

R. Ashton

U N C L A S S I F I E D

PO 141-200

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AGENCY FOR INTERNATIONAL DEVELOPMENT

Washington, D. C. 20523

PROJECT PAPER

SRI LANKA: Low Income Shelter
Program (383-HG-004)

August 24, 1987

U N C L A S S I F I E D

AGENCY FOR INTERNATIONAL DEVELOPMENT PROJECT DATA SHEET	1. TRANSACTION CODE <input type="checkbox"/> A = Add <input type="checkbox"/> C = Change <input type="checkbox"/> D = Delete	Amendment Number _____ DOCUMENT CODE 3
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COUNTRY/ENTITY Sri Lanka	3. PROJECT NUMBER <input type="checkbox"/> 383-HG-004
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4. BUREAU/OFFICE Asia Near East (ANE) <input type="checkbox"/> 04	5. PROJECT TITLE (maximum 40 characters) <input type="checkbox"/> LOW INCOME SHELTER PROGRAM <input type="checkbox"/>
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6. PROJECT ASSISTANCE COMPLETION DATE (PACD) MM DD YY 09 3 09 2	7. ESTIMATED DATE OF OBLIGATION (Under '8:' below, enter 1, 2, 3, or 4) A. Initial FY <input type="checkbox"/> 8 7 <input type="checkbox"/> 9 <input type="checkbox"/> 0 <input type="checkbox"/> 1 B. Quarter <input type="checkbox"/> 1 <input type="checkbox"/> 2 <input type="checkbox"/> 3 <input type="checkbox"/> 4 C. Final FY <input type="checkbox"/> 9 0
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8. COSTS (\$000 OR EQUIVALENT \$1 =)						
A. FUNDING SOURCE	FIRST FY <u>88</u>			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant)	(75)	()	(75)	(150)	()	(150*
(Loan)	()	()	()	()	()	()
Other U.S.						
1. HG Loan				25,000		25,000
2.						
Host Country		25,000	25,000		50,000	50,000
Other Donor(s)						
TOTALS	75	25,000	25,075	25,150	50,000	75,150

9. SCHEDULE OF AID FUNDING (\$000)									
A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH CODE		D. OBLIGATIONS TO DATE		E. AMOUNT APPROVED THIS ACTION		F. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1)	720	850	866			150	25,000	150	25,000
(2)									
(3)									
(4)									
TOTALS						150	25,000	150	25,000

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)	11. SECONDARY PURPOSE CODE
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12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each) A. Code _____ B. Amount _____	11. SECONDARY PURPOSE CODE
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13. PROJECT PURPOSE (maximum 480 characters) <div style="border: 1px solid black; padding: 10px; margin-top: 10px;"> <p>To develop shelter and urban development institutions with policies programs and solutions that (a) increase the effectiveness of limited government resources by maximizing private sector participation, and (b) provide maximum benefit to lower income households.</p> </div>

14. SCHEDULED EVALUATIONS Interim MM YY MM YY Final MM YY 0 1 8 9 0 6 9 0	15. SOURCE/ORIGIN OF GOODS AND SERVICES <input type="checkbox"/> 000 <input type="checkbox"/> 941 <input type="checkbox"/> Local <input type="checkbox"/> Other (Specify) _____
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16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a _____ page PP Amendment.)
 *Development Studies & Training Project (383-0085) or centrally funded project.

17. APPROVED BY	Signature Title Director, USAID/Sri Lanka	18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION Date Signed MM DD YY 0 8 2 4 8 7 MM DD YY
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GUARANTY AUTHORIZATION

PROJECT NO. 383-HG-004

PROVIDED FROM: Housing Guaranty Authority

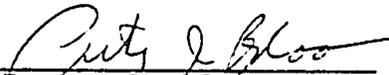
FOR: Sri Lanka - Low Income Shelter Program

Pursuant to the Foreign Assistance Act of 1961, as amended (FAA), the delegations of authority issued thereunder, and the specific delegation of authority to the Mission Director, USAID/Sri Lanka contained in 87 State 239863, I hereby authorize the issuance to eligible U.S. investors (Investors) acceptable to A.I.D. of guaranties pursuant to Section 222 of the FAA of not to exceed Twenty-Five Million United States Dollars (\$25,000,000) in face amount. The guaranties shall assure against losses (of not to exceed one hundred percent (100%) of loan investment and interest) with respect to loans, including any refinancings thereof, made to finance housing and infrastructure projects in Sri Lanka.

These guaranties shall be subject to the following terms and conditions:

1. Term of Guaranty: The loans may extend for a period of up to thirty (30) years from the date of disbursement, may include a grace period of up to ten (10) years on repayment of principal and a grace period on payment of interest, and may include such terms and conditions as shall be acceptable to A.I.D. The guaranties of the loans shall extend for a period beginning with the disbursements of the loans and shall continue until such time as the loans have been paid in full.
2. Interest Rate: The rate or rates of interest payable to the Investor pursuant to the loans shall not exceed that prescribed pursuant to Section 223 (f) of the FAA and shall be consistent with rates of interest generally available for similar types of loans made in the long-term U.S. capital markets.
3. Government of Sri Lanka Guaranty: Prior to disbursement of any loan amounts pursuant to this Guaranty Authorization, a written guaranty to indemnify A.I.D. against all losses arising by virtue of A.I.D.'s guaranties to the Investor or from non-payment of the guaranty fee shall be provided in a form satisfactory to A.I.D. by the Government of Sri Lanka.

- 4. Fee: The fee of the United States shall be payable in dollars and shall be one-half percent (1/2%) per annum of the outstanding guarantied amount of the loans plus a fixed amount equal to one percent (1%) of the amount of the loans authorized or any part thereof, to be paid as A.I.D. may determine upon disbursement of the loans.
- 5. Other Terms and Conditions: The guaranties shall be subject to such other terms and conditions as A.I.D. may deem necessary.



 Peter J. Bloom
 Director
 USAID/Sri Lanka

 24 Aug 1987

 Date

Clearances:	A/DD:DZvinakis	<u>qy</u>	Date	<u>8/24/87</u>
	RLA:LChiles	<u>LC</u>	Date	<u>8/20/87</u>
	GC/PRE:MKitay	<u>(by phone)</u>	Date	<u>Aug. 19, 1987</u>
	A/PRM:JEmmert	<u>JZ</u>	Date	<u>8/20/87</u>
	RHUDO/DPainter	<u>DPainter</u>	Date	<u>8/20/87</u>
	MHA:JJDHagger	<u>JRH</u>	Date	<u>8/2/87</u>

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TABLE OF ABBREVIATIONS

AID	Agency for International Development
CDC	Community Development Council
CDSS	Country Development Strategy Statement
CY	Calendar Year
DCD	Department of Cooperative Development
DS&Ta	Development Services and Training Project (AID Project No. 383-0044)
DS&Tb	Development Studies and Training Project (AID Project No. 383-0085)
FY	Fiscal Year (U.S. Oct. 1 - Sept. 30)
GSL	Government of Sri Lanka
HDFC	Housing Development Finance Corporation
HG	Housing Guaranty
HUP	Housing the Urban Poor (AID Project No. (940-1001)
HTHP	Hundred Thousand Houses Program (1977-83)
IIPUP	Integrated Improvement Program for the Urban Poor (AID Project No. 912-0007)
MC	Ministry of Cooperatives
MIT	Massachusetts Institute of Technology
MLGHC	Ministry of Local Government, Housing & Construction
MFP	Ministry of Finance and Planning
MHP	Million Houses Program (1984-to date composed of RHSP and UHSP components to date)
NHDA	National Housing Development Authority
PRE/H	AID office of Housing, Washington, DC
RHUDO/Bangkok	Regional Housing & Urban Development Office for Asia
RHSP	Rural Housing Sub-Program of the MHP
SMIB	State Mortgage and Investment Bank
UD	Urban Development
UDSS	Urban Development Support Services (AID Project No. 940-1002)
UHSP	Urban Housing Sub-Program of the MHP
ULA	Urban Local Authorities
USAID	United States Agency for International Development
USAID/SL	USAID Mission in Sri Lanka

Currency Equivalents (August 1987)

Currency Unit = Sri Lanka Rupees (Rs)

U.S. \$1 = Rs. 29

Rs. 1 = U.S. \$.035

I. SUMMARY OF THE PROGRAM MEMORANDUM

A. The Proposed Authorization

This Program Memorandum covers Phase IV of the \$100 million Housing Guaranty Program for Sri Lanka which was approved in principle in January 1981. Proposed here is an amendment to the 1981 PP which when approved, will provide an additional \$25 million HG authorization.

Phase I (383-HG-001) was authorized for \$25 million. In 1983 Phase II was authorized for \$10 million, and in 1985 Phase III was authorized for \$25 million. After the authorization of this Phase IV for \$25 million, and subject to the continuing availability of HG authority, a final authorization of \$15 million for Phase V is planned for FY 89. Grant funds were also made available for the program through the HUP centrally funded project and through USAID/Sri Lanka's Development Services and Training Project (DS&Ta) (383-0044). It is anticipated that all of the prior grant and HG funds will be disbursed during CY 1987.

Through capital and technical assistance, Phase IV will continue present housing programs among Sri Lanka's rural and urban lower income households. Phase IV will also continue programs to strengthen private sector housing finance and development institutions, and will extend shelter assistance to the settlers and town dwellers of the Mahaweli agricultural areas.

B. Relation to AID Policy Objectives

Since the approval of the 1981 PP, the GSL has made significant progress in the development of appropriate shelter policies and programs. When the original PP was written, the GSL's was concentrating on the production of highly subsidized rental apartments and houses in the Colombo area. Since that time the GSL's programs have undergone extensive changes, consistent with AID's policy objectives.

Phase IV supports and continues the four major AID policy objectives of institutional development, promotion of private sector initiatives, progressive shelter policy dialogue, and transfer of technology.

In the area of institutional development during Phase III, AID has placed a major emphasis on improving and strengthening the private sector system of Thrift and Credit Cooperative Societies (TCCS) which are increasingly implementing the Rural Housing Sub Program (RHSP) of the Million Houses Program (MHP). Technical assistance is being provided in the financial management and collections area to increase the efficiency of project implementation and to help place the program on a self-sustaining basis. AID in

conjunction with other organizations has also promoted a policy dialogue regarding the clarification of institutional roles within both the shelter and the housing finance sectors to develop a progressive national housing and housing finance policy framework.

The Phase IV project will target new initiatives to increase private sector involvement in the provision of low-cost housing and to foster joint public-private sector housing ventures.

Besides technical assistance for the transfer of technology in the areas of information and collections systems, AID will continue support to the Massachusetts Institute of Technology which has developed new design and construction techniques appropriate for Sri Lanka for sites and services projects.

C. Recommendation

This Program Memorandum amends and updates the Project Paper dated December 19, 1980, as amplified by later Program Memoranda for Phases II and III. In particular, this Program Memorandum is based on and amplifies the data and analysis contained in the Phase III Program Memorandum. Data and analyses previously presented in the Phase III document are not repeated here, and that document should be read in conjunction with this submission. This Program Memorandum serves to modify the Project Paper and earlier Program Memoranda to specify current program activities.

It is recommended that \$25 million be authorized as Phase IV of the \$100 million Sri Lanka Housing Guaranty Program approved in 1981. The GSL will use the loan proceeds to finance its low-income rural shelter and urban development programs.

II. UPDATE ON THE HOUSING SECTOR IN SRI LANKA

A. Decentralization of the Million Houses Program (MHP) and the Role of the Gramodaya Mandala

The Million Houses Program (MHP) unites housing development and local government, and achieves broad coverage through a strategy of decentralization. The devolution of decision-making to the local level is not merely desirable and in keeping with the MHP's bottom-up approach to housing: it is also a clear necessity in view of the enormous scope and size of the program.

The current local government structure was instituted in 1980, and is based on local Gramodaya Mandalas (GM) and area wide Pradeshiya Mandalas (PM). There are about 4500 Gramodaya

Mandalas in the country, each containing an average of some 500 households, usually spread over several villages. The Gramodaya Mandala Committee is formed of the heads of all the voluntary organizations (such as the Rural Development Society, Co-operative Society, Sports Club) who each year elect one of their members as Chairman. The number of members can vary from less than ten to more than thirty.

Until the Million Houses Program, the possibilities for people's participation in planning inherent in this new structure had not been matched by a concrete role for GMs and PMs in rural development. Only an 'advisory role' was defined for them in practice; and in a majority of cases their advisory inputs were neutralized because their advice was not heeded by the higher echelons of decision-making.

The MHP offered the GMs an unmistakable role in rural housing, and through it other facets of rural development. With the launching of the rural sub program in 1984, there was a clear devolution of responsibilities to the GMs. They were entrusted with the tasks of selection, supervision of construction and loan recoveries. They now also have the opportunity to earn income by acting as contractors for small public works such as road repairs and maintenance of culverts. To a large extent, therefore, the MHP has provided a focus for their efforts.

In 1984, all GM areas in the country were allocated an equal amount of funds for housing development under the MHP. In the following year, a performance index based on construction completions and loan recoveries was introduced as a means of allocating further funds. This provides an incentive for GMs to complete housing units and achieve improved loan recovery rates.

Since the rural sub program depended so much on GMs, and since they were so uneven in quality, it became evident that an upgrading program was needed. Although there were attempts in this direction, a strong and effective GM Upgrading Program has yet to be developed.

B. Integration of the MHP with the Thrift and Credit Cooperative Society (TCCS) Movement

As a result of AID's policy dialogue with the GSL during 1984/85, it was decided to experiment with alternative ways of recovering housing loans, and in particular, with using thrift and credit societies for that purpose.

This plan was first tried in the Kandy District in 1985, and was so successful that a policy decision was then taken to integrate the rural and urban sub programs with the Thrift and Credit Cooperative Society (TCCS) Movement on an island-wide basis. A High Level Working Group of the Ministry of Local Government, Housing and Construction (MLGHC) and the

Department of Cooperatives Development was set up to develop and implement this decision.

A basic program - the Thrift and Credit Cooperative Societies Expansion Program (TCCSEP) - was drafted in September 1985. It was expected that an expanded and strengthened TCCS movement could, together with the GMs, manage the housing loans and loan recoveries under the rural and urban sub programs. By 1987, in the districts of Kandy, Kalutara, Gampaha and Galle, the rural sub program had been totally integrated with the TCCSEP, while the integration was progressing at a varying pace in the other districts.

TCCSs are local-level voluntary associations independent of the Gramodaya Mandalas, formed to meet the savings/credit/investment needs of the members. TCCSs represent the collective strength of groups of poorer people who normally do not have mortgageable assets, or who do not have access to commercial banks - ideally, the type of family that constitutes the target group of the rural sub program. Membership of a TCCS usually ranges from 40-60, although there are some societies with 150 members or more.

TCCSs collect funds from their membership through a system of shares for members and through various forms of deposit, with interest rates similar to those prevailing in the monetary market. Societies without sufficient funds are provided with additional funds by the District Unions. The TCCSs give out different types of loans to members - the types of loan, repayment periods, loan conditions, rates of interest, etc., vary from one society to another. District Unions receive deposits from TCCSs and also provide credit facilities to them through an inter-lending loan system.

The Expansion Program for these thrift societies has the following goals (Sept. 1985 program document):

- to develop a strong, community-based Thrift Movement throughout the country;
- to develop a network of strong thrift/credit/financial institutions at the community level;
- to develop a community level institution with financial management capability for low-income communities;
- to develop mutually reinforcing linkages between the TCCs and GMs over the long run; and
- to develop the TCCSEP into a key force in the process of retaining rural surpluses in the villages.

Current objectives are:

- developing new TCCSs where they do not presently exist;

- reactivating dormant TCCSs;
- forming new District Unions (DUs) where necessary;
- achieving effective TCCS coverage in all Sri Lankan villages and urban low-income communities;
- achieving effective DU coverage throughout the 25 districts;
- achieving a community of interests between GMs and TCCSs;
- handing over to TCCSs all housing loan disbursements and recoveries;
- ensuring that TCCSs are formed only on the basis of cooperative principles.

C. Achievements of Phase III of HG Program: Developing a Comprehensive Strategy for RHSP Cost Recovery

During Phase III the use of thrift societies to make housing loans was field tested in Kandy District, as an innovative way to privatize and decentralize the Million Houses Program. The Phase III Program Memorandum listed a number of advantages that were anticipated from the Kandy model:

- reduction in NHDA workload,
- maximization of NHDA technical capabilities,
- utilization of existing thrift institution capabilities,
- creation of a manageable scale for collections efforts,
- increased auditing and performance capacity, and
- enhancement of thrift development.

Progress towards the realization of all these has been evidenced in Phase III.

AID-financed studies have also provided important insights into how the rural loan system actually works. These studies show a significant difference in eligibility criteria in those villages where the TCCS are making loans as compared with other villages using the older, Gramodaya Mandala based method. The studies showed that the TCCS were viewed as a strictly financial organization and made loans on the basis of the applicants ability to repay.

In contrast, it was felt that the chief officers of the Gramodaya Mandala used more political criteria in their selection of loan applicants. The criteria were not particularly party based (since the Gramodaya Mandala system is not party based), but rather tended to spread the loans over all sections (and castes) of the community and throughout all income levels to ensure political harmony within the village. The studies observed that this method was not the most advantageous as far as ensuring prompt loan repayments.

Collections records indicate that average returns are at least 20% higher in those districts which have made the transition to the TCCS system. Conversely, those districts which have highly unsatisfactory rates of collections (e.g. Anuradhapura, Polonnaruwa and Trincomalee) are also those areas which historically had very few TCCS (and are on the fringes of the civil disturbances).

Besides going a long way to improve collection rates for the rural program, the TCCS system is having a number of additional positive effects. The new system is reinforcing the idea of housing credit as a financial, rather than political, device which is earned through ability to repay. The TCCS system is also demonstrating its potential as a private sector rural credit system which could complement public sector initiatives now being considered by the Central Bank. As the rural housing sub-program becomes self-financing, other delivery mechanisms (i.e. capital financing through the SMIB, HDFC or the Regional Rural Development Banks)) might become possible. As the TCCS demonstrate their ability to manage credit, and as demand for this type of credit grows, it may be possible to re-open the interest rate dialogue at a future date, with a view to either adjusting the interest rate upwards or removing the rate ceiling altogether and allowing the TCCS to charge what they feel is the appropriate rate.

The AID-sponsored shift to thrift societies has succeeded. The next step is to strengthen and expand the thrifts. We have begun to do this through training and technical assistance, but more remains to be done. The TCCS system needs to be carefully monitored and nurtured. In particular, the pace of expansion must not be so great as to jeopardize the performance of the thrifts. The pace of expansion must be controlled, training in needed skills must be provided, and provision must be made for thrifts to enter new areas, such as agricultural and small business credit (as suggested by the AID-financed National Agriculture Food and Nutrition Strategy). To accomplish this, additional AID-funded training and technical assistance must be provided.

D. Issues Arising from Phase III

Previous HG program phases have supported a number of important and exciting shifts in housing policy and practice. Sri Lanka's housing program has significantly reduced both costs and subsidies, and achieved levels of loan recovery which are impressive by world standards. Under the MHP, the needs of many thousands of low-income families throughout the island have been met.

The most interesting development is the way in which the program has been decentralized, privatized, and devolved to the local level. Coupled with this has been the growth within NHDA of a philosophy of "learning how to learn" from practical experience.

Inevitably, certain problems remain. These include issues of monitoring and cost recovery, housing finance, the operation of the urban sub program, organizational development within NHDA, the expansion of thrift societies, the exclusion of the very poor from current programs, and the expansion of the program into the Mahaweli and plantation area.

1. Monitoring and cost recoveries. There is a continuing need to improve both cost recovery levels and data-collection for tracking housing loans. The improvement in collection rates is both real and impressive: from approximately 10% in 1982 to 77% overall today (see NHDA Loan Recovery Progress Reports, on file). For the first half of 1987, NHDA recovered 77% of 1987's budget amount. This compares well with other credit programs - e.g., rates of between 60-79% for agricultural credit in Sri Lanka (Central Bank, 1986).

Nevertheless, there is need to maintain the upward movement of collection rates. In this regard, technical assistance at the NHDA level is not what is needed, but rather the continuation of the existing policy dialogue within a context of mutual respect and understanding. The program has so far been highly successful at creating and maintaining this positive context, and efforts will continue during Phase IV to help GSL officials continue and extend their efforts at cost recovery.

The transfer to thrift societies of NHDA housing loans has resulted in a dramatic improvement in collection rates. This trend should continue if the creation and operation of thrift societies is carefully nurtured. This is discussed in Section 5 below.

2. Housing Finance. The growth of thrift societies is one very positive aspect of the growth of private-sector housing finance in Sri Lanka. The other component of housing finance--that of larger institutions--has performed less impressively.

At the present time, Sri Lanka has two institutions--the SMIB and the HDFC--which function as mortgage banks, attracting capital in order to make residential loans. Neither institution operates very effectively to mobilize capital, and neither has been very successful in tapping non-government sources of capital.

The SMIB, HDFC and the thrift societies face an identical and common problem: that of attracting funds into their systems to finance housing loans. All three institutions now find that the demand for their capital outstrips their capacity to attract deposits.

Phase IV will continue to encourage the creation of a national housing finance system within which various institutions--NHDA, SMIB, HDFC, thrift societies, employee trust funds, private insurance companies, etc., -- can operate. To create such a system, the following steps should be taken:

a. The two mortgage banks must actively develop a variety of sources and techniques for accessing capital for on-lending. Up until now they have relied mainly on Treasury capital. Phase IV will assist the banks to explore a number of other options for mobilizing capital, including: (a) direct lending to the banks by outside institutions such as employee trust funds, private provident funds, etc., (b) the sale of marketable securities issued by the mortgage banks; and (c) the sale of mortgages or debentures backed by mortgages issued by the mortgage banks (the true secondary market).

b. One or both mortgage banks should plan how they could handle the cash flow for the rural housing sub program, replacing the NHDA, so that funds could go from the Treasury to the mortgage banks to the District Union of thrifts to the primary TCCS societies to the members and back.

c. Studies should be done to examine whether the loans made under the rural housing sub program could themselves be used as collateral by the mortgage banks either to issue marketable securities or mortgage-backed debentures.

d. Studies should be undertaken to examine the feasibility of mortgage banks playing a broader, more regulatory role in the TCCS system.

3. The Urban Housing Sub Program. The urban sub program has encountered several problems during Phase III. Begun only in January 1985, the urban sub program comprises: (a) individual loans; (b) urban upgrading; and (c) sites and services. Each of these components is different and presents somewhat different problems.

Individual loans represent about 40% of the total and tend to go mainly for house repairs. Urban upgrading (another 40% of the total) and sites and services (20%) are sometimes used together, particularly when an area's population requires re-housing following de-densification.

In Colombo, the program operates in areas where citizens are well-organized and politically astute. Some slum communities have advocated a principle of 'entitlement' to loans irrespective of either income levels or ability to repay. Such approaches obviously run counter to the affordability principle along which NHDA has been operating.

One result of this situation is that collection rates for the urban sub-program are significantly lower than for the rural areas. It should be noted, however, that even these lower rates of collection are probably equal to or better than urban collection levels in many other countries.

Several approaches to this problem will be tried during Phase IV. One involves the creation and promotion of urban thrift societies to take over more of the actual loans. Another is the strengthening of local Community Development Councils (CDCs) with a view to turning them into other loan-administering organizations. Both of these solutions involve the further decentralization of the urban program, along lines already begun.

Another approach involves separating site development and land regularization from housing loans in upgrading areas. Site improvements raise property values, making it possible to impose municipal taxes. Studies done by AID and NHDA show that for the urban poor, security of title and entry into the urban system is a high priority. For this reason, slum and shanty dwellers see municipal taxes as a way of gaining access to urban resources. In this way, site improvements (re-blocking, infrastructure, etc.,) can be recovered through local property taxes ("rates"). Once an area has been upgraded, NHDA will be better able to assess plotters' needs for different types of loans and their ability and willingness to repay those loans.

Finally, measures will be taken on behalf of families who are too poor to qualify for normal housing loans. Details of this are presented in Section 6.

AID will continue to closely monitor the urban sub program and continue to press for more effective and efficient collections procedures, while at the same time encouraging NHDA and local-level organizations to develop innovative approaches to housing loans.

4. Improving NHDA's Capacity. NHDA and its relation to GSL housing programs has been extensively discussed in previous Program Memoranda and other related project documents which are on file. NHDA recognizes the need for improving both its management and financial procedures and its ability to collect information, learn from it, and pass this learning on to others.

NHDA is about to undergo a major reorganization. This is therefore the time to undertake a review of management procedures, and to implement needed reforms. AID will work closely with NHDA to identify management bottlenecks and to devise effective and relevant solutions to them.

Training and research, although part of NHDA's activities now, need to be strengthened and upgraded. In

essence, the organization's ability to learn and change needs to be enhanced. This is particularly important in view of the major changes in role which await NHDA in the 1990s (see below).

One way to upgrade skills and facilitate change is to involve NHDA officers in intensive programs designed to improve their ability to collect, process, analyze, use and transmit information. In this way, the devolution of responsibility and decision-making already underway within NHDA can be made more effective. Training programs in information and communication will improve NHDA's ability to learn and teach, thereby broadening its base of competent managers.

Programs to do this will be carried out with support from AID. To make such programs even more effective, they will be widened to include people from organizations other than NHDA, such as NGOs and community-based organizations. In this way, a common learning and teaching capacity will be built up among all groups operating in rural and urban housing.

Finally, such programs will be coordinated to the fullest extent possible with programs designed to strengthen the thrift societies (see below) and government organizations (see next section).

5. Strengthening the Thrift Societies. The rapid growth of thrift societies and their new role in the MHP has created dangers as well as possibilities. The main danger is that thrift societies will grow and expand too fast, outstripping their capabilities. If this happens, the movement--and with it, the housing program--will be jeopardized.

AID will work to identify weaknesses in the thrifts and remedy them. The skills needed to operate thrift societies at the village level will be identified, and training will be designed to provide or improve those skills.

AID will also continue its policy dialogue with the Federation and NHDA regarding the expansion of thrift societies into new communities. Expansion must be carefully managed to avoid creating 'phantom thrifts' whose only purpose is to disburse government housing money. In addition, experience in other countries has shown that too-rapid expansion often has a negative effect on thrift movements. For this reason, expansion will be carefully monitored.

AID will closely monitor the operation of thrift societies in order to understand in detail their operations, their problems, and their future potential. Of particular interest here are two related issues: (a) maintaining and improving the present high rate of loan recoveries; and (b) expanding the role of the thrifts into other development areas in addition to housing.

The development of the thrift movement will be crucial to the future of the housing program. A failure of the thrifts will have adverse effects on the spread of the MHP, the speed with which communities are served, and the rate at which loans are repaid. AID will pay particular attention to the role of NHDA money within thrifts, to ensure that such funds do not come to dominate thrift societies in undesirable ways. The great danger here--and one which thrifts are aware of--is that by concentrating on housing, thrifts may become subject to some of the same political pressures that have been observed to operate in earlier NHDA programs. Such a development would have very negative effects at several levels, and would undo much of the progress which has been made so far.

6. Taking Care of the Very Poorest. GSL housing programs have worked hard to reduce subsidy levels and increase rates of loan repayment. As noted above, the programs have succeeded in this to a great extent. But while GSL programs do indeed aid below-median families, many of the very poorest families remain outside the programs, because they cannot qualify for loans. Others have been included who have been unable to repay, resulting in lower collection rates, especially for urban programs.

This poses a difficult dilemma: creating a cost-effective housing program under standard creditworthiness tests means necessarily excluding many people who need help the most. There is a policy conflict here between social and financial objectives. Modifying existing programs by raising subsidies or making loans with no expectation of repayment would negate many of the program's positive achievements. Other solutions must be found.

Two possibilities come to mind. One is remedial, the other developmental. Both are feasible within the Sri Lankan context, and both will be explored during Phase IV.

The first involves using charitable organizations to help the very poorest with housing. Since access to land is not a serious problem in rural areas of Sri Lanka, and since urban programs will separate the granting of tenure from the giving of loans (see above), what remains is housing. We know from various AID/NHDA studies that self-help housing can be remarkably cheap in the Sri Lankan context. A variety of charitable organizations exist whose purpose it is to help the poor. These include NGOs religious organizations, and government programs such as the Sevana Fund.

All of these should be investigated as possible sources of aid for the very poorest, in the form of money, building materials, technical assistance or shramadana (voluntary) labor. In addition, it should be possible to channel contributions from better--off Sri Lankans to individual plottolders, in much the same way as various NGOs

make it possible for people to 'sponsor' individual children. In this way, one Sri Lankan could contribute directly to a named individual, making it possible for that person to build a house.

Such a program would be politically attractive, culturally appropriate in the Sri Lankan context, and perfectly feasible. It would tap the enormous reservoir of private money, and could even include the private business sector.

The second possibility involves increasing employment and income among the poor through small enterprise promotion. Although not traditionally an Office of Housing activity, enterprise promotion is probably the next logical step in Sri Lanka for ensuring access to housing loans and decreasing problems with collections, defaults and non-performing loans. The next section discusses local-level enterprise promotion as a way of making affordable housing available to the very poor.

7. The Mahaweli Project. No housing finance institutions currently serve the residents of the Mahaweli. The Mahaweli Authority makes small grants to settlers of some new lands, and the EEC has a grant and soft loan program for others.

Some areas of the Mahaweli have been occupied for periods of over 15 years. The HG program would look first at these mature settlements to assess the possibilities of assistance for housing, and would explore a variety of options for doing this.

These include: funding through a private commercial bank such as the new Investment and Credit Bank; extension of the TCCS system into the Mahaweli area; or funding for housing loans through the Mahaweli Authority in much the same way as this is now done through NHDA. Senior officials of the Mahaweli Authority are supportive of AID's housing initiative, and should be helpful in facilitating the search for appropriate mechanisms to promote housing.

E. Strategies to Sustain the Million Houses Program in the 1990's

The MHP has proved to be a successful and highly innovative approach to low-income housing on a national scale. Looking ahead to the 1990s, there is a clear need to (a) consolidate gains made under the MHP; and (b) elaborate the basic approach in ways consistent with other developments in Sri Lanka.

Five main areas will become important for AID in the next few years: institutionalizing and strengthening the MHP approach in Sri Lanka; helping NHDA define and manage new roles; strengthening the development capabilities of local organizations; encouraging local enterprise promotion; and

documenting and publicizing the use of housing as an organizing principle for development.

1. Institutionalizing the Approach. AID will work closely with the GSL to ensure that the MHP approach, emphasizing decentralizing and cost-effectiveness, is institutionalized.

Particular attention will be paid to improving management skills within NHDA and within thrift societies, and to maintaining and increasing cost recovery levels for housing loans. One of the most important aspects of the MHP is its emphasis on organizational learning through grass-roots experience. AID will encourage and support this emphasis through training, special studies, and publications. AID will encourage the continued devolution of decision-making to local level organizations, and the upgrading of their skills and capabilities.

2. NHDA's Changing Role. Several current trends will have significance for the future role of NHDA. One is the process of devolution to local level organizations, already begun under the MHP. Another is the reorganization of NHDA itself, now underway. A third factor is the national plan for administrative devolution which will, when implemented, create nine provincial governments.

As more housing loans are made, and as loans are increasingly shifted from NHDA to local thrift societies, NHDA will be able to quietly retire from the loan business to a great extent. With the buildup of local-level capabilities (see below), its officers will assume a less direct and directive role in urban and rural housing projects. As national administrative devolution proceeds, regional housing offices will take on more of the responsibilities now carried out by the Colombo head office.

For these reasons, NHDA will need to train itself to assume new roles, while giving up others. Discussions with NHDA officials indicate that they see clearly the need for a redefinition of organizational roles and capabilities to include more involvement with:

- a. local authorities;
- b. Mahaweli and plantation housing;
- c. other major resettlement schemes;
- d. the private sector.

Although b, c, and d in this list are already sub programs under the MHP umbrella, all these activities will require NHDA to develop new policies, procedures and techniques. At the same time, NHDA will also become a resource organization for local-level bodies in terms of technical assistance, policy coordination, training, research and documentation.

One of the main themes emerging from discussions about the future of NHDA is that of information and communication as an aid to all of the above. Efforts to improve the organization's capabilities in these areas, already discussed in the previous section, will be continued in the 1990s.

3. Strengthening Local Organizations. Devolution means not simply increasing responsibilities at the local level, but increasing capacities at that level as well. Thrift societies, Gramodaya Mandalas, Community Development Councils, and NGOs--these are some of the local-level organizations now assuming more important roles in decision-making and the planning and implementation of development activities, in the housing sector and elsewhere.

It is, therefore, important to ensure that these organizations have the skills and knowledge necessary to do this. AID will, as discussed in the previous section, support training for local thrift societies. In the same way, AID will support and encourage other local organizations in the development of skills in project development, finance, management, and implementation. The goal will be to develop local capacities to identify projects, plan them, prepare and present funding proposals, carry out planned activities, and manage financial resources.

In this way, control of local development activities will be further decentralized and privatized, and local skills will be enhanced. It is expected that NHDA will have a major role to play here as a source of information, training and support.

4. Enterprise Promotion. In addition to strengthening local organizations, AID will indirectly encourage and support small-enterprise promotion in rural and urban areas, through thrift societies, local government agencies, and NGOs. Particularly in the urban areas, there is a clear need to develop strategies and programs for improving incomes and increasing employment. Such activities directly support the objectives of GSL housing programs, and are a logical extension of the thrust of the MHP.

5. Housing as an Organizing Principle for Development. As the Sri Lanka experience clearly shows, housing connects to other development activities in a number of ways, particularly so in urban areas. In Sri Lanka, housing has direct links to such issues as urban administration, finance, infrastructure and land-use planning, income and employment generation, and health and nutrition, among others. To the extent that AID continues to be involved in GSL housing programs, it will be drawn into these other related areas as well. There is a need, therefore, for AID to remain aware of developments in these other areas of urban development. The 1990s will provide both the impetus and the opportunity to do.

There is also a need to convey the lessons learned through the MHP to a wider audience, both within Sri Lanka and outside it. AID will support efforts to document and publicize the lessons of the MHP through studies, publications, conferences, workshops and training sessions. In many ways, the MHP approach represents a significant 'next step' in the provision of low-cost housing, and incorporates many elements which are replicable in other countries and contexts. AID will work with the GSL to analyze the MHP experience, to discuss its significance in national and international fora, and to encourage its application in appropriate contexts.

III. PROJECT DESCRIPTION

A. Program Strategy

1. Evaluation Update of Prior HG Phases

A major evaluation of Phase I of the HG program was carried out in July 1984. This evaluation, while concluding that the Hundred Thousand Houses Program represented a "dramatic shift from a focus on direct construction of urban and rural housing to programs emphasizing aided self help", found continued problems of subsidy, low rates of collections, poorly qualified staff and rising costs (i.e., increasing levels of subsidy). The Million Houses Program was also appraised. Although requiring assistance with administration and collections, the MHP was found to be consistent with AID policy goals.

In July 1987, an evaluation of the HG Program was carried out with emphasis on Phase III. Among the issues discussed in this evaluation were: the allocation of housing funds within the GSL budget; organizational changes within NHDA; the operation of the urban housing sub-program of the MHP; the development of the housing finance sector; the development of thrift societies and their role within the MHP; and needs for training. These issues were carefully addressed in the formulation of the current Phase IV Memorandum.

2. Program Goal and Purpose

AID's goal in the shelter program is to improve shelter and services provided to the urban and rural poor. The program purpose for this phase is to assist the GSL to develop policies, programs and solutions which, through coordination with the private sector, will increase the effectiveness of limited government resources and provide maximum benefit to lower income households.

3. Strategy and Objectives

AID's long term objective in the shelter and urban sector is to assist the GSL to accomplish its goal of adequately housing its population by the year 2000 and providing its cities and towns with essential services. To accomplish this, AID will continue to help the GSL to develop supportive shelter, finance and urban development policies for low income households. AID believes that the most important policy concerns the setting of a more appropriate balance between the roles of the public and private sectors. Policy dialogue, therefore, will emphasize ways of enabling market forces to play a more active role in the setting of interest rates and ways of encouraging the role of private sector organizations as housing lenders (and loan recovery agents) with public sector organizations as regulators.

AID's strategy to accomplish this objective is to provide both capital and technical assistance. AID has assisted in the development of a national network of over 5,000 private Thrift and Credit Cooperative Societies (TCCSs) located in most Gramodaya Mandalas to implement the Rural Housing Sub Program (RHSP) of the Million Houses Program (MHP). Pilot efforts are also underway to involve community based entities, including TCCS, in the Urban Housing Sub Program (UHSP).

4. Relationship to CDSS

The latest CDSS for Sri Lanka reaffirms the strategy of enhancing the productive relationship of people to the land with the rural poor seen as the primary beneficiary of these efforts. The CDSS notes that the "most serious development problem in Sri Lanka is the need to raise incomes" and concludes that: "the time has come for Sri Lanka to concentrate on the creation of wealth-income rather than redistribution."

The Housing Guaranty Program works directly in support of this strategy, through a housing and infrastructure program which has had a significant impact on off-farm employment creation in hundreds of small villages throughout the country. The program has generated considerable secondary employment in the areas of furniture making, brick and tile making, metal fabrication, transport and retail trade. All materials used are locally made - often within the same district. In this fashion, the housing program assists in the process of income creation. In addition, employment creation in these rural areas helps to retard the rate of rural to urban migration.

USAID/Colombo has identified four themes which cut across its portfolio and reflect a common purpose:

1. reliance on market forces;
2. maximization of cost recovery;
3. efficient utilization of resources; and
4. local institutional development.

While not equally important in each project, these four themes set the framework and agenda for the Mission's policy dialogue, and provide a rationale for the Mission's selection of interventions.

Market Forces. Directly related to the private sector development concept, the theme of market forces also stresses limits on government involvement in the economy. The strategy calls for highlighting the effectiveness of a free and competitive market environment that capitalizes on comparative advantage and provides incentives to the private sector. The Mission would therefore expect AID assisted programs to promote market rates of interest for housing and other credit.

Cost Recovery. Cost recovery for public services where direct beneficiaries can be clearly determined is closely related to the idea of open competitive markets. It implies reduced subsidies, improved management practices and better use of resources, particularly in the public sector. In housing, an emphasis on cost recovery contributes to the need to conserve public finance by progressively increasing both collection rates for public programs and the supply of housing capital available from the private sector.

Efficient Use of Resources. This theme involves setting priorities so as to insure the full utilization of available resources - human, capital, and natural. The devolution of the MHP to the local level, the reorganization of NHDA, and continued improvements in cost recovery and subsidy are examples of using resources more efficiently.

Organizational Development. An important task in this area is to create a policy and institutional environment which encourages people to meet local needs and solve local problems at the local level. An example of an activity appropriate to this theme is the expansion of the thrift societies to provide initially an efficient private sector housing finance mechanism and, in the long run a more effective rural credit system.

5. Coordination with Other Donors

AID has been the principal external donor in the shelter sector. Short term technical assistance has been provided to the NHDA's Urban Division by the United Nations Center for Human Settlements. Demonstration projects have been funded by various PVOs including US Save the Children, Redd Barna (Norwegian Save the Children) and the German Cooperative Organization (DESWOS).

The World Bank's Water and Urban Development Department has structured a project to provide technical assistance to local authorities for municipal management and financial planning. This project will also provide assistance with the re-structuring of a "municipal bank", and possibly follow-on capital funding for demonstration urban development projects.

AID, the World Bank, and the MLGHC are working closely together to assess the possibilities of an urban development program and Phase IV would permit limited funding of appropriate AID-sponsored urban demonstration programs.

6. Security Concerns

Prior phases of the HG program have achieved excellent geographic spread over the entire country which includes the northern and eastern (predominantly Tamil) Districts. The nature of the HG-financed MHP, - small loans for home improvements - has enabled it to continue in spite of communal disturbances in various parts of the country. The NHDA District Office in Jaffna - the staff of which is entirely Tamil - has continued to function and administer the MHP, unhindered by any of the vying factions.

During an upsurge in civil strife, however, local operations are curtailed temporarily as the supply of building materials is interrupted or as settlement patterns are disrupted. This disruption was noted in Trincomalee especially during Phase III. Although these security concerns are genuine, the HG-financed MHP is unlikely to be seriously affected due to its decentralized program design and its national scope. Even if certain areas were forced to suspend or delay operations for a short while, the national program would only be slightly affected, since resources could be temporarily shifted to other areas remaining in full operation.

The HG program also provides a potential vehicle (through the MHP and the Eligible Mortgages program) for the financing of re-construction activities should a special program become necessary. The HG program is well-suited to provide resources appropriate to the re-construction and rehabilitation efforts which will follow the resolution of the present crisis.

B. Detailed Project Description

1. Capital Assistance

The proposed \$25 million HG loan will be used to continue the following Phase III programs:

(a) Rural Housing Sub-Program (RHSP) of the MHP.

Under the MHP Phase III program in 1986, 60,000 individual shelter loans were made under the RHSP. These small cash loans (up to approximately \$250) enabled rural householders to obtain necessary building materials or services for house building or rehabilitation.

Phase IV will continue funding for this program while technical assistance and training will continue to help develop a network of financial institutions operating in the rural areas (based on village credit unions) which will make and collect these loans.

It is anticipated that RHSP loans will be made throughout the country, including those areas recently affected by communal disturbances. Preference will be given to those districts achieving the best record of collections for prior RHSP loans. It is estimated that approximately \$16 million will be allocated to this program which will result in at least 80,000 individual loans.

(b) Urban Housing Sub-Program (UHSP) of the MHP.

Launched in 1985, the urban sub-program offers four loan options: a shelter upgrading option, a new house option, a utilities package and a sites and services option. The new house and site and service options involve the largest loans (\$400 - 600), and may include a serviced plot, at higher interest rates than the smaller rural housing loans.

It is anticipated that UHSP loans will be made predominantly in the greater Colombo area (Colombo, Dehiwela, Mt. Lavinia, Moratuwa, Kotte and Gampaha) where slum and shanty problems are most pronounced. It is estimated that approximately \$4 million will be allocated to this program which will result in at least 20,000 individual loans.

(c) Eligible Mortgages.

Continued assistance will be provided to Sri Lanka's two semi-private sector housing finance institutions, the State Mortgage and Investment Bank (SMIB) and the Housing Development Finance Corporation (HDFC). Although substantial progress has been made by both institutions (the SMIB has increased its lending nearly 3 fold during the life of the HG program), continued support is necessary to enable them to take over a larger share of the housing finance market from the public sector (including some portion of those households below the median income), and to extend their program of providing construction finance to private property developers (especially for the construction of housing in the \$2,000 - 4,000 range). HG financing will also enable the private housing finance institutions to support demonstration private sector projects

for lower income households. It is estimated that \$3 million will be devoted to this component, resulting in at least 2,500 individual loans.

(d) Demonstration Program in Urban Development/Local Authority Improvement.

In 1985 the GSL took a number of significant decisions to improve the financial position of local authorities so that they could begin a process of rational budgeting and planning for urban capital projects. Central to this effort is the GSL's decision to overhaul the local authority revenue and budgeting process so that in the future, capital projects will be planned, implemented and paid for at the local level and not through the Central Government.

Eligible expenditures under this program may include those costs incurred by local authorities for small demonstration capital projects, in housing, water supply, sewerage, street lighting, roads, pathways, markets and community centers. This approach will complement the Mission's involvement in the water sector, particularly the Water Supply and Sanitation Project (383-0088). Private sector demonstration projects in which a local authority retains a private developer to package and build a project for a fixed price will also be an eligible expenditure under this program. It is estimated that approximately \$1 million will be devoted to these demonstration components.

(e) Demonstration Programs in Finance for Settler/Township Housing and Urban Services in the Mahaweli Areas.

HG funds will be used to support demonstration projects for the financing of housing and services for settlers and town dwellers in the Mahaweli agricultural areas of the country. Because problems of title arrangements remain to be solved, the availability of the Housing Guaranty resources may act as leverage to assist in the resolution of these difficulties.

Mahaweli settlers are income eligible and appear to have positive economic prospects once they become established. At present, however, no agency is extending them credit for housing and services. This demonstration program would complement substantial Mission projects in the Mahaweli. It is estimated that this demonstration project will require \$1 million to finance approximately 500 or more loans for core houses or improvements to existing structures.

2. Technical Assistance and Training

During earlier Phases of the HG program, four types of AID-financed support were provided to the GSL: resident contract advisors, short-term consultants, special

studies and training. The recipients of this assistance have included:

- the Ministry of Local Government, Housing and Construction (MLGHC): resident contract advisor and special studies, including studies of housing management, subsidies and housing needs;
- Ministry of Finance and Planning: special studies on various aspects of housing finance;
- National Housing Development Authority: current resident financial advisor, special studies, including studies on the "Million Houses Program", and short-term consultants to advise on "Kandy Pilot Project", legal agreements development, institutional reorganization and collections program development;
- the State Mortgage and Investment Bank (SMIB): Short-term consultants to advise on organizational procedures, private sector capitalization and automation design;
- the Housing Development Finance Corporation (HDFC): short-term consultants to advise on organization procedures, strategies to target mortgages to lower income borrowers and automation design;
- Federation of Thrift and Credit Cooperative Societies: short-term consultants to advise on training.

Training activities have been largely directed to the major housing implementing agencies, both public and "private", such as the National Housing Development Authority (NHDA), the SMIB, the HDFC, the Ministry of Mahaweli as well as the MLGHC and the MFP.

During Phase IV of the HG program, technical assistance and training will continue to be focused on upgrading the management capabilities of both public and private MHP implementation agencies, and maximizing their capacity to meet the demands of an expanding program.

Under Phase IV, the following have been identified as priority areas for technical assistance and training:

1. Thrift Societies. The thrift societies must be strengthened in terms of skills and management, to enable them to perform adequately and to cope with their current plans for expansion.

2. NHDA's institutional development. NHDA requires training and technical assistance in several areas in order to help carry out its present role and move smoothly into new ones. These areas include skills in rapid appraisal of proposals for shelter improvements or construction and essential infrastructure upgrading, management, monitoring and cost recovery, and training, information and communication. In particular, technical assistance will be provided to NHDA for the development of more efficient and effective financial management. The system adopted for NHDA should be compatible with that being developed by the thrift societies.

3. NGO skills. The urban sub-program of the MHP in particular is moving into a more collaborative relationship with various NGOs. NGOs also have potential roles to play in reaching sections of the population not served by current housing programs. NGOs would benefit from training and technical assistance designed to upgrade their skills in project work, communication and training.

4. Local organization skills. In the same way, local level organizations in both rural and urban areas are also becoming more involved in the MHP. There is a corresponding need to strengthen these organizations and improve their ability to plan and manage local development activities.

These needs will be met in several ways: through long and short-term technical assistance, training programs, conferences and workshops, and special studies.

The first step is to develop a training agenda for the various organizations involved in GSL housing programs. This will be done in first quarter CY 1988, and will require one person-month of technical assistance costing an estimated \$14,000. Funds for this will come from DS&Tb. Based on the resulting training agenda, specific forms of training, information, and technical assistance can be more effectively and efficiently provided.

An illustrative technical assistance and training budget is presented in Annex B.

C. Project Inputs

1. HG

The loan will be for \$25 million and will finance sites and services, housing rehabilitation, infrastructure, urban development activities and pilot efforts to support demonstration projects in the Mahaweli areas and demonstration projects using private financial organizations and developers.

The HG funds will be borrowed by the GSL from private U.S. lenders at the U.S. Treasury rate. Repayment will be guaranteed by the U.S. Government.

2. Grant Funds

Development Studies and Training (DS&Tb)(383-0085) or a centrally funded project. This support will fund selected development activities and training efforts in an amount of \$150,000 (see Annex B).

3. Local Inputs

As its contribution to Phase IV of the HG program, the GSL will provide land, furnish counterparts for AID-funded consultants, and meet the recurrent costs of the project. The bulk of local inputs, however, will be the very substantial investment of private capital and labor provided by the beneficiaries. It is estimated that this beneficiary input will total at least \$50 million based on prevailing costs of comparable housing.

D. Project Outputs

1. Physical

The project will finance approximately 80,000 small shelter loans to rural households and approximately 20,000 small loans to urban households, both under the MHP. In addition, it is anticipated that approximately 2,500 mortgage loans will be given to eligible households by private financial institutions. Selected local authorities will carry out demonstration small-scale urban development activities. Finally, some 500 settler township households in the Mahaweli will receive shelter finance.

2. Institutional

At the conclusion of the master HG program, it is planned that the NHDA will have progressed from making loans at no interest (1983) to making loans which carry an interest rate linked to prevailing market conditions. The NHDA will also have moved from a low rate of collections (approx 10% in 1983) to at least 77% with concomitant reductions in subsidy levels.

The State Mortgage and Investment Bank, the Housing Development Finance Corporation, selected private sector credit union/cooperatives and possibly other new private housing finance organizations will emerge from this project as strengthened institutions. These institutions will have the

ability to both raise and lend funds which are not provided by the Treasury. The institutions will extend their lending facilities to households of below median income.

In the orderly development of the housing finance sector, it is anticipated that the NHDA will become a "regulatory" agency as private financial organizations (including credit unions) and/or NGOs take over the development and financing of housing for below median income households.

Appropriate financial organizations will extend credit for house building or rehabilitation to the Mahaweli areas. Local authorities will have re-structured their financial procedures and revenue base and entered into "turnkey" arrangements with private developers for the provision of urban development.

E. Beneficiaries

The beneficiary profile remains substantially the same as that described in the Phase III Program Memorandum. Additional data on project beneficiaries is presented in Section V of this memorandum.

IV. ADMINISTRATIVE AND TECHNICAL ANALYSIS UPDATE

A. National Housing Development Authority

Since 1985 Sri Lanka has approached the provision of affordable rural and urban housing by revising many long standing policies which had the effect of limiting private sector participation. The National Housing Development Authority has been at the forefront of efforts to improve the housing supply by developing and implementing the Million Houses Program.

AID has worked closely with NHDA since the inception of the HG program in 1981 and has assisted the organization to improve its operations and redefine its long-term goals. During the last few years NHDA has made far-reaching changes in its programs (e.g., the use of the thrift system for loan delivery and recovery.)

It has also changed its cost recovery philosophy. When AID began to work with NHDA in the early 1980s, housing loans carried no interest. Today, interest rates range from 6% for rural loans to 10% for urban loans with additional increases projected. Recovery rates have improved considerably.

Policy changes, although slow in coming, have often resulted from lessons learned in program implementation. A prime example of this is the changes which have occurred in the rural housing program in term of privatization, decentralization and reorganization.

Since 1985, NHDA has been discontinuing its direct housing delivery programs, particularly in the rural areas. Instead, NHDA is increasingly transferring its rural housing loan delivery/recovery system to the Thrift and Credit Cooperative Society (TCCS) system. In 1986, the TCCS system more than doubled in size and capacity to better accommodate NHDA loans.

One third of all NHDA rural housing loans were delivered in 1986 through the TCCS system. Full transfer of the rural loan delivery system to the thrift societies should be completed in 1988. A pilot project has also been started, utilizing selected TCCS, to recover older NHDA direct loans. In those rural areas affected by civil strife, a dual system of direct NHDA and TCCS loan delivery will remain in effect for the time being.

In urban areas, NHDA, in conjunction with the TCCS, has initiated a pilot TCCS expansion project utilizing urban thrifts for loan delivery and recovery. Fourteen urban thrifts are now in operation and beginning to make housing loans throughout the greater Colombo metropolitan area and Gampaha.

The initial results of the TCCS implementation are universally superior to the previous NHDA direct lending figures. Loan origination and servicing costs are lower and recoveries are higher. The May 1987 island-wide TCCS rate of recovery was 89%, with a majority of the districts reporting 100% collections.

The High Level Working Group (composed of representatives of NHDA, the Federation of TCCS and the Ministry of Cooperatives) has become increasingly effective in focusing upon policy issues, program monitoring and strategic planning. The HLWG, has taken the lead in supporting efforts made by NHDA's Institutional Credit Division (Special Unit) and the Federation, with the assistance of a resident technical advisor, to improve and stabilize program recoveries.

NHDA has begun a decentralization process to achieve greater adaptability and responsiveness, and to allow it to more effectively serve its constituency. The operation of the district offices is becoming more independent of head office leadership. Although basic policy decisions are still being made at the head office, lesser policy decisions and most implementation decisions are now made in the districts.

NHDA is in a transitional period, moving away from heavily-subsidized programs and towards increased financial self-sufficiency. Doing this successfully requires organizational changes, as well as a redefinition of roles as NHDA becomes a provider of housing finance to the District Unions of TCCSs, removing itself almost completely from direct lending.

Although NHDA has been effective in modifying programs and policies, these changes have not always been followed by adjustments in its organizational structure. This has sometimes led to inefficiencies in program management and implementation. Such inefficiencies include overlaps in the roles and functions of NHDA's Deputy General Managers, and ineffective program management systems. Both have served to impede program implementation and accountability.

It is planned to decentralize NHDA operations to conform to national devolution plans presently being developed. Under this scheme, the NHDA head office, would function as a policy, planning and monitoring unit, providing necessary support and advice to the district offices. NHDA district offices would become virtually autonomous entities.

In the meantime, NHDA and Ministry officials have embarked upon an interim reorganization plan which provides for changes to NHDA's structure. This approach is bringing about the adjustments required in order to shift loan disbursements and recoveries to the TCCS system. An Institutional Credit Division has been created to handle NHDA-TCCS planning, monitoring and operations. The Kandy District Manager, who initiated the pilot NHDA-TCCS program in his district, has been appointed to head this division. At the same time, the Rural Housing Division is now undergoing a streamlining.

In line with these efforts, AID has identified weaknesses in the NHDA monitoring and evaluation system and has been working with the organization to develop better forms of tracing program activity. AID is also helping NHDA develop a management information system for decision-making. An Automated Data Processing system is being installed in the NHDA home office and the district offices to improve management and accounting methods.

B. Thrift and Credit Societies in Sri Lanka

Thrift and Credit Societies in Sri Lanka date from the early 1900s. Like other Sri Lankan cooperative societies, TCCS are registered and supervised by the Department of Cooperative Development (DCD). Since 1932, the DCD has been responsible for the promotion of thrifts, training of officers and managers, auditing, and arbitration between credit unions and their members.

The 1985 decision to manage NHDA housing loans through thrift societies under the Thrift and Credit Cooperative Societies Expansion Program (TCCSEP) privatized these loans and linked them to a thrift movement that had already begun an ambitious program of expansion. The expansion of the thrifts has been managed by the Federation (TCCS). Although the

Federation's role is technically an advisory one, it has developed into a dynamic organization with responsibility for the needs of both the District Unions and their member primary societies.

Local TCCS have organized District Unions to represent their interests on that level. The 25 established District Unions, in coordination with the district offices of the DCD, promote and organize new TCCS and provide a variety of support services to existing TCCS, including education, supplies and technical assistance in special issues. The District Unions have revised their by-laws enabling them to receive external loans to reloan to their affiliated members. Previously staffed by volunteers, activities undertaken by the District Unions are now carried out by salaried personnel including a local union president, an accountant and a secretary/clerk.

There are now 5,294 active thrift societies (up from 2,116 societies in 1984), of which 4,537 have been certified to give NHDA housing loans. There are 14 functioning urban TCCS - located primarily in greater Colombo and Gampaha - which are beginning to make NHDA housing loans. The total approximate membership of rural and urban TCCSs is 425,200.

Membership of a TCCS ranges from 15 to over 100 households. TCCSs collect funds from their membership by requiring each member to purchase shares at 100 Rupees each. In urban areas a modified share purchase plan is being developed. Various forms of deposits with interest rates similar to those prevailing in the monetary market also supplement TCCS funds. Societies which do not possess sufficient funds are provided with funds by the District Unions.

The Thrift and Credit Cooperative Society system is undergoing major changes associated with taking over housing loan responsibilities from NHDA. Improvements in program operations are being made with the technical assistance of the NHDA AID-financed resident advisor, and local and external short-term technical assistance. Efforts center on helping thrifts handle their increased management, administrative and inter-organizational responsibilities. The Mission is aware that a common failing of credit institutions is their too-rapid expansion. This will be carefully monitored and addressed if necessary.

Through thrift societies, beneficiaries receive loans from less than Rs. 5,000 up to Rs. 7,500. The program initially provided for interest rates of 3% for loans up to Rs. 5,000 and 6% for loans up to the maximum Rs. 7,500. Now, however, a flat rate of 6% is being charged on each loan made through the TCCS system. The urban TCCS pilot project provides for the payment of up to 10% on maximum loan amounts up to Rs. 15,000. AID believes that ultimately thrift societies should be free to set their own, market determined, interest rates.

TCCS receives a Rs.50 service charge against the NHDA loans delivered through the TCCS. An additional service charge is recouped from NHDA at the rate of Rs.150 per loan. Of this charge, Rs. 135 is retained by the TCCS, while Rs. 15 goes to the DU.

Loan recovery through the TCCS system has proven to be a significant improvement over the RHSP recoveries achieved through the direct loan system. The Kandy pilot project demonstrated a 1985 recovery rate of 93%. Recovery rates island-wide reached 89% as of May 1987 with many districts demonstrating 100% recoveries.

In addition to NHDA housing loans, TCCS offers loans for other purposes, according to members' needs. A recent study of some TCCS found that they are making loans for agriculture (seed, tools, fertilizer, etc.,) small business and cottage industry. The number and value of such loans are small. Loan terms are reasonable and there are few problems of delinquent repayments.

C. State Mortgage and Investment Bank

Since 1985 the SMIB has continued to experience substantial growth, aided by the computerization of its accounts and records. In 1986, the institution sanctioned 6225 loans with a value of Rs. 683.7 million (\$ 23.6M). A breakdown of the 8,713 loan applications received during 1986 reveals that over 3,000 were from Colombo and more than half were for amounts ranging from Rs.25,000 (\$ 862) to Rs. 100,000 (\$3450). Many of these applicants would be within AID's HG target group.

The SMIB continues to offer a wide range of interest rates (from 8 - 20%) with smaller loans carrying the lower rates. The Bank's composite cost of funds is slightly higher than 14 1/2% and their spread is positive. During this period, however, we have encouraged them to narrow this range while adjusting some of the categories upwards. It is our conclusion that borrowers of amounts larger than Rs. 100,000 (\$3450) should be paying at least the prevailing market rate, but this has not been the case to date.

SMIB's practice of having the very large loans subsidize the very small ones is being hindered by the fact that other financial institutions are now making credit available to substantial borrowers at 2 - 3% below SMIB's top end. SMIB's recovery rate remains excellent due to the fact that they possess the right of "parate execution", i.e. they can - and do - foreclose and auction mortgaged property without further recourse to the judicial processes. In addition, the SMIB levies a 3% penalty interest charge on delinquent amounts which stops borrowers "playing the market" with repayment proceeds. The SMIB has continued to keep a relatively small staff (233 compared with NHDA's 2,500) and is proud of the fact

that its loan to staff ratio is five times higher than a decade ago.

The SMIB is proposing that its fixed, loan linked or savings deposits be guaranteed by the government. The Chairman has proposed that if this guarantee is passed by Parliament, the SMIB will enter the private capital market for funds rather than relying solely on the sale of government-backed debentures purchased mainly by other government entities.

AID believes that this move would be consistent with our goals of creating a private housing finance system. We also believe that it would force SMIB to undergo the process of interest rate rationalization that is required. Market rates for medium and long term loans for other sectors now begin at approximately 14 - 16%, making 8% loans untenable. There is some indication that with the end of the International Year for Shelter in December, the SMIB will move to increase its rates.

During Phase III, SMIB has come to recognize its predicament: it can no longer rely on public entities to purchase government debentures at significantly lower than market interest rates. At the same time, its interest rate spread prevents the SMIB from earning the return it needs to tap private capital. The result has been more demand for SMIB's funds than there is available capital, and a form of credit rationing has in fact been introduced. AID will continue to work with the SMIB to try to resolve this situation.

D. Housing Development Finance Corporation of Sri Lanka

Since 1985, HDFC has begun to develop as a viable housing finance institution. It is still dwarfed by SMIB, which made more than 6 times as many loans during 1986. HDFC must, therefore, follow SMIB's lead to some extent in matters such as interest rates (although in August 1987, HDFC took the lead in increasing its interest rates to a range from 11.5% - 22%).

HDFC's equity continues to be held 60% by the public sector and 40% by the private. Maharajah Group is the largest private shareholder, and has an ongoing 10 year management contract with HDFC. HDFC continues to have some difficulty getting the right chief executive (it now has its fourth in 4 years) but has been fortunate in having a very high calibre junior staff with a number of talented and dedicated directors.

HDFC has been experiencing severe liquidity problems during the last twelve months for reasons that are almost identical to SMIB: an interest rate structure that presently prevents them from reaching out to tap market rate medium and long term funds, and a public sector which can no longer support them due to the budgetary repercussions of the civil disturbances. HDFC has been actively pursuing ways to remedy this problem: they have supported AID's efforts to investigate how a mortgage-backed security instrument might be launched in

Sri Lanka. They have actively pursued negotiations with domestic sources of medium and long term finance (the Employees Trust Fund). While no answers have yet emerged from these activities, the HDFC has started to play an important role within the government as a spokesman for financial innovations in the shelter sector.

V. SOCIAL ANALYSIS UPDATE

A. Perception of a House and Housing Loan

Studies sponsored by AID and NHDA (see studies by Sunimal Fernando, on file) have shown that low-income urban families perceive state-supported housing as a means of entry into mainstream urban society. The urban poor see a new or upgraded house mainly as a symbol of recognition and acceptance. The house per se is actually less important to them than security of tenure and access to basic services such as water and toilets.

The rural low-income person's perception of a house, however, is qualitatively different. From the time a man marries and establishes his own family, he plans for his own permanent house. Security of tenure is not a major problem. Nor is social acceptance within the village community. He starts building when he can afford to do so but it may be years before he can complete it.

Rural housing is not perceived by rural people as a problem for the State. It is perceived, essentially, as a problem faced by rural families which the State is helping the families to solve. Rural house-building is an activity which is almost sacred in rural society. Obligations on the part of a family are therefore strong towards any person or institution which helps with such an activity. This has a direct bearing on rural peoples' willingness to repay their loans.

B. Housing as a Priority and as a Process

These AID-sponsored studies also indicate that Sinhala speaking rural families have very different investment priorities for housing than their Tamil counterparts. The Sinhalese tend to balance investment in housing, human resource development/education and consumer durables almost equally. In contrast, Tamil families give highest priority to human resource development/education, followed by consumer durables and housing. Within the Jaffna context, for example, housing is seen as a specific object of investment linked to the dynamics of the dowry system.

Differences also emerge in terms of how houses are constructed. In Sinhala districts, houses are built in stages and the aid of NHDA loans is often sought during the process, rather than at the beginning. In the study, twenty percent of

those questioned had taken 6 years or more to build their house. In Tamil districts, particularly Jaffna, home building is a "one shot operation", with construction taking place in one sustained effort. Once the decision to build is made, construction proceeds quickly, with few interruptions.

The pattern of household savings in Sinhala speaking middle and low income families also differs from the pattern prevailing among middle and lower income families of the Jaffna district. Agriculture in Sinhala speaking areas is largely rain fed; if there is no rain or too much rain their crops will fail. Self employment in both agricultural and non-farm activities is associated with an unpredictable and irregular income flow. During periods of surplus, therefore, resources are saved for housing not in the form of cash, but in the form of building materials.

In contrast, because agriculture in the Jaffna area is based upon ground water irrigation not subject to the uncertainties of the rains, incomes are more predictable. Tamil speaking middle and low income families collect their surpluses in cash and jewellery with a fair degree of confidence that the family will not have to use them to meet its basic living expenses in the future. Tamil family incomes are also stabilized by remittances from family members working in salaried positions outside the area. Money that is saved in cash is either deposited in a bank or more commonly kept at home and loaned out at 60% annual interest*. It is only when a family has collected about 50% or more of the essential cost of building a house that it will decide to build.

VI. FINANCIAL PLAN

A. Program Costs

The annual GSL appropriation to the NHDA is approximately \$18 million (Rs. 500 million) per year of which approximately \$14 million is currently devoted to the Million Houses Program. The SMIB's annual production has increased dramatically over the last few years to reach a level of about \$ 20 million in 1986 with plans to increase that amount. Although the bulk of this mortgage financing is ineligible for HG re-financing, the SMIB is actively pursuing business at the lower end of the spectrum and feels confident of making loans with a value of \$2 million annually (Rs. 55 million) to households of below median income in 1988. The HDFC is still too new to accurately predict their loan volume, but they are sensitive to the need to make a certain number of lower income loans while maintaining the overall profitability of the institution. HG financing, therefore, will cover part of the costs of these programs.

Development studies and participant training activities estimated at least \$150,000 over the project period

will be financed through the Development Studies and Training Project (383-0085), central funding or other sources. The GSL will provide land, recurrent costs and counterpart participation to support capital costs, short term consultants, special studies and training. The Mission is supporting a study of interest rates for medium and long-term credit in general and for the housing sector in particular. The aim of this study is to make interest rates more closely approximate true market interest rates.

The borrower under the HG program will be the Ministry of Finance and Planning. Local currency will be made available as part of the normal GSL budgetary process to the MLGHC for NHDA program expenditures. Local currency will also be made available to the SMIB and the HDFC as part of the special line items in the Public Investment Plan for the Housing Guaranty Program. Drawdowns of the HG loan from the U.S. lender will be based on sub program expenditures following the completion of the work. Repayment of the HG loan will be a general obligation of the GSL.

B. Cost to Beneficiaries

Beneficiaries under the Million Houses Program repay amounts depending upon the size of the loan they have taken (from \$150 - 300) and the term of the loan they have selected (5 - 15 years). The payments currently average from \$1 - 3 per month (Rs 29-87) or approximately 5% per month at a median income in the rural areas of \$40 (Rs. 1200). It is anticipated that under the Phase IV program interest rates of at least 6% will be charged depending upon the size of the loan that is selected. Larger loans of up to \$517 (Rs.15,000), for example, can be obtained for construction of an urban site and service basic unit plus latrine, at 10% over 15 years. The monthly repayment on the maximum urban loan is \$5.50 (Rs.160) or 7% of the urban median income of \$79 (Rs.2300). Thus, the NHDA's MHP programs reach far down the income scale.

The SMIB and the HDFC have both tentatively approved the use of a graduated payment mortgage as a means of reducing the loan repayments in early years for lower income groups. The SMIB has reviewed this device and the HDFC has already offered this plan to their general borrowers. These two institutions have sliding interest rates - between 8-20% - depending upon the amount of money borrowed. For small loans to below median income borrowers an amount up to \$1600 could be borrowed at a rate of 8.5 - 9.5% for 15 years employing a graduated payments mortgage. The payment in this case would be approximately 20% of the borrower's monthly income, a proportion which would decline if incomes increase over time.

VII. ECONOMIC ANALYSIS UPDATE

A. Recent Economic Performance

Sri Lanka's economic performance in 1986 was the poorest since 1977, with real growth dropping to 4 percent. Growth by sector varied widely. Production of rice, Sri Lanka's staple cereal, experienced a setback in 1986 despite a marginal increase in average yield. The unsettled security situation in northern and eastern Sri Lanka caused most of the decline in production, which dropped 2.5 percent from its 1985 peak.

The plantation sector also performed poorly in 1986. Tea production was down only fractionally, but because of low prices, the sector's earnings dropped over 10 percent. For much of 1986, Colombo auction prices were below producer costs. The downward trend in world tea prices was exacerbated by the "tea scare" early in the year, when Tamil separatists claimed (falsely) to have poisoned Sri Lankan tea exports. Earnings from coconut production also showed the effects of depressed prices. They dropped a third despite a marginal increase in output. Rubber production was roughly constant, while buoyant prices led to a modest growth in earnings during 1986.

Output in the manufacturing sector increased by 8 percent in 1986, and value rose by 14 percent. Growth was enjoyed by private and public sectors alike. The textile subsector led industrial growth with output and value both rising over 20 percent. While output in the petroleum subsector--chiefly production at the country's oil refinery--increased 7 percent, earnings dropped because of low world prices for petroleum products.

Performance in remaining sectors was mixed. Construction remained depressed, reflecting the completion of most major capital projects associated with the Accelerated Mahaweli Development Program. The transport sector also grew slowly, in part because of the security situation on many parts of the island. On the other hand, utilities performed strongly because of lower petroleum import prices and increased utilization of hydroelectric power. Public administration grew dramatically due to burgeoning defense expenditures. The tourist subsector remained weak.

B. Balance of Payments

The balance of payments remained in deficit in 1986. Exports and imports declined because of drops in world prices for tea and oil respectively. Garments overtook tea as Sri Lanka's number one export by value but not value added in country. Earnings from tourism and direct foreign investment

remained depressed because of the country's uncertain security situation, while remittances from Sri Lankans working abroad remained strong. Debt service reached worrisome levels at nearly 30 percent of export and service receipts.

Despite over \$500 million in foreign assistance, the overall balance remained negative and official foreign exchange reserves dropped to about two months worth of imports by year's end. A breakdown of Sri Lanka's sources and uses of foreign exchange in 1986 follows. All figures are in millions of dollars:

<u>Sources</u>		<u>Uses</u>	
Foreign aid	536	Debt service	457
Garments exports	331	Petroleum imports	231
Tea exports	330	Machinery imports	187
Remittances	324	Textile imports	151
Rubber exports	94	Wheat imports	98
Petroleum re-exports	84	Sugar imports	57
Tourism	82	Transport imports	51

Source: Central Bank

The direction of Sri Lankan trade remained unchanged in 1986. The United States and Japan strengthened their positions as Sri Lanka's number one market and supplier respectively.

The Sri Lankan Rupee depreciated against most major currencies in 1986. The Rupee's strong linkage to the Dollar which had caused, in the opinion of many observers, its overvalue during the early 1980s now led the Rupee in the opposite direction. The Rupee fell about 5 percent against the Dollar, but nearly 25 percent against the Mark and Japanese Yen.

C. Communal Disruptions

As noted in the foregoing analysis, a fair amount of macro-economic uncertainty has been created by communal unrest, particularly in the North. Sri Lanka's debt repayment capacity will continue to be adequate as long as the impacts of the disturbances are largely confined to Tamil regions and to tourism. Nevertheless, the status quo is unacceptable from a purely economic standpoint for three primary reasons:

(1) necessary and probably unpopular reforms in tax and exchange rate policies will be more difficult in a climate of political uncertainty;

(2) increased military expenditures increase budget expenditures and, since most military hardware is imported, exacerbate balance of payments problems.

(3) the existence of the current level of hostilities will discourage some financing of investment.

D. Effects of the Proposed Housing Guaranty Loan

The introduction in the late 1970s of a bold public investment program aimed at growth and wide-ranging economic reforms to improve economic efficiency produced notable early successes. Despite this, certain problems emerged. Externally, there was a continuous decline in the terms of trade between 1978-82 which adversely affected real incomes tax revenues and export profitability. Domestic policies did little to offset these unfavorable developments. External and fiscal deficits widened and debt and debt service grew.

To correct this, authorities in the early 1980s introduced higher interest rates, the scaling down of the Public Investment Program and measures designed to improve revenue performance. During 1984, the authorities used higher tea prices to build up foreign exchange reserves and reduce short-term commercial debt.

In 1985, these gains were substantially reversed when tea prices fell again. This setback emphasized the long-standing structural problems in the economy, one of the most important being an export base that is dependent on few commodities and products for which potential growth is diminishing. Significant increases in security expenditures placed additional pressures on the external and fiscal deficits. The current account deficit increased sharply to 7.1 percent of GDP, the fiscal deficit to 14.3 percent of GDP, and official reserves fell below three months of imports.

Since a higher level of security expenditures will necessitate a further scaling down of the public investment program, the maintenance of an adequate level of investment in the economy will require greater participation by the private sector. For this reason, the authorities intend to pursue a development strategy focusing on expansion and diversification in export-oriented agriculture and on developing a dynamic manufacturing industry for exports.

Within this context, a Housing Guaranty (HG) loan can be viewed as both a timely and appropriate source of financing. This is especially true in light of the probable further scaling down of public investment which will presumably extend to housing.

A HG loan can help maintain low-income housing investment, provide a source of employment for those affected by the slowdown in the large labor-intensive sectors of the economy, and help boost the construction sector's stagnant growth rate. Additionally, the foreign exchange provided by the HG loan can be put to use by the authorities in their pursuit of an export-oriented development strategy. A HG loan

represents a timely infusion of capital which, together with its attractive terms relative to other commercial sources, makes it an appropriate source of funding.

The proposed HG program is essentially an agreement by the U.S. to guarantee dollar-denominated loans by U.S. investors to the GSL Ministry of Finance and Planning, the proceeds from which can then be used to retire short-term debt. The quid pro quo is an agreement by the GSL to make loans in the same total amount in local currency to eligible housing consumers. In addition, the GSL must agree to guarantee repayment by the borrowing agency and make specified policy and program commitments. Thus, the HG loan itself will improve the GSL's debt situation by permitting the substitution of long-term for short-term debt.

It is estimated that more than 95% of the GSL expenditures under its housing program are local cost items; HG funds are therefore available for balance of payments support. HG funds are available on reasonable terms, currently at a fixed market rate of approximately 9.5% or a floating rate of approximately 7% with a 10 year grace period on principal and up to a 30 year maturity. These terms compare favorably with other resources available to Sri Lanka especially in regard to the 30 year length of the loan (which matches Sri Lanka's current requirements). It is anticipated that the HG loan would replace short term (one to three year) Eurocurrency loans which cost the GSL more than current HG rate.

In addition, the AID shelter sector program encourages improved domestic economic performance by reducing unnecessary subsidies, encouraging greater cost recovery and improved targeting of the public sector program to focus on low income households. The program fosters private sector involvement in the production and financing of housing. For all of these reasons, the Mission and the Office of Housing conclude that a HG loan is a reasonable, secure and advantageous program for both AID and the GSL.

IX. PROJECT IMPLEMENTATION

A. AID Program Management

USAID/Sri Lanka is responsible for the policy framework within which the HG is implemented. Within this framework, the AID Office of Housing and Urban Programs (PRE/H) will be responsible for HG program development, negotiation and implementation. PRE/H's responsibilities will be carried out by the Mission Housing Advisor assigned to USAID/Sri Lanka under the overall technical guidance and supervision of the Regional Housing and Urban Development Office (RHUDO) for Asia.

The Mission Housing Advisor, together with the Mission and RHUDO/Asia will program such short term consultants,

training or studies as may be necessary and are funded out of technical assistance grant funds.

The Implementation Agreement for Phase IV will be negotiated in November/December 1987. It is anticipated that the initial Loan Agreement will be negotiated in November and December 1988. The fourth phase HG program may be disbursed in two tranches: one for approximately \$10 million in the first quarter of FY 89 and the second for approximately \$15 million one year later in FY 90. Conditions in the U.S. capital market will influence the exact timing of the GSL's borrowing.

B. Program Monitoring and Evaluation

Progress in meeting the outputs for the overall program will be documented through regular evaluations as prescribed in the PRE/H Evaluation and Monitoring Guidelines. The operational responsibilities for the evaluation will rest with the Mission Housing Advisor, and will be coordinated through the Mission and RHUDO. These evaluation reports will note any deviations from the program and sub-program purposes, goals and schedules set forth in the Implementation Agreement and will present a detailed factual basis for such revisions of the program as may be necessary.

There will be two scheduled evaluations of this project: the first will be a mid-term evaluation to review the progress of the three major components (RHSP, UHSP and Eligible Mortgages), and to determine whether additional inputs are necessary to accomplish the two demonstration components (Mahaweli and urban development). In addition, this mid-term evaluation of Phase IV will be coupled with the final evaluation of Phase III (which will examine the impact of the project at the purpose and goal levels). This combined evaluation exercise is planned for early CY 89, and will require three weeks in the field.

The results of the evaluation will be made available to, and discussed with, interested parties. Besides the Mission Housing Advisor (representing the Mission and RHUDO/Bangkok), other primary users of the evaluation results include a variety of GSL officials such as the Director, Policy & Programming, MLGHC; the General Manager, NHDA; the Chairman, SMIB; the Executive Director, HDFC (SL); the Director of Economic Affairs, MFP; and the Executive Director (Settlements), Mahaweli Authority.

The evaluation will focus on three issues of interest to the primary users. The first is the degree to which the MHP is self-sustaining, maintaining an acceptable rate of collections, reaching the target group and being monitored adequately at both the local and national level. The second issue is the extent to which the MHP, as administered through the thrift societies, is adequately extending housing credit on

the one hand and strengthening village government structures on the other, to promote rural development. A third issue concerns the role of the HG program in strengthening the private sector in terms of the supply of building materials, housing finance and private building and development. Institutions such as SMIB, HDFC, the credit unions, and the newly emerging private building developers will all be examined. The evaluation will also look at whether the program has stimulated the beginnings of a secondary mortgage market in Sri Lanka.

The evaluators will use the following indicators (as well as those specified in the logframe) to measure the project's achievements:

(1) for the MHP: rate of lending and recoveries, amount of program administrative overhead, analysis of beneficiaries and their geographic spread, and the amount of private beneficiary investment in the program;

(2) for the credit union administered portion of the MHP: (in addition to the foregoing) the extent to which credit unions have spread (i.e. new ones formed and existing societies' membership increased), assets have grown, "new members" taken in for the purpose of housing loans have become integrated into full, active membership; and

(3) for the private sector: the asset base of SMIB, HDFC, and participating credit unions, the extent to which these housing finance institutions raise their capital from the private sector rather than rely on public sector contributions, the number of loans being extended to households of below median income, the number of private developers receiving construction loans, and commitments to provide long-term mortgage finance to ultimate home buyers.

The evaluation team will be composed of a housing generalist with a background in housing finance, a systems analyst familiar with automated monitoring and collections programs for the shelter sector, and a credit union/cooperative specialist familiar with the implementation of housing programs for lower income households.

The anticipated cost of an IQC providing a three-person team for three weeks to carry out the combined final evaluation of Phase III and the mid-term evaluation of Phase IV is \$50,000. PD&S funds will be sought for the evaluation activity in FY 89.

C. Phase V and the New HG Master Program

The mid-term evaluation of Phase IV, to be done in early CY 1989, will lead directly to the next and final phase of the current HG program (Phase V) and the design of a new HG

Master Program for the 1990s.

The mid-term Phase IV evaluation will be used to prepare a Program Memorandum for Phase V, which will conclude the current HG Master Program. This Program Memorandum will also identify specific areas and issues for study and analysis during CY 1989, leading to a Project Paper for a new HG program for Sri Lanka in early CY 1990.

In reconstruction needs in Sri Lanka turn out to require acceleration or modification of the existing program, then this will be done as circumstances warrant.

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SUBJECT: PHASE IV HOUSING GUARANTY PROGRAM (383-HG-004)

REF: COLOMBO 04622

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1. AA/ANE HEREBY DELEGATES TO MISSION DIRECTOR, USAID/SRI LANKA, THE AUTHORITY TO APPROVE PHASE IV HOUSING GUARANTY PROGRAM (383-HG-004) AND TO AUTHORIZE DOLS. 25,000,000 IN FY 87 GUARANTY AUTHORITY UNDER THE PROGRAM. DELEGATION IS BASED ON ACTION MEMORANDUM PREPARED FOLLOWING MEETING OF PROJECT REVIEW COMMITTEE, WHOSE DELIBERATIONS ARE SUMMARIZED BELOW. AA/ANE UNDERSTANDS DELEGATION WILL BE EXERCISED IN CONSULTATION WITH THE RUHDO/ASIA.

2. PROJECT REVIEW COMMITTEE MET ON JULY 20 TO CONSIDER MISSION'S REQUEST (REFTEL) FOR DELEGATION OF AUTHORITY TO APPROVE IN THE FIELD PHASE IV HG PROGRAM IN THE AMOUNT OF DOLS. 25 MILLION. COMMITTEE NOTED THAT AID/WASHINGTON HAS GENERALLY NOT ELECTED TO DELEGATE AUTHORITY ON SPECIFIC HG APPROVALS, ALTHOUGH THERE IS NO APPARENT PRECLUSION OF SUCH DELEGATION IN AN APPROPRIATE CASE. HOUSING GUARANTIES ARE INCLUDED IN THE DEFINITION OF QUOTE PROJECT UNQUOTE IN HANDBOOK 3, AND THUS CAN BE

TREATED LIKE ANY OTHER PROJECT FOR PURPOSES OF REDELEGATION TO THE FIELD.

3. IT WAS THE COMMITTEE'S CONSENSUS THAT THE SRI LANKA HG PROGRAM IS BOTH INNOVATIVE AND SUCCESSFUL, PARTICULARLY IN ITS EFFORTS TO PRIVATIZE HOUSING FINANCE, RATIONALIZE SHELTER-SECTOR INTEREST RATES AND IMPROVE LOAN REPAYMENT PERFORMANCE. COMMITTEE ALSO AGREED WITH MISSION THAT PHASE IV PROGRAM, AS DIRECT FOLLOW-ON TO PHASE III, APPEARS NOT TO PRESENT NEW POLICY ISSUES OR PROGRAMMATIC INITIATIVES. AFTER DISCUSSING THE ISSUES DESCRIBED BELOW, THE COMMITTEE RECOMMENDED APPROVAL OF THE DELEGATION.

4. PACE OF PROGRAM IMPLEMENTATION: COMMITTEE NOTED THAT GSL HAS JUST COMPLETED A \$15 MILLION BORROWING UNDER PHASE III AND EXPECTS TO ACCRUE THE REMAINING \$10 MILLION UNDER PHASE III BY THE END OF THE CALENDAR

OFFICE	ACT	REF
DIR		✓
D.D.		✓
RLA		✓
HSG	X	
PRM		✓
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YEAR. THIS SUGGESTS THAT THE \$25 MILLION NOW PROPOSED FOR AUTHORIZATION UNDER PEASE IV WOULD BE REQUIRED SOMETIME IN CY 1988. PRC CONCLUDED THAT THIS PACE OF IMPLEMENTATION IS REASONABLE AND DOES NOT APPEAR TO POSE ANY SIGNIFICANT PROBLEM OF UNUSED GUARANTY AUTHORITY.

5. DEMONSTRATION PROJECTS: PRC NOTED THAT IMPLEMENTATION OF TWO DEMONSTRATION PROGRAMS INCLUDED IN PEASE III HAS BEEN DELAYED, BUT THAT MISSION PLANS TO CONTINUE EFFORTS TO GET THEM UNDERWAY UNDER PEASE IV. SOME PRC MEMBERS QUESTIONED HOW CONSTRAINTS ENCOUNTERED DURING PEASE III (E.G., MARAWELI LAND TITLING PROBLEMS AND LACK OF SUITABLE FINANCIAL INTERMEDIARY FOR URBAN COMPONENT) WOULD BE ADDRESSED IN PEASE IV. MISSION HAS REQUESTED TO PROVIDE FURTHER INFORMATION VIA CABLE PRIOR TO PROJECT AUTHORIZATION ON PROBLEMS ATTENDING THESE DEMONSTRATION SUBPROJECTS AND THE APPROACHES THAT WILL BE TAKEN TO SOLVE THEM UNDER PEASE IV.

6. PEASE III EVALUATION: THE COMMITTEE NOTED THAT PEASE III IS CURRENTLY UNDERGOING EVALUATION, AND REGRETTED THAT NEITHER THE RESULTS OF THE EVALUATION NOR THE CASE STUDIES MENTIONED IN REFTEL ARE AVAILABLE TO AID/W WHEN AID/W IS ASKED TO DECIDE WHETHER TO DELEGATE APPROVAL AUTHORITY. WE WOULD APPRECIATE MISSION CABLEING RESULTS OF THE EVALUATION FINDINGS AND AN INDICATION OF HOW THESE FINDINGS ARE BEING INCORPORATED INTO PHASE IV DESIGN. MISSION HAS REQUESTED TO PROVIDE AID/W WITH A SUMMARY OF RESULTS TO COMMUNITY.

7. LOW-INCOME TARGET POPULATION: THE COMMITTEE WAS PLEASED TO NOTE THAT THE URBAN COMPONENT OF THE EG PROGRAM AVOIDS SUPPORT FOR PUBLIC HOUSING SCHEMES AND RENTAL SUBSIDIES TO MIDDLE- OR UPPER-INCOME HOUSEHOLDS (WHICH HAD BEEN FOCUS OF EARLIER GSL ACTIVITIES), BUT QUESTIONED WHETHER PRESENT FOCUS ON LOW-INCOME OCCUPANT OWNERSHIP MIGHT RESULT IN EITHER EXCLUSION OF THE VERY POOR FOR LACK OF CREDITWORTHINESS OR IN POOR REPAYMENT PERFORMANCE FOR VERY LOW-INCOME HOUSEHOLDS. AID/W WOULD APPRECIATE MISSION'S RESPONSE TO THESE QUESTIONS. MISSION SHOULD APPROPRIATE TIME AND DISCUSSION CONTAINED IN THE PROJECT URBAN COMPONENT REPORTS RELATING TO THE POOREST HOUSEHOLDS. ALL BEING ADDRESSED UNDER THE URBAN PROGRAM AND WHETHER, FOR EXAMPLE, THERE IS ANY EFFORT TO INTEREST PRIVATE COMMERCIAL DEVELOPERS IN PROVIDING LOW-INCOME HOUSING.

8. ADVANCE PLANNING FOR NEW FY 90 EG PROGRAM: THE COMMITTEE SUGGESTS THAT THE MISSION INCLUDE IN ITS PEASE IV PROJECT MEMORANDUM A PARAGRAPH ON THE SCHEDULE FOR DESIGN OF THE NEW EG PROGRAM SCHEDULED FOR FY 1990. SHULTZ
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#9863

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VZCZCCMI *
 RR RUEHC RUEHBΔ
 DE RUEFCM #5523/01 229 **
 ZNR UUUUU ZZH
 R 171144Z AUG 87
 FM AMEMBASSY COLOMBO
 TO RUEHC / SECSTATE WASHDC #198
 INFO RUEHBA / AMEMBASSY BANGAΔ 4427
 ET
 UNCLAS SECTION 01 OF * COLOMBO 05523

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CLASS: UNCLASSIFIED
 CHRGE: AID 08/17/87
 APPRV: DIR:PJBLOOM
 DRFTD: MHA:JJDRAGGER:M
 CLEAR: A/DD:DZ;PRM:JE;
 W:AGR:JF
 DISTR: AID AMB DCM

AIDAC

E.O. 12356: N/A
 SUBJECT: PHASE IV HOUSING GUARANTY PROGRAM:
 - (383-HG-004)

cc. PRJ
 PRM
 AGR

REF: STATE 239863

1. PARA 5 OF REFTEL REQUESTS MISSION TO PROVIDE FURTHER INFORMATION CONCERNING THE TWO SMALL, LIMITED DEMONSTRATION PROJECTS (MAHAWELI HOUSING AND URBAN DEVELOPMENT) WHICH ARE INCORPORATED IN PHASE IV HG PROGRAM. THESE DEMONSTRATION PROJECTS WERE AUTHORIZED IN THE PHASE III PROGRAM BUT HAVE NOT YET COMMENCED OPERATIONS. THE MISSION WILL PURSUE THE FOLLOWING APPROACHES TO IMPLEMENT THESE COMPONENTS UNDER PHASE IV.

2. MAHAWELI HOUSING.

NO FORMAL SECTOR HOUSING FINANCE INSTITUTIONS CURRENTLY SERVE THE RESIDENTS OF THE MAHAWELI. THE MAHAWELI AUTHORITY MAKES SMALL GRANTS TO SETTLERS OF SOME NEW LANDS AND PROVIDES BUILDING MATERIALS FOR HOUSE ROOFS, LATRINES, AND WELLS UPON INITIAL OCCUPATION. THE FEC HAS DEVISED A GRANT/SOFT LOAN HOUSING PROGRAM FOR NEW SETTLERS IN SELECTED AREAS. ALL OF THE ABOVE, HOWEVER, IS FOR INITIAL SETTLEMENT. SOME AREAS OF THE MAHAWELI HAVE BEEN OCCUPIED FOR PERIODS OVER 15 YEARS. NO SYSTEMS HAVE BEEN DEVELOPED TO FINANCE HOUSING CONSOLIDATION, EXPANSION AND IMPROVEMENT. THE HG PROGRAM WOULD TARGET THESE MATURE MAHAWELI SETTLEMENTS WHICH ARE NOW READY FOR FORMAL SECTOR CREDIT INCLUDING ASSISTANCE FOR HOUSING. IN PHASE III THE MISSION ATTEMPTED TO USE A PRIVATE SRI LANKAN COMMERCIAL BANK TO MAKE LOANS TO QUALIFYING BENEFICIARIES IN SYSTEM H ZONE 5. THE BANK WAS CONCERNED WHETHER IT WOULD RECEIVE SUFFICIENT SECURITY FOR ITS LOANS, AND CONSEQUENTLY DECLINED TO PARTICIPATE.

IN PHASE IV THE MISSION PROPOSES TO INVESTIGATE THE FOLLOWING OPTIONS: FUNDING THROUGH A DIFFERENT PRIVATE COMMERCIAL BANK (THE NEW INVESTMENT AND CREDIT BANK) WITH A RESOLUTION OF THE COLLATERAL ISSUE; EXPANSION OF THE THRIFT AND CREDIT COOPERATIVE

SOCIETY (TCCS) SYSTEM INTO THE MARAWELI; OR FUNDING THROUGH THE MARAWELI AUTHORITY OF A CERTAIN AMOUNT FOR TARGETTED HOUSING LOANS IN MUCH THE SAME WAY AS THIS IS BEING DONE THROUGH NHDA. THE MISSION BELIEVES THAT IT WILL SUCCEED WITH ONE OF THESE OPTIONS SINCE THE SENIOR OFFICIALS OF THE MARAWELI AUTHORITY ARE SUPPORTIVE OF AID'S HOUSING INITIATIVE.

3. URBAN DEVELOPMENT.

AID HAS BEEN SUPPORTIVE OF THE MAJOR GSL EFFORT FINANCED BY THE IERD, UNDP AND UNCHS TO REFORM THE BUDGETTING, TAXING, AND ADMINISTRATIVE FUNCTIONS OF SRI LANKA'S CITIES AND TOWNS. THE MUNICIPALITIES WHICH SUCCEED AND ESTABLISH THEIR ECONOMIC VIABILITY AND ADMINISTRATIVE CAPACITY WILL THEN BE CLEARED TO ENTER INTO LOAN AGREEMENTS WITH THE MINISTRY FOR SELECTED CAPITAL INFRASTRUCTURE IMPROVEMENTS. THE MUNICIPALITIES MUST BE ABLE TO DEMONSTRATE THAT THEY CAN GENERATE THE REVENUES TO RETIRE THE DEBT INCURRED TO FINANCE THE CAPITAL IMPROVEMENTS.

DURING PHASE III SUBSTANTIAL UNDP FUNDED TECHNICAL ASSISTANCE AND TRAINING WAS PROVIDED TO MUNICIPAL STAFF. NO MUNICIPALITIES WERE JUDGED READY TO BEGIN CAPITAL PROJECTS. THEREFORE, THERE HAS NOT YET BEEN ANY REQUEST FOR CAPITAL FINANCE UNDER THE LIMITED HG DEMONSTRATION COMPONENT. IT IS ANTICIPATED, HOWEVER, THAT DURING PHASE IV SOME MUNICIPALITIES MAY ACHIEVE AN APPROPRIATE FINANCIAL POSITION TO PERMIT LIMITED BORROWING FOR CAPITAL IMPROVEMENTS. WHEN THIS POINT HAS BEEN REACHED, THE FOCUSED UD COMPONENT OF THE HG PROGRAM WILL COMMENCE. THE MISSION REMAINS COMMITTED TO ENCOURAGE, THROUGH ITS LIMITED UD COMPONENT, THE CONSTRUCTION OF URBAN CAPITAL PROJECTS BY PRIVATE CONTRACTORS USING THE QUOTE TURN-KEY UNQUOTE METHOD.

4. THE PHASE IV PROGRAM MEMORANDUM WILL CARRY FORWARD THE SAME MINIMUM LEVEL OF FUNDING FOR THE DEMONSTRATION PROGRAMS AS SET FORTH IN PHASE III BROKEN DOWN AS FOLLOWS: I.E. MARAWELI: DOLS.

1,000,000 AND UD: DOLS. 1,000,000. FYI: THE

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 RR RUEHC RUEHBA
 DE RUEHCM #0523/02 220 **
 ZNR UUUUU 22H
 R 171144Z AUG 87
 FM AMEMBASSY COLOMBO
 TO RUEHC / SECSTATE WASHDC 4199
 INFO RUEHBA / AMEMBASSY BANGKOK 4428
 BT
 UNCLAS SECTION 02 OF 02 COLOMBO 05523

CLASS: UNCLASSIFIED
 CHRG: AID 08/17/87
 APPPV: DIR:PJELCOM
 DRFTD: MHA:JJDHAGGR:N
 CLEAR: A/DD:DZ;PRM:JE;
 B;AGR:JF
 DISTR: AID AMB DCM

AILEAC

E.O. 12356: N/A

SUBJECT: PHASE IV HOUSING GUARANTY PROGRAM:

AGREEMENT ALLOWS THESE FUNDS TO BE ABSORBED INTO THE RURAL HOUSING SUP PROGRAM IF THEY ARE NOT REQUIRED FOR THESE DEMONSTRATION PURPOSES.

5. PARA 7 OF REFTEL REQUESTS MISSION TO INFORM AID/W HOW THE HOUSING PROBLEMS RELATING TO THE POOREST URBAN HOUSEHOLDS WILL BE ADDRESSED IN THE PHASE IV PROGRAM MEMORANDUM.

DURING PHASE III SRI LANKA BEGAN A LARGE SCALE PROGRAM OF UPGRADING URBAN HOUSING AND SERVICES AND DEVELOPING SITES AND SERVICES SCHEMES (THE URBAN HOUSING SUB PROGRAM OF THE MILLION HOUSES PROGRAM). SIGNIFICANT BREAK-THROUGHS WERE ACHIEVED IN INVOLVING LOW INCOME COMMUNITIES IN THE PLANNING AND IMPLEMENTATION OF PROGRAMS TO ADDRESS THEIR SHELTER AND INFRASTRUCTURE NEEDS. NEVERTHELESS, THE PROGRAM HAS NOT YET SORTED OUT THE OPTIMAL INSTITUTIONAL ARRANGEMENTS FOR PROVIDING FOR BASIC SERVICES AS WELL AS CREDIT TO THE POOREST URBAN HOUSEHOLDS. REFTEL CORRECTLY FRAMES THE DILEMMA OF A POLICY ATTEMPTING TO ASSIST URBAN LOW INCOME HOME OWNERSHIP, I.E. EITHER EXCLUSION OF THE VERY POOR FOR LACK OF CREDIT-WORTHINESS OR POOR REPAYMENT PERFORMANCE FOR VERY LOW INCOME HOUSEHOLDS. THERE IS NO EASY ANSWER TO THIS PROBLEM. GSL REGULATIONS AGAINST RENTAL HOUSING HAVE BEEN SUBSTANTIALLY REPEALED OR MODIFIED DURING THE LAST FEW YEARS. THERE ARE CURRENTLY NO PROHIBITIONS AGAINST SUB LETTING ROOM(S) IN THE EXISTING AID-FINANCED SITES AND SERVICES SCHEMES. INSPECTION OF THE LATEST COLOMBO DEVELOPMENTS INDICATE CONSIDERABLE PARTIAL RENTING ACTIVITY. NEVERTHELESS, IN SITUATIONS WHERE VERY LOW INCOME HOUSEHOLDS ALREADY POSSESS OCCUPATION RIGHTS TO LAND, AND, THEREFORE, ARE NOT TARGETS FOR RENTAL SCHEMES. THE GOVERNMENT IS COMMITTED TO IMPROVING THEIR LIVING CONDITIONS. DURING THE LAST YEAR, PROCEEDS FROM A NATIONAL LOTTERY (THE SEVANA FUND) HAVE BEEN MADE AVAILABLE TO THE NHDA TO BE USED AS GRANTS (MAXIMUM AMOUNT RUPEES 5,000) FOR ELDFRLY, HANDICAPPED OR FEMALE-HEADED HOUSEHOLDS WITHIN UPGRADING AREAS, BUT THIS FUND REACHES ONLY A RELATIVELY SMALL NUMBER OF

HOUSEHOLDS. NHDA IS RELYING ON A NUMBER OF NGOS (U.S. SAVE THE CHILDREN, NORWEGIAN SAVE THE CHILDREN ETC.,) AS WELL AS THEIR OWN STAFF TO COUNSEL LOW INCOME HOUSEHOLDS IN APPROPRIATE CREDIT USE. DURING PHASE III, THE URSP TENDED TO INCORPORATE RATHER THAN EXCLUDE LOW INCOME HOUSEHOLDS WITH A CORRESPONDING NEGATIVE EFFECT ON COLLECTIONS.

DURING PHASE IV, THE MISSION WILL WORK WITH THE NHDA TO INVOLVE QUOTE THE URBAN EQUIVALENT OF THE THRIFTS UNQUOTE SUCH AS THRIFTS, NGOS, COMMUNITY DEVELOPMENT COUNCILS AND OTHER NON-GOVERNMENTAL ENTITIES IN THE CREDIT ALLOCATION AND RECOVERY ASPECTS OF THE PROGRAM IN CONJUNCTION WITH THE USE OF NON-AID RESOURCES (SEVANA FUND ETC.,) FOR THOSE HOUSEHOLDS WITH PARTICULARLY SEVERE PROBLEMS.

IT SHOULD BE KEPT IN MIND THAT SRI LANKA IS ATTEMPTING TO REACH A VERY LARGE NUMBER OF FAMILIES (EQUIVALENT TO THE ANNUAL URBAN IN-MIGRATION). THE SRI LANKA PROGRAM IS ATTEMPTING TO ADDRESS THE NATIONAL URBAN HOUSING PROBLEM USING LIMITED RESOURCES, INCLUDING THE HG PROGRAM, WHICH BALANCES THE MAXIMUM COST RECOVERY WITH THE ECONOMIC REALITIES. THE MISSION BELIEVES THAT THE UHSP IS HEADED IN THE RIGHT DIRECTION, CAN BE MADE INCREASINGLY COST EFFECTIVE, AND IS WORTHY OF CONTINUED SUPPORT IN PHASE IV. SPAIN
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FM AMEMBASSY COLOMBO

TO RUEEC / SECSTATE WASHDC 4196

INFO RUEHEA / AMEMBASSY BANGOR 4425

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UNCLAS SECTION 01 OF * COLOMBO 05522

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CLASS: UNCLASSIFIED
 CHRG: AID 08/13/87
 APPRV: DIR:PJELoom
 DRFTD: MHA:JJDFAGGER:N
 CLEAR: A/DD:DZVINAKIS;
 KMMERT;PRJ:PPAI
 DISTR: AID AMB DCM

AIDAC

E.O. 12356: N/A

SUBJECT: EVALUATION SUMMARY: SRI LANKA HOUSING
 - GUARANTY PROGRAM

cc. PRM
 PRJ

REF: STATE 239863

1. PARA 6 OF REFTEL REQUESTS MISSION TO CABLE A SUMMARY OF THE HOUSING GUARANTY PROGRAM EVALUATION FINDINGS AND A STATEMENT OF HOW THESE FINDINGS ARE BEING INCORPORATED INTO THE PHASE IV HG DESIGN. UNFORTUNATELY THE FINAL EVALUATION REPORT IS NOT YET IN MISSION HANDS. DUE TO THE RECENT DISTURBANCES AND CURFEW DURING THE LAST WEEK OF THE EVALUATION, THE EVALUATOR WAS UNABLE TO SUBMIT THE FINAL REPORT AS PLANNED BEFORE DEPARTURE. CONSEQUENTLY THIS MESSAGE IS BASED ON THE DRAFT REPORT. MISSION DOES NOT EXPECT MAJOR CHANGES IN EVALUATION FINDINGS AND RECOMMENDATIONS, ALTHOUGH THERE COULD BE MINOR SHIFTS OF EMPHASIS OR WORDING.

2. EXCERPTS FROM THE EVALUATION'S DRAFT EXECUTIVE SUMMARY AND RECOMMENDATIONS FOLLOW WITH THE MISSION'S COMMENTS ON HOW THEY ARE BEING INCORPORATED PRELIMINARILY, PENDING RECEIPT OF FINAL REPORT, INTO THE PHASE IV PROGRAM MEMORANDUM.

3. QUOTE LOOKING OVER THE 3 PHASES OF THE SRI LANKA HOUSING GUARANTY (HG) PROGRAM DURING THE 1981 TO 1987 PERIOD, HOWEVER, WHAT STANDS OUT ARE NOT THE FAILURES BUT THE MOVEMENT AND GROWTH WHICH HAS TAKEN PLACE IN THE HOUSING SECTOR. THE SRI LANKAN HOUSING PROGRAM HAS MOVED FROM A HIGH COST AND CONCENTRATED EFFORT TO A LOW COST, EXTENSIVE NATIONAL PROGRAM. IT HAS STEADILY MOVED FROM A LARGER TO SMALLER ANNUAL BUDGETS, FROM PROVIDING FEWER UNITS AT HIGH COST TO MANY AT MUCH LOWER PER UNIT COST, FROM FEWER, WEALTHIER BENEFICIARIES TO A FAR GREATER NUMBER OF BENEFICIARIES AT MEDIAN INCOME OR BELOW, FROM ONE HUNDRED THOUSAND HOUSES TO ONE MILLION HOUSES AS A PROGRAM TARGET, FROM RELIANCE ON THE GOVERNMENT TO PROVIDE HOUSING TO PARTICIPATION OF GOVERNMENT WITH THE PRIVATE SECTOR TO ENABLE INDIVIDUALS AND FAMILIES TO PROVIDE HOUSING FOR THEMSELVES, FROM GRANTS TO NO INTEREST TO LOW INTEREST LOANS, (MOST RECENTLY, 6 PERCENT LOAN CHARGES) AND FROM EXTREMELY LOW OR

NON-EXISTENT COLLECTION EFFORTS TO marginally (FYI: MISSION BELIEVES IMPROVEMENT IN COLLECTION OF RESP FROM 40 TO 70 PERCENT IS SUBSTANTIAL AND NOT MARGINAL.) IMPROVED COLLECTION WITH A STRONGER COMMITMENT TO IMPROVE.

SOME ISSUES WHICH ARE CLEARLY PRESENTING THEMSELVES NOW INCLUDE:

- (A) THE ALLOCATIONS OF HOUSING FUNDS WITHIN THE
- GSL BUDGET AND THE ROLE OF HG FUNDING.
- (B) ORGANIZATIONAL CHANGES WITHIN NHDA, PROBLEMS
- AND OPPORTUNITIES.
- (C) THE VIABILITY OF AID ASSISTANCE TO THE URBAN
- HOUSING SUB PROGRAM.
- (D) THE VIABILITY OF THE HOUSING FINANCE SUB
- SECTOR.
- (E) THE EMERGENCE OF THE TCCS AS A NEW NETWORK
- OF PRIVATE ORGANIZATIONS ATTEMPTING TO HELP
- IMPLEMENT NATIONAL HOUSING POLICY AND TO
- SURVIVE AS VIABLE FINANCIAL ORGANIZATIONS.
- (F) EXTENSIVE VS. INTENSIVE NEEDS FOR TRAINING.
- UNQUOTE.

4. A SUMMARY OF THE EVALUATION DRAFT REPORT'S
RECOMMENDED ACTIONS ON THE ABOVE ISSUES FOLLOW:

- (A) VIEWING HG FUNDS AS QUOTE ADDITIONAL UNQUOTE
- PRESENTS AID WITH OPPORTUNITIES TO INCREASE
- ITS EFFECTIVENESS IN ITS POLICY DIALOGUE;
- (B) DUE TO THE LACK OF MANAGEMENT DEPTH WITHIN
- NHDA AID SHOULD INCREASE ITS SUPPORT FOR
- IN-COUNTRY TRAINING AND ORGANIZATIONAL
- DEVOLUTION
- (C) THE MISSION SHOULD DEVELOP A BROAD URBAN
- DEVELOPMENT STRATEGY ENCOMPASSING A WIDER

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 RR RUEHC RUEHBA
 DE RUFHCM #5522/02 229 **
 ZNR UUUUU 22H
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 FM AMEMBASSY COLOMBO
 TO RUEHC / SECSTATE WASHDC 4197
 INFO RUEHBA / AMEMBASSY BANGKOK 4426
 FT
 UNCLAS SECTION 02 OF 02 COLOMBO 05522

CLASS: UNCLASSIFIED
 CHRG: AID 08/13/87
 APPRV: DIR:PJBLOOM
 DRFTD: MHA:JJDEAGGER:NM
 CLEAR: A/DD:DZVINAKIS;P
 EMMERT;PRJ:PBALI
 DISTR: AID AMB DCM

AIDAC

E.O. 12356: N/A

SUBJECT: EVALUATION SUMMARY: SRI LANKA HOUSING

- SCOPE THAN JUST THE PROVISION OF HOUSING.
 - THE EVALUATION IMPLIES THAT A CERTAIN
 - SUBSIDY WILL BE REQUIRED BY THE POOREST OF
 - THE POOR IN THE URBAN AREAS;

 - (D) ACTIONS TO ASSIST SMIB OR HDFC SHOULD
 - PLACE IMPROVING THEIR FINANCIAL VIABILITY
 - AS THEIR PRIMARY OBJECTIVE;

 - (E) WHILE SUPPORTING THE EXPANSION OF THE THRIFT
 - AND CREDIT COOPERATIVE SOCIETIES (TCCS)
 - MOVEMENT THE MISSION SHOULD BE GUIDED
 - BY TWO PRINCIPLES: THE MAINTENANCE OF
 - THE INTEGRITY OF THE TCCS'S AND THE
 - VIABILITY OF EXPANSION. THE REPORT
 - ALSO RECOMMENDS THAT A DEMONSTRATION
 - LENDING PROGRAM SHOULD BE STARTED IN
 - THE STRONGEST THRIFTS TO INTRODUCE FLEXIBLE
 - MORTGAGE INSTRUMENTS IN THEIR HOUSING
 - LENDING PROGRAMS;

 - (F) A COLLABORATIVE TRAINING PROGRAM SHOULD
 - BE IMPLEMENTED WITH NEDA AND THE TCCS IN
 - WHICH ON-GOING NEEDS ARE IDENTIFIED AND
 - IN-COUNTRY PROGRAMS DESIGNED TO MEET THOSE
 - NEEDS. THE EVALUATION COMMENDS THE
 - MISSION FINANCED, LOCALLY PRODUCED CASE
 - STUDIES AND URGES THEIR CONTINUATION AND
 - WIDE DISTRIBUTION;

 - (G) THE MISSION SHOULD MAKE A RENEWED EFFORT TO
 - INTRODUCE A HOUSING FINANCE VEHICLE INTO
 - THE MAHAWELI AREA.
5. THE MISSION GENERALLY CONCURS WITH ALL OF THE ABOVE RECOMMENDATIONS EXCEPT FOR (C). WE BELIEVE THAT THE RECOMMENDATION OF A BROAD URBAN DEVELOPMENT STRATEGY GOING BEYOND THE PROVISION OF LOW COST SHELTER AND VERY LIMITED URBAN DEVELOPMENT DEMONSTRATION PROJECTS USING THE PRIVATE SECTOR, TAKES US TOO FAR OUTSIDE OF OUR EXISTING COUNTRY STRATEGY AT THIS TIME. THE MISSION HAS CONCLUDED THAT THE OTHER RECOMMENDATIONS REPRESENT A

SUBSTANTIAL AGENDA IN THEIR OWN RIGHT WHICH HAVE BEEN ADDRESSED IN THE PHASE IV PROGRAM MEMORANDUM.

6. THE MISSION HOPES TO HAVE THE FINAL EVALUATION REPORT PRIOR TO AUTHORIZATION OF PHASE IV. HOWEVER, FROM THE DRAFT REPORT AND DISCUSSIONS WITH THE CONSULTANT, WE FEEL CONFIDENT THAT THE SUBSTANCE OF THE EVALUATION WILL HAVE BEEN FULLY TAKEN INTO ACCOUNT. THE ISSUE OF THE ROLE OF URBAN HOUSING/URBAN DEVELOPMENT IN THE PHASE IV PROGRAM MEMORANDUM WILL BE THE SUBJECT OF A SEPTEL AS REQUESTED IN PARA 7 OF REFTEL. SPAIN

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ANNEX B

Illustrative Technical Assistance & Training Budget

Phase IV will require a coordinated program of development studies, short term technical assistance and both U.S. and local participant training.

There will be a variety of sources of support for this program: the RHUDO Office in Bangkok will make available short-term services of regional advisors as appropriate; AID/W core grants will be used as far as possible for cooperative and privatization inputs; and the DS&Tb project will be available for activities supported by the GSL and the Mission. In addition, Phase IV will benefit, at least through March 31, 1988, from the on-going work of the long-term advisor. The World Council of Credit Unions, Inc., has submitted a substantial proposal to the GSL/USAID under the PVO Co-Financing II Project which, if funded, will make a significant contribution towards meeting the technical assistance needs of the HG program.

It is estimated that \$150,000 will be required from DS&Tb or central funds to support the following program:

6 months of short term U.S. based technical assistance at an estimated cost of \$14,000 per month (more technical assistance can be provided if procured locally); and 11 months of U.S. based participant training at a cost of \$6,000 per month.