance), VMVDU and the AMSS is a prior condition for disbursement of the AMSS Institutional Strengthening component. At a minimum, the agreement will include the terms specified in paragraph 3.3 and will indicate the reimbursable nature of the transfer of resources as well as the AMSS's obligation to transfer the counterpart resources for this component.*

3.43 This component will be carried out by the Municipality of San Salvador through the Coordinating Unit for Subprogram III on the same terms and conditions as the preceding component. The component will finance the following activities: (a) establishment and functioning of the PCU; (b) institutional strengthening of the AMSS district units; (c) the specialized consulting services to support neighborhood upgrading program; (d) the preparation of environmental maps and studies on municipal housing policies; and (e) training for municipality staff in housing programs.

3. Ability to pay

3.44 Since 1998, the Bank has been assisting the Municipality of San Salvador with institutional and financial under technical-cooperation programs that have enabled the municipality to boost its current revenue and keep its payroll costs under control. As a result, its current revenue touched US$32.5 million in 2000, with debt service remaining at approximately 18% of current revenue. The loan that the municipality will receive under this program will not place any constraints on municipal finances.

G. Environmental strategy

3.45 The program will respond to the environmental vulnerability needs of low-income settlements in El Salvador in two main areas: certification of low-cost earthquake-resistant construction technologies and the introduction of effective tools to prevent natural disasters.

3.46 In the first area, the program will finance studies to identify low-cost earthquake-resistant construction technologies (reinforced adobe and iron-reinforced concrete systems, among others) and disseminate information about these construction systems. The VMVDU will certify these systems so that they are eligible for the use of subsidies through the reconstruction program and families will receive technical assistance to build houses using these technologies. Visits to settlements destroyed by the earthquakes have indicated that many houses were not destroyed by landslides, but by earthquake damage to the weak adobe structures of houses in rural areas. Appropriate technologies will be used in the reconstruction component, and families will be trained in their use.

3.47 In the second area, the program will support the prevention of natural disasters by financing local environmental risk maps in municipalities participating in the neighborhood upgrading component, and in those affected by the earthquakes. During program preparation, pilot projects were conducted in the municipalities of La Libertad and Santa Ana for implementation of a methodology developed by the IDB and used in other countries in the region to create local maps that identify risk and preservation zones for each urban area. These risks and resources (areas subject to flooding, landslides, fire and other risks, protected areas, critical watersheds, forests, and other resource areas and cultural sites) were mapped using a simplified scheme as "habitable" and "uninhabitable". These simplified areas were selected through a participative process, and once technically appropriate procedures had

been used to identify all "uninhabitable" areas, a local consultation process was undertaken to set priorities jointly with municipal government and community representatives.

3.48 As a result of these pilot projects, a manual was developed for creating environmental maps that is adapted to the situation in El Salvador, and a workshop will be held to train municipalities in preparing and implementing these maps. Additionally, the study reviewed the institutional and legal environmental situation in El Salvador and concluded that the most effective way to implement the environmental maps is to include them in the urban development plans now being prepared by the VMVDU and the municipalities. The study also concluded that the VMVDU and the municipalities are the institutions most capable of ensuring compliance with environmental considerations in urban areas, as part of the approvals process for development and construction projects.

H. Gender strategy

3.49 Household surveys in El Salvador show that 30% of urban households are headed by women. As this percentage is greater still amongst low-income groups, the program will largely benefit this segment of the population. To guarantee access by women on equal terms and conditions, the subsidies in the formal and informal markets will be granted on behalf of the couple or the woman, if the latter is the head of the household. The same criterion will be adopted in the case of titling of properties purchased and/or legalized under the program and all of these conditions will be contained in the subsidy program operating manual. In addition, the reconstruction component will give priority to family groups in which the head of the household is a woman (paragraph 3.26).

3.50 The program monitoring and evaluation system will need to have indicators to gauge access by women to the housing program and to propose measures to correct any problems when situations impeding their participation are detected.

I. Contingencies and general costs

3.51 The general financial costs of the project will be recorded in the budget of the VMVDU's project coordinating unit. The Government of El Salvador will pay the credit fee, as well as the interest and inspection and supervision charges. The government has requested that the interest on the loan be capitalized. The Municipality of San Salvador will reimburse the Government of El Salvador for its share of the credit fee, and capitalization of interest and payment of the inspection and supervision fee, as specified in the agreement between the two parties.

J. Revolving fund and disbursements

3.52 A revolving fund will be established in the amount of 10% of the account administered by the PCU. This recommendation is made based on the fact

sufficient funding will be required to start up the programs, particularly the housing reconstruction program.

3.53 The VMVDU's project coordinating unit is the channel of communication through which will be handled all requests for loan disbursements with the exception of requests in connection for subprogram III, which may be submitted by the Municipality of San Salvador to the Bank, with a copy to the PCU. Each co-executing agency will prepare reconciliation statements for the funds administered, and will submit them semiannually to the PCU, which will consolidate them and submit them to the Bank.

3.54 Phase one of the program is to be disbursed in four years, in accordance with the tentative disbursement schedule presented in Table 3.1.

Table 3.1

DISBURSEMENT SCHEDULE Equivalent in US$(000s)					
SOURCE	**YEAR 1**	**YEAR 2**	**YEAR 3**	**YEAR 4**	**TOTAL**
IDB/OC	24,555	24,691	10,996	9,758	70,000
Local	2,511	2,873	8,218	10,452	24,055
Total	**27,066**	**27,564**	**19,214**	**20,210**	**94,055**
%/Year	**29%**	**29%**	**20%**	**21%**	**100%**

K. Contracting and procurement of construction work, goods, and services

3.55 The standards and criteria of the Bank will apply to all contracting for goods and services. International competitive bidding procedures will be followed for construction contracts for amounts greater than US$1,000,000, and for procurement of goods and consulting services for amounts greater than US$200,000. Contracting for goods, construction, and consulting services for less than these amounts will be governed by national law provided that the law does not contravene the Bank's principles on this issue.

L. Recognition of expenditures

3.56 Up to US$1.1 million in expenditures incurred since 31 March 2001 may be charged to the Bank financing, provided that procurement procedures substantially similar to those of the Bank have been followed. Of the total amount, expenses will be recognized as follows: up to US$100,000 incurred by FSV to hire consultants for the FSV institutional and financial strengthening component; up to US$400,000 in expenses incurred by VMVDU to hire consultants for the modernization of the Vice Ministry component; and up to US$600,000 in expenses incurred by Municipality of San Salvador to hire consultants for the Municipality of San Salvador institutional strengthening component and for investments in the Municipality of San Salvador neighborhood upgrading component.

M. Program monitoring during execution

3.57 **Start-up workshop**. A start-up workshop will be held to establish the basic outlines for project execution, reach a consensus on the activities of the different coexecuting agencies, to review the project execution matrix, and to establish the work plan for the year one. A training seminar will also be held in the use of the Bank's financial administration system.

3.58 **Annual reports and meetings**. Through the project coordinating unit, the VMVDU will prepare consolidated semiannual reports on program execution for the Bank, detailing the execution of each component, the state of compliance with each of the annual targets specified in the execution matrix, and incorporating the results of evaluations. Every year, the VMVDU will invite the Bank and the participating agencies to meet within one month after submission of the annual report to evaluate any adjustments that may need to be made to the program and the execution plan, and to prepare an annual work plan for the following year. In each semiannual report, the VMVDU will inform the Bank of the extent to which the conditions of the FONAVIPO activities have been fulfilled (paragraph 3.16). The VMVDU will submit updates of the program's consolidated financial data to the Bank semiannually.

3.59 **Final and midterm evaluations**. Under the program (i) a midterm evaluation will be performed 24 months after the loan agreement enters into effect or after 50% of program resources have been disbursed, whichever comes first; and (ii) a final evaluation will be performed when 90% of the program resources have been disbursed. These evaluations will analyze quantitatively the extent to which the program objectives have been attained, measured by the monitoring indicators proposed in the execution matrix. Agreement will be reached on the terms of reference for these external evaluations and their cost will be charged to the program as part of the administrative costs of the VMVDU modernization component. In addition, an external evaluation will be done of the FSV component for consideration of a phase two, to be based on the indicators mentioned in paragraph 2.22 and to be financed out of the FSV financial and institutional strengthening component which; (b) improvement in the quality and delivery of services by the VMVDU.

N. Audits

3.60 Decentralized execution requires efficient supervision tools that provide timely information enabling the co-executing agencies to make any corrections that may be necessary. To that end, an operating and financial audit will be performed on the executing agency and all project coexecuting agencies, the results of which will be forwarded to the IDB in quarterly reports and one final report on a sample of projects and disbursements representing at least 35% of the amount of payments made during the period but which in no event may be less than the result from calculating a statistically valid and reliable sample. The audits will review the

projects' financial statements and technical results, at least in accordance with the terms of the agreement, the Bank's AF-100 and AF-300 standards, and the specific terms of reference agreed on between the Bank and the executing agency.

3.61 The operating audit will review (i) the extent to which the program objectives have been accomplished, (ii) the extent to which the program Operating Regulations and plans have been fulfilled, and (iii) a physical inspection of a sample of neighborhood upgrading projects in subprograms II and III, home reconstruction, and a sample of municipalities participating in subprogram II.

3.62 The program will begin using a disbursement system with ex ante evaluations and based on the first quarterly audit report, once the executing agency and the coexecuting agencies have demonstrated satisfactory financial management capacity, the Bank will then be able to implement a disbursement system with ex post verifications, which will streamline project execution. This audit will be financed out of the proceeds of the loan, as part of the administrative costs of the VMVDU modernization subcomponent.

IV. BENEFITS AND RISKS

4.1 The program targets two submarkets in the housing sector: the formal market where complete houses built by construction firms may be purchased with mortgage backed loans, and the informal market where houses are constructed over time by the owner occupants. The principal benefits of these program interventions consist in the deployment of better policy instruments and the development of the institutional capacity to implement them efficiently. Quantifying such benefits is a complex task and this chapter will simply outline the most salient benefits expected and the principal risks to their realization.

A. Formal Market

1. Benefits

4.2 **Development of Secondary Mortgage Market.** The development of this market will enable banks to correct the mismatch of maturities between their assets and liabilities, allowing them to increase mortgage origination. The prospect of substantial institutional investment in mortgage backed securities has been enhanced by the monetary integration insofar as it will allow foreign investors to enter the market without assuming foreign exchange risk. Experience in the United States market suggests that by offering mortgages that are readily securitized, originators can reduce interest rates between 250 and 500 basis points.

4.3 **Reforms in the FSV: Institutional Strengthening and management.** The intensive program of institutional strengthening that will be carried out by the FSV will enhance its efficiency and build the necessary consensus on implementing political reforms that allow it to be financially sustainable over the longer term. while changes in its management structure will help it obtain the autonomy that is so needed for its operations.

a. **Efficiency**. Currently, poor origination and credit analysis procedures mean that FSV is faced with a heavy administrative burden in servicing loans and managing collections on delinquent accounts, and foreclosed properties. As it upgrades its information systems and improves its origination procedures, these administrative costs should come down substantially.

b. **Sustainability**. The FSV's financial policies presently depend on the very low cost of resources it accumulated before the 1998 pension reforms. With marginal interest rates below the marginal cost of funding, its future was limited. The FSV has reached agreement with the Central Bank on increasing interest rates to a level that is high enough for the institution to be sustainable in the short term. Also, as part of the modernization plan, the institution will adopt a risk management system to enhance its financial performance. In the medium term,

adopting a market interest rate policy, a condition for phase two of the program, will allow the FSV to create conditions for its long-term survival.

c. **Autonomy**. Recent events demonstrated that the FSV is highly vulnerable to political pressure. Pressures from the construction industry and from government policy have caused its financial condition to deteriorate still further over the last few years. The bill agreed to by the authorities will provide an additional margin of protection. The legislation would remove from the governing board representatives of the construction industry, whose presence produces an obvious conflict of interest.

2. Risks

4.4 There are two principal risks to the program of reforms to the FSV: (i) financial failure; and (ii) political intervention.

4.5 **Financial failure**. Since 1998 FSV has had to operate as an intermediary in a capital market. While it has successfully mastered the transition from managing captive fiscal resources to funding from bond issues, its financial policies have lagged behind the new reality. The FSV is faced with a challenging task of modernization in a stressful financial environment. Any delay in introducing the new policies on rates, lending, and subsidies, a failure to bring its costs under control, to correct the deterioration in its portfolio, to implement sound lending policies and financial management systems will undermine its financial viability.

4.6 To reduce this risk, a detailed modernization plan has been developed, with a carefully selected set of financial indicators to allow management, and the bank to monitor its financial progress. The process of designing the plan and agreeing on the critical target values for the indicators has been supervised by the FSV's senior Management team and has their support.

4.7 **Political Intervention**. Perhaps the most difficult risk to control is that of political intervention. First tier "housing banks" under public sector management do not have a good track record in Latin America. Their Achilles heel is vulnerability to political pressure. This pressure has manifest itself through interest rates too low to be sustainable, lax underwriting standards and weak response to delinquent accounts. The short term political benefits of these policies frequently culminate in financial catastrophe for the housing bank.

4.8 In contrast, the FSV has had an unusually strong track record. Nevertheless a series of events over the last few years has demonstrated that it too is vulnerable to political pressures and the consequent financial deterioration. Whether the source is distress in the construction industry or the economic strategy of the government, the effects have been negative. Portfolio quality has deteriorated and the financial viability of the institution has been jeopardized. The reforms outlined above are designed to bolster the FSV's institutional autonomy, but these measures can only go so far. In the short and medium term, the institution will remain politically vulnerable.

B. Informal Market

1. Benefits

4.9 **The subsidy program for neighborhood upgrading.** This program will introduce a subsidy with a low unit cost that benefits low-income households through a transparent system of targeting and setting priorities. The arrangements for implementing the program are intensely participatory, involving both neighborhoods and local governments. The subsides provided by the central government will leverage additional resources from local governments and participating households, further increasing investment in improvements in the stock of existing housing stock and hence in the living conditions of El Salvador's urban population.

4.10 The program will result in a marked improvement in the efficiency of public resources currently used to support low-income housing. It will gradually switch these resources away from operations that help create new subdivisions and away from failed attempts to manage a microcredit institution; both of these important services can be, and are, provided more efficiently by private firms.

4.11 Over the four years of the present operation, the subsidy program will improve the infrastructure for basic urban services (drinking water, sewage, paving, etc) for some 23,000 households. Preparatory studies suggest that the average monthly income of the beneficiaries will be some US$230 putting them in the lowest four deciles of the urban income distribution.

4.12 The upgrading component to be executed by the Municipality of San Salvador will have essentially the same set of benefits. The financing and independent execution of the municipal component are also likely to encourage a benign form of competition with the national program. The teams have established good working relationships during program preparation and the exchange of experiences will make it possible to identify and disseminate rapidly best practices and apply them to resolving common problems.

4.13 **Certification for progressive subdivisions.** The main program impact will be to provide better information to low income households wishing to buy land in a progressive subdivision. The process of certification itself will generate detailed information on best practices in the industry. Certification will pay particular attention to identifying developers that observe environmental risk mapping, use land that is legalized, and provide fair financial treatment. Disseminating this information in major cities will allow purchasers to compare the quality of service provided by different developers. This in turn will reduce the scope for abuse and provide an incentive for developers to improve the quality of their product and services. Subdivisions will be better sited in relation to existing infrastructure facilities and away from areas of environmental risk. The certification will be carried out by private companies but the housing ministry will bear the cost of

disseminating the information to the public. There is no doubt that in terms of cost efficiency, no action taken in the housing sector will have more impact than this component.

4.14 Over the four years of the present operation, this program could benefit more than 10,000 households in the lowest four deciles of the urban population.

4.15 **Land Legalization**. It is highly unlikely that households occupying land will invest in housing improvements if tenure of the land is irregular. Legalization is thus a very cost-effective means of increasing the level of private investment in housing and hence of upgrading the stock of existing housing. The ILP, a pubic agency with extensive experience in this field, will carry out this component. The principal benefit accruing from the legalization program will be to expand the scale of actions to reduce the backlog of illegal subdivisions and use ILP's institutional capacity to the full. Some 20,000 households will benefit over the period of program execution.

4.16 **Environmental Impact**. The Program will finance environmental risk maps and training for all participating municipalities. This will provide them, for the first time, with tools that can be used to improve decision making on urban growth and risk mitigation measures. The maps will be very simple to interpret so that developers and households purchasing new lots can make better-informed decisions. The certification process for developers will reinforce these effects.

4.17 **PTI Justification**. In 2000, the official urban poverty line was ¢509 colones *per capita* per month, or about US$240 per household per month. This is approximately equivalent to the lowest two quintiles of the urban income distribution or 1.7 times the legal minimum salary.

4.18 For subprograms II and III, eligibility criteria require that 70% of the households in neighborhoods to be benefited by subsidized actions have incomes below two minimum salaries. A conservative estimate would put the percentage of poor to benefit from these programs at 60%. As a result some 30,600 poor households will directly receive subsidized benefits from subprograms II and III (subsidies for upgrading, reconstruction, and legalization). If the households that could benefit from the certification program are included (even if they do not receive a direct subsidy) the number of poor households that stands to benefit rises to some 40,600.

4.19 As a result, some 40,000 households, at or below the poverty line will benefit from the four years of program execution, approximately 66% of the total.

2. Risks

4.20 **Neighborhood upgrading subsidy sustainability**. The principal risk to the subsidy program concerns its budgetary sustainability. The program will help the government to shift its priorities in the area of housing policy and to use funding for the housing sector more efficiently, with ensuing savings for the housing policy budget.

4.21 As it stands, housing policy in El Salvador costs on average US$18.6 million annually. The new policy will reduce this figure to just US$15.9 million. Such a reduction is attributable to two factors. First, the program will expand the targets of the programs at a lower individual subsidy cost with greater leverage of other resources and greater impact (such as neighborhood upgrading programs and land legalization). Secondly, the new policy involves the elimination of programs that consumed considerable government resources with very limited effect (such as FONAVIPO lending and subsidy programs for lot purchases and home construction).

4.22 Accordingly, the government will be in a position to sustain the program financially. Also, the program stresses the need to ensure a transition process that provides for the gradual commitment of local resources for its financing. For the first twelve months of the program, the Bank will provide 100% of the subsidy funds; by year four the Bank will provide a maximum of 40%. As a result, the process of making budget allocations to sustain the program will be better established by the time the operation is complete. In addition, the program will put substantial resources into the hands of municipal governments, many of which are currently controlled by a party other than that of the national government. The program is likely to generate substantial cross party support, making its termination less likely.

EXECUTION MATRIX, FORMAL MARKET SUB-PROGRAM ACTIVITY

OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
L prove the housing sector's capacity pond to the demand for housing g the various income groups in the population.			
POSE pport the Government of El dor in developing and introducing a sustainable housing policy ments. **ormal market** To promote long-term channeling of esources to the sector. To ensure the medium-term financial sustainability of the FSV.	1. Issuance of mortgage instruments 2. New policy of direct subsidies approved and new market interest rate policy.	Securities Commission report, semiannual progress reports, FSV financial reports, SSF bulletins, and annual program evaluations.	Political and economic context is favorable for the development of the housing markets.
COMES **ormal market** Regulatory framework revised and nstruments designed.	1. Institutional operations model for the mortgage market implemented.	Semiannual progress reports, FSV financial reports, SSF bulletins, annual program evaluations.	National Assembly adopts the FSV bil Broad consensus built on FSV policy reforms. FSV does not come under political pressure

OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
FSV modernization plan executed and credit policies strengthened.	2. Overall modernization plan completed. Defaults in existing portfolio reduced to 10% and defaults in new portfolio to 5%. All dual-indexed loans converted to level payment loans. Reserves maintained in accordance with national standards. Lending rate is raised by 1% (except for new loans under US$9,700), is based on average deposit rate, and adjusted at least once every six months.		
POSE **:fficient informal market**			
To improve access to basic services in marginal urban settlements and to support municipalities in implementing housing policies.	1. Increase access to water service from 74% to 75% in year two and 76% in year four. Number of municipalities that continue to implement improvement programs with their own resources.	Semiannual progress reports, annual program evaluations, DIGESTYC Multi-Purpose Household Survey, construction sector bulletins.	Political and economic context is favorable for the development of the housing markets.
To provide an adequate housing solution for the population affected by the earthquakes.	2. Percentage of the population served in relation to demand.		
To reduce illegal land possession in marginal urban areas.	3. Percentage of settlements with normalized ownership increases by 1% in year two and 2% by year four over base year (see activities, year one).		
To improve market performance in the progressive subdivision development market.	4. Percentage lots sold each year with a certification seal, in relation to the total sold.		
To improve the VMVDU's efficiency.	5. Percentage of VMVDU administrative expenses is less than 15% of total expenses in the sector.		

OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
TCOMES			
nformal market			
Subsidies functioning transparently and in a focused manner, leveraging private resources, and municipalities strengthened.	1. Number of subsidies granted and paid per year, and average cost. 50% of beneficiary households have incomes of less than 1.5 minimum salaries, local contributions to the program are 30%, and 50 municipalities have environmental risk maps.	Semiannual progress reports, annual program evaluations.	Public sector priority on housing investments maintained throughout program execution. Local interest in participating in progr and political election processes do not interrupt execution of municipal programs. Flexibility maintained in the applicati of regulations governing development the progressive subdivision market.
Subsidies meeting the demand in a transparent and focused manner.	2. Number of subsidies granted and paid per year, and average cost. 70% of beneficiary households have incomes of less than 1.5 minimum salaries. All homes have water connections and latrine.		
Targets of the expanded land regularization program and improved efficiency of the process.	3. Number of titles delivered, and average cost. Average time required for normalization reduced to 150 days. 70% of beneficiary households have incomes of less than 1.5 minimum salaries.		
Subdivision companies certified.	4. 3 companies certified, 3,000 lots produced with a quality seal. Annual publication by certified companies.		
Modernization plan completed. Processes and information systems improved.	5. 100% of the modernization plan completed. Project approval process reduced to 1 month, sector information published annually.		

OBJECTIVES	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
RPOSE			
Efficient informal market in AMSS Better access to basic services in low-income neighborhoods Strengthen municipal housing policy	1. Greater access to water and sanitation service 2. Increased local investment in neighborhood improvement programs	Semiannual progress reports, annual program evaluations, DIGESTYC Multi-Purpose Household Survey, OPAMSS reports and studies, construction sector bulletins	Political and economic context is favorable for the development of the housing markets.
TCOMES			
Informal market in AMSS Subsidies are functioning transparent and targeted and leveraging private resources	1. Number of subsidies granted and disbursed each year, and average cost. 50% of beneficiary households have incomes of less than 1.5 minimum salaries; beneficiary contributions amount to 10% of program.	Semiannual progress reports, annual program evaluations, DIGESTYC Multi-Purpose Household Survey, OPAMSS reports and studies, construction sector bulletins	Public sector priority on housing investments maintained throughout program execution.
Municipality strengthened	2. Municipality has an environmental risk map and qualified staff		Local interest in participating in programs and political election proces do not interrupt execution of municip programs. Flexibility maintained in the applica of regulations governing developmen the progressive subdivision market.

DETAILED EXECUTION MATRIX: FORMAL MARKET SUBPROGRAM

CTIVITIES	As of February 2002	YEAR 1	YEAR 2	YEAR 3	YEAR 4	SOURCES AN COMMENT
ORMAL MARKET						
Strengthening the mortgage market	i. BMI coordinator appointed					Include the objective purpose, and contrac
activities (hiring sultants)	ii. Mortgage Market Working Group					schedule in the actio plan
Construction sector financing	iii. Execution agreement signed	(a) Contracted and done (US$60)	(a) Implemented			
Collection instruments	iv. Action plan submitted	(b) Contracted and done (US$65)	(b) Implemented			(b) Coordination SSF
Asset/liability mismatch regulations		(c) Contracted (US$65)	(c) Done and implemented			
Property registry		(d) Contracted and done (US$65)	(d) Implemented			(d) Coordination CNR
Judicial mechanisms for execution of mortgage guarantees		(e) Contracted (US$65)	(e) Done and implemented			
Secondary mortgage market schemes		(f) Contracted (US$60)	(f) Done and implemented			
Information mechanisms		(g) Contracted and done (US$60)	(g) Implemented			(g) Coordination OPES/VMVD
Mortgage issuance standardization		(h) Contracted and done (US$60)	(h) Implemented			
Strengthening of the FSV	i. New managers appointed	All dual-indexed loans converted to level payment loans. Reserves maintained in accordance with Central Bank standards.	Reserves maintained in accordance with Central Bank standards.			Include the objective purpose, and contrac schedule in the actio plan.
nization plan ies (hiring of tants and ement)	ii. Execution agreement signed					
Risk management	iii. Action plan submitted	(a) Contracted and implemented (US$350)				

DETAILED EXECUTION MATRIX: FORMAL MARKET SUBPROGRAM

CTIVITIES	As of February 2002	YEAR 1	YEAR 2	YEAR 3	YEAR 4	SOURCES AN COMMENTS
Loan operations area	iv. FSV reform bill sent to National Assembly	(b) Contracted and implemented (US$450)				
Other operational areas	v. Consulting firm contracted to assist with implementation of the modernization plan	(c) Contracted and implemented (US$100)				
Internal control	vi. 75% of dual-indexed loans converted to level-payment loans	(d) Contracted and implemented (US$100)				
Financial management		(e) Contracted and implemented (US$200)				
Technology and systems		(f) Contracted	(f) Implemented (US$2,566)			
Strategic planning		(g) Contracted and implemented (US$150)				
INFORMAL MARKET						
Neighborhood upgrading subsidies	i. Regulations of the existing FONAVIPO subsidy fund reviewed for adaptation to El Salvador's new subsidy policy.	2,700 families benefited (average of 20 neighborhoods), and 5 municipalities benefited, institutionally strengthened, and with risk maps prepared.	4,800 families benefited (average of 40 neighborhoods), and 5 municipalities benefited, institutionally strengthened, and with risk maps prepared.	5,100 families benefited (average of 45 neighborhoods), and 20 municipalities benefited, institutionally strengthened, and with risk maps prepared.	5,400 families benefited (average of 50 neighborhoods), and 20 municipalities benefited, institutionally strengthened, and with risk maps prepared.	
Reconstruction subsidies	ii. Regulations of the FONAVIPO subsidy fund adapted to this new line of activity. iii. Operating Regulations for the reconstruction component.	4,000 families benefited	4,000 families benefited			

DETAILED EXECUTION MATRIX: FORMAL MARKET SUBPROGRAM

CTIVITIES	As of February 2002	YEAR 1	YEAR 2	YEAR 3	YEAR 4	SOURCES AN COMMENT
Land legalization MVDU will hire P to handle all of legalization, ommunity fication to ation of titles with IR.	i. ILP action plan for providing land legalization services ii. Draft agreement between the ILP and VMVDU for contracting ILP services.	4,500 titles registered Base-line study completed. Better idea of proportion of homes without registered legal title.	4,800 titles registered	5,100 titles registered	5,600 titles registered	A US$400,000 advar will be provided for t first 2,000 titles; thereafter, payment v be made for each 2,0 titles registered. An estimated 20,000 titles, at an average c of US$200 each.
Progressive subdivisions lting and ement of goods:	i. Appointment of the coordinator for the assigned component at OPES/VMVDU.					
Development of standards	ii. Action plan submitted.	(a) Contracted and done (US$150)				
Reviewing PHDP regulations		(b) Contracted and done				
Coordination of standards with the sector		(c) Contracted and done				
Program promotion		(d) Contracted and done				
Training companies to comply with the standards		(e) Contracted and done at one company	(e) Contracted and done at one company	(e) Contracted and done at one company	(e) Contracted and done at one company	A minimum of three developers highly representative of the market are expected certified and have qu seals.
Evaluation of compliance			(f) Contracted and done at one company	(f) Contracted and done at one company	(f) Contracted and done at one company	
Issuance of quality seals			(g) One company certified	(g) One company certified	(g) One company certified	There are annual publications about th sector.
Dissemination of sector information			(h) Publication with market information	(h) Publication with market information	(h) Publication with market information	

DETAILED EXECUTION MATRIX: FORMAL MARKET SUBPROGRAM

CTIVITIES	As of February 2002	YEAR 1	YEAR 2	YEAR 3	YEAR 4	SOURCES AI COMMENT
VMVDU modernization ılting and rement of goods	i. Creation of the PCU. ii. Program coordinator selected.					Evaluations will incl the formal and infor market components. Evaluations must at l cover the indicators specified in this mat including policy foc efficiency, resource leveraging, program impact with respect demand, and benefic satisfaction.
Restructuring the PCU	iii. Action plan prepared by the coordinator.	(a) Contracted and implemented	(a) In execution	(a) In execution	(a) In execution	
Human resources		(b) Contracted and implemented				
Improvement in processes and performance measurement		(c) Contracted and implemented				
Information system		(d) Contracted and done	(d) Implemented	Same as prior year/US$30M	Same as prior year/US$30M	
Computer infrastructure		(e) Goods procured and installed	(e) Strategy implemented US$30M			
Communications		(f) Contracted	(f) In execution			
Outside auditing		(g) Auditing contracted and in execution	(g) Auditing contracted and in execution	(g) In execution	(g) In execution	
Sector studies		(h) Studies contracted and done	(h) Studies contracted and done	(h) Auditing contracted and in execution	(h) Auditing contracted and in execution	
Evaluations		(i) Annual evaluation contracted	(i) Year 1 evaluation done, midterm evaluation contracted	(i) Midterm evaluation done, year 3 evaluation contracted	(i) Year 3 evaluation done	
Subsidies for neighborhood improvements	i Regulations of improvement program	620 beneficiary families (average 5 neighborhoods) and	900 families benefit (average 8 neighborhoods) and	960 families benefit (average 8 neighborhoods)	620 families benefit (average 5 neighborhoods)	
Institutional strengthening of AMSS	ii Program executing unit set up iii Action plan approved	Risk map completed and in use	Personnel trained			

TENTATIVE PROCUREMENT PLAN

MAIN PROCUREMENT	SOURCE OF FINANCING	TOTAL AMOUNT (000s)	PROCUREMENT METHOD	PRE-QUALIFICATION	ESTIMATED DATE
SUBPROGRAM I – FORMAL MARKET					
Strengthening the mortgage market					
8 consultants at an average cost of US$60,000	100% IDB	US$500	LB	No	2002
Institutional and financial strengthening of the FSV					
1 consultant	100% IDB	US$1,350	ICB	Yes	2002
Procurement of computer hardware	IDB/Local	US$1,500	ICB	Yes	2003, 2004
SUBPROGRAM II – INFORMAL MARKET					
Marginal neighborhood upgrading					
110 upgrading construction projects at an average cost of US$300,000 ICB will apply for construction projects > US$500,000	IDB/Local	US$40,000	LCB	Yes	2002, 2003, 2004, 2005
Progressive subdivisions					
4 consultants at an average cost of US$10,000	IDB	US$50	LB	No	2002
17 consultants at an average cost of US$50,000	IDB/Local	US$950	LCB	No	2002, 2003, 2004, 2005
Modernization of the VMVDU					
50 consultants at an average cost of US$25,000	IDB/Local	US$1,330	LCB	Yes	2002, 2003, 2004, 2005
1 program manager consultant	IDB/Local	US$240	ICB	Yes	2002, 2003
4 annual consultants to support municipalities, at an average cost of US$400,000	IDB/Local	US$1,600	ICB	Yes	2002, 2003, 2004, 2005
Procurement of computer hardware	100% IDB	US$300	LCB	Yes	2002
Concurrent outside auditing (US$250,000/year)	IDB/Local	US$1,000	ICB	Yes	2002, 2003, 2004, 2005
SUBPROGRAM III – MUNCIPALITY OF SAN SALVADOR (AMSS)					
Marginal neighborhood upgrading					
30 upgrading construction projects at an average cost of US$300,000 ICB will apply for construction projects > US$500,000	IDB/Local	US$10,000	LCB	Yes	2002, 2003, 2004, 2005
AMSS institutional strengthening					
13 consultants at an average cost of US$50,000	100% IDB	US$640	LB	Yes	2002, 2003, 2004, 2005
Procurement of computer hardware	100% IDB	US$115	LB	Yes	2002
ICB International competitive bidding LB Local bidding LCB Local competitive bidding					

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ES-0087
Original: Spanish

PROPOSED RESOLUTION

EL SALVADOR. LOAN No. _____/OC-ES TO THE REPUBLICA DE EL SALVADOR

(Housing Program, Phase I)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the República de El Salvador, as Borrower, for the purpose of granting it a financing to cooperate in the execution of the first phase of a Housing Program. Such financing will be for the amount of up to US$70,000,000, from the resources of the Single Currency Facility of the Bank's Ordinary Capital, and will be subject to the "Special Contractual Conditions" and the "Financial Terms and Conditions" of the Executive Summary of the Loan Proposal.

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ES-0087
Original: Spanish

PROPOSED RESOLUTION

EL SALVADOR. PARTIAL PAYMENT OF INTEREST ON LOAN No. ___/OC-ES TO THE REPUBLICA DE EL SALVADOR

(Housing Program, Phase I)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, as administrator of the Intermediate Financing Facility Account, hereinafter referred to as the "Account", to enter into such contract or contracts as may be necessary with the República de El Salvador, as Borrower, and to adopt such other measures as may be necessary to utilize the resources of the Account to pay a part of the interest due by the Borrower on outstanding balances of up to US$32,400,000 of the loan authorized by Resolution DE-___/__, in accordance with applicable Bank policy.