

7/22/85
July 22, 1985

PD-MAJ-977
IN 53767
INTERIM REPORT
532-HG-012

Jamaica Shelter Sector Support

I. SUMMARY AND BACKGROUND

A. Summary

The Jamaica Shelter Sector Support project, 532-HG-012, was approved for \$40 million in September 1983 when the first \$25 million was authorized. This Interim Report shows that the Government of Jamaica has not departed from the strategy articulated in the 1982 National Housing Policy, that authorization of the final \$15 million tranche in FY 85 is timely, and that the activities proposed will continue to carry out AID's objectives as described in the Project Paper including furthering AID's policy dialogue on the issues raised at the time of initial approval (83 State 242061). This report also responds to the questions raised in paragraph 7 of State 144704 and to State 174023. USAID and RHUDO request AID/W approval to proceed to preparation of a Project Paper Supplement which will update the relevant sections of the 1983 Project Paper as described in Section IV of this Report for submission for FY 85 authorization.

In summary, proceeding with a \$15 million authorization at this time will allow USAID to influence key institutional and program decisions of the GOJ. This will include use of \$10 million of Housing Guaranty resources to launch a private sector low income starter home program for families with incomes below the median. The mechanism used to make funds available to the private institutions will contribute to establishing a secondary mortgage market facility in the National Housing Trust, the institution most appropriate for this activity. The new structure is designed to facilitate private sector direct delivery of low income shelter. This will be done by channeling HG funds through private institutions to finance HG eligible projects and through expansion of NHT's leveraging programs. It is expected that the GOJ will begin deregulating the financial institutions in the next year. This will allow a secondary mortgage market facility to compete in the capital markets for resources to be channeled to shelter.

GOJ is in the process of streamlining the Ministry of Construction (Housing) (MOC(H)) organization and staff (a management audit as a part of the GOJ Administrative Reform Program is underway) and, as a part of this project, will introduce contractor pre-selection and competitive bidding for all HG financed projects, the purchase of land prior to start of construction, and tightened construction management procedures. A substantial USAID technical assistance package is planned in FY 86 to assist with the changes described above..

The capital project activities include a continuation of those financed under HG-011 and HG-012, settlement upgrading and starter homes. New additions will be as contemplated in the HG-012 Project Paper, a private sector starter home program, a pilot sites and services project and a testing of more comprehensive upgrading where several of the program components are coordinated for delivery to an existing neighborhood. Specific project requirements will focus implementing agency attention on improved efficiency and construction management.

An evaluation of the HG-011 project was completed, along with an evaluation of the HG-010 project in 1983. These evaluations described substantial achievements for the program as a whole and documented the positive application of lessons learned from the HG-010 project to the implementation procedures of the HG-011 upgrading program. The areas identified for further attention in the evaluation have been incorporated into the design of the first tranche of HG-012 and are reflected in this report.

The activities contemplated also advance AID's policy dialogue on the issues raised in the PID approval cable. This project further reinforces the shift of the MOC(H) out of direct construction to a role of review/approval. The management audit currently under way in the MOC(H) will be making organizational management recommendations that AID intends to reinforce with the design of its project activities and the structure of its FY 86 shelter technical assistance project (532-0121). The new private sector initiative will further take the pressure off the GOJ by reducing the market it has a social obligation to serve.

The financial mechanisms and relationships described in this report result from a year's collaborative effort of AID, IBRD and GOJ reviewing the public and private housing finance institution structure. The institutional roles proposed will set the groundwork for a more rational financial institution structure. Moving the emphasis to the NHT provides the institution with the resources to develop the capacity to carry out the GOJ's objectives in the sector.

The GOJ's mortgage interest rate structure has been under serious review for the last year. The MOC(H) and the NHT have agreed to adopt an escalating payment mortgage that would annually increase the yield on the mortgage. The subsidy, therefore, would be targetted at the time of mortgage origination to the family's ability to pay. The program would then increase the mortgage payment each year to produce an increasing yield on the mortgage until such time as the yield was the market rate.

A more modest approach to launching the secondary mortgage market facility is proposed at this time. It is tied to the institutional broadening of the NHT. Initially, NHT will test the potential with its mortgage certificates and provision of HG resources to the private sector through a mortgage discount mechanism. These two approaches have the potential to be expanded as appropriate. The reality of the current economic situation in

Jamaica indicates that expansion of a secondary mortgage market facility is probably a longer term goal.

B. Background

USAID and the GOJ have been involved in a dialogue on shelter policy and institutional development since 1981. As a part of this effort, USAID assisted the GOJ to elaborate a National Housing Policy. Adopted by Cabinet in October 1982, the Policy clarified institutional roles and established the goals and framework within which sectoral problems and constraints are being addressed. A fundamental objective was to rationalize the roles of the public sector shelter finance and production institutions so that affordable shelter could be efficiently provided to low income people on a cost recoverable basis. The National Housing Policy also outlined how the reorganization of the housing finance system could encourage greater private sector participation in both the financing and production of housing.

The USAID shelter program has been designed to assist the GOJ to meet the objectives of its Policy. From 1982 to 1985, AID's shelter activities directed (and redirected) Housing Guaranty (\$40 million in 3 projects) and Development Grant resources (\$1 million) toward implementing housing production and institutional realignment policy goals. The \$15 million HG-011 project, contracted in March 1983, provides financing for starter homes, settlement upgrading, and credit union sponsored home improvement and mortgage loans. This loan is 75% disbursed against works in place, with physical works initiated on all program components. Of this, about 25 percent of the project is complete with mortgages issued, and 55 percent of the project has physical works complete with mortgage origination to begin in September 1985.

The Jamaica Shelter Sector Support PP, 532-HG-012, was approved for \$40 million in September 1983 and the first \$25 million was authorized at that same time. The strategy for the first \$25 million was to support the Government of Jamaica's efforts to achieve its shelter objectives as stated in its 1982 National Housing Policy in a two-step process: a first \$10 million loan for an accelerated starter home program and a second \$15 million loan to support and continue HG-011 initiatives, such as settlement upgrading and the Credit Union League mortgage program.

USAID did not authorize HG-012 investor selection for the first \$10 million until late 1984 because of an uncertain macro-economic environment and debt servicing capacity. Progress in the six months since the borrowing has been very good. Design work is complete on the 5 sites programmed for this phase. On a 221 unit site, 80% of the infrastructure and 50% of the unit construction is complete. Sales of these units have begun so that buyers will be able to occupy the units as soon as they are ready in November 1985.

Measurable achievements of the last two and one-half years of implementation effort include: public sector interest rates have been increased; MOC(H) has divested most of its own mortgage portfolio to the CHFC, a well run housing finance institution; MOC(H) housing units are priced on a cost basis; a portion of production has been shifted to the private sector; basic MOC(H) planning and monitoring functions have been introduced and are being institutionalized; and, unit and site design is based on the affordability of the solution to the proposed beneficiary.

II. THE PROBLEM, RATIONALE, AND STRATEGY

A. The Problem

The Jamaican economy has been badly battered by international economic events. Real incomes have fallen sharply over a long period of time. It is now 13 years since the stagnation in per capita income began and real per capita income is still 25 percent lower than it was in 1972, and forecasted by GOJ to fall by an additional 3 to 4 percent in 1985.

Besides the fall in income, inflation has surged to over 30 percent in the past year from less than 5 percent in 1981. The rate of private savings has been halved, the financial system generally and the housing finance system in particular are undergoing severe stress, and the market for the economy's leading export, bauxite and alumina, has collapsed.

At least through the end of 1983, the extraordinarily large fiscal deficit (equal to more than 17 percent of GDP), and the severe foreign exchange problems posed by the overvalued Jamaican dollar continued to impede what was at best a very fragile economic recovery. As long as the GOJ had such a large presence in the credit markets and artificially inflated the value of the Jamaican dollar, no serious in-roads could be made in encouraging more private investment in the economy or the housing sector. This was the situation in 1983 and 1984 when USAID was attempting, unsuccessfully, to help the Jamaica Mortgage Bank launch its secondary mortgage market activities. However, in 1984 the GOJ began a serious assault on the fundamental components of Jamaica's economic problems:

1. the fiscal deficit was reduced by more than half, i.e., an amount equal to more than 8 percent of GDP; and
2. in November 1983 a unified foreign exchange auction was introduced which allowed the Jamaican dollar to fall from an average level of J\$2.26 to the US dollar in Nov. 1983 to J\$5.62 in June 1985, a fall of 148 percent.

The maintenance and continuation of these two policies will go a long way towards addressing the chief obstacles to Jamaica's development. Reducing the government deficit will reduce pressures on credit markets that prevent capital formation; allowing the

Jamaican dollar to float will reduce the demand for imports and foreign exchange and encourage foreign inflows.

However, these policies are not without costs. The "producer of government services" sector was one of the largest sources of increases in GDP during the 1973-80 period. Government was and still is a dominant actor in the economy and any actions it takes are likely to have serious repercussions. Therefore, efforts to reduce the growth of the government sector through massive spending cuts must be accompanied by an increased private sector role as well as improved targeting of government resources.

The unanticipated protraction of severe economic circumstances and the very aggressive GOJ response to these circumstances have created two problems for the functioning of the economy:

1. a financial system, and particularly the housing finance system, which is under severe stress; and
2. the need to curtail government expenditures on long-lived import consuming goods such as housing.

The fact that housing became increasingly expensive because of the import content (direct and indirect) further reduced the amount of housing needs that could be satisfied with a given expenditure. The drop in the value of the Jamaican dollar alone has caused the price of a constant quality house to increase by 70 percent since November 1983 in inflation-adjusted terms. If one also takes into account the effects of the depressed financial system on the value of real assets such as land, which has appreciated considerably in real terms, and the decline in real purchasing power of most lower income households, it is clear that housing has become far less affordable than it was in 1982.

When the negative rates of return on non-housing forms of wealth-holding, such as deposits and smaller denomination financial assets, are combined with the rapid appreciation in existing house values and the collapse of the residential construction industry, the wealth distribution becomes more skewed. The structure of Jamaica's housing delivery system then causes both poor and newly formed households to bear a disproportionate share of the macroeconomic adjustment costs. In such a context there is a greater need for housing for lower income households now than there was in 1983 at the time of authorization of HG-012.

B. Rationale

The 1983 Project Paper makes clear that the chief rationale for the project was to help implement the GOJ National Housing Policy. The project purpose focused on three of the specific areas identified in the housing policy and was responsive to the GOJ's formal project request:

1. increase private sector production of shelter and related services through an accelerated delivery program;

2. inject housing funds into the public and private sector through reactivation of a secondary mortgage market; and
3. expand public sector institution building.

Those objectives remain paramount in both the GOJ's and USAID's strategy for Jamaica. However, the macroeconomic context has changed considerably since the Project Implementation Agreement was signed: Jamaica's international debt situation deteriorated sharply causing major disruption to the shelter sector. As part of his response, the Prime Minister convened a Housing Finance Task Force to examine the state of mortgage financing in Jamaica and recommend how the system could be liberalized to make mortgages more affordable. In May 1985 the Task Force made recommendations for improving affordability and credit availability.

To improve affordability, the Task Force recommended that in general the Government intensify its efforts with private sector institutions to provide less expensive new housing units. Specifically, it suggested that different types of mortgage contracts that lower the household's burden and redistribute the costs be adopted, that different types of broader financial services arrangements be made available such as contract savings for housing, that different ways of deducting the taxes on the financing costs of housing be explored and that different types of institutional arrangements which would allow blending of public and private resources be explored. Specific measures were also proposed to increase and maintain the flow of funds into the housing sector and improve the flow of funds throughout the financial systems. These included regulatory changes and improvements in long-term investors' access to the home mortgage market.

This project anticipates some institutional realignment in the public sector consistent with the recommendations of the Mortgage Finance Task Force report. This realignment should increase the ability of shelter institutions to achieve the goals established in the 1982 shelter policy by providing a mechanism for HG resources to flow to the private sector, supporting the evolution of the NHT into a broader role which will include evolving a secondary mortgage market facility and supporting improved efficiency in the delivery of the GOJ shelter program. HG resources will be channeled through the new institutional structure to assist the Government to implement these changes.

Thus the GOJ has already made many of the difficult political decisions. Furthermore, the most recent budget document and GOJ agreements with the IMF and the IBRD call for further significant expenditure cuts in coming years. The policies that have been pursued are very difficult policies to enact and the GOJ, at the prodding of the IMF, IBRD and USAID, must be given a great deal of credit for undertaking these changes. Perhaps equally important, however, is the realization that:

1. a partial structural adjustment is in the long run no adjustment at all; and
2. the costs of adjustment policies pre-date considerably the benefits that they produce.

Accordingly, the political will to sustain these costs must be high; otherwise successful completion of the adjustment, and thus any adjustment at all, is impossible. In short, if the structural adjustment process is not completed, the difficult choices already enacted may not succeed. Consequently, it is quite certain that fulfillment of future IBRD structural adjustment loan agreements and IMF standby agreements will require the kinds of GOJ policies that are needed to assure that the private sector can continue its recent redevelopment.

The original purposes of HG-012, to encourage the private sector, revitalize the secondary mortgage market and expand public sector institution building assumed a certain macro and microeconomic environment. At the time the project was approved, the macroeconomic environment was characterized by: very favorable borrowing advantages for government, creating competition for the funding required by the secondary market facility; interest rate ceilings on mortgages that helped existing homeowners but choked off the supply of new private loans; and lack of GOJ recognition of liability for the exchange rate risk at the Jamaica Mortgage Bank.

In this environment it is clear that the prerequisites for success were in place only if the economy grew, government credit needs declined, and both interest rates and exchange rates remained stable. Unfortunately, none of these conditions were achieved. Private sector financial institutions that should have been interested in investing in the debentures that JMB could have issued were forced by high liquidity and reserve requirements to hold GOJ paper instead. Public institutions such as the MOC(H) did not make loan repayments to JMB in a timely fashion.

The JMB therefore could not establish itself as a financial intermediary that could independently operate in the financial system. It thus became an arm of government that absorbed the severe costs of the GOJ adjustment program by decapitalizing itself to meet the repayment requirements of hard currency loans (including HGs) with devalued local currency. The private sector's role in housing did not increase, and JMB became technically insolvent and operationally impotent. The 1982 assumption that JMB could effectively fulfill its role as defined was therefore not valid. This role can more appropriately be played by an institution like the NHT that has an independent resource base which it can use to gain the attention and respect of the private sector. In this manner, it can become the prime intermediary between government's shelter program and private financial institutions.

Nevertheless, in spite of the substantial macroeconomic difficulties in the past two and one half years, the GOJ has made significant progress in achieving what can be termed the microeconomic objectives of housing policy. Institutional responsibilities within the housing sector have been clarified and institutional specialization has been adopted. The MOC(H) is no longer originating sales agreements and holding long term mortgages on its schemes. A major part of its portfolio (some 5000 sales agreements) has been turned over to the CHFC, a commercially operated institution, for servicing. Mortgages on all new projects are now being originated by either the CHFC or the NHT. The NHT is no longer acting as a developer other than to complete former schemes. Furthermore, as stipulated in the Policy, the NHT law was amended in 1984 to provide for home allocation under a Priority Entitlement Index (PEI), or points system, which gives preference to lower income, longer time contributors. The PEI replaced a simple, random lottery system.

On the supply side, the MOC(H) has established and staffed a Policy and Planning Secretariat in the Ministry which is monitoring construction operations in the sector using computerized techniques. It is also responsible for the annual development program, sectoral statistics and other reports required of the Ministry.

The MOC(H) has also established a limited liability state corporation, Estates Development Co. (EDCO), to do most of the design, tendering, and construction supervision for settlement upgrading and smaller new projects. In addition, it uses Sugar Industry Housing, Ltd. (SIHL), a former builder of sugar estate housing attached to the Ministry of Agriculture, to manage large low income housing schemes. This is a dramatic change from the previous situation where the Construction and Maintenance Division (CMD) of the MOC(H) developed many of the Ministry housing projects by force account. The CMD is now relegated principally to an intermediary position of accepting and turning over completed projects to the financial institutions, NHT or the CHFC, for sales and marketing. Furthermore, within the MOC(H) itself, a management audit is presently being carried out under the GOJ's Administrative Reform Program. Implementation of the audit findings will have a significant impact on Ministry operations and should help achieve the project purpose of public sector institution building.

Although housing units are presently sold at below market interest rates, these reflect the cost of funds to NHT, the primary GOJ shelter finance institution. NHT's resources are mobilized from a payroll tax. However, rates were increased to just below market rates in 1982 and full costs of land, infrastructure, unit and management fees are now factored into the price of the unit. This is in contrast to the former policy under which there was a 20 percent capital subsidy on units being sold by MOC(H) and repayments were calculated with an 8% simple interest rate. The NHT at present is also studying the feasibility of instituting an escalating rate mortgage for those beneficiaries whose incomes have increased above a certain amount. This system would further increase interest yields on NHT mortgages.

What might be considered the most laudable policy objective, the attempt to provide freehold title to all beneficiaries, has complicated the settlement upgrading program. The process the GOJ must follow to clear title so the upgraded lot can be sold to the occupant is far more complex than the process required for GOJ to declare an area for upgrading and recover the costs from beneficiaries under a long term lease. However, both GOJ and AID believe the clear title approach has significant advantages, such as stimulating self-help improvements, and is worth the extra effort.

The changeover from a leasehold arrangement utilized by the previous administration to transfer of freehold title under the present administration has entailed a massive effort under the first upgrading project, HG 010. In this project, all the sites were selected and most of the physical works were completed prior to the policy change. There are now substantial additional costs involved in the acquisition, survey, and titling of formerly leased lands. The HG financed upgrading programs have been the actual tests of this changeover and lessons learned from the 1978 HG-010 loan have been applied in the design of the more recent 011 and 012 projects. In recognition of the complexities involved in the sales and marketing (non-production aspects) of these projects, MOC(H) established a special Task Force to market these HG upgrading and other externally financed projects.

There are still a great many constraints in the shelter sector, and as yet the capacity of the private sector to produce low income housing remains largely untapped. However, to a great extent, the microeconomic constraints to achieving policy objectives are being eliminated. Further, the macroeconomic conditions have made housing sufficiently expensive that builders may be forced to downscale their units. This background suggests that attention should focus on what is different about the policy context that makes it likely that USAID's microeconomic successes will function in a more enabling macroeconomic context.

The difference in the policy environment is perhaps best summarized in the policy advice stressed as the basic theme of the Prime Minister's recent Task Force on Mortgage Finance:

The Task Force believes that liberalizing and rationalizing the regulatory and tax structure of the housing finance system will certainly both improve housing affordability and increase the availability of mortgage credit. But perhaps even more importantly, correctly structured change in this sector can effect broad macroeconomic gains that over the longer term will make a significant contribution to lowering interest rates.

The GOJ and USAID are in agreement with this view. Moreover, the IMF and IBRD are both requiring movement in this direction as preconditions to further assistance. The interest rate ceilings on mortgage loans have already been eliminated, and the very high reserve requirements at financial institutions that impede the functioning of a secondary market facility should be significantly reduced in the near future. Because of the important role of these reserves in monetary policy, the timing of their removal is an important issue, but the IMF, IBRD and the Bank of Jamaica agree that they can be reduced and rationalized in the near future.

Finally, the Task Force recommended, and the Prime Minister has agreed, that the GOJ should recognize the exchange rate losses for existing international debts incurred by JMB. Moreover, in informal discussions with USAID there has been provisional agreement by the Ministry of Finance to explicitly recognize the future exchange risks of both new and all outstanding and authorized HG funds.

In summary, both a macroeconomic policy environment that will be conducive to fulfillment of the goals of HG-012, and significant improvements in the microeconomic constraints on housing policy have been realized since 1982. The result is a significantly improved environment for the use of HG funds. Thus, out of the crisis of the current economic situation has emerged not only greater need, but also greater leverage to implement essential policies.

The additional \$15 million in HG funds by itself does not carry sufficient leverage to induce the kinds of policy changes needed for success. However, when the changes that will be insisted upon by the IBRD are combined with sectoral improvements resulting from past HG investments, it is clear that prior loans have helped lay a groundwork for this loan's success. This loan could therefore make a significant contribution to USAID's strategy of helping the GOJ sustain the inevitable social and political costs of the large structural adjustment policies it is pursuing.

C. Strategy

Under the proposed project, the Borrower will be the GOJ rather than a parastatal housing institution. As Borrower and Guarantor, the GOJ will assume the devaluation risk. It will lend the equivalent in Jamaican Dollars to the NHT, the primary source of resources for financing Government's shelter program. The NHT will manage the HG resources destined for public sector programs, and it will act as an intermediary between the GOJ's shelter program and private financial institutions. In this role, it will manage the onlending of HG resources to private sector financial institutions, probably using a mortgage discount mechanism in order to reach HG target group families.

Previously, the Jamaica Mortgage Bank undertook these roles. Although AID provided technical assistance, the JMB was never able to successfully launch a secondary mortgage market program or attract participation by private financial institutions since it was not sufficiently capitalized by the GOJ and did not have sufficient authority delegated to carryout its mandate. Furthermore, it was supposed to rely on off shore borrowing to build its capital base although it had no means to maintain the value of the foreign exchange. Since 1983, as a result of major devaluation of the Jamaican dollar, it has exhausted its reserves and is no longer considered viable.

The remaining \$15 million of the 1983 authorization is being designed in conjunction with the design exercise for the new \$15 million authorization proposed by this Interim Review. The funds from the latter portion will be combined with the US\$15 million previously authorized, but not yet programmed, to continue and expand the two most successful GOJ low income shelter programs; starter home and settlement upgrading. It would also finance GOJ's new pilot sites and services program and private sector produced and marketed starter home units for low income families. Authorization of the additional resources at this time should facilitate the initiation of private sector provision of low income housing.

The impact of the program will be increased by earmarking some of the resources for targeting a combination of sub-project activities in low income areas in Kingston. Low income neighborhoods where the resident population can afford to pay for improvements and the housing stock is upgradable are being identified to benefit from coordinated delivery of a combination of types of solutions. The package will include a combination of settlement upgrading, construction and sale of public and private start-a-homes on vacant land, and agreement with credit unions to commit resources for home improvement loans to residents of the area. Additional resources will also be programmed to finance improvements to secondary infrastructure needed to assure viability of the program.

III. THE PROJECT

A. Expected Accomplishments

The project will continue to pursue the goals of the original project paper. It will also seek to complement the macroeconomic changes in policy being pursued by USAID, the IBRD and the IMF, and continue the improvements in the microeconomic functioning of the housing sector.

A major achievement of the project will be the involvement of the private sector in the development and financing of low income shelter affordable by households earning below the median income. Closely related to this achievement will be the establishment of a limited secondary market facility through which funds can be channeled to the private housing sector. The broadening of the role of the NHT in this regard should contribute to its ability to adapt to alternative funding sources if the GOJ accepts the IBRD recommendation to abolish the NHT Tax.

Among the most important achievements in the public sector will be: greater accountability in public sector operations, improved and more competitive contractor performance, greater efficiency in institutional operations and a more coordinated, comprehensive approach to project development.

B. Project Scope

Funds from the \$15 million HG loan to be authorized for this project will be combined with the \$15 million previously authorized to continue and expand the two major low income shelter programs of the GOJ, starter homes and settlement upgrading, as well as initiate a third program of serviced sites. In order to obtain the original project purpose as well as increase the impact of the funds, the three programs will be undertaken through both the public and private sectors. Table I outlines the various project components and how they will work. It is expected that the \$30 million HG funds would finance some 2000 starter homes, approximately 1200 serviced sites and 2100 upgraded plots. In addition, \$4 million would be available for remedial works to related infrastructure in order to effect comprehensive urban improvement in selected areas of inner Kingston.

532-HG-012: PROJECT COMPONENT OUTLINE

<u>Component</u>	<u>Amount</u>	<u>Description</u>	<u>Implementing Institution</u>	<u>Short-Term Finance & Mgt.</u>	<u>Long-Term Finance</u>
	<u>US\$</u>				
1. <u>START-A-HOME</u>					
a) Public Sector	20M (10M)	New schemes of Start-A-Homes & lower standard new solutions (may be combined with #4)	MOC(H)	Funds made available through NHT to MOC(H)	NHT & CHFC
b) Private Sector	(10M)	Same as above	Private Developers	Funds made available through NHT to private financial institutions	Building Societies Trust Co. Credit Unions
2. <u>SETTLEMENT UPGRADING</u>	4M	Settlement Upgrading in urban areas only (may be combined with #4)	MOC(H)	Funds through NHT to EDCO	CHFC
3. <u>SITES & SERVICES SCHEMES</u>	2M	New projects and conversion of existing subdivisions. Plot sales to low income families	MOC(H) and Private Developers	Funds through NHT to NHC	Private sector institutions, NHT and CHFC
4. <u>COMPREHENSIVE URBAN IMPROVEMENT</u>	4M	Construction of & remedial works for infrastructure in selected areas of inner Kingston	MOC(W) NWC	Funds budgeted directly to NWC and MOC(W)	NA

C. Institutional Arrangements

1. The Borrower

The Borrower will be the GOJ through its official fiduciary, the Bank of Jamaica. The GOJ as Borrower and Guarantor will take the devaluation risk and will onlend the local currency equivalent to the financial coordinator.

2. The Financial Coordinator

The National Housing Trust will be the financial coordinator of HG funds. As the principle finance agency for low income shelter, the NHT will manage the HG resources programmed for the public sector. The HG funds channeled for this purpose will be used to finance shelter for NHT contributors as well as non-contributors whose mortgages are originated by the CHFC. This expanded role is consistent with the programs currently being designed by the NHT to issue mortgage and savings certificates and institute an escalating payment mortgage that would increase the interest yield above the current interest rates. These programs should allow the NHT to function more effectively as the Government's major source of shelter resources and support GOJ shelter policy objectives.

The NHT will also manage the onlending of HG resources earmarked for the private sector. One of the major recommendations of the Housing Finance Task Force was the issuance by the NHT of mortgage certificates roughly equivalent to the price of a starter home.

Those beneficiaires who would rather negotiate individually for a house than accept an NHT unit and are eligible for a benefit will be issued a mortgage certificate for the equivalent of a mortgage on a starter home. They can take the certificate to a private financial institution for mortgage origination or blend it with additional market rate resources.

The issuance of mortgage certificates is especially important in that it not only establishes a link with the private sector but is also the first step in the creation of a limited secondary mortgage market facility. Such a facility could act as the prime intermediary between Government's shelter program and private financial institutions. In the case of HG funds, NHT will make the Jamaican dollars earmarked for private sector low income housing available to private sector financial institutions using a mortgage discount mechanism. The low income families will then have access to mortgage terms comparable to those offered by the Government under its programs. In this expanded role, NHT will be able to use part of its resources and its status as a Government entity to encourage private financial institutions to participate in social interest shelter activities for the Government's target group.

3. Development Coordination

For public sector programs, the MOC(H) will continue to coordinate project development largely through the Estate Development Company, Ltd. (EDCO) and Sugar Industry Housing Ltd. (SIHL). EDCO is primarily responsible for the design and management of settlement upgrading schemes while SIHL manages the larger starter home projects, most of which have been undertaken on a 'turnkey' basis. Either institution would be able to manage the design and construction of pilot sites and services schemes. Funds for the construction of and/or remedial works for infrastructure in selected areas of downtown Kingston would be budgeted directly to the National Water Commission and the Ministry of Construction (Works).

Development of private sector programs will be through the traditional procedures of private developers and financial institutions. Based on initial contacts with the sector, substantial interest in accessing HG funds for low income shelter has been expressed on the part of building societies, trust companies and credit unions. Large private developers also feel the AID target population can be served at margins slightly above HG rates. Details of the financial mechanism by which funds would be passed to the private sector will be established as part of Project Paper design.

D. Project Components

1. Starter Homes - 2000 units

(a) Public Sector

This component would continue and expand what has to date been the major GOJ program for low income housing. Since early 1982 when starter homes, a 288 square foot core house on a 3-4000 square foot plot, were first introduced on a large scale, demand has far outstripped the production of these units by the MOC(H). In the completed projects, householders have rapidly demonstrated a capacity to expand and landscape their units. AID began supporting this effort in HG-011 by disbursing against mortgages of recently completed MOC(H) units in Kingston and Montego Bay and providing construction finance for an additional 285 units. As mentioned earlier, the first tranche of HG-012 is devoted to the accelerated development of these type of projects. At present three of the five schemes in this phase are under construction, with one to be occupied in November 1985. The remaining two are scheduled for contracting in August 1985.

The macro-economic effects referred to earlier, however, have had a serious impact on the costs and hence the affordability of these units. Since the affordability problem results from the combined costs of land purchase, site development and unit construction, all factors contributing to the costs of starter homes are closely reviewed when projects are submitted to the MOC(H).

Based on past experience with projects in which titles were not available at the completion of construction, ownership of land by the MOC(H) will also be a major condition for project acceptability. In addition, in order to obtain better construction performance than in the past, all contractors will be pre-qualified and competitive bidding will be strictly adhered to.

One aspect which is expected to lower costs will be new concepts for more efficient site design which will illustrate to other agencies, private developers, and the target population that this program is affordable to low income families. To this end, one of the principal objectives will be to work more closely with the Town Planning Department to gain acceptance of more efficient site design and infrastructure concepts and to speed up the approval process. These are also the goals of AID's Urban Sector Technical Assistance project (532-0117) which should be of great assistance in this effort.

(b) Private Sector

Private sector financial institutions and developers have expressed an interest in developing projects for lower income brackets. However, the cost of construction and mortgage financing, presently in the range of 31 percent and 24 percent, respectively, have prohibited any such initiatives. HG resources for this component will allow private sector institutions to access funds at rates which are affordable to AID's target population. Given the crisis in the private housing finance sector referred to earlier, and the very limited availability of financing for the upper income market, this initiative is very timely. Moreover, since the GOJ definitely wants to create a secondary market mechanism and, in addition, cannot afford the total expenditure to meet low income housing demand, it has a definite interest in seeing that such an initiative by the private sector is successful. Efforts by the private sector to serve moderate and low income families will also allow the GOJ to concentrate increased resources on the provision of shelter for the lower income population.

Efforts have already been initiated with interested private developers and financial institutions on land in inner Kingston. Plans have been developed and costs have been estimated in order to ascertain the feasibility of a starter home project which is affordable to AID's target population. A preliminary presentation has also been made to the Town Planning Department in order to obtain acceptance of more efficient site designs and lower infrastructure standards. As with the public sector, this will be an area where future AID technical assistance will be focused.

2. Settlement Upgrading - 2000 plots

Settlement upgrading is one of the major components of HG-011 and was proposed as an activity for the second phase of HG-012 in the 1983 Project Paper. The upgrading activities implemented under HG-010 and 011 have provided valuable experience

which will be utilized in the program design and administration of this component. For example, due to the difficulties of acquiring, subdividing, and issuing individual titles to residents, a land pre-feasibility analysis has been established which must be carried out before the MOC(H) will approve any upgrading project. Further, due to low densities and the high cost of off-site infrastructure in rural areas, only settlement upgrading projects which are located in urban areas will be eligible for AID financing.

In order to increase the impact of the funds, resources for this component will be combined with those from other components in selected low income areas of inner Kingston. For example, a shelter program focused on an inner Kingston neighborhood offers the potential to improve the effectiveness of the current upgrading program while being attractive for several other reasons. It provides the opportunity to serve a low income target population virtually untouched by previous shelter programs. It offers the opportunity to utilize existing infrastructure capacity as a means of reducing development costs. Furthermore, it offers Government a more cost effective alternative to its current high standard, high density, highly subsidized approach to low income residential development.

In order to avoid dissipating the impact of the HG investment on enclaves of new development in otherwise deteriorating neighborhoods, this new approach to inner Kingston improvement would be focused on pre-determined neighborhood areas. These inner Kingston neighborhoods would be identified on the basis of a set of selection criteria. A set of illustrative criteria would include the following: quality of existing housing stock and infrastructure networks; land tenure/ownership patterns, i.e., amount of government owned land, sizes of individual parcels, intensity of "yard" configuration, cooperation of local landlords; quantity of vacant or derelict sites; type and level of commercial activity; potential for related private and public investments.

After the identification of several neighborhoods, detailed socio-economic and physical surveys would be carried out prior to the initiation of substantial lending activities. Individual projects would be planned and designed on the basis of development briefs.

3. Sites and Services Schemes - 1200 Plots

This component supports a new GOJ initiative to develop affordable standards and reach low income groups outside of Kingston through a pilot sites and services program. The feasibility of developing raw land for sites and services will be reviewed. Pilot projects would also be tested on existing premature, or abandoned, subdivisions located throughout the island whose historical infrastructure development reduces the price of the finished lot. Most have been abandoned by the original developer due to a lack of funds to complete and/or absence of necessary Parish Council and Town Planning approval.

The pilot program would be designed to bring current owners and/or banks in as project partners and provide access to financing through this mechanism, rather than for GOJ site purchase. Based on successful negotiations a Joint Venture Agreement would be entered into between the owner/bank and the project manager.

The National Housing Corporation which has undertaken many joint ventures with private sector developers and which also knows the history of many of these potential sites would be the project manager. To assist in the sales and self-help development of the plots, a sponsoring organization such as a community, church or employment based group would be sought. Sales of plots would be direct to individuals with long term finance from private financial institutions such as a local credit union, the CHFC, or the NHT depending on the eligibility of the beneficiary.

4. Comprehensive Urban Improvement

The main objective of this component would be to fund infrastructure improvements in selected areas of inner Kingston which would complement the primary HG activities of new construction and settlement upgrading. Funding would be used to improve infrastructure networks (water, sewerage, roads and drainage) in those development areas where significant project activity was already underway. It is also anticipated that this type of improvement could provide the necessary stimulus for private landlords or developers to invest in projects similar to those financed under the HG program. Furthermore, this component envisions that HG funds would be combined with USAID development loans and grant funds in order to provide loans to small businesses and to undertake community projects (construction of parks, renovation of schools and health clinics, etc.) in areas where a concentration of physical projects warrants this.

Cost recovery would be on a direct basis for the new construction and settlement upgrading components where individual units and/or plots are sold to the occupants, and on an indirect basis for infrastructure improvements and settlement upgrading where the owners retain land ownership. Indirect means would be through utility rates and a land improvement or 'betterment' tax which already exists in Jamaica.

IV. PROJECT DEVELOPMENT, CONDITIONS, AND COMVENANTS

A. Project Development

The mission proposes to submit a project amendment covering the unprogrammed \$30.0 million to the LAC for review and approval as per the initial approval cable (state 242061/83). As called for in the cable, a detailed description of those components not fully described in the PP will be provided including the relevant analysis and a summary of the HG-011 evaluation. The amendment will reflect the experience, policy adjustments and program changes of the last two years and modify and update those relevant parts of the PP necessary to describe the \$30 million program.

Much of what is proposed for the amended program has been detailed in the PP. For example, the goal and purpose remain the same as does most of the technical analysis and all of the social analysis found in the annexes. The emphasis will be on modifying and updating the relevant portions of the PP itself, as necessary and appropriate, to develop a separate and cohesive PP amendment. Those sections now noted as "Phase II" will be changed to include the full \$30.0 million and not just the authorized but unprogrammed \$15.0 million. The amendment will include: a revised project rationale and description; a revised financial plan and cost estimates; a modified implementation plan; an adjusted monitoring and implementation plan including an outline of proposed new technical assistance; technical, economic, financial and administrative analysis summaries; and, revised conditions and covenants.

B. Conditions and Covenants

1. The Government of Jamaica would be the borrower of record;
2. The Ministry of Finance will carry the exchange rate risk of the old and new Housing Guaranty loans on its budget;
3. Government will budget sufficient resources to provide its counterpart contribution on a timely basis.
4. Government of Jamaica will be current on its Housing Guaranty repayment obligations.

In order to obtain increased efficiency in the public construction sector:

1. The award of contracts for all HG financed projects in the public sector will be through competitive bidding;
2. Only pre-qualified contractors will be eligible to bid on HG financed projects; and
3. MOC(H) will acquire land prior to start of construction for both upgrading and new construction programs using counterpart funds (ESF if necessary).

In addition to the foregoing the Government will also make every effort to:

1. Deregulate the financial system such that the secondary market facility can effectively compete for credit in the capital market;
2. Broaden the mandate of the NHT such that it can undertake an expanded role as the Government's financial intermediary in the public sector and between the public and private sectors.

3. Make managerial and/or institutional changes necessary to assure that the rationalization of Government functions described in the National Housing Policy document is realized.