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PROGRESS ON BENEFICIARY SELECTION PROCESS FOR USAID FUNDED AL KARAMA APARTMENTS (GAZA)

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THE USAID WEST BANK AND GAZA MISSION
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MANAGEMENT SYSTEMS INTERNATIONAL

NOTE

The following report refers to a number of references. Because of the volume involved a decision was made not to include the attachments as part of the report. If readers would like to see the references they are located in the Office of Engineering in the USAID West Bank and Gaza Mission in Tel-Aviv.

I. BACKGROUND

This report is a follow up to an earlier report prepared for the USAID Mission in the West Bank and Gaza in October, 1995. The **REPORT ON THE BENEFICIARY SELECTION PROCESS AND AFFORDABILITY OF THE USUSAID FUNDED AL KARAMA TOWERS IN GAZA** provided a framework within which the USAID Mission could determine its final position on the beneficiary selection process for the subject apartments. Recent policy decisions taken by the PHC also have had a material impact on the beneficiary selection process. Specifically, the PHC in an effort to avoid unusually high densities in the Al Karama Towers has decided to limit the number of persons per household to 10 people. This will have a long term positive effect in that it will minimize the demands on the mechanical systems in each building. Lower densities will also have a positive effect on the overall quality of life in the project. The negative effect of this decision is that it further constrains the available pool of applicants.

The PHC has also refined its list of applicants from the original 2000 applications received for Al Karama. This process resulted in a list of 765 applicants from which the final beneficiaries will be selected. **(See Attachment A)**

As the construction phase of the project nears completion (now scheduled for late February or early March) the PHC and USAID need to reach some agreement on just how the apartments will be awarded to the target beneficiary group. To that end, the USAID Mission forwarded a letter to the PHC requesting, per the Memorandum of Understanding, that it formally submit its selection process and plan for awarding the units. Further, USAID requested that the PHC inform USAID of the price of the subject units and the terms under which they would be sold. All have been received with the exception of the price of the units, and the final list of beneficiaries. The beneficiary selection process has yet to be completed by the PHC. The organization is now in the process of interviewing each of the applicants on its current list and is making further determinations on their ability to pay both the required 20 percent down payment and the monthly rental charges. It is safe to assume that this will constrict the list to even fewer applicants. The primary focus of this report is the development, **in close consultation with the PHC,** of a final set of income and family size criteria which will provide a set of beneficiaries which insures that the project provides maximum benefit to poorer families. The approach and guidelines developed must at the same time maximize the recovery of costs by the PHC in order for it to remain a financially viable organization. This is all the more critical in that the newly established Housing Bank and Ministry of Housing have little, if any funding, and no experience in developing credit schemes and shelter solutions affordable to low income Palestinians. This leaves the PHC as the only organization in Gaza and the West Bank with the resources and capacity to serve this population group. Recent decisions taken by the PHC are evidence that they are planning their second generation of projects for that target group of lower income families. The reflows which the PHC will receive from both the EU and USAID grant funded projects will be used, inter alia, for lower cost shelter solutions, and home improvement loans for families now living in substandard conditions. The final plan for the reflows will be developed with the assistance of EU funded technical assistance. USAID's MOU with the PHC calls for USAID to develop with the PHC a mutually agreed upon use of those funds.

II. PHC COSTING AND SALES POLICIES

As of the date of this report, the PHC has not determined selling prices for the USAID funded units. While the decision is imminent, USAID has yet to receive official notification of the precise pricing of Al Karama. Substantial progress is evidenced in an agreement between the EU and the PHC regarding this matter. The EU has provided USAID of copy of their correspondence to the PHC containing the following **(See Attachment B)**:

1. a detailed understanding of the Contract Conditions of the transfer of the units; and

2. an enumeration of the variables to be used for the derivation of sale prices for all units currently under the control of the PHC.

USAID endeavors, while operating within its target group limitations, to coordinate with the EU in all major policy issues relating to the PHC. The criteria formulated through EU technical assistance and adopted by the PHC provides a realistic framework in which USAID can make further determinations regarding the Al Karama Project.

A. Derivation of Sales Price

1. the historical price of land, without any surcharges for interest during construction (whenever land is/was given to PHC at large discounts or for free, the estimated historical market price at time of acquisition will be used).

2. all project specific cost including cost of construction, design and studies, direct supervision, and on site infrastructure;

3. interest (cost of money) during construction, calculated at 7.0 percent; and

4. administrative cost above $2.0 million, estimated to be 6.7

percent of the total project cost of (a) through (c).

The EU funded technical expert, Dr. Von Rabenau, developed a computer based pricing model which the PHC is using in calculating the cost of the EU funded units. This model appears to be very comprehensive and highly detailed in its criteria. If correctly applied, the model will produce the true cost of PHC construction activities.

The EU in this agreed upon procedure is allowing a subsidy (grant to PHC) of approximately 4 percent of their total grant funding for construction. The subsidy, according to the EU, "...reflects the cost of PHC institution building, staff training, and organizational strengthening." However, this policy will only apply to this first round of funding by the EU. Future finance and sales policies for EU funded projects, "...will be put in place that includes the full recovery of all cost, including:

1. the recovery of land at current market prices, irrespective of historical cost;

2. the recovery of all administrative cost;

3. the recovery of all other project specific cost, including the cost of construction,infrastructure, design, studies, planning, and supervision; and

4. interest during construction. The interest rate charged for long-term loans will be equal to LIBOR (London Interbank Offer Rate) plus 3.5 - 4.0 percentage points. A lower spread would be possible for adjustable rate payment schedules. The interest rate charged for interest during construction will be equal to LIBOR plus 2.5 - 3.5 percentage points depending on project risk."

In consultation with the EU the PHC has also developed the following contract conditions for the transfer of the EU funded units:

B. Contract Conditions(a sample copy of the contract is Attachment C)

The PHC sells housing units under the following conditions:

1. Beneficiaries rent housing units with an 'option to buy' contract which specifies the rental payments over the term of the contract and confers ownership at the end of the contract upon meeting all contract conditions. When beneficiaries change prior to final sale of unit, the new owner should be from the same or lower income group as the initial owner, or PHC must recover all subsidies;

2. The down payment shall not be less than 20 percent of the housing price;

3. Monthly payments will consist of rental payment plus a cooperative fee covering the cost of maintenance, services, and cooperative administration and management;

4. Monthly rental payments at the time of sale shall not exceed 35% of a beneficiary's household income at the time of the sale;

5. The cooperative fee shall be 1 percent of the housing unit's price for the first five years, and thereafter shall be raised to cover the true cost of cooperative maintenance,services, administration, and management;

6. Beneficiaries will have two guarantors, each guarantor with an income three times the total rent plus fixed debt payment requirements he would have to make, if assuming the beneficiary's debt. Hence, if the guarantor were paying $200 per month on his own housing rent, and if the beneficial' monthly rent were $300, the guarantor's income must be $1,500 per month. Alternatively, a guarantor could qualify by owning unencumbered net assets equal to 1.5 times the value of the beneficiary's housing unit;

7. All payments are valued in US dollars. The beneficiary is responsible for currency risks;

8. The term of the rental contract with option to buy is 15, 20, or 25 years leaving the choice of term to the beneficiary's;

9. Rental payments follow a stepped payment plan (chosen by the beneficiary) with an average interest rate of 9 percent per year;

10. Beneficiary may receive early ownership, by paying off the remainder of is rental payments as per attached schedule, allowing for discounts of up to 4 percent for immediate debt retired above the 20 percent down payment, declining to 1 percent for debt retired in advance of schedule after 29 years; and

11. Up to US$ 1.0 million of PHC interest income will be used to subsidize life and fire insurance (with possible payouts to go to the PHC) and/or partial cooperative fees for those beneficiaries with monthly income of $700 or less.

The PHC agreement to the above policies commits their organization to full cost recovery and an optimal use of their resources as they move toward their second generation of projects. If followed, these policies and practices will result in a more market oriented approach which further guarantees an efficient use of their asset base. It should be noted that substantial progress is further evidenced by the PHC agreement to use a market rate of interest in computing their amortization (rental) tables. Market distorting subsidies are obviated which will insure, in part, sustainability of PHC activities. Technical assistance in planning, construction/building management, and fiscal administration is being provided to the PHC through further grant funding by the EU.

III. PROGRESS ON BENEFICIARY SELECTION PROCESS - Impact on Affordability

The PHC officially transmitted revised copies of the questionnaire and point system used in evaluating applicants for housing or loans under current PHC programs. This letter was responsive, in part, to USAID's written request that the PHC submit documentation demonstrating its compliance with the conditions set forth in the MOU.

The issues identified in the October review of earlier drafts of the questionnaire have been addressed in these revised documents. Specifically, the "hardship cases" are now defined as people who have experienced one or any combination of the following:

- civil detention;
- are handicapped;
- lost one or more members of the family as the result of war;
- have the major income earner living outside of the country; and/or
- are living in extremely substandard conditions.

The last category are people currently living in refugee camps or have lost their previous home.

These re-defined criteria appear to satisfy USAID's earlier concern about the PHC definitions of "special circumstances". No more than 25% of the total units now under the control of the PHC will be allocated to this group.

It continues to appear that the PHC has and will continue to operate on a transparent basis. It has exercised exhaustive measures to validate data gathered in the administration of its application process. This process, as carried out to date, has resulted in the PHC approving 765 of the original 1200 applications which it received for the combined EU and USAID funded Al Karama units. As was discussed earlier, the approved applicants fell within an income range of $42.86 per month to

$2,857 per month. It is from this narrowed pool of applicants that the PHC will select the ultimate beneficiaries of the 192 USAID funded units. Given on going discussions about affordability, USAID's chief concern at this point is whether or not there will be enough successful applicants who fall within the income constraints imposed by the Project Paper and subsequent USAID audit reviews.

In my October of 1995 report on the beneficiary selection process a number of options which would make the units affordable were put forward. At that time USAID decided that it was possible, given the terms of the sale of the units and amortization of the cost of the units over 25 years, that a monthly payment (representing an acceptable market rate interest of 9%)of $235 per month was affordable to families earning no less than $680 per month. If 192 of the applicant families fell within this range the apartments were "...expensive, but affordable". Even after making a modest adjustment (for inflation)upward on the income cap from $700 per month to $800, a review of the most current list of approved applicants shows that there are not sufficient applicants in this target range to fill the 192 USAID funded units.

One possible remedy for the surfeit of applicants would be to re-advertise the availability of apartments. The advertisements would call for applicants who fall within a strict income range. After discussion with Dr. Shadid, Chairman of the PHC this option was found to be impractical and unacceptable because of the very real political pressures being felt by the PHC to deliver the units. The USAID funded Al Karama units will be the first units completed of the 1200 currently under construction by and under control of the PHC. It is worth noting that the beneficiary selection process has been going on for close to three years. Most of the currently acceptable applicants began the process that long ago. It is clear that every attempt, within certain parameters discussed later in this document, to make the awards from the current list of approved applicants should be made.

In order to develop income criteria which would serve the mutual goals of USAID and the PHC, consultations werre held with PHC research and financial staff and an analysis of the current applicant pool led to the following proposal which fairly satisfies the programs dual requirements of:

1. Maximizing cost recovery of the grant funds; and
2. Insuring that project funds provide the maximum benefit to lower income groups.

A. Recommended Income Ranges For Beneficiaries Of USAID Funded Units

Our base calculations were determined by taking the originally intended $700 per month income ceiling which was calculated in 1993 dollars and adjusting that figure for inflation. Using IMF Cost of Living Index figures of the West Bank and Gaza which were 11% for 1994 and 14% for 1995 that same family would now have to be earning $985 per month. As this figure was much higher than the target established in the Project Paper only applicants falling within in that range but at the lower end of the scale were counted. We found the largest pool of applicants would fall within the $680 - $800 per month range. The lower end of the affordability scale was placed at $680 per month as this figure represents the minimum amount of income required to service a $32,000 mortgage with a 9% interest rate over a term of 25 years. If USAID allows for inflation, it is well within its original target group by allowing an $800 per month income for the average Palestinian family of 6 persons per household. Using these figures, 131 potential applicants were identified.

As this is short of the 192 required to fill the apartments it becomes necessary to expand the pool of eligible applicants. Based on the assumption that a family of smaller size is relatively better off than a family of a larger size earning the same income - It is recommended that USAID calculate monthly income on a per capita basis. The per capita income of the average family of six earning $800 per month would be $133 per household member per month. This should be done only when considering applicants with families of 7, 6, 9, or 10(limit placed by PHC). If this figure is rounded out to $135 per month the following table illustrates an adequate applicant pool of low income earners from which to choose the ultimate beneficiaries of the Al Karama units. (See table below)

PROPOSED EXPANDED BENEFICIARY POOL

No. of Beneficiaries	Income range in US $'s	Family Size Persons per household
131	680 - 800	10 (and less)
17	801 - 935	7
18	801 - 1070	8
15	801 - 1200	9
7	801 - 1330	10
TOTAL 188		

It can be safely assumed that this pool of applicants will shrink further. The PHC will require each applicant to make a 20%($8,000) down payment on an assumed price of $40,000 per unit. An undetermined number will certainly not be able to fulfill that requirement. However, the processes used by the PHC in their initial selection provides a high degree of confidence in the ability of these applicants to meet its requirements. Nevertheless, there will be some attrition because of unforeseeable factors. In order to fill the balance of the apartments using the current pool of applicants it is proposed that USAID exercise its option to allow some capital subsidy on the remaining units. This should be done only for applicants earning less than the figures represented above. Using the same assumptions for allowing the per capita income rises for the larger families, it can be assumed that families with 5 persons and less earning less than $680 per month would have more disposable income available for shelter than larger families earning much more. In order to minimize and possibly obiavte the subsidies which would be required, an income of no less than $500 per month would be required for this group. Using an income range of $500 - $679 per month this would expand the available pool of applicants by 48 families for a total of 233 families. Even allowing for attrition both USAID and the PHC could accomplish their original goals for the project.

There are options available to the PHC other than subsidies to make these apartments affordable to the lowest income applicants. The EU provided the PHC with a number of payment plans which would make the apartments affordable. For example, a graduated payment plan with rents (payments) rising over the life of the term would minimize the monthly payments for the first few years of the lease. The PHC has the ability to design a specific plan based on the income of each family. While it should not become a permanent policy of the PHC the minimal amount of apartments involved would not present a severe financial strain to the PHC at this time. While allowing the PHC to proceed on the above basis USAID still requires the complete list of beneficiaries selected. In addition, the PHC should inform USAID of the payment terms reached for the lowest income group.

This approach and criteria were developed during close consultation with the executive and research staff of the PHC.

IV. MAINTENANCE PLAN FOR AL KARAMA UNITS

As discussed in the October report, the PHC will develop a maintenance plan for each of its projects. This plan will be developed together with the cooperative boards proposed for each tower. In order to facilitate the development of a comprehensive plan, Louis Berger International, Inc. (LBII) with USAID's staff engineer has developed a plan and schedule for maintenance of all aspects of the project buildings and site. LBII developed a budget plan for this as well. USAID should provide this plan with a full explanation and walk through of the building and site to the PHC management staff. Only then will the PHC will be in a position to refine its current plans and submit its final operations and management plan to USAID **(See Attachment D)**.

V. USAID'S COST OF AL KARAMA UNITS

USAID's chief engineer has developed a cost basis for the Al Karama project which comes to approximately $36,000 per unit exclusive of the price of land (memoranda on this are attached). The land was purchased for the PHC through a grant from the EU for $2 million. This adds a per unit cost of approximately $4,000 per unit bringing the per unit cost to approximately $40,000 per unit. For the purposes of this project, it is recommended that USAID accept this figure as the basis of any further negotiations with the PHC **(See Attachment E)**.

VI. OUTSTANDING ISSUES

1. Final List of Beneficiaries: With the Mission's acceptance of the suggested income guidelines the PHC can freely move ahead with the final selection of beneficiaries for the Al Karama units. The MOU still requires them to provide the final list of beneficiaries with sufficient evidence that they meet the mutually agreed upon criteria. A suggested response to the PHC on USAID's acceptance of the presented criteria reminds the PHC of their obligation in that regard. Local Mission staff should stay in touch with Dr. Ishaq Al Qutub who is managing the selection process at the PHC. Periodic calls or visits to their offices over the next three weeks will serve to expedite this process.

2. Formal Transfer of Operations & Management Plan to PHC: As mentioned in Section IV of this report a plan an illustrative budget for the continued operation and management of the Al Karama towers was developed by Stan Kowal and other LBII staff. Carl Maxwell has suggested some refinements to this plan. When it is completed, it should be formally transmitted to the PHC. In order for USAID to have some confidence in the continued maintenance of this high profile project it is strongly recommended that USAID contract or direct hire staff actively engage the PHC in the development of their plan. This can be accomplished with one or two highly focused meetings where the documentation developed by Stan Kowal can be fully explained. There may be budget considerations for this exercise.

3. Use and Tracking of Reflows: The MOU speaks to this subject in the following manner in Article 2 Section 2.2 (j):

> **ensure that reflow funds from down payments and mortgage payments are maintained in a separate interest-bearing account and used (1) to repay**

the European Community (EC), in an amount to be determined between the EC and the PHC, for the cost of the land which the EC has made available to the PHC to construct USAID financed apartment buildings at the GAZA/Jabalya site less any services to the site financed by USUSAID not directly related to the six apartment buildings and (2) for other program related purposes4 as agreed between the parties. The PHC shall furnish USUSAID quarterly reporting on actual uses of reflow funds for a period ending with such date, to be subsequently agreed between the parties and periodically adjusted between the parties, as the last of such reflows is expected to be spent.

The EU has subsequently granted to the PHC the $2million used to purchase the site in Jabalya and has allowed the PHC the recover those costs through the sale of the units for their own use. It is my understanding that the PHC has no further obligation to the EU in this regard. As this materially changes the original understanding, USAID needs to consider other eligible uses for these funds.

a. The EU has recommended to the PHC that part of their reflow funds be used to capitalize the PHC's investment in the World Bank proposal to establish a wholesale provider of funds for mortgage lending in the West Bank and Gaza. The WB has proposed that the recently established Palestinian Housing Bank would play that role. The current state of that plan is unknown. Dr. Von Rabenau reports that a consensus has yet to develop around this issue. Current World Bank thinking calls for an initial capitalization for the Housing bank in the amount of $10 million. The PHC would be a logical investor in such an institution. Through such an investment, the PHC would be using some of the funds now available to them to ensure that the retail banking system provides mortgage financing to lower income families. The availability of this end user finance should encourage the private building sector to develop more affordable shelter solutions for this population group. Such a facility will also encourage and support the work of not for profit groups like the PHC to continue in their efforts to reach the lower end of the housing market. If this proposal moves ahead, and if the private banking sector is involved in this effort, USAID should give consideration for allowing some of the reflow from Al Karama to be used for this purpose. Dr. Shadid reported that the PHC has decided to invest in the Housing Bank by taking up to a 20 percent ($2million) equity position in the enterprise, USAID should encourage this effort.

b. The Mission's support of the Home Improvement Loan Program managed by the Cooperative Housing Foundation could be bolstered by requiring that a percentage of or all of the reflows for the Al Karama project be dedicated to that program. All funds would then be subject to the reporting requirements of that project. The management and reporting systems inherent in this effort would effectively minimize any additional management burden to the Mission.

c. A brief review of the management and reporting of reflows required in USAID Housing Guaranty Program offer some guidance on how the Mission should approach this issue. This can be done either through a request to the RHUDO in Tunisia or consultations with the Global Bureau's Office of Environment and Urban Programs at USAID/W.

This need not be a complicated issue, but it does demand some attention over the next two or three months. The PHC is not prepared to discuss this in any meaningful way in the very near term. They are currently engaged in developing their financial management and planning capacity with technical assistance provided by the EU. The EU is also addressing the issue of reflows and their exercise will provide USAID valuable information which can guide USAID's final decisions regarding this matter. Therefore, it is important for the Mission to maintain its communications with the EU, particularly Fernand Clement, regarding this issue.

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