

MULTIPHASE PROGRAM
TENEMENT ACTION PROGRAM IN THE STATE OF SÃO PAULO¹
(BR-0298)

EXECUTIVE SUMMARY

Borrower:	The State of São Paulo			
Guarantor:	The Federative Republic of Brazil			
Executing agency:	Companhia de Desenvolvimento Habitacional e Urbano do Estado de São Paulo (CDHU) [Housing and Urban Development Company of the State of São Paulo]			
Amount and source:	In US\$ millions	Stage 1	Stage 2	Total
	IDB (OC):	US\$34	US\$76	US\$110
	Local:	US\$36	US\$74	US\$110
	Total:	US\$70	US\$150	US\$220
Financial terms and conditions:	Amortization period:	25 years		
	Grace period:	4 years		
	Disbursement period:	4 years		
	Commitment period:	3 years		
	Interest rate:	variable		
	Inspection and supervision:	1%		
	Credit fee:	0.75%		
	Currency:	IDB currency pool		
Multiphase approach:	Owing to its innovative nature and complexity, the program will require more than one execution cycle, and therefore a multiphase approach is proposed. The main reasons for this are: (i) the program includes participatory methods and execution mechanisms that are new in the country and require the involvement of civil society and private sector stakeholders who need training to be fully involved; (ii) the process of dialogue and the quest for solutions that are acceptable to all parties requires a maturation period that could easily take more than two years from the identification of beneficiaries to the design,			

¹ The Portuguese term for tenement is 'cortiço', which literally means a beehive. It is popularly used in São Paulo to denote old buildings that have been subdivided into small rooms.

construction and sale of housing solutions that are best suited to the needs and ability to pay of tenement residents; and (iii) the institutional strengthening required by CDHU to work act on a larger scale, directly supporting demand, is a long-term and gradual process.

The first phase to be carried out on a pilot basis will develop new financial instruments and strengthen CDHU institutionally so that it can finance a pilot project for 5,000 families living in tenements to purchase housing in downtown São Paulo. A larger-scale second phase will finance housing solutions for at least another 11,000 families living in different municipalities in the state. With respect to changes in the state government's housing finance policy, phase one calls for CDHU to develop and introduce a new intervention model for the 5,000 families, based on organization of demand accompanied by a system of explicit advance subsidies and complementary loans. The second phase will extend the subsidy and loan system to the other state housing programs. By the second phase, the loans granted in the first will have constituted a portfolio whose management will be outsourced under an administration contract that will promote portfolio recovery. The results of a portfolio management study are expected to be available prior to the start of phase two and at least 50% of the portfolio constituted by CDHU's other intervention models will be managed as recommended in that study.

Objectives: The general objective of the program is to improve the quality of life of poor families living in substandard housing in tenements in the downtown areas of municipalities in the state of São Paulo, by financing housing solutions, renovating existing tenements and taking steps to promote urban renewal in those zones.

Description: **Components**

1. Financing demand for housing solutions (US\$59.6 million)

This component offers families living in tenements financing to purchase low-cost housing, based on family size and income level. It will grant mortgage loans to families living in tenements, supplemented by direct subsidies. This financing can be used to buy housing on the market, renovate their current housing, or purchase housing collectively. In cases in which more time is required to regularize ownership and the properties cannot be immediately transferred to the beneficiaries, they will temporarily pay rent for them, which will be credited against payment for their housing solution.

The solutions will be defined for each group of families living in a tenement or group of tenements in the same neighborhood that are priorities for program interventions. Priorities will be established in conjunction with the municipalities for integrated urban renewal activities.

A one-room apartment up to 30 square meters in size, including a bathroom and kitchen, would be eligible and can be purchased with a subsidy of US\$5,000 and a mortgage for the same amount. If family income permits, the mortgage can be increased up to US\$10,000, although the subsidy will remain US\$5,000 for each beneficiary family. In the latter case, apartments up to 45 square meters could be purchased.

2. Projects and social action (US\$4.5 million)

This component will finance:

- a. The preparation of **architectural and engineering designs** to prepare proposals for housing solutions for program beneficiaries; and
- b. **Social actions** intended to promote: (i) the organization of families living in tenements (including registration, program recruitment, socioeconomic particulars and technical and social advisory services); (ii) support for the beneficiaries in implementing the proposed individual or collective solutions, including social services during construction, when necessary; and (iii) support and counseling on living in the new housing, establishment of condominiums and post-works follow-up. This component will be implemented by NGOs or specialized firms, qualified and contracted by CDHU to support program execution.

3. Institutional development (US\$1.1 million)

The following institutional studies and measures will be financed:

- a. **Review of the state of São Paulo's housing policy**, which includes systemization and analysis of the legislation and standards governing its housing programs, an analysis of practices and recommendations for their improvement (US\$200,000).
- b. **Improvement in CDHU management**, which includes: (i) an evaluation of the financial status of its current loan portfolio, with projections of flows of funds, analysis of accounting systems and loan-recovery methods, with a view to improving portfolio

management, either by selling it or outsourcing its management; and (ii) a management analysis and implementation of institutional, financial and operational measures (US\$600,000).

- c. **Rental guarantee fund**, which includes a study of the feasibility of establishing a self-sustainable fund to provide low-income families with rental guarantees so they can rent on the formal market (US\$200,000).
- d. **Training and dissemination**, which includes seminars to study and disseminate new housing policy instruments, including the instruments in the proposed program (US\$100,000).

Administration and supervision (US\$4.5 million)

The program's administration and supervision costs are: (i) central administration (US\$400,000) to cover incremental personnel and other costs incurred by CDHU for program administration; (ii) contracting a project management firm to support the operation and supervision of the works (US\$3.8 million); and (iii) monitoring and auditing, which will finance the system for tracking the technical and qualitative performance of the program and independent auditing costs (US\$300,000).

Dynamics of program execution

The selection of the beneficiary tenements will be made through a dual process: (i) initially, CDHU will reach agreement with the municipalities regarding the zones for program intervention, identified according to urban renewal priorities, the number of tenements and the feasibility of intervention in the zone; (ii) a socioeconomic analysis will then be performed, including a description of the physical condition of the tenements in the zone; (iii) this information will be used by program management to make a preliminary selection of eligible tenements; (iv) the program will then be promoted among the tenement residents by CDHU, supported by consulting firms or NGOs contracted to perform the social and technical work and to organize the tenants into associations; (v) these organized groups will prepare proposals for housing solutions, which must meet program eligibility requirements; (vi) CDHU will review the proposals and select the eligible ones, signing contracts to finance the solutions with the beneficiaries, in the form of letters of credit (a promise made by CDHU to provide a mortgage loan when the housing is built or the beneficiary has found housing on the market) and subsidy certificates; with those documents, beneficiaries gain the right to purchase a housing solution provided under the program or to buy housing on the

market; all the residents of the selected tenements will receive support from the program in finding a solution; (vii) construction of new housing, purchase of buildings or renovation of tenements by construction companies or CDHU; (viii) payment by CDHU of the cost of the works in exchange for the endorsed subsidy certificates and signature of mortgage or rental contracts with the beneficiaries; (ix) recognition by the Bank of the costs incurred by CDHU; and (x) social services of the beneficiaries for two years to help them adapt to condominium ownership and to understand their obligations and rights in their new roles as owners or renters.

**The Bank's
country and
sector strategy:**

The Bank's strategy established in the country paper approved in July 2000 is to cooperate with the government in achieving growth with stability and reducing inequity and poverty. The main areas are: (i) to promote and deepen reform and modernization of government on the federal, state and municipal levels; (ii) to boost competitiveness and market access for Brazilian products, reducing the "Brazil cost" by modernizing the productive sectors and the financial system, rehabilitating infrastructure and promoting regional integration; and (iii) to address the problems of social inequity and poverty, giving priority to education and health care and actions to improve the efficiency of social spending and support the decentralization of social services.

The proposed program is consistent with this strategy since it is designed to meet basic housing and sanitation needs, thereby improving the quality of life for low-income groups needing priority attention in São Paulo.

**Environmental
and social
review:**

Positive impact. The program will have a positive impact on the direct beneficiaries and on the quality of life in metropolitan São Paulo by eliminating the physical, sanitary and urban deterioration represented by the tenements. Participation by the beneficiaries in the conception, design and implementation of the projects will make it possible to better serve their needs. The eligibility and selection criteria for beneficiaries will include specific safeguards to ensure that women have equitable access to the program (see paragraphs 4.13 to 4.15).

Environmental protection and social action. To secure the positive impact and minimize any negative effects, CDHU prepared a socioenvironmental evaluation and a social action plan. The following factors were considered, to the Bank's satisfaction: (i) capacity to provide basic services in the sample of projects proposed by CDHU; (ii) the applicable environmental and social legal and regulatory framework; (iii) the process of consultation with affected groups and the methodology for their full participation in the project cycle; (iv) the

need to resettle families and an analysis of resettlement procedures; (v) an analysis of barriers and factors that limit access by women to low-cost housing; (vi) provision of spaces for recreation and community use; and (vii) technical and environmental eligibility criteria for projects, compatible with current standards (see paragraphs 4.16 to 4.20).

Monitoring, oversight and evaluation. In addition to the normal program monitoring parameters, the following will be included in phase one of the program: (i) procedures for environmental and social monitoring and oversight; (ii) monitoring of a sample of beneficiary families; and (iii) an evaluation of the impact of repopulating and revitalizing urban centers.

Benefits:

The first stage of the program will benefit 5,000 families currently renting substandard housing, who will become owners of a housing solution with adequate sanitation. The project will also lead to an increase in property values and environmental rehabilitation. The main intangible benefits that are difficult to measure are promotion of the social capital of poor families through the creation of social networks and community ties.

There will be additional incidental urban benefits in the areas where the tenements are located, as a result of revitalizing existing urban infrastructure, improving urban quality and raising property values.

Risks:

The program will design a transparent system of subsidies combined with loans for the beneficiaries at interest rates that cover the cost of attracting and operating medium- and long-term financing in Brazil. It is expected that this system, which will initially be used to finance the tenement program, will eventually be adopted by CDHU for all its operations. There are potential difficulties on account of administrative inertia and the practices and regulations applied under in the current system, which may impede the adoption of this new form of financing. Although this risk does not jeopardize the program's general objectives, studies and information seminars will be carried out to overcome any resistance to changes in current housing financing practices.

The program involves certain logistical and social aspects that are particularly complex. Organizing families who rent into groups that can gain access to housing solutions under the program requires specialized advisory and organizational services. Careful prequalification will be used to contract consulting firms or NGOs that specialize in these areas, with experience in similar programs.

Special contractual conditions:

1. **As a condition precedent to the first disbursement, the borrower, through CDHU, will present the following documentation to the Bank;** (i) an agreement between the State of São Paulo and the executing agency (paragraph 3.1); (ii) evidence that the program's Operating Regulations, including its annexes have entered into force (paragraph 3.2); (iii) the model letter of credit, subsidy certificate, sales contract, and contracts for public services to be used in the program, duly approved by authorized representatives of the executing agency (see paragraph 3.14).
2. **During execution.** Twelve months after signature of the loan contract, the CDHU will submit evident that consulting services have been hired to: (a) support the borrower in program in program management (paragraph 3.4); and (b) assess the impact of the first phase of the program (paragraph 3.32). In order for a municipality to participate in the program, the CDHU must demonstrate that it has signed a letter of intent and/or an agreement for the activities to be carried out under the component for financing housing solutions with the municipality (paragraph 3.6). CDHU will present the terms of reference, in advance, for the following studies under the institutional development component: (i) diagnostic studies on the borrower's housing policy and recommendations to enhance it; (ii) organizational improvement of the CDHE, including a review of procedures for management of its subborrower portfolio; (iii) feasibility of the rental guarantee fund and (iv) seminars and other activities for training in and dissemination of the new instruments for housing policy implementation (paragraph 3.25).

Poverty-targeting and social sector classification:

This operation qualifies as a social equity enhancing project, as described in the key objectives of Bank activity set forth in the Report on the Eighth General Increase in Resources (document AB-1704). Furthermore, this operation qualifies as a poverty-targeted investment (PTI). The borrowing country will not be using the 10 percentage points in additional financing allowed for poverty-targeted investments (paragraph 4.21).

**Exceptions to
Bank policy:**

According to the application of the Brazilian government, the guarantee contract to be entered into between the Federative Republic of Brazil and the Bank will not include a guarantee by the Federal Government to provide local counterpart resources or to meet those of the borrower's obligations to perform that lie outside the legal competence of the Federal Government. This decision derives from the constitutional and legal provisions in force in the country in matters of administrative decentralization and from the policy for the control of public expenditures. The financial analysis shows that the Borrower has the requisite capacity to provide the counterpart contribution (see paragraphs 4.41 and 4.42).

Procurement:

Procurement of goods and the awarding of contracts for consulting services under the program will be carried out in accordance with Bank procedures. International competitive bidding will be required for goods over US\$350,000 and services over US\$200,000. The program does not provide for the awarding of construction contracts.

I. FRAME OF REFERENCE

A. Socioeconomic framework

1. Macroeconomic context

- 1.1 Since the 1998 crisis, Brazil's economic policy has been focusing on four main areas: restoration of the fiscal balance, a competitive exchange rate policy consistent with annual inflation goals, continuation of the process of reform and modernization of the State, and trade liberalization and regional integration of the economy.
- 1.2 In the final months of 1999, Brazil began a gradual recovery from the adverse effects of the recession in Asia and the Russian moratorium. This favorable economic performance continued to gather speed in 2000. Real GDP grew by 4.6 percent, which was the largest increase in five years. At the same time, there was significant improvement in employment rates, the fiscal adjustment continued and inflation was low. This virtuous circle had a major impact on investor confidence, mirrored in a large boom in foreign investment and a reduction in the Brazil cost. The country's economic situation deteriorated in the first half of 2001 owing to external and internal factors.
- 1.3 Those factors have affected the economy in various ways. First, as a result of the uncertainty in Argentina and other sources of speculative pressure, the *real* fell in value by almost 16 percent between January and the start of June. This has forced the authorities to raise interest rates in order to achieve the inflation target of 4 percent for the year. The higher interest rates are also affecting the economic recovery, as can be seen in the slowdown in GDP which grew by 3.8 percent in the first quarter of 2001, compared to 4.6 percent in the previous one. The rise in interest rates is also complicating the government's efforts to reduce the foreign debt and achieve its fiscal adjustment goals.
- 1.4 Despite these difficulties, the government achieved a milestone in May 2000 when Congress passed the Fiscal Accountability Act. Implementation of that act is expected to lead to a significant improvement in state and municipal finances in the short term, since it calls for rationalization of current expenditures and new debt. Last, the government is introducing other major reforms, such as tax reform. Passage is pending of a series of ordinary laws to ensure effective implementation of other reforms already approved. Progress in these areas is essential for obtaining higher rates of public savings. Those savings are necessary to sustainably increase public investment, which has averaged less than 2 percent of GDP in recent years, and to prevent larger hikes in interest rates. Low interest rates are essential for the success and sustainability of initiatives such as the proposed program.

2. Population growth, urbanization and housing

- 1.5 Brazil has a population of about 170 million. According to census data, over 60 million Brazilians joined the urban population during the 1970s and 1980s, for annual growth rates of 4.4 percent and 3.3 percent, respectively. In tandem with that growth, the urban population rose from 34 percent of the total population in 1950 to 75 percent in 1991. By 2000, 80 percent of all Brazilians and 88 percent of the people living in the southeast, where São Paulo is located, lived in cities. This has led to strong pressure on the supply of urban infrastructure services and housing solutions, particularly in metropolitan regions and their satellite cities.
- 1.6 In 1995, close to 8 million families lived in poor neighborhoods, with 2.4 million living in overcrowded areas and 5.6 million in substandard housing with scant urban infrastructure. They lack public water services (12.5 percent), sanitary sewerage (25.7 percent), electricity (10.3 percent) and final waste disposal (51.5 percent). The situation is particularly critical in São Paulo, where over 25 percent of the city's 10.6 million people live in substandard conditions – 2 million in slums and 600,000 in tenements.

3. Substandard housing

- 1.7 Substandard areas are classified as follows: shantytowns, illegal subdivisions and tenements. Shantytowns are unplanned settlements marked by substandard housing, no legal connections to sanitation services, irregular layouts of public streets, overcrowding and the absence of property deeds. **Illegal subdivisions** are areas unlawfully subdivided by real-estate promoters, located outside urban boundaries and/or on land that is not apt for construction owing to environmental protection or risk factors. In general, the lots do not comply with minimum urban standards, which makes it impossible to obtain property deeds, even though residents have almost always bought their lots from promoters.

Figure I -1. Origin of the problem of tenements

Tenements appeared in São Paulo in the closing decades of the 19th century as a housing solution for poor families. They first appeared between 1870 and 1900 as a result of heavy immigration of poor European families who could not find acceptable quarters on the outskirts owing to the shortcomings of the urban transportation system and the high cost of urban land. With the improvement of transportation systems, settlements on the outskirts grew and have become the main residential alternative for the lower and middle classes. This phenomenon led to gradual deterioration in the old downtown core as a result of the change in the socioeconomic profile of the population and the activities located there.

In recent decades, with the speed-up in urban growth and the increase in demand by low-income families with jobs in the city center, tenements regained their popularity as housing solutions for poor families in São Paulo (other large Brazilian cities such as Rio de Janeiro, Recife and Campinas have similar problems in their downtown cores). The limitation on other alternatives imposed during the 1980s under the Leyman Act, which criminalizes illegal settlements, has sped up the transformation of properties in decaying urban areas into tenements.



- 1.8 Tenements (see Figure I-1 and the photo), in turn, are defined as collective housing units (old houses or apartment buildings) that have been subdivided into small rooms. They are generally located in downtown areas and are overcrowded. The rooms do not have sanitary services or kitchens. Sanitary services are shared and kitchens are improvised, combining common areas for dishwashing and the use of small electric or gas burners in the rooms. Accidents and fires are frequent and sanitary conditions are very poor. The tenements are generally run by the owners or middlemen to whom the residents pay relatively high rents, given the quality of the units and the general condition of the buildings.

4. Socioeconomic description of tenement families

- 1.9 There are an estimated 24,000 tenements in São Paulo, where 160,000 families¹ or 596,000 people, accounting for 6 percent of the city's population, live. Almost one half of tenement residents are women. They also make up 34.7 percent of the heads of households in the tenements.² Furthermore, women account for almost 60 percent of heads of households over the age of 40.
- 1.10 Families living in the tenements are generally small, with an average of 3.3 members; 37.2 percent of families are childless, with that figure including 17.4 percent single-person families.

¹ For the purposes of this program, families are defined as a couple, a couple with children or individuals living alone.

² A household head is defined as the man or women living in a tenement who is responsible for the family group.

- 1.11 Over one half (50.8 percent) of people living in tenements are between the ages of 15 and 40. Forty-eight percent hold paying jobs although only half of them work in the formal sector. Over 50 percent of the families have family incomes of less than five minimum monthly wages³. However, more than two-thirds of them are unable to demonstrate their income owing to the informal nature of their work. Accordingly, although they have the ability to pay, about 37 percent of people living in tenements do not have access to official programs to finance low-cost housing or to the formal rental market.
- 1.12 This, and the difficulty of obtaining rental guarantees for accommodation on the formal market, is one of the reasons why the tenements are a convenient housing alternative for some families. The main reason why families use this alternative is its proximity to their places of work and the social equipment and services available in the central parts of the city. This allows families to save between 20 percent and 30 percent of their incomes.



- 1.13 On the supply side, the tenements are explained by the interest of the owners of run-down properties in obtaining acceptable minimum returns while retaining the option of selling the buildings at a higher price in the event municipal works are undertaken that increase their value. In decaying or environmentally undesirable urban areas (for example next to superhighways or railways), turning their properties into tenements is an acceptable solution for owners who have no other use for them.

³ According to the Economic Research Foundation (FIPE) survey of 1997, 24% of the families living in tenements have incomes of less than 3 minimum monthly wages, 27% are in the bracket of 3 to 5 minimum wages, 39% in that of 5 to 10 minimum wages, and 10% of the families have incomes of over 10 minimum wages.

5. Tenements and the low-cost housing market

- 1.14 The rental market for low-income groups is informal and not protected. Usually, a middleman who manages the building collects the rent, payments for water and electricity and taxes from the families, without giving them the guarantee of a formal lease. This situation and the rivalry among families for small common areas leads to violence and poor sanitary conditions.
- 1.15 The value of low-cost housing in decaying areas in the center (US\$780/m²) is almost double the price on the outskirts (US\$400) for similar properties. Monthly rents, which are proportionate to the market price of housing (between 0.8 percent and 1 percent), reflect this difference as well. At about US\$100 a month, families end up paying more for a room in a tenement than for a house with one bedroom, a separate kitchen and a bathroom on the outskirts.

6. The housing sector and its main problems

- 1.16 One of the main problems in the housing sector in Brazil has been the lack of continuity in policies to support demand, particularly by low-income groups. As a result, the housing solutions of the very poor—shanties and tenements—are unsatisfactory in terms of quality and suitability. The pressure to build more and better housing continues in mid-sized and large cities, despite the drop in the population growth rate.
- 1.17 In 1986, the federal institutions that provided financing for the housing sector changed radically. The Banco Nacional da Habitação (BNH) was liquidated and housing program were transferred to the Caixa Econômica Federal. Funding for the Sistema Financeiro de Habitação [housing finance system] was cut back sharply. This led to a series of state and municipal initiatives. The municipalities gave priority to urbanization and improvement of slums, the supply and regularization of urban lots and, secondarily, to the construction of new housing, owing to the lack of funds for investments of that kind.
- 1.18 Tenements are one of the market solutions to the problem of the housing shortage in large cities. As solutions, they present legal, sanitary and safety problems. From the standpoint of their urban impact, tenements generate negative externalities that contribute to deterioration of the areas where they are located which, in turn, lowers land values.
- 1.19 The problem in the large metropolitan areas in São Paulo today is explained by several factors that contributed in the past to making the supply of urban land and housing for low income groups rigid in the face of rising demand. However, the municipality and the state have taken steps to increase the supply of land and make construction standards and land-use regulations more flexible, removing restrictions that drove up construction prices. The law that controlled rents and housing supply

in this market segment in the municipality of São Paulo was repealed in 1993. Also, since 1990, both the state and the municipality have been supporting demand by the poorest groups in shantytowns through construction or financing to enable them to obtain housing solutions.

- 1.20 Considerable difficulties still exist with regard to subsidies and targeting the most vulnerable groups. The use of subsidies needs to be optimized by making their value explicit at the time they are granted, linking them to the income of target groups and mobilizing the ability to pay of program beneficiaries who, as in the case of tenement residents, spend a large part of their earnings on accommodation. It will be necessary to eliminate the restriction on CDHU loans that requires that just 10 percent of income be used for loan payments, when tenement residents are actually spending between 25 percent and 35 percent of their income on rent.
- 1.21 Also, the existing system of housing financing discourages private participation, since mortgage loans are difficult to foreclose. CDHU finances 100 percent of the cost of housing and does not require contributions from beneficiaries, thereby missing out on an opportunity to recover costs and use the beneficiaries' savings.

B. Policies of the municipality and state of São Paulo

- 1.22 The extent and complexity of the problem of tenements in the municipality of São Paulo have meant that all actions taken over the years have been stopgap and limited in scale. The municipal housing plan (1983-1987) attempted several kinds of action with owners, middlemen or primary lessors and families residing in tenements. The experience showed that: (i) without adequate incentives and the ability to implement punitive measures, owners are not interested in rehabilitating their buildings and middlemen do not comply with their commitments to improve the physical condition of housing; (ii) the public needs to be organized, with legal assistance and the support of efficient organizations in order to defend their rights; (iii) specific legislation is needed on tenement buildings.
- 1.23 The municipality designed its housing policy on that basis, linking the problem of tenements to a policy for urban renewal in the downtown core. The guidelines are: (i) to keep low-income families in central areas that offer access to services and employment, optimizing the use of existing infrastructure; and (ii) promoting the recovery, legalization, renovation and reorganization of low-cost housing in the downtown core under specific legislation. However, the difficult fiscal situation in the municipality made it impossible to fully implement its rehabilitation policy.
- 1.24 The main municipal program under way is the high-rise housing project in shantytowns, known as the Cingapura project, financed with funds from the Bank, the Caixa Econômica Federal and the Self Help Fund (which is only backed by the Municipal Housing Fund). The Bank loan is 70 percent disbursed but has encountered difficulties owing to the lack of counterpart resources. In particular, the

1998 devaluation demand a greater effort by the municipality to maintain the disbursement rate in domestic currency.

- 1.25 The main functions in the state's housing policy are carried out in practice by CDHU, which builds directly, assigns housing to beneficiaries, grants housing loans and subsidies, and administers the loan portfolio.
- 1.26 The state of São Paulo institutionalized a new source of funding for low-cost housing in 1990, through a one percentage point increase in the turnover tax based on value added (ICMS). It is the main source of funding for investments in the sector, with 75 percent going to the state and 25 percent to the municipalities. The tax was designed to remain in effect for a limited time and was to be adjusted in function of the deficit. The increase in the ICMS permitted the state of São Paulo to obtain revenues averaging US\$570 million a year between 1991 and 1997. Income from the ICMS accounts for over 90 percent of the new funds for investments in housing in the state of São Paulo. Since the 1998 devaluation, revenue from the ICMS for low-cost housing has dropped to around US\$350 million a year.

- 1.27 In its 30 years of existence, CDHU has marketed about 280,000 housing units. Seventy-five percent of those transactions took place after 1991, when financing was begun through the ICMS. Most of those houses were built on the outskirts of cities, where land was relatively cheap, but it was necessary to extend services. After they were built under one of the programs described in Figure I-2, they were given to beneficiaries

Figure I-2. CDHU Programs

Turnkey contracts (chamamento integral). CDHU calls for bids for an entire housing project, including the land, establishing a maximum price for the contract, and awards it to the prequalified company that offers the best discount on the indicative price, with certain restrictions.

Global contracting (empreitada global). This program is also developed by awarding contracts for housing projects, built on land belonging to CDHU or to the municipalities in which the project is to be built, particularly in the metropolitan region of the city of São Paulo. The land may already belong to CDHU or may be obtained by it through expropriation. Land belonging to the municipalities was given as a donation.

Self-management or self help (mutirão) These are projects in the metropolitan region in which the beneficiaries, whose eligibility criteria are established by CDHU for the type of housing to be built, contribute a given amount of personal labor, with the rest performed by specialized operators. The initiative is taken by associations, NGOs or other organizations. The land may belong to CDHU or to the associations themselves.

Municipal programs (abiteto). Housing developments built outside the metropolitan region in cities with populations of under 100,000. The special feature of this program is that CDHU gives funds to the municipalities based on progress in the works and the municipalities are responsible for managing and administering the projects. In these cases, the land is also donated by the municipalities, which also undertake to provide the basic infrastructure. Under this program, a basic basket of materials is financed.

- who qualified in regional selection processes. Most of the housing was intended for the very poor, with family incomes of less than three minimum monthly wages (US\$300). Residents of tenements and shantytowns who complied with the income requirements were eligible for housing constructed by CDHU but, in the event they were selected, they had to abandon the place where they lived and worked.
- 1.28 CDHU uses financial terms and caps on financing granted from its own resources that are based on the rules of the housing finance system. As a contractual instrument, it uses a 'promise to sell' and in theory retains ownership of the building until the beneficiary has paid off the debt. The interest rate varies with the

size of the loan – from 1 percent for loans up to US\$1,000 to 5 percent a year for loans over US\$10,000. The repayment period can be up to 25 years.

- 1.29 The subsidies are granted to beneficiaries in the form of a discount on the monthly payment calculated under the above conditions. The discount is personal and nontransferable and is extended under a specific contract that establishes the value of the discount on the monthly payment on the basis of the beneficiary's income. The subsidy is computed over the life of the loan and the cost is posted when the payments fall due.
- 1.30 The main problems with this system are as follows: (i) the subsidies are included in the interest rate, which confuses beneficiaries about the cost of the housing; (ii) it leads to distortions in the financial market for private housing by artificially driving down interest rates that prevent the private sector from competing; and (iii) the fact that CDHU itself constructs large housing projects prevents the development of a private sector that builds low-cost housing on a smaller and more personalized scale. This set of problems is mirrored in the fact that many of the beneficiaries of the 280,000 houses are not willing to pay for them, which has led to a large informal resale market.
- 1.31 The state of São Paulo designed the tenement action program because tenement residents have shown their preference by renting housing, despite its poor condition, that has the central location they prefer, which is a good indicator of their ability to pay. The program posits that demand and its organization are basic conditions for establishing and defining a housing product that truly meets their needs.

C. Program strategy

- 1.32 The program to solve the housing problem in tenements is medium to long term. It is based on the premise that the selective interventions for the recovery of run-down areas will have an impact on urban renewal by improving housing quality. Downtown areas have significant advantages with regard to location and it is expected that the initial intervention of CDHU and the municipality will spur private sector participation as property values rise in those areas.
- 1.33 The program will also structure and direct the credit function of housing finance institutions and rationalize housing subsidies. The first step for including loans in the financial system is to confer solidity and liquidity on CDHU mortgages. The program will use a system of direct subsidies whose amount is known when they are granted, which will be gradually adopted by CDHU in the rest of its operations. Loans will be granted to beneficiaries at interest rates that cover the cost of attracting and operating medium- and long-term financing and a separate account will be used to grant direct subsidies to complement those loans. CDHU will recover part of its costs and the difference will be open and equitable subsidies. The

subsidies and the loans can be used for CDHU housing, housing offered by the municipalities or housing available on the market.

- 1.34 Use of explicit subsidies in operations to support tenement residents in downtown areas is an initial strategy to facilitate the subsequent adoption of the system in all CDHU operations. The process of change is complex, since existing rules are well known and

Figure I-3. Bank country strategy

The Bank's strategy established in the country paper approved in July 2000 is to cooperate with the government in achieving growth in a frame of stability and reducing inequity and poverty. The main areas are: (i) to promote and entrench reform and modernization of government on the federal, state and municipal levels; (ii) to boost competitiveness and market access for Brazilian products, reducing the Brazil cost by modernizing the productive sectors and the financial system, rehabilitating infrastructure and promoting regional integration; and (iii) to address the problems of social inequity and poverty, giving priority to education and health care and actions to improve the efficiency of social spending and support the decentralization of social services. The proposed program is consistent with this strategy since it is intended to meet basic housing and sanitation requirements, thereby improving the quality of life for low-income sectors needing priority attention in metropolitan areas.

enshrined in its administrative norms and practices. The program will facilitate analysis of the necessary changes and will promote and inform about the advantages of the new practices.

- 1.35 Establishment of an integrated system for beneficiary identification and classification is a key for rationalizing the system. It will permit better targeting of the beneficiaries most in need of assistance and offer suitable options for the different demands and socioeconomic situations of beneficiary families. In relation to the supply of housing to meet this demand, the first option to be considered will be a remodeling of an original tenement itself, which is generally the least-cost option. Also, to keep the beneficiaries in their chosen area of residence, they would have the option of housing units built over the old tenements or apartments available on the market in that area. At first, the CDHU, the major supplier of housing for low-income families, would be charged with providing that housing in remodeled and/or rebuilt tenements until the publicizing of the financing system has promoted the availability of privately supplied housing.

- 1.36 CDHU initially asked the Bank for a loan of US\$140 million, which is consistent with the program and the financing required. Since the operation is a pilot project, the government authorized financing in two stages —the first for US\$34 million and the second for US\$76 million. Phase one of the program is described in the following chapter. The objectives and indicators for phase two are presented in the logical framework (Annex II-1).

D. Bank experience in the sector

- 1.37 The Bank's recent experience with low-income neighborhood improvement projects in Brazil includes the following: the urban improvement program in Rio de Janeiro, stages I and II (898-OC/BR of 1995 and 1241-OC/BR of 2000), the slum improvement project in São Paulo (938/OC-BR of 1996) and the slum improvement project in the state of Rio de Janeiro "Baixada Viva" (1037/OC-BR of

1997). In 1998, it approved the improvement program known as Habitar-Brasil (1126/OC-BR), which established guidelines for federal housing policy, placing special stress on the regularization of shantytowns and illegal subdivisions.

- 1.38 The lessons learned from the Bank's past experience indicate that comprehensive assistance for families through social action programs that, in addition to improving infrastructure, cover basic social services and allow people to stay where they are is an efficient option from the economic and social standpoints, chiefly because it saves relocation costs, allows for maximum use of the sunk costs in in-situ infrastructure and existing social services and strengthens existing community ties. Social follow-through, particularly when beneficiary families have to live in condominiums, has proven to be highly important for the sustainability of the actions. The lessons learned from these operations also point to the importance of participation and linkage among the different levels of government and including them in the design and execution of programs, each helping to solve social emergencies in accordance with its mandate.
- 1.39 The Bank's experience in the region with housing programs for the poor that promote direct financing of demand through loans and subsidies⁴ recommends the greatest possible transparency and simplicity in the plan for targeting subsidies. Transparency permits the beneficiaries to know the cost of the solutions, the subsidies they received and the obligations they incur, all of which legitimizes cost recovery. The "Cingapura" program for high-rise buildings in shantytowns also points to the advisability of simplifying subsidies and building solutions in areas that are attractive to low-income groups. It also highlights the importance of ensuring that the financing arrangements are in line with the economic possibilities of the beneficiaries, in order to achieve self-targeting. The latter makes it possible to recover the costs from the beneficiaries, thereby increasing the coverage and sustainability of such programs.
- 1.40 The operation to support the tenement action plan (ATN/FC 6431-BR) funded by the French Trust Fund is intended to support CDHU by developing technical methods for comprehensive urban interventions, agreements with the municipalities, low-cost rentals and social follow-through for participatory management of communally-owned buildings.

⁴ Program to support the housing sector (UR-0036) and support for reorganizing the housing sector in Paraguay (PR-0031).

II. THE PROGRAM

A. Objectives

2.1 The general objective is to improve the quality of life of poor families living in substandard housing in tenements in the downtown areas of municipalities in the state of São Paulo, by financing housing solutions, renovating existing tenements and taking steps to promote urban renewal in those zones.

2.2 The specific objectives are:

- a. To improve the housing situation of families living in tenements through the supply of a variety of solutions that are compatible with their aspirations, needs and ability to pay.
- b. To guide and promote the organization of tenement residents so they will be ready to participate in the actions promoted by the program.
- c. To promote the rehabilitation of city cores and the preservation of historical buildings in those areas.
- d. To develop the housing policy instruments of the state of São Paulo, seeking better focus for subsidies for low-cost housing, greater efficiency in its institutions and better sustainability of the housing loan system.

2.3 Owing to its scope and complexity, the program requires more than one execution cycle (see Figure II-1), and a multiphase program is therefore proposed. The first phase will be a pilot project to test operating, financial and social mechanisms and procedures with a sample of 5,000 families in the

municipality of São Paulo. Phase one will develop new financial instruments and strengthen CDHU institutionally. With regard to changes in the state's housing finance policy, in this phase CDHU will develop and implement a new intervention model based on the organization of demand, accompanied by a system of explicit advance subsidies and complementary loans for the 5,000 families. It is expected that the results of a study on portfolio management will be available before phase two begins and that at least 50 percent of the portfolio generated by CDHU's other intervention models will be managed as recommended in the study. Phase two,

Figure II-1. Reasons for the multiphase proposal

- The program includes participatory methods and execution mechanisms that are new in the country and require the involvement of civil society and private sector actors who need training to act optimally;
- The process of dialogue and the quest for solutions that are acceptable to all parties requires a maturation period that could easily take more than two years between the identification of beneficiaries and the design, construction and sale of solutions that are best suited to the needs and ability of pay of tenement residents; and
- The institutional strengthening required by CDHU to act on a larger scale, directly supporting demand, is a long term and gradual process.

which will be larger, will finance housing solutions for at least another 11,000 families living in tenements in different municipalities in São Paulo. It will extend the system of subsidies and loans to other state housing programs. By that time, the loans granted in stage one will have formed a portfolio whose management will be outsourced under an administration contract that promotes loan recovery (see Annex II-1).

- 2.4 The goals of stage one that will trigger the processing of phase two⁵ include: (i) comprehensive assistance for 5,000 families living in tenements (in the form of social assistance, letters of credit and subsidy certificates), (ii) introduction in CDHU of a system of explicit advance subsidies for program financing and completion of studies to extend it to the company's other operations; (iii) the conclusion of the study on the rental guarantee fund and an analysis of the feasibility of the resulting proposal; (iv) reduction in CDHU's arrears portfolio to 30 percent of its loans⁶ (arrears in the loans granted under the program, which will be outsourced, may not be above the normal thresholds of national mortgage banks for a portfolio of the same age);⁷ and (v) 50 percent of the loan disbursed and 75 percent committed.
- 2.5 When phase two is prepared, the gains in phase one will be used as the foundation for the following anticipated goals: (i) assistance for 11,000 additional families; (ii) the approval of a clear strategy for institutional change in the CDHU, and the indicators for the monitoring of this process (see par. 2.16 subparagraphs a and b); (iii) extension of the system of transparent explicit subsidies to CDHU's other operations; and (iv) a reduction in arrears in the loan portfolio to 20 percent.

B. Components

- 2.6 The following components have been included in stage one of the program.

⁵ The difference between the execution indicators for phase one and the triggers for phase two is that the second are a critical subgroup of the first, whose expected values at the time of the evaluation (50 percent of the loan disbursed and 75 percent committed) are described in paragraph 2.5.

⁶ At May of this year, arrears (loans with three or more installments due and unpaid) accounted for close to 38 percent of the all loans in CDHU's portfolio.

⁷ The index for the number of loans with at least three installments due and unpaid over the total number of loans in collection will have to be below that of the Caixa Econômica Federal for loans to beneficiaries with less than 10 monthly minimum wages. The latter index has ranged between 30% and 40%. Since in the present operation the subsidy has been designed so that the installments payable by the beneficiaries shall be commensurate with their long-term paying capacity, this value should not exceed the range of 0% to 5%.

1. Component 1. Financing of demand for housing solutions (US\$59.6 million)

a. Description

- 2.7 The program will provide the residents of selected tenements in the municipality of São Paulo⁸ with the financial capacity to purchase inexpensive housing, suited to their family size and income. The housing will be financed by a combination of mortgage loans and direct subsidies, which will be supplemented by contributions from the beneficiary families.
- 2.8 With respect to housing supply,⁹ the program will provide different options: (i) construction of new housing in downtown areas by tenement residents, organized into associations, with the support of NGOs; (ii) purchase by beneficiary families of individual housing or apartment buildings already on the market or new housing offered by the private sector; (iii) purchase and renovation of tenements by their current residents or owners, conditional upon subsequently offering the units at prices compatible with the ability to pay of the tenants; and (iv) direct construction of housing by CDHU and its subsequent sale or rental to groups of tenement residents.

b. Instruments

- 2.9 The instruments to be used are:
- a. **Mortgage loans.** Individual loans for up to US\$10,000 to be used to buy properties already on the market, new buildings or to renovate tenements. Eligible families (or groups of beneficiaries for collective purchases) will also receive subsidy certificates.
 - b. **Direct subsidies.** Individual and nontransferable subsidies of US\$5,000, which can be used alone or in combination with loans to purchase housing on the market, finance new buildings or renovate tenements. Subsidies will also be used to assist tenement residents whose family income is insufficient to pay the monthly costs of an individual property. In that event, an agency that promotes social programs under the project will receive the subsidy in order to build or improve collective housing that beneficiaries will be able to rent.
 - c. **Rental contracts** (or use concessions). Use concessions will be utilized in cases in which ownership cannot be transferred at the time the housing is delivered

⁸ Only the municipality of São Paulo will participate in the first phase. Other municipalities may participate if they meet the eligibility criteria established in the Operation Regulations of the program.

⁹ The program will not finance works. Housing built by CDHU and the municipalities to offer to beneficiaries will be put to tender under the applicable legislation.

(owing to legal or other problems) or in the case of collective housing.¹⁰ They are of two types. (i) Five-year leases with the option to buy at the end of the period, financing the outstanding balance over 15 years. Leases will be used in combination with subsidy certificates worth up to US\$5,000. The rent will be capitalized and deducted from the liquid value of the property. (ii) Use concessions for indeterminate periods, without the option to buy (equivalent to low-income rentals), for beneficiaries whose family income is insufficient to purchase or lease a property, the elderly or individuals who do not qualify for other arrangements under the program.

c. Housing solutions

- 2.10 Proposals for projects must include solutions for all the people living in the selected tenements, the form of tenure of the housing in function of the beneficiaries' ability to pay, and financing instruments, including a combination of the following options:

Table II-1. Housing solutions and financing instruments (*)		
Situation at the end of the project	Financing instruments	Housing solutions
Housing owned by the beneficiaries	Letter of credit (up to US\$10,000) and subsidy certificate (up to US\$5,000)	New building Building already on the market Renovated tenement Renovated building
Housing rented with the option to buy	Lease Subsidy certificate (up to US\$5,000) Letter of credit (up to US\$10,000)	
Housing conceded in use	Lease (up to US\$5,000)	Renovated building
Without tenure	Relocation assistance (up to US\$900 per person)	Voluntary relocation
(*) The loan and the size of the housing solution (a maximum of 45 m ²) are determined by the value of the building and the economic capacity of the beneficiary.		

d. Eligibility criteria

- 2.11 **Eligible institutions.** The following are eligible to promote the program's projects: (i) CDHU for its own projects and activities; (ii) legally-established tenants' associations; (iii) NGOs and consulting firms representing a group of tenement families; (iv) municipalities; and (v) private companies acting as construction companies and organizers of tenement residents.
- 2.12 **Eligible tenements.** Must be located in a priority area, i.e. in a basic intervention sector, defined in function of urban renewal priorities, number of tenements and feasibility of the activities, and be included in a zone project that has examined the socioeconomic characteristics of the zone and the physical condition of the

¹⁰ To make loans for the purchase of real estate, the CDHU will review the deeding documents to ensure that they are in order. In cases of apartments built or remodeled in old tenements, when the deeds cannot be regularized quickly the CDHU will sign lease (with option to buy) contracts with the future owners during the period in which their deeds are being processed.

buildings, which must have been tenements for at least five years. Ownership of the building should not present insurmountable obstacles to legalization.

- 2.13 **Eligible beneficiaries.** The beneficiaries must demonstrate that they have lived in tenements located in the same basic intervention sector for at least two years.

2. Component 2. Projects and social action (US\$4.5 million)

- 2.14 Since the essence of the program is that each family and each group of families in a tenement can choose the solution they prefer and, given the variety of socioeconomic situations and the different ownership, occupation and physical conditions in the tenements, social work with these families is fundamental for the success of the interventions. The mobilization of tenement residents and their organization for cooperative action among themselves and with the other agents involved will lead to housing solutions that respond best to their requirements. Development of good cooperation among the beneficiaries is also important for their coexistence in their new housing situations.

- 2.15 This component will finance the preparation of engineering and architectural projects for renovations or new buildings financed by the program. It also includes social actions to promote: (i) organization of the families residing in the tenements for participation in the Program, including presentation and explanation of the options, among the different alternatives offered under the program, that will be available to each family based on their characteristics and interests; (ii) social and technical assistance in obtaining financial support under the program, and social assistance during the phases of construction or the purchase of houses on the market; and (iii) support and counseling regarding coexistence in the new housing, establishment of condominiums and social orientation in general. This component will be executed by specialized organizations that CDHU will carefully select and contract, based on the program's specific requirements.

3. Component 3. Institutional development (US\$1.1 million)

- 2.16 In terms of the opportunities that arise to improve the effectiveness of the state of São Paulo's housing policy, which, in turn, requires a substantial improvement in CDHU procedures and new instruments for social action, the following studies and institutional measures will be financed:

- a. **Review of the state of São Paulo's housing policy (US\$200,000).** Includes systemization and analysis of the laws and standards governing housing programs, an analysis of practices and recommendations for improving them. The work will be performed by a specialized consulting firm with international experience and will make proposals on changes in state and CDHU housing finance policy and how they can be implemented.

- b. **Improvement in CDHU management (US\$600,000).** Two consultants will be contracted to study and introduce changes in internal management, focusing on: (i) the **loan portfolio**, studying loan financing conditions, evaluation of the existing portfolio, projections of flows of funds, accounting and loan recovery systems, and will propose measures to improve management of the portfolio, including its sale or collection by third parties; and (ii) the **organizational changes** needed to improve the operating efficiency of CDHU, consolidation of areas, decentralization, management controls and other relevant aspects. The consulting services include monitoring of the introduction of the proposed institutional, financial and operating measures.
 - c. **Rental guarantee fund (US\$200,000).** Since a large number of families are forced to live in tenements because they do not have the guarantees necessary to rent in a legitimate building (usually evidence that they hold jobs in the formal sector), even though they are able to afford the rent, a study will be conducted of the feasibility of establishing a rental guarantee fund. The fund would be operated by an NGO and would be self-sustainable (by collecting a fee proportionate to the rent guaranteed), thereby giving low-income families access to rental housing available on the market.
 - d. **Training and dissemination (US\$100,000).** Includes seminars to study and inform about the new housing policy (including the tenement action program).
- 2.17 **Program administration and supervision costs (US\$4.5 million).** The costs are as follows: (i) central administration (US\$400,000) for incremental personnel and other costs incurred by CDHU for program administration; (ii) support for management and supervision to be provided by a project management company to administer the operation and supervise works (US\$3.8 million); and (iii) monitoring and auditing, which will finance technical and qualitative monitoring of the program and the costs of independent audits (US\$300,000).
- C. **Cost and financing**
- 2.18 The cost of stage one of the program is an estimated US\$70 million equivalent, with US\$34 million coming from the Bank's Ordinary Capital (OC) and US\$36 million from the local counterpart.

Table II-2. Costs (in US\$ million)				
Category	IDB/OC	LOCAL	TOTAL	%
1. Administration and supervision	0.90	3.60	4.50	6.4
1.1 Central administration		0.40	0.40	
1.2 Support for management and supervision	0.80	3.00	3.80	
1.3 Monitoring and audits	0.10	0.20	0.30	
2. Investment components	32.76	32.40	65.16	93.1
2.1 Housing solutions	31.16	28.40	59.56	85.1
2.1.1 Loans	16.16	14.00	30.16	
2.1.2 Subsidies	15.00	14.40	29.40	
2.2 Projects and social action	1.00	3.50	4.50	6.4
2.3 Institutional development	0.60	0.50	1.10	1.5
2.3.1 State housing policy	0.10	0.10	0.20	
2.3.2 Financial analysis & consulting CDHU	0.20	0.40	0.60	
2.3.3 Rental guarantee fund	0.20		0.20	
2.3.4 Training/information	0.10		0.10	
Subtotal	33.66	36.00	69.66	99.5
3. Inspection and supervision fee	0.34		0.34	0.5
TOTAL	34.00	36.00	70.00	100.0

- 2.19 The total cost of both stages of the program is roughly US\$220 million, with US\$110 million coming from the Bank's Ordinary Capital and the remaining US\$110 million from the state of São Paulo.

D. Financial terms and conditions

- 2.20 The following terms and conditions are proposed for the prospective Bank loan:

Table II-3. Financial terms and conditions	
Amortization period	25 years
Grace period:	4 years
Commitment period:	3 years
Disbursement period:	4 years
Interest rate:	variable
Inspection and supervision:	1 percent
Credit fee:	0.75 percent

III. PROGRAM EXECUTION

A. Borrower, guarantor and executing agency

- 3.1 The borrower will be the State of São Paulo, with the guarantee of the Government of the Federative Republic of Brazil. The executing agency will be the CDHU, a decentralized agency of the Department of Housing of the state of São Paulo. *Presentation of a signed agreement between the state government and CDHU designating it as program executing agency will be a condition precedent to the first disbursement.*

B. Program execution and administration

- 3.2 The program will be executed in accordance with the Operating Regulations whose main features are described in this chapter. *Entry into effect of the Operation Regulations is a condition precedent to the first disbursement.*

1. Organization

- 3.3 Responsibility for program execution Executive Vice President of the CDHU. The General Superintendency of the Tenement Action Program (SGPAC), which reports to the Office of the Vice President, will act as executing unit. The president of CDHU has appointed an executive secretary who will act as its head and coordinate program strategy and management and relations with international and national agencies involved in its execution. A consultative group composed of representatives of the state government and civil society will also be established¹¹ to steer policies for integrated program execution and inter-governmental coordination of activities. The municipal governments, tenants' associations, NGOs and private enterprises will have the role of supporting and promoting program activities.
- 3.4 As executing agency, SGPAC is responsible for the program's planing, direction, control and results. It will be supported by a management firm and an internal executive committee in CDHU, which will coordinate program activities with other CDHU line units. The internal executive committee will be chaired by the executive secretary of SGPAC and composed of five representatives of the company's line units.¹² The management firm will support SGPAC in administering the system for beneficiary identification and classification, project evaluation, control and monitoring of projects under way and follow-up on beneficiaries. *Contracting of the management firm is a condition precedent to the first disbursement.*

¹¹ The group will be chaired by the vice-president of CDHU and be composed of representatives of the State Housing Department, the Ministerio Público, the State Department of Justice and Citizenship, municipal housing departments and up to five delegates from tenants' associations.

¹² Officials in the areas of finance, legal advisory services, works, social action, and planning and projects.

- 3.5 The municipal governments, tenants' associations, NGOs and private enterprises will act as housing project promoters. The beneficiaries, like those of other projects sponsored by CDHU, will have access to direct subsidies and loans under the program. The tenants' associations will be a vehicle for participation in the program by the target population and the associations can contract NGOs, with financing from CDHU, for project formulation, social action and project monitoring.

2. Participation by municipalities

- 3.6 In addition to being eligible to present projects, the municipalities participating in the program will act as organizers of beneficiaries who present projects. They will be active in: (i) planning integrated activities in priority urban areas (preparation of zonal plans) in cooperation with CDHU; (ii) facilitating project approval in their areas of competence; (iii) organizing demand (low-income groups), identifying eligible tenements and beneficiaries, preparing projects, negotiating purchases or agreements with owners and acting as facilitators between the beneficiaries and CDHU; (iv) contributing to the projects through the sale or donation of land for new buildings; and (v) inspecting the original tenements to ensure they do not continue to operate in their existing substandard condition after their residents have found suitable housing solutions.¹³ *The municipalities will sign participation agreements and letters of intent with the state, the terms of which have been agreed on with the Bank, and signature of which is a condition precedent to disbursement of component 1 of the program to each municipality for subsidies and loans.*

3. The project cycle

a. Project planning, dissemination and preparation

- 3.7 Program execution begins by prioritizing the areas for intervention (by mutual agreement with the different municipalities) and preparing a physical study of existing tenements and their socioeconomic features. Interested municipalities must sign a participation agreement and the action strategy and changes in urban regulations for effective program implementation will be worked out with them.
- 3.8 Once the area and the eligible priority tenements have been identified, SGPAC will directly contract or finance preparation of projects presented by eligible entities (municipalities, NGOs, tenants' associations, construction companies). These projects and social action with the tenement families will be carried out by consulting firms or NGOs selected in advance and trained in the work required.
- 3.9 The work includes publicizing the project in the selected areas, a more detailed study of the residents of specific tenements, assistance for them in establishing their

¹³ The prospect of having their tenements closed down and losing this source of income is a strong stimulus for their owners to negotiate their sale to current tenants so they can be reformed.

associations, preparation of preliminary projects on the proposed housing solution for each beneficiary, physical survey of the tenements, features of the construction projects, preliminary cost calculations, legal status of the tenements or other buildings to be purchased, intervention strategy in evacuated tenements, timetable of activities, letters of intent signed with the beneficiaries, etc.

- 3.10 The preliminary projects will be presented to SGPAC for evaluation, which will verify that they meet the eligibility criteria, study the proposed housing solutions, verify the methodology used and the precision of the information provided. Once the project has been examined and approved, SGPAC will authorize the promoter to conduct the feasibility study, with architectural and engineering plans, costs and financial timetable, analysis of technical, environmental, economic, financial and administrative feasibility and a social work plan for project execution. A financing table showing loans and subsidies per beneficiary and type of housing solution is also required. SGPAC will examine the project and issue the corresponding report to the internal executive committee for approval, and will then sign the execution agreement. The Bank's Country Office will perform ex post reviews of a random sample of approved projects.

b. Project execution

- 3.11 Approved projects will be executed by eligible entities or by CDHU, as pertinent, with its own resources and following its own procedures for the purchase of existing buildings or land, selection and contracting of the construction company, building of new works or renovations or demolition of tenements. Although CDHU can use the revolving fund to finance projects, the subsidy certificates in the possession of the executing agency and the mortgages covered in the respective letters of credit will only be paid at the time the individual solutions are delivered to the beneficiary. Rental buildings will be recognized on the basis of the present value of the contract.
- 3.12 SGPAC will permanently carry out the tasks of supervision, quality control and project monitoring and will report periodically to the internal executive committee on execution of each of the approved projects.

c. Sequence of social work

- 3.13 The work of program promotion, organization and follow-through on the beneficiaries, technical and social support during and after program activities will be performed in all phases, as shown in Table III-1. Preparation of the zone projects and engineering studies will be contracted out to NGOs and specialized consulting firms following Bank procedures when loan proceeds are used. The execution agreement for each project between the promoter and CDHU will establish the work plan, timetable for social activities and events to be concluded as a condition precedent for paying the NGO or firm for its services. Social actions will be

supervised by the promoter, which will verify compliance with the work plan and present follow-up reports to SGPAC for payment for those services.

Table III-1. Social work – execution stages		
Project stages	Information and communications	Social work stages
Planning stage (6 months)		
Definition of zones for urban intervention and analysis	<p>Selection of firms to provide social communications services.</p> <p>Preparation of the communications instruments and plan.</p> <p>Preparation of a manual containing guidelines for the establishment of tenants' associations and instruments .</p>	<p>Preliminary social planning:</p> <ul style="list-style-type: none"> - Contracting of firms to organize demand; - Preliminary study of residents' interest in participating in the program; - Identification of existing tenants' associations or NGOs and their degree of formalization.
Execution stage (1 to 2 years)		
Feasibility studies, identification of alternative solutions, definition of alternatives for each family and project preparation	<p>Application of the social communications plan:</p> <ul style="list-style-type: none"> - Meetings of and with tenement residents. 	<ul style="list-style-type: none"> - Presentation of the results of the physical studies on solutions for the tenements. - Updating of socioeconomic information and preparation of a census of residents. - Establishment of tenants' associations. - Formalization of participation in the program (agreements signed by the associations containing the options selected). - Meetings for the presentation and discussion of the projects with beneficiaries and the community and adjustments in the design.
Construction of new units	Maintenance of the flow of information during all stages in program execution; these activities are closely linked to social work and are strategic for its development.	Support for residents in their original tenements, enabling them to remain there until completion of the works. Continuity of social work to support the establishment of condominiums, sanitary and environmental education and counseling regarding access to social services, monitoring of the works.
Renovation of tenements.		Support for the temporary relocation (during the works) to housing near the original location and maintenance of ties among the residents.
Post-intervention stages (1 to 2 years)		
Completed works		Follow-up on beneficiaries through continued sanitary and environmental education, education in coexistence in condominiums and other actions needed to guarantee the sustainability of the investments.

d. Issue of credit and subsidy instruments

- 3.14 CDHU will issue letters of credit, subsidy certificates and rental contracts to beneficiaries, tailored to the proposed solution. *Presentation of the models for the letters of credit, subsidy certificates, sales contracts and contracts for concession of public services to the private sector subject to private-sector investments in the services (concessão onerosa) to be used in the program, duly approved by authorized representatives of the executing agency will be a condition precedent to the first disbursement.* The instruments are described below.

- 3.15 **Letter of credit.** A letter of credit is a promise that serves as a transitional instrument until the new housing solution chosen by the beneficiary can be purchased and the documentation accompanying the sale is complete and individualized. For housing purchased on the market, the letter of credit will be individual for a term of from one to two months and the beneficiary will endorse it to the owner of the property who will present it to CDHU, together with the deed, for payment. CDHU will sign loan contracts with the beneficiary and pay the letter of credit to the owner.
- 3.16 In the case of housing solutions involving renovated or expanded tenements and new buildings, the letters of credit will be issued to the tenants' association for the estimated construction period, renewable if delays occur. The associations will endorse the letter of credit to the promoter and upon completion of construction, the promoter will present the letter, together with the sales contract for the building, to CDHU for payment. Before the beneficiaries occupy the building, CDHU will sign individual mortgage contracts with them.
- 3.17 **Subsidy certificates.** The subsidy certificates to help finance housing through the purchase of buildings on the market, renovation of tenements or new buildings, will be issued and paid in the same way as the letters of credit.
- 3.18 For subsidies that supplement leases with the option to buy, the certificates will be issued to the beneficiaries at the start of the renovation or construction. The beneficiaries must opt to purchase the building within five years after signing the lease.
- 3.19 When subsidies are granted to renovate buildings (pensioners or individuals with insufficient family income to purchase a property or rent one), the beneficiaries will sign contracts conceding use for an indeterminate period. The subsidy to be paid to CDHU or the promoter is US\$5,000.
- 3.20 **Leases-purchase contracts.** Leases with the option to buy will be used in cases in which ownership of the building cannot immediately be transferred to the beneficiaries for legal reasons. The contracts will be for up to five years, at which time the beneficiaries can opt to buy the building and finance the outstanding balance over 15 years. The present value of rental contracts can be recognized as a subsidy for up to US\$5,000. The rent recognized as a subsidy will be capitalized and deducted from the liquid value of the building to be financed for the purposes of the loan that will be granted when the beneficiary exercises the option to buy.
- 3.21 **Relocation assistance.** Tenement residents who are not interested in (or who do not qualify for) any of the program's options, will be offered compensation equivalent to US\$900. They are typically persons living alone or temporary tenement residents. In these cases, the assistance – which represents about six months rent in

a boarding house – will be given to the beneficiaries 15 days before the tenement is closed for reforms or is closed permanently.

- 3.22 **Bank disbursements.** For the housing solution component, CDHU will pay for houses bought on the market, new construction, and renovation of buildings and when they are ready for occupation by eligible beneficiaries, the Bank will compensate it for that spending. Bank disbursements will be made against presentation by CDHU of evidence that it has given beneficiaries loans and subsidies to buy buildings on the market or has signed contracts with them conceding the right to use buildings belonging to it.
- 3.23 The documentation must be accompanied by evidence of the eligibility of beneficiaries and tenements, the social action procedures followed, and other relevant aspects agreed upon with the Bank's Country Office, that demonstrate compliance with the Operating Regulations. The executing agency will keep the supporting documentation for the loans and subsidies on file, subject to ex post revision by the Bank.

4. Conditions for onlending

- 3.24 The borrower will be required to charge interest at rates consistent with those available in the Brazilian mortgage-financing system (SFH), which provides financing for virtually all home buyers earning up to 10 minimum salaries. To provide such financing, the SFH draws on the Length of Service Guarantee Fund, which is funded through a payroll deduction paying a 3% annual return. The financial terms and conditions of these loans, which are granted by the Federal Savings Bank, set a ceiling on the rates charged by private banks serving this market. The rates on low-income housing loans vary from 6% to 8.5% per annum plus an adjustment for inflation.
- 3.25 The interest rate charged on loans under the program will initially be computed according to a cost factor, based on the terms and conditions of the financing that the Bank offers to the state of São Paulo (plus CDHU intermediation costs). This rate will be reviewed each year for new loans to ensure that it is consistent with market conditions, or that it does not compete with lending from other public and private entities for buyers earning up to 10 minimum salaries. If such lending is substantial, the higher rate will be charged.
- 3.26 Loans made to provide housing solutions for beneficiaries out of resources of the Program shall be subject to the following conditions established in the Operating Regulations: (i) amount: save by agreement with the Bank, the amount, in local currency, may not exceed the equivalent of US\$10,000 per housing solution at the the Central Bank of Brazil's day's-end buying commercial rate. The local currency amount will be adjustable annually by the consumer price index (CPI) of the Economic Research Foundation of São Paulo University (FIPE). Only one loan

may be made to each beneficiary; (ii) interest rate: fixed for each loan. Adjustments of the rate shall be determined in agreement with the Bank, based on the changes in the Bank's lending rate for the State of São Paulo and the CDHU's administration costs. For the first year the effective rate proposed by the CDHU is 8.3 % a year, based on 7.3% a year (the Bank's rate for Ordinary Capital loans on 30 June 2001) plus the CDHU's management fee, estimated at 1%; (iii) term: up to 25 years; (iv) payment: monthly installments in equal amounts according to the Price Table system, adjustable yearly based on the FIPE CPI; (v) grace period: one (1) month following the date of occupancy of the housing unit by the beneficiary; (vi) guarantees: a mortgage on the housing in accordance with the Housing Financing System (SFH) or transfer in trust pursuant to the standards of the Real Estate Financing System (SFI). The terms and amount of the subsidy will be reviewed annually on the basis of the performance of the portfolio for purposes of adjusting the installments to the paying capacity of the beneficiaries.

5. Execution of the institutional development component

- 3.27 CDHU will contract consulting services to execute this component, based on terms of reference prepared by SGPAC and approved by the Bank. *Presentation of the terms of reference for the studies and consulting services mentioned in paragraph 2.16 (a, b and c) will be a condition precedent to contracting those activities.*
- 3.28 The study on state housing policy and the consulting services to analyze CDHU's loan portfolio and organization will be contracted with specialized firms, following Bank procedures. The results of the studies and consulting services will be discussed by CDHU's board of directors in order to build consensus for their implementation. In support of the study on housing policy, seminars will be held to publicize and discuss the proposals. SGPAC, supported by the internal executive committee, will monitor the consulting services on organization. Those services and the studies will be contracted during the first year of the program and the results and recommendations should be available by the time of the mid-term evaluation.
- 3.29 The selection and contracting of consulting services and procurements of goods and equipment will be carried out in accordance with Bank procedures, as stipulated in Annexes B and C of the loan contract. International competitive bidding will be required when loan proceeds are used and the estimated cost of the consulting services is over US\$200,000 and the cost of goods and services is over US\$350,000 (see Annex III-2).

C. Monitoring and evaluation

- 3.30 Program monitoring and evaluation will measure its impact on aspects identified in the logical framework as priority goals. It will measure aspects such as improvement in the standard of living of the beneficiary families, their satisfaction

with the program, the status of the associations, generation of social capital, the impact on urban development in the intervention zones and effective introduction of changes in CDHU policies and procedures. A specialized firm will be contracted to perform the monitoring, using tools such as specific surveys in the intervention zones, in eligible tenements (surveys of residents to ensure adequate focus of the housing solutions) and of beneficiary families, and examine CDHU's administrative and financial records.

- 3.31 Processing of that information and the indicators obtained will be used to support program execution and verify compliance with the goals defined as triggers for the second phase (see paragraph 2.5) and as input for the impact evaluation studies after completion of the program.

1. Bank monitoring

- 3.32 The Bank will supervise the program through its Country Office in Brazil. The ex post method is proposed for reviewing the supporting documentation for disbursements and procurements, examining a random sample of the technical and financial aspects of projects during execution. Special attention will be paid to compliance with the Operating Regulations in the assignment of loans and subsidies. Periodic inspection visits and annual program evaluations will be conducted to detect and correct any problems that arise during execution.
- 3.33 In addition to the normal project monitoring parameters, the following will be included when evaluating the first phase of the program: (i) procedures for environmental and social control and supervision; (ii) follow-up on a sample of beneficiary families; (iii) evaluation of the impact of reattracting people to and revitalizing downtown cores; and (iv) implementation of operating procedures and determination of the values that the indicators must attain in order to process the second phase, such as level of disbursements, level of commitments of funds, presentation of audited financial reports and the results of the evaluation by external auditors.
- 3.34 *CDHU will contract independent consulting services to evaluate the first phase of the program. Twelve months after the loan has been declared eligible for disbursement, CDHU will present evidence that it has contracted a firm to conduct the study on the impact of phase one of the program.*

2. Semiannual progress reports

- 3.35 The borrower, through CDHU, will present the Bank within the first 60 days after the end of each semiannual period, with a progress report on program execution, describing actions and activities carried out, use of funds and outputs obtained, goals achieved, problems and proposed solutions.

3. Evaluations

- 3.36 Considering that a multiphase program is proposed, a mid-term evaluation should also be included (when the loan is 50 percent disbursed). During that evaluation, progress in the indicators defined as triggers for the second phase will be examined and any corrections that are needed in its course will be made.
- 3.37 The final evaluation will be conducted by an independent firm. It will be based on the results and inputs offered by the monitoring system. The evaluation will be funded from the loan and will examine the specific results and objectives achieved during execution.

D. Execution period and disbursement schedule

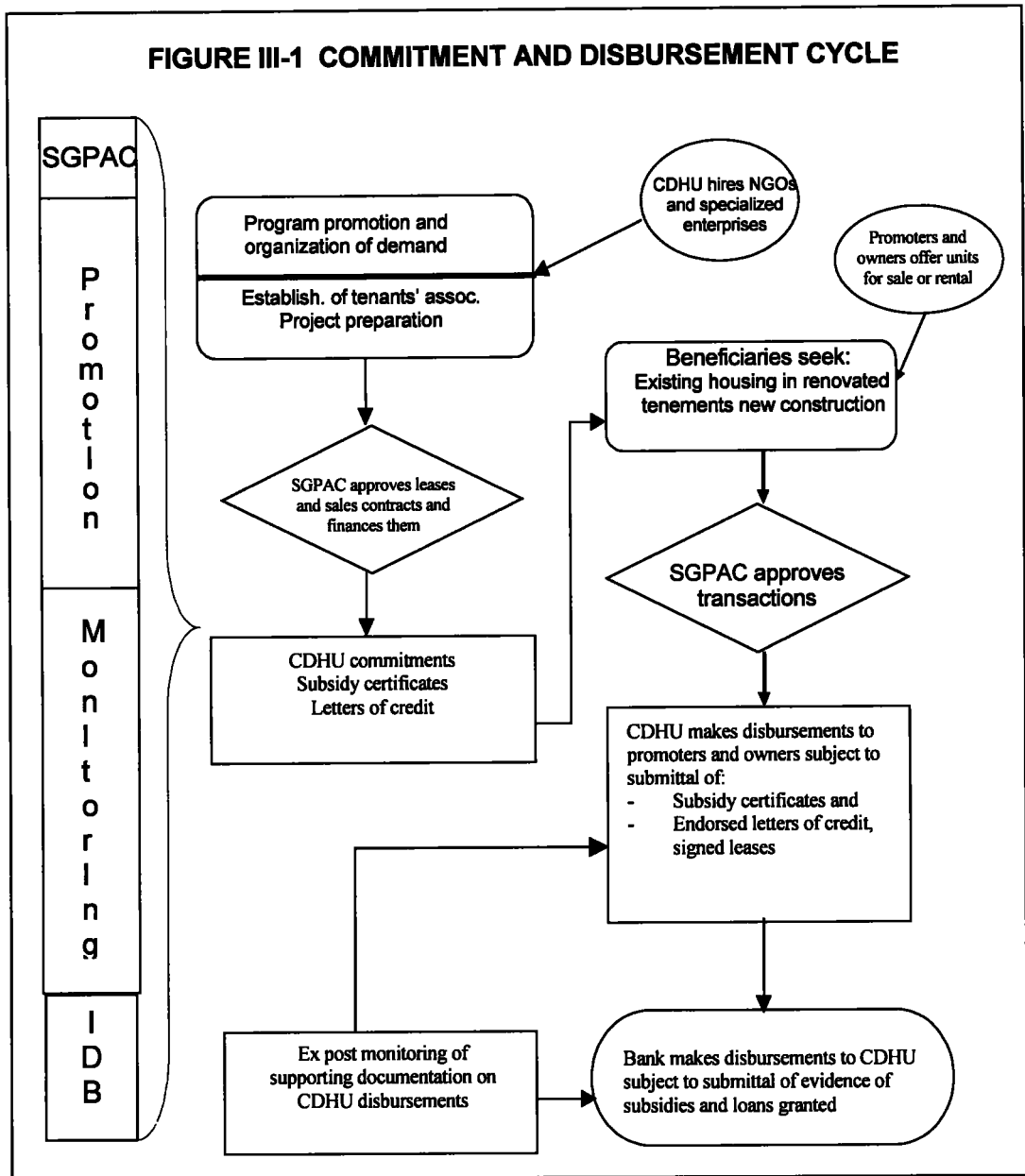
- 3.38 Phase one of the program will last for four years and have the following projected disbursement schedule:

Table III-2, Disbursement schedule (in US\$ thousands)					
Components	Amount	Year 1	Year 2	Year 3	Year 4
Housing solutions	58,600	11,700	17,500	17,500	11,900
Social actions	4,500	1,500	1,300	1,000	700
Institutional development	1,100	550	550	-	-
Administration and supervision	4,500	1,000	1,300	1,300	900
Financial costs	1,300	700	200	200	200
Total	70,000	15,450	20,850	20,000	13,700
%	100.0	22.0	30.0	28.0	20.0

E. Financial administration and external auditing

- 3.39 Through SGPAC, CDHU will be responsible for presenting disbursement requests and justification of the use of program funds to the Bank, including semiannual reports on the revolving fund and disbursements. SGPAC will keep specific accounting and financial records on the program, separate from other programs managed by CDHU. Loan and counterpart funds will be managed through specific, separate bank accounts.
- 3.40 CDHU will present the Bank annually with its own financial statements, the financial statements for the program and the guarantee fund, audited by a private firm of accountants acceptable to the Bank. Within 60 days after the end of each six month period, CDHU will present semiannual auditor's reports on the review of the supporting documentation for the disbursements, in accordance with terms of reference approved by the Bank. The costs of the audits will be financed from loan proceeds.

FIGURE III-1 COMMITMENT AND DISBURSEMENT CYCLE



IV. PROJECT FEASIBILITY AND RISKS

A. Characteristics of the sample

- 4.1 A technical and economic analysis was performed of a sample of 19 projects, which will accommodate the people residing in 49 tenements in the Pari sector in downtown São Paulo (zone defined together with the municipality as a priority area for program intervention). The main characteristics of the sample are presented in the following table:

Table IV-1 Main characteristics of the sample					
Type of project	No. of tenements	No. of families (1)	Area in m ²	Current rent (US\$ month)	Family income (US\$ month)
1. Rehabilitation	22	140	22.8	88,8	354.4
2. Demolition and construction on site	4	23	16.1	110.0	301.2
3. Demolition and purchase outside the project.	3	30	30.7	-	323.7
4. Closure	20	209	9.2	69.9	268.0
Total	49	402	15.9	73.3	304.2
(1) Average number of people per family = 2.38					

- 4.2 The beneficiaries of the projects in the sample are 402 families or 900 people living in tenements, or 8 percent of the 5,000 families included in the program in the pilot stage.
- 4.3 Twenty-two of the tenements in the sample will be renovated, seven will be demolished and new housing built on the site and 20 will be closed with the families moving to new apartment buildings in the area.

B. Technical analysis

- 4.4 The designs for the sample of projects were reviewed by the project team, which found they conform to the standards and specification of the municipal and state agencies responsible for the provision of different kinds of infrastructure. The projects are technically feasible, present minimum-cost solutions and comply with the urban development legislation of the municipality of São Paulo. The unit costs of materials and labor are based on indexes estimated using market prices. Therefore these solutions are eligible for loans and subsidies under the program.
- 4.5 The design of the housing solutions is based on a minimum standard size, whose average cost will be US\$350 per square meter. The team's evaluation of the designs

found that they are minimum-cost solutions. The project costs were compared to the Sistema Nacional de Pesquisa de Custos e Índices da Construção Civil (SINAPE) and it was found that the values used in the project are comparable with construction costs for low-cost housing.

C. Economic feasibility

- 4.6 The main objective of the sample was to generate reliable information for estimating the market value of the housing solutions proposed by the program, with a view to establishing the technical and economic parameters needed to calculate the economic returns required for the projects in the sample.

1. Willingness to pay

- 4.7 The results of a socioeconomic survey of tenement residents, which provided information on family income and spending and on the price, construction quality and location of housing, were used for the economic evaluation of the program. A total of 400 questionnaires were administered, 350 of which were validated. The size of the program's subsidies was based on the difference between the cost of minimum solutions on the construction market and the willingness to pay (WTP) of the beneficiaries for each type of solution.
- 4.8 Table IV-2 presents the results of the analysis, which indicate that for a single-room solution (26.4 m²), WTP was US\$90 a month or the equivalent of about US\$6,700 at present value.¹⁴ For a one-bedroom apartment (up to 45 m²), WTP was US\$120 (equivalent to US\$8,300 at present value).

Table IV-2. Proposed project solutions					
Type of project	No. of units	Area in m ²	WTP per unit (1) US\$	Investment per unit (2) US\$	Difference per unit (1) - (2) US\$
Renovated tenement	113	26.4	6,736	9,756	(3,020)
Construction on the original tenement site	51	49.5	5,276	12,647	(7,869)
Market	22	40.1	5,894	12,654	(6,760)
New construction by CDHU	160	47.4	4,367	12,654	(8,87)
Supplementary assistance	56		-	-	-

- 4.9 From the values obtained by calculating the difference between cost and WTP (US\$3,020 to US\$8,287), it was determined that the program should offer a subsidy of US\$5,000. This was verified through a survey of housing costs in central São Paulo. A sample of 157 apartments on the market was used to determine value and size, as follows:

¹⁴ The present value of a US\$90 monthly payment, using a discount rate of 12 percent.

Table IV-3. Size/value of housing		
Apartment	Area (m ²)	Cost (US\$)
1 room	34	14,500
1 bedroom	41	19,150
2 bedrooms	50	21,450

- 4.10 As can be seen, there is not a great difference between the values of properties of 34 m² and 41 m² and the costs estimated in Table IV-2.
- 4.11 It was established that the value of the subsidy should be US\$5,000 for all beneficiaries and the value of the loan to purchase a minimum cost solution (30 m²) should be US\$5,000. When permitted by the beneficiary's income, the loan could be up to US\$10,000 to finance up to 45 m². To ensure the focus of these instruments, the subsidy and loan cannot be used to buy housing costing more than US\$22,500. The difference between the cost and the maximum financed by the program will be covered by family savings (or other sources).
- 4.12 Fourteen percent of the population in the sample do not have high enough income levels or are not eligible for a long-term loan. They will receive the subsidy to enable them to obtain an acceptable housing solution or relocate voluntarily. For example, for elderly persons who do not qualify for mortgage loans, it is provided that the subsidy will be used in a rental contract with specialized agencies. Those who do not qualify as beneficiary families or do not wish to acquire housing or opt for rental will be given an indemnification of US\$900 per person to cover the costs of relocation to rooming houses.

D. Social and environmental feasibility

- 4.13 **Favorable impacts.** The program will have a positive impact on the direct beneficiaries and the quality of life in downtown areas by eliminating the physical, sanitary and urban squalor represented by tenements. Access to homes with adequate sanitary and safety conditions (enough space, individual bathroom and kitchen, etc.) will contribute greatly to better living conditions for the families.
- 4.14 Owing to the large number of families headed by women (35 percent), the program will also have a positive impact on this group. The eligibility and selection criteria will include specific safeguards to ensure that women have equitable access to the program, such as the requirement that deeds, letters of credit and subsidy certificates be issued in both a couple's names.
- 4.15 The social work will lay the groundwork to enable the beneficiaries to participate fully in the process of project planning, design and implementation. It will also help to facilitate access by beneficiaries to basic social services, such as nurseries, schools and job training and income-earning opportunities.

- 4.16 **Environmental protection and social action.** To ensure that any potential negative impacts are mitigated and in accordance with CESI's recommendations when it approved Profile II on 6 November 1998, the project team and CDHU gave consideration to the following aspects: (i) the capacity to deliver basic services in the sample of projects proposed by CDHU; (ii) the legal framework and relevant environmental and social legislation; (iii) consultations with the groups affected and methods for ensuring their full participation in the project cycle; and (iv) the need for temporary relocation of families and an analysis of the procedures to be used.
- 4.17 The results were published in a socioenvironmental evaluation report that CDHU made public on 22 March 2001. In June 1998, it had held a public consultation with representatives of beneficiaries and NGOs. The main conclusions of the studies indicate that the buildings are located in preferred core areas of cities, with sufficient capacity to deliver sanitary, social and public transportation services. They are areas that pose no natural or environmental risks. The physical process is well established in the new Works and Building Code of the Municipality of São Paulo (Law 11228 of June 1992). Since the works mainly involve buildings between 2 and 14 stories high that house between 5 and 30 families, the environmental impact will be minimal and therefore no environmental permits will be required. However, the bid documents will include technical environmental specifications and safety standards for workers.
- 4.18 The program excludes interventions in historical buildings (Law 25 of November 1937). Furthermore, when an intervention is located within 300 meters of such buildings, the project must be evaluated and approved by the Municipal Historical, Cultural and Environmental Heritage Conservation Council of the Municipality of São Paulo. Also, any changes to plant cover must be approved by the Department of Parks and Green Areas. The environmental ramifications of the program will be closely monitored by CDHU's Environmental Management Office, which also carries out environmental education activities. In addition to the works supervisors, the community should be equipped to verify that environmental measures are included.
- 4.19 Program preparation included a social intervention plan to orient the social work of organizing the beneficiaries during the identification, planning and execution stages, and a counseling plan to be carried out with program beneficiaries after they have occupied their new housing. The main items in the plan are stress on the initial organization of the residents of each tenement through the establishment of a tenants' association that will define and agree on the preferred housing solution with CDHU and monitor execution of the works. Furthermore, the system will offer as many options as possible to the beneficiaries to ensure that the needs of each family are met.
- 4.20 The social support actions are designed to assist the beneficiaries during the pre-intervention, intervention and post-occupation stages. The Bank's resettlement

policy will be applied to any voluntary resettlement or temporary accommodation in shelters and agreements on compensation payments. Last, the purpose of these actions is to consolidate the organization of communal associations to manage the new buildings, in the event this is the option chosen by the groups of beneficiaries. The cost of social intervention per family financed by the program is US\$1,200. The São Paulo municipal government will support the program under agreements between CDHU and the municipal health and housing departments, when necessary.

- 4.21 The analysis of the operation established that it qualifies as a poverty-targeted investment (PTI) because it will improve housing for low-income groups. The program gives priority to vulnerable groups, particularly families living in unsanitary conditions (tenements that do not meet the minimum hygiene and privacy requirements). The project specifies performance indicators to measure the improvement in the standard of living of the beneficiaries (see Annex II-1). The executing agency stated that it would not be using the ten percentage points in additional financing allowed for PTI projects.

E. Institutional and financial feasibility of the CDHU

1. Type and purpose

- 4.22 The CDHU is a stock company established for an indefinite duration and subject primarily to the legislation governing the public sector. The stock capital is held almost entirely by the State of São Paulo, with a small portion in the hands of other public institutions of the same state. The CDHU is headquartered in São Paulo, the state capital, and has 12 branches elsewhere in the state. Its management consists of a president and eight directorates, under which are the superintendencies and departments with functions specific to their spheres of action.

- 4.23 The CDHU's principal purpose, prescribed by law, is the development of housing solutions for families earning lower incomes in the range of one to ten minimum wages (US\$100 to US\$1,000) and residing in the state of São Paulo, in order to gradually supply the existing deficit in that

Figure IV-1 Scale of CDHU operation

The CDHU operates with about US\$450 million a year, a budget larger than the budgets of most of the municipalities in the state of São Paulo and than those of at least 15 states of Brazil. Since commencing its operations it has built and marketed more than 1,700 housing settlements in more than 500 municipalities. It has produced a total of about 10 million square meters of enclosed structures. This housing shelters more than 1 million persons, a larger population than that of most Brazilian cities.

sector.¹⁵ Since 1996 its operations have grown at an average rate of 26,7%, and it has built, through private contractors, up to about 30,000 units a year throughout the state and has accumulated a roster of about 280,000 beneficiaries since opening its doors. These housing solutions are assigned to beneficiaries who receive long-term loans from the CDHU secured by mortgage guarantees. The CDHU has thus become a kind of nonbanking financial institution without being one in the strict sense of the term.

2. Institutional issues

- 4.24 In 1997 the CDHU commissioned the Getúlio Vargas Foundation (FGV) to study its organization and recommend changes that would improve the efficiency of its management. The new organization that emerged from the FGV study is in implementation and comprises the following levels: office of the president, directorates, superintendencies, and departments.
- 4.25 The principal function of the office of the president is to oversee the company's internal and external operations and its economic and financial management. The directorates include the office of the vice president, administration, planning and projects, finance, regional operations, works, business development, and community self-help. Under each directorate are superintendencies, which in turn break down into departments, which span the full gamut of the company's activities for the accomplishment of its purposes. A superintendency for management of the tenement action program has been set up under the office of the vice president to oversee execution of the proposed Bank program.
- 4.26 In the course of this reorganization the CDHU has already let go all its contract personnel, outsourced many of its administrative and professional services, and placed all works in progress under the supervision of management enterprises. As a result, its staff, which numbered 2,400 in 1993, dropped to about 900 in the year 2000.

3. Economic and financial issues

- 4.27 The CDHU receives funding from the state and allocates it to the construction and financing of housing solutions with a subsidy component for low-income groups in the state of São Paulo. It receives capital contributions from the state, ranging from US\$300 million to 350 million¹⁶ a year, which it uses for the accomplishment of its

¹⁵ To this end, the CDHU may carry out the following activities: (i) purchase, develop and subdivide land for housing purposes; (ii) develop and market sites and install public services; (iii) construct and/or market housing; (iv) rent low-cost housing and expand and/or renovate existing housing; (v) upgrade substandard housing in unregulated settlements; (vi) purchase and sell construction materials and prefabricated units; (vii) provide technical assistance, legal counsel, community assistance and financial aid under state and municipal housing programs; and (viii) develop a stock of land to ensure program execution.

¹⁶ Before the devaluation in 1998 these resources amounted to some US\$500 million a year.

purposes. The CDHU also receives recoveries from its loan portfolio, currently amounting to 20% of its revenue in capital contributions. This percentage is low because its financing is provided at terms of 25 years and its nonperforming loans have been on the rise.

- 4.28 The institution's financial structure presents no problems, for the bulk of its resources are received as capital contributions. It thus finances 85% of its operations from capital rather than with debt. Accordingly, it has no significant liabilities (considering the magnitude of its operations), since the resources obtained from the ICMS are allocated to the performance of its functions. However, the CDHU is completely dependent on the ICMS, and is hence vulnerable to any reduction in those resource allocations, especially as their availability is contingent on the passage of an annual act by the state legislative assembly, which is a political body.
- 4.29 By the first quarter of 2001 the outstanding balance of the mortgage loan portfolio came to 3,770 million reais (approximately US\$1.8 billion). The portfolio analysis showed that more than 30% of the debtors are behind to varying degrees in the fulfillment of their payment schedules. This proportion is within the range allowed under the housing financing system (Caixa Econômica Federal) for low-income beneficiaries.

4. Viability

- 4.30 The CDHU proposes a resolute attack on the operational problems in all its management areas, and particularly for the recovery of past due balances in its portfolio so as to reduce its dependence on the ICMS. It also plans to implement or supplement its information processing systems so that they will provide the data required, broken down as needed, so that the systems can serve as management tools that will demonstrate the impact of the policies implemented. In addition to the portfolio recovery work and the upgrading of its information processing, the CDHU will modify its policies loan approval and pricing for the loans to be granted under the proposed program (see paragraph 3.24).
- 4.31 The CDHU has very extensive institutional experience in the execution of housing programs. Thanks to the outsourcing of many of its traditional functions, its internal structure and working methods are being modernized. The CDHU follows national competitive bidding procedures (Law 8.666) for all its procurement. These procedures are considered acceptable by the Bank and will be used for procurement under the program carried out with internal resources of the CDHU.
- 4.32 CDHU's staff¹⁷ has the necessary ability to carry out the program, and the institutional structure proposed for executing it is suitable. However, in view of the

¹⁷ Of the total, 450 are professional and 500 support staff. This personnel is distributed among the headquarters and the regional branches and offices throughout the state.

scale of program operations, the management capacity of SGH, a line unit of the CDHU, will be strengthened through the services of a management consulting firm to administer the program. Execution will be facilitated by outsourcing services and hiring a specialized management firm to provide support for functions such as project analysis, supervision, physical and financial planning and other administrative and financial control activities.

F. Financial feasibility

1. Financial analysis of the program

- 4.33 The local counterpart for the program will come from CDHU and the loan proceeds will be channeled through it. The IDB loan will be repaid by the state of São Paulo.
- 4.34 The tenement action program will require US\$15 million a year for the first four years, which will be guaranteed by the federal government. This figure is relatively small compared to the transfers of approximately US\$300 million that CDHU has been receiving from the government in recent years and ensures that no problems will arise regarding the counterpart.
- 4.35 Loans will be granted to beneficiaries at interest rates that cover the cost of attracting and operating medium- and long-term financing. Direct subsidies to supplement those loans will be granted from a separate account. Accordingly, CDHU will recover part of the cost and the difference will be open and equitable subsidies.
- 4.36 The state's housing policy, financed through an increase in the goods and services tax, assumes that the revenue from that tax will be capitalized to serve as a fund that is lent and recovered in function of the capacity to pay of very low-income beneficiaries. The system to be introduced under the program is designed to repay the Bank's loan out of recoveries from the subloans to program beneficiaries. Provided that the state has funds available for subsidies to accompany the loans, the system is sustainable and the tax burden will be reduced as CDHU recovers the loans it makes. The program's financial sustainability is based on maintaining an open subsidy policy and complementary loans and on effectively recovering those loans, thereby creating a culture of payment among the beneficiaries and discipline in collections by CDHU.

2. Financial situation of the state government

- 4.37 The state of São Paulo has experienced significant fluctuations in its financial situation since 1997. This is largely a reflection of the volatility of the country's economy—in which the state accounts for approximately 40 percent of GDP—in

particular its exposure to external crises in the markets of emerging countries.¹⁸ The 1999 economic adjustment had a negative impact on the state's finances, particularly in terms of dollars (the *real* was devalued by 50 percent between 1999 and the end of 2000). For example, state revenues fell from US\$27.8 billion in 1998 to US\$18.6 billion in 1999. Spending in dollars fell correspondingly, from US\$20.3 million to US\$13.6 million.

- 4.38 The state government has made a significant fiscal effort, not merely containing growth in current expenditures—particularly personnel costs—but generating new resources through an extensive privatization program.
- 4.39 As part of this adjustment process, the state has renegotiated its main debts with the federal government, reducing its earlier uncertainty regarding the size of annual debt service (debt service payments have been limited to 13 percent of net income). The agreement with the federal government also establishes fiscal goals for the state regarding the ratio between its debt stock and net income (2:1), growth in own revenues (3.7 percent between 2000 and 2001), the ratio between personnel costs and net income, positive primary results (see Table IV-4), etc.
- 4.40 The state government has been complying satisfactorily with these targets and has even exceeded some of them, thanks to its fiscal efforts and the favorable economic climate in the past two years. Part of these results are the outcome of a project to strengthen its financial management, partially financed by the IDB.¹⁹
- 4.41 The present operation falls within the state's debt and debt-service ceilings established in the above-mentioned debt renegotiation agreement. It can be concluded from these considerations that the state will be in a financial position to comply with its commitment to provide counterpart funds for the program and to service the Bank's loan.

¹⁸ The state of São Paulo maintains its predominant position over the other Brazilian states, with per capita GDP 65 percent higher than the national average, which accounted for 35 percent to 40 percent of the country's total between 1970 and 1998.

¹⁹ National fiscal administration program for the states (PENAF), loan 980/OC-BR.

Table IV-4. Fiscal situation 1997-1999 and 2000-2002 program of the state of São Paulo (US\$ millions)						
CATEGORY	1997	1998	1999	2000*	2005*	2010*
1. Gross income	28,183	27,84	18,632	21,787	24,523	28,606
1.1 Municipal transfers	6,503	6,116	4,168	5,246	5,867	7,047
2. Net income (1-1.1)	21,680	21,724	14,464	16,541	18,656	21,559
3. Current expenditures	20,327	20,346	13,573	16,051	16,529	19,102
3.1 Employees and managers	13,716	14,071	9,421	10,653	10,82	12,504
4. Primary results (2-3)	1,353	1,378	0,891	0,490	2,127	2,457
5. Debt service	3,928	2,756	1,537	1,991	2,253	2,457
6. Financing requirements	2,799	1,748	856	440	126	-
Targets and results in percentages						
Primary results/net income >0	6.24	6.34	6.16	2.96	11.40	11.40
Personnel costs/net income <60%	64.1	64.7	64.3	58.8	58.0	58.0
Debt service/net income <13%	18.3	12.7	10.5	11.0	12.1	12.5
* Fiscal agreement projections. During the analysis of the operation in March 2001, it was verified that the preliminary figures for 2000 met or exceeded the goals of the agreement.						

- 4.42 In conclusion, the analysis indicates that: (i) the counterpart for the program will pose no problems since sufficient funds are available from the increase in state revenues from the goods and services tax; and (ii) the positive impact of the measures for fiscal adjustment and reform ensure that the government of the state of São Paulo will have the capacity to service the debt with the Bank.

G. Program benefits and sustainability

- 4.43 In the pilot phase, the program will benefit 5,000 families that are currently renting substandard housing and who, with the project, would become owners of a sanitarly adequate housing solution. The project will also lead to a recovery in property values and the environment. The main intangible benefits that are difficult to measure are promotion of the social capital of poor families by creating social networks and community ties.
- 4.44 There will be additional urban benefits in the zones where the program tenements are located, by making use of using existing urban infrastructure, revitalizing the zones, improving urban quality and increasing the value of properties located in them.
- 4.45 Materialization of these benefits rests on the sustainability of the social intervention model and the new instruments developed during the pilot phase. The key aspects for program sustainability are, apart from loan recovery and financial sustainability, the introduction, dissemination and maintenance of the intervention model, the social instruments developed and the institutional reforms proposed for this first phase (see paragraphs 2.4 and 4.19).

H. Risks

- 4.46 The program will design a transparent system of subsidies combined with loans for the beneficiaries at interest rates that cover the cost of borrowing and operating medium- and long-term financing in Brazil. It is expected that this system, which will initially be used to finance the tenement program, will eventually be adopted by CDHU for all its operations. There are potential difficulties on account of administrative inertia and the practices and regulations applied under in the existing system, which may impede the adoption of this new form of financing. Although this risk does not jeopardize the program's general objectives, studies and information seminars will be conducted to overcome any resistance to changes in current housing financing practices.
- 4.47 The program involves certain logistical and social aspects that are particularly complex. Organizing families who rent into groups that can gain access to housing solutions under the program requires specialized advisory and organizational work. Careful prequalification will be used to contract consulting firms or NGOs that specialize in these areas, with successful experience in similar programs.

TENEMENT ACTION PROGRAM IN THE STATE OF SÃO PAULO

LOGICAL FRAMEWORK FOR THE MULTIPHASE PROGRAM

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>Improve the quality of life of poor families in substandard housing in tenements in the urban areas of municipalities in the state of São Paulo.</p>	<ul style="list-style-type: none"> Program beneficiaries live in better housing and are satisfied with it (more space and better access to social services). 	<ul style="list-style-type: none"> Program monitoring reports (situation of the beneficiaries) Case study using the tracer's study method Progress reports Inspection visits 	<ul style="list-style-type: none"> Absence of economic crisis Consistency of the program and state policy.
<p>Improve the housing situation of families living in tenements by offering a variety of housing options that are compatible with their aspirations, income, and ability to pay.</p>	<ul style="list-style-type: none"> Families living in adequate conditions (total of 16,000 in the entire program). 	<ul style="list-style-type: none"> Program monitoring reports (situation of the beneficiaries) Progress reports Inspection visits Surveys to verify the situation of program beneficiaries 	<ul style="list-style-type: none"> Commitment of local authorities to the program and participation in the policy.
<p>Promote the organization of tenement residents and enable them to participate in interventions to improve their socioeconomic condition and standard of living.</p> <p>Promote the process of urban renewal in the urban cores of the cities included in the program and the preservation of historical buildings in the urban areas.</p> <p>Improve the state of São Paulo's housing policy, with greater transparency in low-cost housing programs, greater efficiency in its institutions, and sustainability for the credit system.</p>	<ul style="list-style-type: none"> Tenants' associations and condominiums operate satisfactorily in 80% of the buildings benefiting from the program. Property values increase in the beneficiary zones by at least 20%. Demolition/rehabilitation of substandard buildings in the program's priority areas. The system for financing low-cost housing has been modified, subsidies are transparent and the credit system is self-sustainable (recovery of 80% of the portfolio). 		

COMPONENTS	PHASE ONE	PHASE TWO	MEANS OF VERIFICATION	ASSU
<p><u>Financing for housing solutions</u></p> <p>Granting of direct subsidies and financing of mortgage loans for beneficiaries to purchase or renovate housing units.</p> <p><u>Technical and social action</u></p> <p>Preparation of architectural and engineering projects needed for housing solutions proposed by project beneficiaries.</p> <p><u>Social actions to organize</u></p> <p>Assessment residents, technical, sanitary and social advisory services during construction, as necessary.</p> <p><u>Support for coexistence in the</u></p> <p>New housing, establishment of condominiums and post-works follow-up.</p>	<ul style="list-style-type: none"> • 5,000 families assisted by the program. • Number of people per residence is compatible with sanitary conditions. • 100% of solutions have suitable technical projects prepared by architectural firms financed by the program and comply with standards, including environmental ones. • 100% of tenants' associations assisted by the program have received advisory services from NGOs or private consultants. • 80% of the families live in condominiums that operate satisfactorily and have received post-works assistance. • Arrears in the loans portfolio of program beneficiaries are below 20%. 	<ul style="list-style-type: none"> • 11,000 families assisted by the program. • 100% of solutions have suitable technical projects prepared by architectural firms financed by the program. • 100% of tenants' associations assisted by the program have received adequate advisory services from prequalified NGOs or private consultants. • 80% of the families live in condominiums that operate satisfactorily and have received post-works assistance. 	<ul style="list-style-type: none"> • Follow-up report on beneficiary families • Program execution reports • Auditors' reports • Socioeconomic surveys • Follow-up report on beneficiary families • Program execution reports • Auditors' reports • Financial reports 	<ul style="list-style-type: none"> • Quality control and performance CD established • Increased supervision and intervention as a coordinator between and municipalities

COMPONENTS	PHASE ONE	PHASE TWO	MEANS OF VERIFICATION	ASSUMPTIONS
<p>• Institutional development of the state of São Paulo housing policy.</p>	<ul style="list-style-type: none"> • Study conducted and recommendations on policy changes have been proposed and extensively discussed. 	<ul style="list-style-type: none"> • System for financing low-cost housing has been changed, subsidies for housing are transparent and the credit system is self-sustainable. 	<ul style="list-style-type: none"> • Follow-up reports 	<ul style="list-style-type: none"> • Commencement of local authorities' proposals in the state housing institutional policy.
<p>• Implementation of measures to improve CDHU's loan portfolio.</p>	<ul style="list-style-type: none"> • Analysis performed and recommendations implemented. Arrears in the loan portfolio are below 25%. 	<ul style="list-style-type: none"> • Arrears in the loan portfolio are below 15% and the portfolio administration has been outsourced. 	<ul style="list-style-type: none"> • Execution reports 	<ul style="list-style-type: none"> • Continuation of financial management of CDHU.
<p>• Management analysis and implementation of institutional, financial and operational strengthening in CDHU.</p>	<ul style="list-style-type: none"> • Management analysis and definition of actions for institutional, financial and operational strengthening of CDHU have been completed and short-term recommendations have been implemented. 	<ul style="list-style-type: none"> • Actions for the institutional, financial and operational strengthening of CDHU have been implemented. 	<ul style="list-style-type: none"> • Auditors' reports 	
<p>• Rental guarantee fund (guarantees income families to enable them to take rental contracts on the market).</p>	<ul style="list-style-type: none"> • Feasibility study on establishing the fund has been completed and seed capital requirements have been determined. 	<ul style="list-style-type: none"> • Rental guarantee fund established. 		

PROCUREMENT PLAN FOR THE TENEMENT ACTION PROGRAM IN THE STATE OF SÃO PAULO

Program procurements	Financing (US\$ thousands)			Selection method	Type of bidding	Prequalification	Publication		
							Year	Bidding	
	IDB	CDHU	Total					International	Local
For program management and monitoring (1)	800	3.000	3.800	Best technical	ICB	Yes	2002	Yes	
Acquisition of goods and services for central administration (several)		400	400	Price	LCB		2001 to 2003		
Engineering and audits (2)		300	300	Technical	LCB		2002		
Selection of firms for sector projects and monitoring during the works (4)		3.700	3.700	Technical and price	LCB		2001 to 2002		
Selection of architectural firms to prepare the project (30)		1.500	1.500	Technical and price	LCB		2002 to 2003		
Development of scenarios and review of housing policy (1)		50	50	Technical and price	Letter of invitation	List approved by IDB	2002		
Review of CDHU's loan portfolio (1)	50		50	Best technical	LCB	Yes	2001	Yes	
Implementation of institutional reform (1)		250	250	Technical and price	ICB		2002		
Study for study and dissemination	100	0	100	Technical	ICB	List approved by IDB	2001	Yes	
Study on the rental fund (1)	50	0	50	Best	IDB procedures	Yes	2002	Yes	

PROPOSED RESOLUTION

**BRAZIL. LOAN /OC-BR TO THE STATE OF SÃO PAULO
OF THE FEDERATIVE REPUBLIC OF BRAZIL
TENEMENT ACTION PROGRAM IN THE STATE OF SÃO PAULO
FIRST PHASE**

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 State of São Paulo, as Borrower, and the Federative Republic of Brazil, as Guarantor, for the purpose of granting the former a financing to cooperate in the execution of the first phase of a Tenement Action Program in the State of São Paulo. Such financing will be for the amount of up to thirty four million dollars (US\$34.000.000), or its equivalent in other currencies, except that of the Federative Republic of Brazil, which are part of the Ordinary Capital resources of the Bank, and will be subject to the "Special Contractual Conditions" and the "Financial Terms and Conditions" of the Executive Summary of the Loan Proposal.