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Report No: 76829-IN

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 66.1 MILLION
(US$100 MILLION EQUIVALENT)

TO THE

REPUBLIC OF INDIA

FOR A

LOW INCOME HOUSING FINANCE PROJECT

April 18, 2013

Finance and Private Sector Development Unit
South Asia

CURRENCY EQUIVALENTS

(Exchange Rate Effective February 22, 2013)

Currency Unit = Indian Rupees (Rs)

US$1	=	Rs 54.24		
US$1.51483	=	SDR 1		
Rs 1 lakh	=	Rs 100,000	=	US$1,843.66
Rs 1 crore	=	Rs 10,000,000	=	US$184,365.80

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

ACB	Audit Committee of the Board
ACHFS	Apex Cooperative Housing Finance Societies
ADB	Asian Development Bank
AP	Andhra Pradesh
ARCS	Audit Reports Compliance System
BSUP	Basic Services to the Urban Poor
CAAA	Controller of Aid Accounts & Audit
CARE	Cooperative for Assistance and Relief Everywhere
CAS	Country Assistance Strategy
CFIs	Community based Financial Institutions
CIB	Credit Information Bureau
CMD	Chairman & Managing Director
CQS	Cost & Quality Selection
CRISIL	Credit Rating Company
DEA	Department of Economic Affairs
DC	Direct Contracting
DFS	Department of Financial Services
DGS&D	Directorate General of Supplies & Disposals
DPE	Department of Public Enterprises
EA	Environment Assessment
EC	Executive Committee
EDD	Environmental Due Diligence
EHS	Environment, Health & Safety
EWS	Economically Weaker Section
FA	Financing Agreement
FBS	Fixed Budget Selection
FIL	Financial Intermediary Loan
FM	Financial Management
FX	Foreign Exchange
GDP	Gross Domestic Product
GoI	Government of India
HFC	Housing Finance Company
HR	Human Resources
IBRD	International Bank for Reconstruction & Development
ICB	International Competitive Bidding
ICR	Implementation Completion Report

ICRA	Information Credit Rating Agency
IDA	International Development Association
IFC	International Finance Corporation
IFR	Interim Financial Report
IFS	International Financial Statistics
IHSDP	Integrated Housing & Slum Development Project
ISHUP	Interest Subsidy Scheme for the Housing of the Urban Poor
ISP	Implementation Support Plan
IT	Information Technology
ITR	Income Tax Returns
JNNURM	Jawaharlal Nehru National Urban Renewal Mission
KYC	Know Your Customer
LCS	Least Cost Selection
LIB	Limited International Bidding
LIG	Low Income Group
MBS	Mortgage Backed Securities
M-CRIL	Micro Credit Rating International
M&E	Monitoring & Evaluation
MFI	Microfinance Institution
MFIN	Microfinance Institution Network
MIS	Management Information Systems
MoF	Ministry of Finance
MoHUPA	Ministry of Housing and Urban Poverty Alleviation
MoUD	Ministry of Urban Development
NBFC	Non-Banking Financial Company
NCB	National Competitive Bidding
NGO	Non-Governmental Organizations
NHB	National Housing Bank
NPA	Non Performing Asset
NPL	Non-Performing Loan
OECD	Organization for Economic Co-operation & Development
ORAF	Operational Risk Assessment Framework
PA	Project Agreement
PIU	Project Implementation Unit
PLI	Primary Lending Institution
POM	Project Operations Manual
PPP	Public-Private Partnerships
QBS	Quality Based Selection
QCBS	Quality & Cost Based Selection
RAY	Rajiv Awas Yojana
RBI	Reserve Bank of India
RCC	Reinforced Cement Concrete
RRB	Regional and Rural Bank
R&S	Regulation and Supervision
RTI	Right to Information
SAP	Centralized Computerized Accounting System
SHF	Federal Mortgage Society, Mexico
SCB	Scheduled Commercial Bank
SEA	Social & Environment Assessment
SEWA	Self Employed Women's Association
SIDBI	Small Industries Development Bank of India
SPV	Special Purpose Vehicles
SRFP	Standard Request for Proposal
SSS	Single Source Selection
TOR	Terms of Reference
UCB	Urban Cooperative Bank
ULB	Urban Local Body
UIDSSMT	Urban Infrastructure Development Scheme for Small & Medium Towns
UIG	Urban Infrastructure & Governance
UNDB	United Nations Development Business
WBG	World Bank Group
WBI	World Bank Institute

Regional Vice President:	Isabel M. Guerrero
Country Director:	Onno Ruhl
Sector Director:	Sujata Lamba
Sector Manager:	Henry K. Bagazonzya
Task Team Leader:	Michael Markels

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India
Low Income Housing Finance

PROJECT APPRAISAL DOCUMENT

SAR FPD

Date: Country Director: Onno Ruhl Sector Director: Sujata Lamba Sector Manager: Henry K. Bagazonzya Team Leader(s): Michael Markels Project ID: P119039 Lending Instrument: Financial Intermediary Loan	Sector(s): Housing Finance Theme(s): Other Finance & Private Sector EA Category: FI

Project Financing Data:

Proposed terms: IDA

[ ] Loan [x] Credit [ ] Grant [ ] Guarantee [ ] Other:

Source	Total Amount (US$100m)
Total Project Cost:	US$100 million
Borrower (Government of India)Total Bank Financing:	
IDA	
New	US$100 million
Recommitted	
Parallel financing: National Housing Bank	US$3 million

Borrower: India

Responsible Agency: Ministry of Finance and National Housing Bank
Contact Person: R.V. Verma, CMD
Telephone No.: 911-2464-2722
Fax No.: 9112464-9030
Email: rvverma@nhb.org.in

Estimated Disbursements (Bank FY/US$ million)

FY	2013	2014	2015	2016	2017	2018

Annual	0	13	30	40	10	7
Cumulative	0	13	43	83	93	100

Project Implementation Period: 5 years
Expected effectiveness date: June 30, 2013
Expected closing date: December 31, 2018

Does the Project depart from the CAS in content or other significant respects?	○ Yes x No
If yes, please explain:	

Does the Project require any exceptions from Bank policies?	○ Yes x No
Have these been approved/endorsed (as appropriate by Bank management?	○ Yes x No
Is approval for any policy exception sought from the Board?	○ Yes x No
If yes, please explain:	

Does the Project meet the Regional criteria for readiness for implementation?	x Yes ○ No
If no, please explain:	

Project Development Objective
To provide access to sustainable housing finance for low income households, to purchase, build or upgrade their dwellings.

Project description: The project has three components which are (I) *Capacity Building* of the National Housing Bank (NHB), Qualified Intermediary Institutions, and Qualified Primary Lending Institutions (QPLIs), (II) *Financial Support for Sustainable and Affordable Housing* for NHB to refinance, directly or indirectly through Qualified Intermediary Institutions, low-income housing loans made by QPLIs to Primary Borrowers to purchase, build or upgrade their dwelling, and (III) *Project Implementation*. The three components are mutually dependent as the refinancing alone is not sufficient for lenders to start expanding to the informal among lower income groups. By combining the three, NHB, Qualified Intermediary Institutions, and QPLIs will be given the necessary capacity building and implementation support and incentives to expand lending to lower income groups who may earn their income in the informal sector (no documentation of income) or who may not have access to formal (titled) property as collateral for a mortgage.

Safeguard policies triggered?	
Environmental Assessment (OP/BP 4.01)	x Yes o No
Natural Habitats (OP/BP 4.04)	○ Yes x No
Forests (OP/BP 4.36)	○ Yes x No
Pest Management (OP 4.09)	○ Yes x No
Physical Cultural Resources (OP/BP 4.11)	○ Yes x No
Indigenous Peoples (OP/BP 4.10)	○ Yes x No
Involuntary Resettlement (OP/BP 4.12)	○ Yes x No
Safety of Dams (OP/BP 4.37)	○ Yes x No
Projects on International Waterways (OP/BP 7.50)	○ Yes x No
Projects in Disputed Areas (OP/BP 7.60)	○ Yes x No

Conditions and Legal Covenants:

Financing Agreement Reference	Description of Condition/Covenant	Date Due
Article V, 5.01	The Subsidiary Agreement has been executed on behalf of the Recipient and NHB, and all conditions to its effectiveness (other than the effectiveness of the Financing Agreement and the Project Agreement) have been fulfilled.	(Condition of) Effectiveness

I. Strategic Context

A. Country Context

1. Between 2001 and 2011, the urban population in India increased by 91 million people to 377 million urban dwellers.[1] While urbanization has not been as fast as in other countries, at least based on official statistics, the numbers are staggering – India's urban population as presently defined will be close to 600 million by 2031, more than double that in 2001. Already the number of metropolitan cities with a population of one million and above has increased from 35 in 2001 to 50 in 2011 and is expected to increase further to 87 by 2031.[2] The expanding size of Indian cities will happen in many cases through a process of peripheral expansion, with smaller municipalities and large villages surrounding the core city becoming part of the metropolitan area.

2. Population densities in and around the largest metropolitan areas are extremely high. There are on average 2,450 persons per square kilometer in the 50 kilometer vicinity of the seven largest metropolitan areas (with populations above four million in 2001).[3] The challenges posed by the urbanization process are manifold – spurring economic activities and creating jobs in urban areas, providing decent services to new and existing urban dwellers, rethinking urban planning from cores to peripheries, and improving governance structures.

B. Sectoral and Institutional Context

3. Housing shortages in India are nothing short of dramatic: it is estimated that a third of urban dwellers live in slums, and millions more are homeless. The 2012 urban housing backlog was estimated at 19 million,[4] and urban housing demand continues to grow as population increases and incomes rise. India's demographic trends also play a role in determining housing demand: households are getting smaller; the size of the average Indian household has decreased from 4.9 persons in 1999 to 4.5 persons in 2009.[5] More than 90 percent of the housing shortage is faced by low-income and poor families; 'decent'[6] housing in the formal sector is beyond the reach of the vast majority of these households.

4. Housing shortages are the result of a complex set of factors on both the supply and the demand side. On the supply side, inappropriate land use policies and building norms artificially restrict the availability of housing. There is a lack of land serviced by utilities, with appropriate zoning, a lack of formal property rights and a non-transparent regime for approvals from government. Developers tend to refrain from entering the low-income market due to the

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[1] Census of India.
[2] The High Powered Expert Committee (HPEC) for Estimating the Investment Requirements for Urban Infrastructure Services, 'Report on Indian Urban Infrastructure and Services,' March 2011, p. XXII.
[3] World Bank, 'Urbanization beyond Municipal Boundaries: Nurturing Metropolitan Economies and Connecting Peri-Urban Areas in India,' 2013.
[4] MoHUPA, 'Report of the Technical Group on Urban Housing Shortage (TG-12) (2012-2017),' September 22, 2012.
[5] NSS (National Sample Survey), 55th and 66th rounds.
[6] 'Decent' housing here is defined as one that meets basic requirements per UN-Habitat guidelines in terms of structural quality and access to basic services (water, sanitation, electricity).

perceived 'risk' associated with these buyers, which is attributed largely to their lack of access to conventional finance. Still, the low-income housing market in urban India showed the beginnings of a robust supply of affordable, high-quality housing. In 2010, due to a pause in demand for mid-market housing, there were more than 25 developers in urban areas across India who moved down market, building (or about to build) multi-family units in the Rs 3 lakh (~US$5,500) to Rs 7 lakh (~US$12,900) price range.[7] But since then prices are escalating in urban areas, further out of reach of low-income households. It is estimated that these 25 developers built about 16,500 units in the Rs 3-7 lakh price range as of May 2010. By November 2011, 25,000 units were built in the Rs 6-10 lakh price range. Housing prices at the low end continue to rise. However, the capacity of developers to build affordable housing to scale depends on their capacity to identify effective demand.

5. On the demand side, housing finance is constrained, more so than in other emerging economies. Many lower-middle income families could afford simple, 'decent' units if such units were available, and if they had access to finance under reasonable terms. However, traditionally, this segment of the population has not been a commercial target for mainstream financial institutions or private developers. This is largely due to the fact that the bulk of this population works in the informal sector, and needs customized lending policies for which the required capacity is still lacking. Most banks do not have the tools or the capacity to assess and manage credit risk for this market segment and lower their transactions costs sufficiently. Other financial entities, such as microfinance institutions (MFIs), Non-Banking Financial Companies (NBFCs), and financial cooperatives, who could more effectively serve these groups, typically lack adequate funding bases, organization, and expertise to offer long-term, collateralized lending products.

6. The growth of the mortgage market has been concentrated in the middle and high income segments. India's mortgage mid and high-end market has witnessed steady growth of 15 percent a year over the past five years, driven by supportive fiscal, monetary and legal policies complemented by ample liquidity in the financial system, a competitive environment and a growing middle class.[8] In 2012, the total outstanding amounts of the housing loans held by Indian financial institutions amounted to around Rs 6,89,701 crores (~US$125.4 billion). Scheduled Commercial Banks (SCBs) held around two thirds of the housing loans outstanding, Housing Finance Companies (HFCs) held about one third, and a small percentage was held by other lenders. The Mortgage Debt-to-GDP ratio is around six percent, lower than in other emerging economies.

7. Because the formal financial markets are closed to them, low-income households are forced to use unregulated, informal sources of finance. There is a ready supply of credit from money lenders at much higher rates of interest and shorter tenors than the formal market. Housing finance, both secured and secured by alternative security arrangements (or 'alternatively

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[7] Monitor Group, 'Building Houses, Financing Homes: A Study Report of India's Rapidly Growing Housing and Housing Finance Markets for the Low-Income Customer,' World Bank/ First Initiative, 2010.

[8] Sridhar S., et. al., 'Report of the committee to explore, examine and recommend setting up of a dedicated micro finance company with a focus on micro-housing finance,' Report of a Committee set up by the Ministry of Housing and Urban Poverty Alleviation, Government of India, 2010.

secured') lending, at formal interest rates that reflect risk and longer tenors would allow the same families to access better housing and bring more households into the formal market.

8. The vast majority of households in India make money, but they have no paystub or other documentation of income. MFIs lend to this segment because borrowers are known to the MFI, there is a history of savings, borrowing and repayment, and borrowers are motivated to repay by affiliation, solidarity and the likely prospect of future financing. Credit is an intimate relationship, especially for borrowers with low income, particularly those with informal income. Scaling up is a challenge because the intimacy, defined as frequent communication and monitoring, must be maintained in order to sustain the repayment.

9. The path to secure property rights in developing countries, including India, follows a different sequence than for developed jurisdictions. The formal and legal processes stated in law and regulation assume that land occupation follows this pattern:

1. Land conversion from rural to urban
2. Land titling as urban
3. Approval of land development plans
4. Approval and implementation of urban infrastructure (roads and utilities)
5. Approval of housing plans
6. Houses are built and occupied.

The majority of the population in developing countries begins with the sixth step, occupying the land and building their houses. After this step, they usually take the fifth step followed by the fourth, enhancing durability by seeking government support for the provision of roads and utilities, and by making further investments in the dwelling. After some tenure stability is gained, they start the process aimed to regularize all the approvals described in steps one to three.

10. Low-income households often have informal property rights.[9] The lack of formal tenure rights, which is the right to occupy the land on which the dwelling is situated, obviates qualification for a secured mortgage and certainty that the borrower can build equity in the property over time. In this case, the households cannot provide the documents that are needed to secure a loan from a formal housing finance institution. The dwelling may not be registered; tenure and title may not be formal. So they tap the informal financing market instead. These structures, mostly self-constructed incrementally over time, are financed primarily by borrower's cash, money lenders and by MFIs.[10] The primary lenders look for certain evidence that shows the borrower's climb up the tenure ladder, providing comfort to the lender that the borrower will not be evicted. As a practical matter, these may include one or more of the following evidence:

- Proof that a settlement has been in existence for at least ten years
- Proof of recognition of address by issuing Government cards
- Electricity bills as proof of residence and stability
- Government issued cards as proof of residence and stability

[9] Formal settlements are defined as registered property with conclusive title. Informal settlements are everything else. The Project will require some evidence of tenure rights for the occupant, subject to the risk management, due diligence, and local knowledge of the primary lenders. The Project file includes a study by an Indian lawyer which helps to define, in a sample of states in India, informal settlements which can be banked. This work shows plenty of legal space for the use of Project Component II.

[10] SEWA Bank estimates that 40 percent of microfinance is diverted to incremental housing needs.

- Proof that the owner has paid for its dwelling and some local evidence of ownership such as a power of attorney[11]
- Supply of Municipal water to the settlement
- Supply of Municipal sanitation to the settlement
- An examination of a Town planning or master plan scheme to ensure that this land is not to be used for any immediate purpose
- An assurance (oral) from the authorities that no eviction notices has been sent.

11. National Housing Bank (NHB) is the apex level financial institution for the housing finance system established in 1988 by an Act of Parliament (National Housing Bank Act, 1987). NHB was instrumental in building the mortgage market in India. Its Board's recent guidance is to sustainably support the low-income housing finance market. NHB is strategically placed as the government owned apex financial institution in the sector able to address, articulate, and support policy and developments in the housing sector and the housing finance system.[12]

12. The Primary Lending Institutions (PLIs) on NHB's client list include HFCs, urban cooperative banks, state owned commercial banks, regional rural banks and at the other end of the spectrum, MFIs and nongovernmental organizations (NGOs). PLIs receive wholesale funding from NHB. NHB funds against conforming secured mortgages presented by the PLI. NHB takes the corporate credit exposure on the PLI and the PLI bears the risk on the retail mortgages. The PLIs provide part of their mortgage loan portfolio as collateral for the NHB loan. Should any of the loans provided as collateral become delinquent they are replaced with performing loans. This ensures that NHB minimizes any direct credit risk to the mortgage market. NHB recognizes that the smaller PLIs, primarily MFIs, do not have the balance sheet to originate and then distribute. Instead, NHB advances the funding to the MFI before it originates the retail mortgages.

13. MFIs have the low income, informal sector client base. MFIs underwrite informal income by using group affiliation and history. These institutions cannot lend in large size and long tenor, because their funding is short and their experience is livelihood finance. For instance, SEWA's housing finance entity depends on special guidelines to mitigate credit risk; if the borrower is over 55 years old, a joint borrower is required, as well as formal title, gold or jewelry, fixed deposit or other alternative collateral. NHB plans to enhance support to the MFI/NGO segment, as provided under updated regulatory requirements, so that they can participate at increasing scale in housing finance under this Project. The Small Industries Development Bank of India (SIDBI) has wholesale funding relationships with MFIs as well as small and medium sized enterprises.

14. The regulatory framework for primary lenders, which make housing related loans, varies by type of license. For example, HFCs follow NHB's regulations, which mirror the regulations RBI uses for banks. HFCs can make secured and 'alternatively secured' loans for housing purposes; alternatively secured loans have a higher risk weight than secured mortgages. Banks, including cooperative banks, can make alternatively secured loans up to a maximum of Rs 1 lakh (~US$1,800). Microfinance NBFCs, a new license category, can only make loans for livelihood

[11] Absent other documentation, the seller grants the purchaser power of attorney to all matters related to the property.
[12] See Annex 12, NHB Today.

purposes, not expressly for housing related purposes, and are not eligible institutions for refinance by NHB. In addition, NBFC MFIs are excluded from being a banking correspondent (an agent[13] for a commercial bank). Non-NBFC MFIs are not so restricted. As a result, some MFIs are changing licenses to HFCs (or opening HFC subsidiaries) and banks. The Supreme Court has decided that banks should not finance dwellings where no proper zoning exists (on disaster management grounds).

15. Government of India (GoI), NHB and the World Bank have been consulting for the past five years on how to sustainably provide access to housing finance for low-income households. NHB requested an IDA credit for refinancing and technical support to reach out to impoverished, informal sector households, including those in informal settlements. Financial inclusion is a priority of the GoI and this proposed project will allow NHB to innovate on financial product supply with the aim of improving livelihoods at the bottom of the pyramid.

16. The market failure addressed by the Project is the exclusion of low-income households from housing finance in India. The drivers of this failure include informality of the borrower's income (no documentation of income), and for most low income people, the informality of their dwelling (no clear mortgageable title to the property). The Project will address this by giving the necessary capacity building and implementation support and incentives to NHB, Qualified Intermediary Institutions (QIIs), and Qualified Primary Lending Institutions (QPLIs) to expand lending to lower income groups, who may earn their income in the informal sector (no documentation of income) or who may not have access to formal (titled) property as collateral for a mortgage. The Project also provides finance for NHB to refinance, directly or indirectly through Qualified Intermediary Institutions, low income housing loans made by QPLIs.

17. This Project will address the demand side (housing finance) and complements ongoing and planned operations by the Government on the supply side of affordable housing and inclusive cities in India.[14] On the demand side, the International Finance Corporation (IFC) invests in HFCs, and provides complementary capacity building. The financing provided by the IFC serves a higher income segment (up to Rs 25,000 per household per month) than this Project is targeting, and IFC is focused solely on secured mortgage finance. In addition, the Ministry of Finance (MoF) recently launched a national financial inclusion project, to be supported by banking correspondents for outreach (agents to cover the last mile from bank to customer), and biometric identifier, streamlined Know Your Customer (KYC) and no frills bank account to establish formality of the beneficiary. The combination of supply and demand side support should result in strategic impact for low-income housing solutions in India.

C. Higher Level Objectives to which the Project Contributes

18. One of the three pillars of India's Country Partnership Strategy FY13-17 is to support financial inclusion, and addresses urbanization. People moving to cities need to be able to finance a place to live. Both of these themes reflect GoI's objectives in the five year plan. The

[13] A MFI/Bank combination could be a good model for this Project; each according to its comparative advantage. However, either a qualifying license would have to be acquired by the MFI, or RBI regulation would have to be changed to allow it.
[14] See Annex 13, Affordable Housing Projects by GoI.

Project directly supports financial inclusion by providing access to housing finance to low-income and informal sector households. It will further enhance the capacity of NHB as the government-owned institution mandated to provide market rate housing finance with adequate incentives for PLIs to provide housing finance to low-income borrowers, within a prudent risk assessment and mitigation framework.

19. The Project supports GoI's strategy to foster inclusive urban development and provide decent housing options to households currently condemned to substandard living conditions, although market forces often push new housing to the peri-urban rings, if not farther.[15]

II. Project Development Objectives

A. PDO

20. The Project's development objective is to provide access to sustainable housing finance for low-income households, to purchase, build or upgrade their dwellings.

B. Project Beneficiaries

21. The key beneficiaries of the Project are low-income households, in particular those on informal incomes and including those with informal dwellings. The target groups are the urban poor categorized as Economically Weaker Section (EWS)[16] and Low Income Group (LIG).[17] The eligible income of the Primary Borrowers will not exceed the LIG income ceiling of Rs 200,000 per annum (or Rs 16,667 monthly income equivalent).[18]

22. Other direct beneficiaries of this Project will be NHB, Qualified Intermediary Institutions, and QPLIs because of the capacity enhancement and implementation support that will be provided (under Project Component I & III) and the proof of business model generated by the Project's Pilots.

23. Other stakeholders, such as GoI's other development partners (e.g. KfW, DFID), will benefit from the harmonization and donor coordination that the Project aims to bring about.

C. PDO Level Results Indicators

24. The Indicators aim to capture how well the Project is delivering on reaching down to lower income households while maintaining quality standards for the loan portfolio.

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[15] The 'Affordable Housing for All' initiative, JNNURM, and the Interest Subsidy Scheme for Housing the Urban Poor (ISHUP), recently replaced by RAY, are central schemes designed to implement this strategy.
[16] EWS: ≤Rs 100,000 household income per annum (equivalent of Rs 8,333/mo, US$113/mo or $5.05/day)
[17] LIG: ≤Rs 200,000 household income per annum (equivalent of Rs 16,667/mo, US$307/mo or $10.10/day)
[18] The income ceilings are based upon the GoI memorandum on 'Revision of Income Ceilings for Economically Weaker Section (EWS) and Low Income Group (LIG),' dated November 14, 2012. To reflect new realities, these income targets can change upon mutual agreement between the World Bank and NHB.

- The increased number of primary lenders (eligible for refinance from NHB) active in the EWS and LIG segments.
- The increased volume of lending in the EWS and LIG income segments by primary lenders which are refinanced by NHB.
- The annual percentage increase in the number of borrowers in the EWS and LIG income segments receiving loans from primary lenders which are refinanced by NHB.
- The percentage of replacements of non-performing with performing sub-loans by the QPLIs required for pools of loans which have been refinanced by NHB.

III. Project Description

25. The project has three components which are (I) *Capacity Building* of the National Housing Bank (NHB), Qualified Intermediary Institutions, and QPLIs, (II) *Financial Support for Sustainable and Affordable Housing* for NHB to refinance, directly or indirectly through Qualified Intermediary Institutions, low-income housing loans made by QPLIs to Primary Borrowers to purchase, build or upgrade their dwelling, and (III) *Project Implementation*. The three components are mutually dependent as the refinancing alone is not sufficient for lenders to start expanding to the informal among lower income groups. By combining the three, NHB, Qualified Intermediary Institutions, and QPLIs will be given the necessary capacity building and implementation support and incentives to expand lending to lower income groups who may earn their income in the informal sector (no documentation of income) or who may not have access to formal (titled) property as collateral for a mortgage.

A. Project Components

26. The Project has the following components to support sustainable access to housing finance for low-income households:

27. **Component I, *Capacity Building*** (US$2.0 million funded by IDA): Under this Component activities will be financed to strengthen the capacity of NHB, Qualified Intermediary Institutions, and QPLIs. This will be achieved by using consultants' services and engaging in Pilots with state/municipality agencies, experts and practitioners and selected QPLIs. The aim will be to develop new financial products, loan standards, risk management tools, and financial literacy and consumer protection capacity. In addition, Pilots will be designed, launched and monitored. Building upon and complementing NHB's monitoring and evaluation (M&E) systems and processes, this component will also support an impact assessment to independently assess the social and household level impact of the Project. The areas targeted for capacity building and related activities are summarized in Table 1 and detailed in Annex 2.

28. NHB will provide US$2.5 million in parallel financing covering capacity building within NHB with regard to low-income housing finance. Also, NHB's financing will facilitate the roll out (including training) of new tools, instruments, norms and guidance within NHB and to Qualified Intermediary Institutions and QPLIs.

Table 1: Capacity Building: Target Areas and Related Activities

Areas	Activities
Capacity to appraise and serve low-income and informal income/dwelling households	• Develop prudential norms for loan underwriting and servicing • Credit risk assessment tool for informal sector customer
Expanding the coverage of credit bureaus	• Gap analysis of credit scoring for informal segments • Development of credit bureau function for informal segments
Financial literacy and counseling and consumer protection capacity	• Consumer information and disclosure norms • Housing finance / mortgage literacy and awareness
Piloting	• Develop and support implementation of new types of housing loans that can be given in informal settlements • Monitor the Piloting (financed under Component II) of new types of loans
Impact assessment	• Assess the social and household level impact of the Project

29. **Component II, *Financial Support for Sustainable and Affordable Housing*** (US$97 million funded by IDA): This Component will finance NHB to refinance, directly or indirectly through Qualified Intermediary Institutions, low-income housing loans made by QPLIs to Primary Borrowers to purchase, build or upgrade their dwelling. NHB takes the corporate credit exposure on the eligible primary lenders according to its policies and procedures. NHB has recently prepared a refinancing scheme for secured low-income housing loans to borrowers with formal and informal incomes. NHB will develop guidelines (to be formulated and reflected in the Project's Operations Manual) for the provision of alternatively secured housing loans to formal and informal borrowers. Refinancing guidelines to cover the right side quadrants will be prepared during the first year of the Project. Technical support will be used to innovate and mitigate the higher risk associated with the right side quadrants in Table 2. Retroactive financing will only cover loans which are eligible under NHB's lending criteria and are acceptable to the Bank (as described in the Project's Operations Manual) and have been disbursed since Project appraisal.

30. Refinancing on a Pilot basis will test innovations in loan products and processes suited to informal settlements as designed under Component I. The Project's Operations Manual defines the volume and process for Pilot refinancing.

31. Table 2 shows the segmentation of lower income households under Component II of the Project by the (in)formality of the borrower's income and the (in)formality of the dwellings. Initial allocations of Component II across these segments for the Project have been agreed, and are subject to change based on the Project's studies, pilots or any other factors upon review and mutual agreement by NHB and the Bank during the Project period and will be formulated and reflected in the Project's Operations Manual (POM).

Table 2: Segmentation of Project Component II by formality of income and property[19]

	Formal Dwelling	Informal Dwelling
Formal Sector Income	*Secured loans for home purchase or construction to salaried borrowers.*	*Loans secured using alternative collateral for home purchase or construction to salaried borrowers.*
Informal Sector Income	*Secured loans for home purchase or construction to informal sector borrowers.*	*Loans secured using alternative collateral for home purchase or construction to informal sector borrowers.*

32. **Component III, *Project Implementation*** (US$1 million funded by IDA): A Project Implementation Unit (PIU) will be set up within NHB to help implement the Project, carry out monitoring and evaluation, be responsible for legal issues and grievance redressal, overseeing and monitoring the social and environmental 'due diligence' (including conducting annual third party audits of QPLIs), keeping the Project's Operations Manual updated, and financial management and carry out any procurement necessary under the Project. Low-income housing expertise will also be added to the PIU to provide technical inputs to the procurement of consultants' services under Component I. The PIU will be staffed by a combination of reassigned and new NHB staff and consultants' services.

33. NHB will provide parallel financing of US$0.5 million covering NHB staff for PIU management, M&E, legal, grievance redressal, and financial management functions as well as tasks including the organization of training, roll out of social and environmental guidelines (e.g. literacy training). External communications on the Project would also be covered by NHB staff. Lastly, NHB would also take on responsibility for dissemination and communication activities under its own budget, such as conferences or workshops.

B. Financing of the Project

34. The proposed lending instrument is a Financial Intermediary Loan (FIL). The Project will be funded through an IDA Credit for an amount of US$100 million. The terms of the credit will be IDA terms currently applicable to India. The Credit documents include a Financing Agreement (FA) between IDA and India, and, a Project Agreement (PA) between IDA and NHB, who will be the responsible implementing agency.

35. Eligible expenditures under the loan (US$100 million) will cover capacity building of US$2 million, refinancing of US$97 million, and US$1 million for Project Implementation. The IDA loan allocations for Capacity Building and Project Implementation will cover goods, works, consultants' services, and training and Operating Costs. NHB will provide parallel financing of US$3 million for Capacity Building (US$2.5) and the Project Implementation (US$0.5).

[19] With a maximum borrower income across all 4 quadrants of Rs 200,000 per annum, equivalent to Rs 16,667/month.

C. Lessons Learned and Reflected in the Project Design

36. **A cadre of incumbent PLIs, lenders which already have experience with low-income borrowers, is key to healthy disbursements from NHB's refinancing line**, funded under this Project. NHB has about 25 PLIs which make use of NHB's refinance product, and 37 PLIs (including 20 MFIs) which make use of NHB's 'pre-finance'[20] product. 25 PLIs are already lending to informal sector households (no documentation of income). That breaks down to 5 larger PLIs (refinance) and about 20 MFI/PLIs which use NHBs pre-finance product. The challenge of the Project will be to get the 25 incumbents to scale up, and to increase the capacity of all PLIs to direct resources to low-income households.

37. **Numerous lessons were learned as a result of the US sub-prime crisis and the dangers of pushing housing finance too far down the income distribution without due regard to risk.** Two of the key lessons which are part of the project design are (i) the need for fuller and clearer disclosure – clear and transparent descriptions of the products and payment schedule, potentially even showing some stressed scenarios and impact on payments and (ii) need for greater consumer financial education and literacy. This is all the more critical in an emerging market where familiarity with secured lending products will be minimal in the target borrowing population.

38. **The microfinance crisis in Andhra Pradesh also provided a number of lessons which have been incorporated into the Project design**. In that case, over-indebtedness, high interest rates and lack of regulation resulted in cases where borrowers where overwhelmed by their level of indebtedness. The Project design has specifically taken an approach of introducing Pilots initially to test lending products. One of the aims is to preserve affordability even for lower income informal segments of the population by finding alternative forms of collateral to reduce credit risk and keep interest rates at manageable levels. Over-indebtedness will be monitored as part of the impact assessments, and regular monitoring will be done of the loan quality in the target borrower segment.

39. **IDA Low-Income Projects work best where there is strong stakeholder ownership**. In the case of this proposed project, six formal consultations[21] were held with potential primary lenders which reach out to the primary borrowers targeted under this Project. Several field visits were conducted to gain a better understanding of the housing and finance related challenges faced by people in the formal and informal sectors. PLIs are segmenting themselves along the spectrum of informality described in Table 2, with relatively few tackling informal dwellings on the right side of the matrix. There is considerable energy and motivation to expand into new niches, under NHB's guidance. Regarding NHB, the PLIs on their panel for refinance are positive. Key issues raised by stakeholders during consultations, which have informed Project design:

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[20] 'Prefinance' refers in this instance to NHB funding the MFI up-front against loans to be originated within pre-agreed parameters. NHB offers this product to MFIs/NGOs because they often do not have the balance sheet to front the funding.

[21] See Annex 10, Consultations with Practitioners.

- The details of what loans would be refinanced will matter. If the bar is too high on eligibility criteria, there will be limited loans.
- The regulatory environment in which MFIs and HFCs can lend and NHB can refinance needs to be clarified, particularly vis-à-vis alternatively secured loans and loans for housing in informal/un-regularized settlements.
- The operation should support various pilots.
- The income criteria for formal housing loans will be reviewed.
- The safety criteria will be reviewed.
- Capacity building would not be limited to NHB but would also be provided to QPLIs.

40. **FILs have a better chance to succeed when supported by technical assistance appropriately sequenced with disbursements from the refinancing component.** The design and delivery of the technical assistance is critical to the sustainability and development impact of the Project. In Mexico, December, 2008, the Bank lent US$1 billion (refinancing and technical assistance) to Federal Mortgage Society, Mexico (SHF), a second tier mortgage finance institution. The purposes were to provide wholesale finance to primary lenders and support development of the low-income market. Disbursement to SHF's refinancing window were rapid because of a liquidity crisis, but was disconnected from the technical assistance. As a result, the institution building was below expectations. The key lesson is that capacity building is better upfront in the Project.

IV. Implementation

A. Institutional and Implementation Arrangements

41. NHB will be the implementing agency for all three Components of the Project.[22] A PIU composed of the appropriate mix of management capacity, one procurement specialist, one social and one environmental expert, and an appropriate mix of staff to fill M&E, legal, grievance redressal, training coordination and financial management functions as well as senior specialists will be responsible for the day-to-day running of the Project. It will draft the Terms of References (TORs) to commission consultants' services to deliver the activities of the Capacity Building Component and complement NHB staff in the PIU. Other development partners have expressed interest in supporting similar demand side low-income housing projects, with NHB as the implementing agency. In this case, as discussed with NHB, DfID and KfW, a single PIU would be the preferred option.

42. To enhance distribution of housing finance under this project, NHB can work with Qualified Intermediary Institutions, which are institutions refinancing underlying loan transactions between QPLIs and Primary Borrowers. Some of the Primary Lending Institutions

[22] The ownership of NHB, which is a subsidiary of, and is regulated by, RBI, is expected to change in the near term. NHB currently regulates and supervises HFCs. Before Parliament is an amendment to the NHB Act which would transfer ownership of NHB from RBI to the Ministry of Finance (MoF), which would resolve the conflict of interest of RBI as both the owner and regulator of NHB. In addition, NHB will supervise HFCs; RBI will regulate HFCs. This will resolve the conflict of NHB being both the promoter and regulator of HFCs.

on NHB's Panel have relationships with specific segments of PLIs (primarily MFIs). As Qualified Intermediary Institutions, these QPLIs take up a wholesaler role, in which the flow of funds would go from NHB to a Qualified Intermediary Institution to QPLIs to Primary Borrowers.

43. There are other banks and institutions which have relationships with specific segments of PLIs, which NHB will work with as technical partners or service providers. For example, SIDBI is a successful state owned apex financial institution, which channels funds to MFIs and SMEs. NHB will partner with appropriate institutions to enhance distribution of housing finance under this Project, given their relationships with MFIs or other entities who touch the target households under this Project.

B. Results Monitoring and Evaluation

44. **NHB will maintain robust monitoring and evaluation systems**. The management information processes of the Project will be part of the PIU's responsibilities, but will rely upon NHB's existing systems. The Monitoring System will track performance indicators, scheduling and implementation related data, and expenditure as shall be agreed within the framework of the annual work plan and budget. NHB will provide quarterly implementation reports. The team responsible for the M&E system of this Project will be composed of two staff, will report to the Chairman and Managing Director, and will work closely with the PIU. The complete Results Framework is provided in Annex 1.

45. **The project will conduct an Impact Evaluation**, with the objective of determining whether the low-income households who borrow from the QPLIs are better off thanks to access to finance under the Project (and are not worse off due to over-indebtedness) compared to similar households who had no access to formal low-income housing finance. As part of the evaluation, beneficiaries will be surveyed before and after they receive assistance under the Project to assess changes in their housing situation and other relevant outcome indicators, such as possibly health indicators and employment and income-earning opportunities.

C. Sustainability

46. This Project is designed to be sustainable by designing a replicable financing model and building the capacity of the wholesale and retail lenders. New loan standards and technical assistance products will provide guidance to the market on ways to include informal borrowers and informal dwellings in formal finance. Long-term effect of the project will be to bring the MFI/NGOs (alternatively secured lenders) up market and HFCs and banks (secured mortgage lenders) down market to serve the previously underserved segments of the market.

V. Key Risks and Mitigation Measures

47. **Scale and Informal Sector Households**: Housing finance, designed to cater to informal household characteristics, is limited in scale. To build the portfolio of informal sector borrowers and QPLIs that will lend to them will take time. Proxies have been developed and piloted for

income eligibility, to mitigate the challenge of income qualification. Increasing opportunities for scale is anticipated once the unique, individual ID is rolled out, along with KYC, no-frills bank account and access by a credit bureau, all of which will bring these primary borrowers into the formal sector. The risk is that NHB's effort to scale up housing finance for households with informal sector income could be hampered if parallel efforts by GoI to provide an identity for these households stall.

48. **Market Infrastructure**: Supporting demand without adequate market infrastructure may lead to over-indebtedness. These risks will be mitigated under the Project through linkages with credit bureaus, partnerships with states which formalize tenure and title rights in formerly informal settlements, and through an enhanced financial literacy campaign suitable for longer term debt obligations.

49. **Limitations on Outreach**: Project risk increases as NHB lends to primary lenders that reach poorer households (EWS and LIG). There is a greater degree of informality in terms of primary borrowers (less documentary evidence of income, residency, tax payments, etc.) and a greater degree of informality in terms of property collateral for the financing (notified or regularized slums). Specifically, there is a risk that some primary borrowers could be evicted by a public authority during the term of a loan from a primary lender that is refinanced by NHB. At the same time, NHB is a prudential banking institution with well-defined corporate and lending policies and regulations. Therefore, this Project's risk mitigation will be enhanced through NHB's own refinancing guidelines, credit analysis and due diligence, supported by consulting services, advanced training and education of primary lenders and NHB staff.

50. **Moral Hazard**: Moral hazard could undermine the Project, but it is likely to affect only a small part of the underlying refinancing portfolio. Design can mitigate, but not eliminate this risk. For example, middle-income borrowers can hide income from PLIs in order to qualify for better financing. PLIs could seek refinancing from NHB for loans to primary sector borrowers that include formal sector incomes, but are presented by the PLI as informal sector (no documentation). The project aims to mitigate the risks by (a) recognizing the difficulty of underwriting informality, and allowing for a relatively small allocation of refinance to formal sector income and dwellings; (b) NHB's supervisory review of loan files and visits while performing on-site supervision; (c) grievance redressal will be available for the beneficiaries; and (d) capacity and systems of NHB and QPLIs to monitor this behaviour, costs which can be paid for out of the loan. For primary borrowers who purposely default, without cause, practitioners say that the agreements with the borrower are enforceable, but they are rarely enforced. The borrowers pay when the bailiff shows up. At the same time, NHB is a prudential banking institution with a well-defined risk management framework.

51. **Over-extended PLIs**. 25 PLIs are currently lending to households with informal incomes and formal title, at a small scale. Incumbents will have the opportunity to scale up, supported by improved market infrastructure, tools like a credit scoring model and TA for financial literacy. New entrants into this space will need to learn the business, choose a niche and be disciplined about following their strategy. NHB's supervision of HFCs provides close scrutiny of the portfolio of each HFC. Others (banks, MFIs and NGOs) on NHB's client list provide detailed reporting for access to the refinance function. Comfort also comes from the fact that players like SEWA Bank are already lending to informal households in informal dwellings. SEWA lends up

to Rs 50,000 for alternatively secured incremental housing and up to Rs 120,000 for capital improvements without a mortgage. Tenure status, government vs. private lands, disputed ownership, reference to the town plan, etc., all are part of the underwriting process. No go areas include land slated for road widening. Designation of social housing and future notification are evidence of tenure rights that provide the comfort for the lender.

52. **Property rights**: Would risks be lower by first fixing the regime of property rights such that all primary borrowers have clear title and all financing under the project is secured by a mortgage in Anglo Saxon sense?[23] Fixing the land rights regime in India is a necessary, but long term proposition, which would obviate any intervention for households purchasing or improving their dwellings in informal settlements. Instead, the Project helps households to move up the 'ladder' of tenancy (the right to occupy), invests in the productivity of these people by adding durability of the dwelling, and creates incentives for the government and primary borrower to seek formalization in the future. In this context the Project will seek to support some pilot schemes which will expand access to credit for households with informal tenure. The Pilots will test alternative forms of collateral and how the process of formalization can be supported, for instance by allocating some of the credit to help bring a dwelling up to building code or to cover costs of registration.

VI. Appraisal Summary

A. Economic and Financial Analysis

53. **The expected impacts of the Project can be grouped along three main categories**. The *macroeconomic* impacts would be channeled through the Project's demonstration effects by increasing the size of the mortgage market and making mortgage loans available to households who previously had no access to housing credit. The *financial* impacts would operate by strengthening the balance sheets of the QPLIs and allowing the lenders to expand the availability of credit and/or increase the orientation of their portfolio towards mortgage loans. The *microeconomic* impacts would take place at the household level through improvements in the welfare of households who obtain mortgages from the QPLIs, as well as any effects on the welfare of households who may benefit from improved access to credit in the future through the Project's demonstration effects.

54. **The Project's target beneficiary households are substantially disadvantaged relative to richer urban households**.[24] The target households, i.e., those with household incomes below Rs 16,666 per month, make up about 73 percent of the urban population (76 percent if the six major metro areas are excluded). On average, these households earn around Rs 7,744 per month;

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[23] See 'The Mystery of Capital,' Hernando DeSoto

[24] The analysis in this and the following paragraphs is based on data from the 2004-05 India Human Development Survey (IHDS). IHDS is a nationally representative, multi-topic survey of 41,554 households in 1503 villages and 971 urban neighborhoods across India. The household interviews covered several topics including income, consumption and debt. The survey fieldwork was conducted during the period between November 2004 and October 2005. IHDS was jointly organized by researchers from the University of Maryland and the National Council of Applied Economic Research (NCAER), New Delhi. For the purpose of the analysis in this section, IHDS data was converted into today's rupees using CPI inflation.

just over half of the mean income in urban areas, and more than 27 percent of them has consumption levels below the poverty line. Compared to households with incomes above Rs 16,666 per month, the target households are half as likely to have salaried employment or business as the primary source of their income. They are also four times less likely to have health insurance than richer households. Last but not least, they have much lower levels of education: only around 15 percent of target households have attained education levels above grade 12, against 58 percent for those earning more than the threshold income.

55. **The target households face high borrowing costs**. Households with incomes below Rs 16,666 per month who borrowed funds to purchase or improve a home paid, on average, 27.1 percent annual interest rate on these loans. On the other hand, those above the threshold income paid an average annual interest rate of 13.9 percent. Part of the explanation for the higher rates lies in the high reliance of target households on informal sources of credit (i.e., money lenders, friends, relatives, NGOs) who charge much higher rates than banks or government-sponsored programs (Figure 1). In fact, only 31 percent of target households with housing loans obtained their mortgages from the two cheapest source of credit—banks and government programs—vs. 71 percent for households above the threshold. However, with the exception of loans from relatives or the government, poorer households face a disadvantage even when borrowing from the same source. When borrowing from an NGO or an employer, households in the bottom 40 percent of the urban income distribution pays 760 basis points more than the average rate extended by these same lenders. Similarly, money lenders charge the poorer households a 200 basis points premium over the average, while banks collect around 80 basis points more from these borrowers. Finally, female-headed households—which are slightly more common among the target households relative to the overall urban population—tend to pay, on average, more than two percentage points more in interest than an average (male-headed) household.

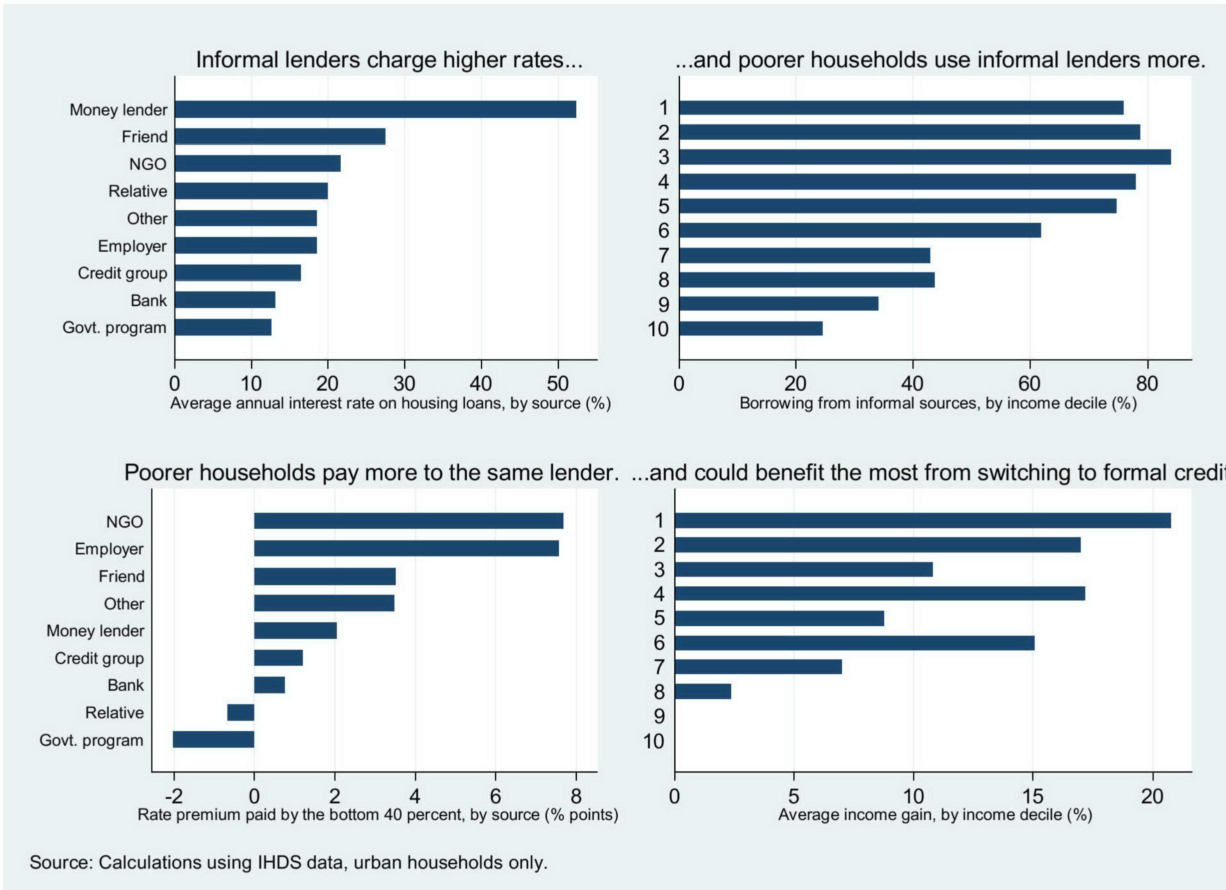
56. **Increasing access to formal sources of finance could have the biggest benefits for the poorest households**. By allowing target households to switch from expensive informal finance to formal sources and subsequently benefit from the lower rates offered by banks and government programs, the Project could contribute to a more than 11 percent increase in the average income of beneficiary households. If the increased access to formal sources of finance is also accompanied by households being able to take larger loans (assuming they were previously borrowing less than what they would have liked) at longer maturities, the potential benefits would be even greater. Furthermore, as shown in the bottom right panel of Figure 1, households at the lower end of the income distribution would reap proportionately larger benefits from gaining access to formal finance (e.g., more than 17 percent for the poorest decile) because they tend to face the highest borrowing costs. Therefore, the Project—to the extent that it is scaled up at the national level—has the potential to have an important positive distributional impact.

57. **Financing under the Project will create incentives for lenders to focus on lower income households**. The net all-in reduction of the QPLI's cost of funds from Bank funding will be approximately 200-300[25] basis points. This is an incentive to the QPLIs to support the low-income households. Once the project has been completed, the QPLIs will have sized the spread they need to do this business at scale, and will charge accordingly. 200-300 bps additional cost to

[25] The hedging cost varies as the market changes. This excess spread has recently compressed to about 100 bps.

the end borrower, once the project is finished, is still in the affordable range for the target households, given that their only choice is money lenders at multiples of the rates under the project.

Figure 1: Distributional benefits of expanding access to finance



58. **IDA funding is small in comparison to overall market but significant relative to current levels of lending in specific lower income group and in particular in informal sector both for income and property.** In the key market targeted by the project of loans at Rs 5 lakh and below, NHB data show that in FY2012, total disbursements amounted to Rs 13,098 crore, with majority of lending going to those earning Rs 10 lakh and above. SCBs dominate this space accounting for 83 percent of lending. In this context the IDA loan would represent around four percent of current annual lending to this segment. The vast majority of this lending is likely to be concentrated in the formal income, formal property segment, so there is considerable opportunity for the IDA loan to have impact in the other segments where it would represent a large influx of new funding.

59. **Loan performance across the board is generally good, but does deteriorate for smaller loans done to lower income households.** NHB reports that loans made by SCBs for Rs 2 lakh or lower have a delinquency level of 11.54 percent versus a 2.63 percent on the overall portfolio. This has risen sharply in the past year from a typical level of around six percent

previously. This underscores importance of pilots and of the technical assistance to support development of underwriting techniques for lower income borrowers.

60. **Overall the balance sheet of HFCs and SCBs can easily absorb additional lending made possible by new refinance window**. The IDA financing will allow for approximately an additional Rs 500 crore. Assuming a risk weight of 50 percent for the mortgage loans and an 8 per cent capital ratio, means an additional Rs 20 crore would be required to meet regulatory capital requirements for the whole IDA credit. This compares to current capital levels for HFCs alone, who are likely to do the majority of this new lending, over Rs 37,103 crore.

61. **NHB is well capitalized and the additional refinancing it would have on its balance sheet can be easily managed**. NHB's balance sheet at end 2012 was over Rs 31,000 crore, meaning that the additional IDA funding would grow NHB by less than 2 percent. NHB is also well capitalized with a regulatory capital ratio of 19.82 percent. It has non-performing assets of 0.01 percent of its balance sheet. In addition, NHB has access to the local capital market with the government rating so is able to raise debt funding at competitive rates.

62. **The beneficiary population represents one-third of overall urban population, yet in 2012 accounted for just three percent of housing finance lending.** The project targets those able to obtain loans in the range of 3 lakh up to 5 lakh, which implies monthly incomes of between Rs 5,000 and Rs 16,666. In terms of the urban income distribution this covers the 30th percentile up to around the 66th percentile, so the middle third of the urban income distribution. This third of the population currently represents some 86 million households, yet lending to this segment represented just 3 percent of total lending in 2012.

63. **The project could also have important social benefits by increasing opportunities for lower income households**. While these benefits are hard to value, they could include increased returns on economic activities and a reduction in the vulnerability of households who use their dwellings to conduct a family-operated business. Improved housing could also have significant benefits on health through improved water supply and sanitation. Finally, a formal or improved dwelling could increase safety and provide dignity, especially to women.

B. Technical

64. **Monitor Group** (2010[26]) showed that customized business models can lower the cost of extending and managing small value mortgages. Such models, possibly in combination with risk sharing mechanisms where appropriate,[27] can also help to enhance lenders' capacity to manage the credit risks involved in serving lower income customers. In general, the foreclosure mechanics in India (for secured lending against formal sector properties) is reasonably efficient since the creation of an out-of-court proceeding in 2002.[28] HFCs and some banks now occupy this niche.

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[26] Monitor Group 2010-11, funded by FIRST. Monitor Group is an international consulting firm with offices in India. Financial inclusion is a significant part of their practice.
[27] See Annex 13 for a description of GoI's proposed default guarantee fund.
[28] SERFAESI Act.

65. **Supply and Demand**: Monitor Group has assessed supply and demand in the different segments of income and informality of both the household and the property. Annex 11 provides a snapshot of estimated demand and supply across income ranges and informality. It shows the significant opportunity to finance self-constructed improvements in low-income neighborhoods (which by definition have adequate tenure rights), among others. It shows that formal housing is unaffordable[29] for households earning Rs 15,000 per month, the top of the range of incomes targeted under the Project.[30] This will change during the Project as the markets change; these are only estimates of the opportunity at the time of the assessment across the segments.

66. **NHB Business Plan**: NHB has produced its business plan which reflects the changes necessary at NHB to serve the lower income and informal sectors of the market. This delta will be supported by the Project. Overall, NHB has the capacity to carry out the implementation of this project.

67. **Cost of Funds**:[31] NHB can allocate the cost savings from the IDA Credit as compared to their cost of funding in the bond market towards higher operating costs associated with lending to grassroots financial institutions. NHB typically takes a one percent spread above its cost of funds. Under the Project, NHB management has the discretion to set this margin, and the QPLIs have the discretion to allocate any margin benefit passed to them to compensate for the higher cost of lending to lower income, informal sector borrowers, and the higher cost per loan due to small loan size. Lending by the QPLIs to the primary borrowers will be at market rates. The above rates are expected to be fixed for the entire tenor of the loans (i.e. 15-20 years). The hedging cost has risen recently, reducing all-in excess spread of NHB's funding in the market over the cost of IDA funding from about 300 bps to about 100 bps.

C. OP8.30 Summary

68. An OP8.30 appraisal of a proposed FIL: (a) determines if it is the appropriate intervention to achieve the desired objectives with due regard to the sustainability of the financial sector; (b) establishes the economic justification of the operation; (c) confirms, for a FIL justified by its poverty-reduction goals, that it is a practicable, cost-effective way of achieving such goals; (d) confirms the eligibility of financial intermediaries proposed for inclusion; and (e) ascertains that implementing the FIL is unlikely to undermine the financial condition of participating financial intermediaries.[32]

69. **Poverty Reduction**: This is a cost effective, market driven, practicable method for achieving poverty reduction goals. It will bring more low-income borrowers into the system. Organizations that lend to LIG and EWS groups will be able to increase their lending capacity.

[29] Especially due to the lack of affordable, serviced land in the large metros, which means that tier II and III cities are a more likely target market for a dwelling, and that incremental housing will be a significant use of funds for the Project.
[30] At the time of the survey, an income of Rs 15,000 per month was the proposed ceiling for income eligibility within the Project.
[31] See Annex 15, Funding Costs at Each Level of the Financing Chain.
[32] OP 8.30 - Financial Intermediary Lending, July, 1998.

70. **Eligibility**: NHB has a history of strengthening the financial condition of participating financial intermediaries. NHB has successfully supported the development of the mid-market mortgage industry, which is now predominately private. In addition to this middle market business, NHB's Board has decided to refocus its portfolio on primary lenders (PLIs) which serve the housing finance needs of low-income households. NHB's Board has approved a business plan which reflects this transition.

a. NHB currently functions as a second tier liquidity facility providing short and long term refinance of banks and housing finance companies (HFCs) collateralized by their housing loan portfolios. Created in 1988, NHB has been a catalyst for the development of housing finance in India. It regulates and supervises the HFCs, provides loans to its clients funded by bonds issued both domestically and globally and functions as an APEX housing finance institution providing leadership and support of a wide variety of housing finance programs. It has a diversified funding base. It increasingly accesses the local bond market with an AAA rating to raise funds.

b. At small scale, NHB pre-finances[33] microfinance institutions MFIs and NGOs which target informal borrowers in various parts of the country for both self-built housing and improvements and formal housing. The volume is small; from 2004-to date, NHB has refinanced 25,000 units through these first tier lenders for a total portfolio of about US$20 million. NHB's lending to microfinance institutions is secured by a claim (hypothecation) on the MFI's loan book. NHB also requires that the MFI uses mortgage instruments on the retail loan where possible (but allows for alternatively secured loans as well), the retail borrower has successfully repaid at least three lending cycles with the MFI, and a group guarantee on a housing related loan. Currently, when NHB refinances a portfolio of loans for a primary lender, its staff check the loan files for evidence that the retail borrower has adequate property rights and that construction approved by building inspectors as required by the relevant authority. Under the Project, NHB will issue guidelines which allow for prudent lending in the informal spaces, including tenure and titling noted herein.

c. Throughout its history NHB has operated in a conservative and low risk manner. It provides loans to registered and regulated financial institutions, backed by portfolios of home loans. It provides some project finance to state agencies, backed by state guarantees. It administers subsidy programs on behalf of GoI but does not itself provide subsidies. Its credit risk is low reflecting its corporate lending to financial institutions and the collateral that is pledged to support such lending. Its interest rate risk is low reflecting almost exclusive use of adjustable rate financing. It operates on a very efficient basis with a low expense to revenue ratio.

d. NHB's five-year business plan envisions a significant expansion in the breath of its activities. In particular it will strive to substantially increase its funding of lower income formal and informal housing through lending to newly created HFCs and MFIs, increase

[33] NHB 'pre-finances' MFIs and NGOs, which is different from the refinance it provides to Housing Finance Companies. The difference is that NHB funds the MFIs/NGOs before the retail level loans are originated.

its construction finance to private/public agencies targeting LIG borrowers, promote rural housing, and greatly expand its research and training capabilities.

e. The expansion of NHB's activities during the five year plan period has the potential to increase NHB's risk, both credit and operational. Thus the implementation plan needs to focus on identifying the resources, both human and other, necessary to implement in a safe and sound manner.

71. **Use of Bank Funds**: This Project will be used to finance the increase of lending to lower income groups and to strengthen financial institutions that serve these groups. The World Bank and NHB have agreed on the eligibility and development criteria of QPLIs and on the appropriate arrangements to monitor compliance. NHB will monitor any losses that the Pilots show as a given in each quadrant. This will inform future decisions by GoI necessary to maintain sustainability.

72. **The on-lending terms** are not negative in real terms, provide adequate margins for the financial intermediaries to cover all their costs, including credit and other risks, as well as an adequate profit margin and will not discourage resource mobilization in the market.[34] Interest rates will be determined by the market.

73. **Monitoring**: NHB will maintain comprehensive and robust consultation, monitoring and evaluation systems. The management information processes of the Project will be part of the Project Implementation Unit's responsibilities. The Monitoring and Evaluation System will track the performance indicators, scheduling and implementation data, and expenditure as shall be agreed within the framework of the annual work plan and budget. NHB will provide quarterly implementation reports. The team responsible for the M&E system of this project will be composed of two staff, will report to the Chairman and Managing Director, and will work closely with the PIU. The complete Results Framework is provided in Annex I.

74. **Impact Evaluation**: An Impact Evaluation is covered as part of the Project. The project envisages two surveys of beneficiaries, one at mid-term and one at the end. The purpose of a project's Monitoring and Evaluation system is to provide information useful to monitor progress towards achieving the objectives of the project and evaluate its impact on intended beneficiaries.

75. **The monitoring system** generally tracks input indicators (expenditures), output indicators (services provided), and sometimes outcome indicators (use of the services by beneficiaries).

D. Financial Management

76. **NHB, the nodal Project implementing entity**, has a robust system of financial management (FM), as well as systems for appraisal, approval and oversight over loans provided

[34] Since this OP830 assessment was conducted, market conditions have changed. The cost of the IDA loan to NHB varies with the US$-to-Rs hedging cost. If the IDA loan becomes significantly more expensive than NHB's funding in the local bond market, then NHB is less likely to draw loan funds from IDA.

by it to PLIs. These systems have been assessed as adequate to account for and report on sources and uses of Project funds as envisaged in the Project design. Accordingly, the FM arrangements for the proposed Project would rely on and be aligned with the systems established within NHB. NHB will create a PIU, including amongst others NHB staff for management and FM functions. Internal controls of the Project would be predicated on existing controls/oversight mechanisms for assurance on end use of funds by the PLIs as established in NHB. Agreed Project FM arrangements have been documented in the Project's Operations Manual (POM).[35]

77. NHB has developed a Special Program and guideline for Refinance of QPLIs/QIIs active in Urban Low Income Housing Finance. The Program also has a maximum loan amount of 5 lakhs. It has been approved by NHB's Board, and is applicable to lending in respect of formal dwelling segment (left side of the Project allocation Matrix meant for formal dwelling). Similar programs would be also developed for MFIs and NGOs. During Project implementation in the first year, NHB will develop a guideline and a program for the informal dwelling segment (right side quadrants of Table 2) based on consultations with stakeholders, Capacity Building, and/or pilots. The Programs will be reviewed by the Bank for acceptability and included in the POM.

78. NHB's Corporate Governance arrangements compare well with the Model Guidelines on Corporate Governance issued by the Department of Public Enterprises.[36] There is a 'Governance and Accountability Action Plan', prepared for this Project, attached as Annex 9.

79. **The Department of Financial Services** (DFS), GoI, would provide for Project funds in its budget and pass on these to NHB on a back to back basis, who, in turn, will provide financing to QPLIs/QIIs duly appraised and approved by NHB in accordance with the procedures detailed in the POM. The eligibility of the sub-loans to PLIs will be determined on the basis of end-target primary borrowers and the framework as agreed and documented in the POM. The appraisal of the sub-loans will include an assessment of the FM capacity and systems of the PLI/QII to ensure that adequate systems are in place for accounting and reporting end use of Project funds. This assessment would be recorded in the appraisal note that is put up for sanction before the competent authority. Project accounting would be streamlined using NHB's existing centralized computerized accounting system (SAP). This system will facilitate capturing Project transactions through separate general ledger account codes.

80. **NHB has a formal system of internal controls**, which have been assessed to be satisfactory and would be applied to the Project. Internal audit would cover the Project transactions in accordance with terms of reference as noted in the POM. The internal audit reports would be reviewed by the Bank during missions. In case the internal auditors make any adverse comment in respect of the Project transactions, NHB will forthwith inform the Bank along with a timed-line plan for its resolution. NHB will submit quarterly Interim Financial Reports (IFRs), including cash forecasts for a period of six months, to the Bank within 45 days of the end of the period. These IFRs will also provide a list of end primary borrowers who have received financial assistance under the Project through refinance made available to QPLIs by NHB. The IFRs will be the basis for disbursement by the Bank which will include a rolling

[35] Detailed arrangements are discussed in Annex 3, Implementation Arrangements.
[36] See Annex 3, Implementation Arrangements.

advance for forecasted expenditures for six months. The external audit of the Project financial statements will be carried out by a firm of chartered accountants on terms of reference included in the POM. The Project would be eligible for retroactive financing up to 10% of the IDA Credit in respect of sub-loans made by NHB between the end of appraisal and the Project's effectiveness date. Such expenditure would be claimed by NHB through a stand-alone IFR.

E. Procurement

81. **Procurement for the proposed Project** would be carried out in accordance with the World Bank's 'Guidelines: Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers' dated January 2011 (Procurement Guidelines); and 'Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers' dated January 2011 (Consultant Guidelines) and the provisions stipulated in the Financing Agreement. In addition, the Project will also be subject to the World Bank's 'Guidelines on Preventing and Combating Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants' dated October 2006 revised January 2011. The World Bank's Standard Bidding Documents, Requests for Proposals, and Forms of Consultant Contract will be used. There are no procurement activities under the Component 2.

82. **For each contract to be financed by the Credit**, the different procurement methods or consultant selection methods, the need for prequalification, estimated costs, prior review requirements, and time frame are agreed between the Borrower and the Bank Project team in the Procurement Plan.

83. **The Project is going to be implemented by NHB**. Based on discussions and interactions with NHB staff it has been concluded that NHB carries out procurement largely consisting of IT equipment, and small value consulting services and hence its staff has limited or no experience in handling procurement of large value consultants' services which would form a majority of the procurements under the Component I and III of the Project. NHB has limited experience of carrying procurement under Bank funded/donor funded Projects.

84. **Given the low capacity and overall risk environment in Government**, the procurement risk (prior to mitigating measures) is assessed as 'High', which will be changed to 'Moderate', depending on the risk mitigation measures implemented by NHB. The mitigation measure includes the inclusion of an external procurement professional in the PIU. The procurement plan for the Project has been finalized. It will be updated at least annually (or as required) to reflect Project implementation needs and improvements in institutional capacity.[37]

F. Social (including Safeguards)

85. **Key Stakeholders**. The primary stakeholders of the Project are (i) low-income people (EWS and LIG) who will seek, receive and utilize housing finance under the Project; (ii) QPLIs

[37] A brief summary of the procurement capacity assessment and Project procurement arrangements are provided in Annex 3. More details are available in the Project files.

whose key roles include mobilizing primary borrowers, appraising loans for their housing needs, overseeing repayment, and ensuring appropriate quality construction; and (iii) NHB which is the primary implementing agency receiving Bank funds and refinancing QPLI lending. These groups have been consulted during Project preparation and will be key in implementation, with NHB having the primary role in M&E. Secondary stakeholders include entities such as builders and urban local governments who have a role in ensuring safe and legal housing construction. The key negative stakeholders are moneylenders who are an informal source of housing finance for low-income households.

86. **Social Impacts and Risks**. The Project is expected to have significant positive impacts on low-income beneficiary households through housing improvements. Households with both formal and informal incomes are included, with the greatest risks being to those with informal incomes and without property titles. Title deeds will not be required for such households but the risks of borrowing without secure title will be made clear to them by QPLIs, and evidence of tenure (right to occupy) will be required for them to receive loans. A variety of evidence may be acceptable based on local conditions and the PLI's risk management procedures (which include site visits and KYC processes) which will be developed further during the first year of the implementation.

87. Borrowing for improvements to occupants who lack any evidence of property rights will be ineligible. The project will not fund housing projects by government or builders (which may call for land aggregation and hence cause involuntary relocation without proper compensation) – only individual housing purchases or incremental construction will be financed. Violation of land zoning laws is unlikely as QPLIs will verify that borrowers build informal/incremental housing in accordance with laws, environmental and safety requirements. The risk of elite capture is low as both income levels and loan sizes will be capped to ensure that only loans to the low-income target groups will be refinanced by the IDA credit. The potential for loan or property 'sharks' usurping Project benefits would also be mitigated by diligent needs assessment and follow-up by QPLIs.

88. **The risk of social or gender-based exclusion** from the Project will be mitigated by ensuring that only PLIs that have an equitable approach to borrowers are selected by NHB, and achievements will be monitored by NHB. QPLIs are expected to improve the access of all groups to housing finance, providing loans to those households who meet financial requirements. A possible negative impact is the risk of indebtedness of some poor households if they are given loans that they cannot repay due to inadequate incomes. This risk will be mitigated by enabling QPLIs to develop flexible repayment schedules for borrowers. Section V and Annex 4, Risks and Mitigation Measures, describes the reputational as well as credit risks associated with social issues. Many of the social and reputational risks of the project are addressed by PLIs' credit risk management processes.

89. **Consultations, Disclosure and Grievance Redress.** Seven consultations were held with PLIs during the course of Project preparation, and they in turn were in touch with potential primary borrowers and reflected their voices in the meetings. Information on the Project will be made public by the NHB through its website and offices across the country and by QPLIs through personal interactions with borrowers as well as through their websites and possibly other

means of communication. Grievances of borrowers against QPLIs or of QPLIs would be received and dealt with by designated officers at the NHB, possibly with support from a local institution (e.g. law firm), and PLIs also have ready recourse to other government redress channels as well as to the Bank.

G. Environment (including Safeguards)

90. The environmental safeguards management for the Project relate to considering appropriate measures to ensure environmental considerations in QPLI lending operations to borrowers. While the formal housing scenario addresses most of the environmental issues through housing regulations (such as municipal bylaws, land use and zoning, safety, etc.), the informal housing sector is devoid of such inherent environmental management considerations. In this context, the assessment of environmental aspects assumes importance, although the issues are not significant in nature and hence OP 4.01 is triggered.

91. The Environmental Assessment (EA) relates to environmental due diligence mechanism in NHB's operations under the project, including QPLI lending operations, which need to address: (i) analysis of environmental issues related to siting, basic amenities and services, and building safety; and (ii) institutional mechanism for Project implementation and monitoring, and to meet the requirements and standards of the World Bank's operational policies relevant to the Project. Further, in view of the potential environmental issues, focus group discussions and consultations were held involving NHB and PLIs to ascertain the key requirements to minimize environmental risks associated with the project. Based on the feedback from PLIs and environmental risk analysis, an Environmental Due Diligence (EDD) mechanism is developed which covers: (i) negative list of settlements location – locations that will be excluded for lending; (ii) requirements of basic water supply and sanitation services at settlement; (iii) exclusion of households that are involved in negative list of activities; and (iv) positive list of requirements that are necessary to be met to ensure structural safety. The EDD will be enforced as part of lending operations by NHB/Qualified Intermediary Institutions/QPLIs under the Project. NHB will conduct the annual third party environmental auditing of QPLIs under the Project. This is a category FI Project. The ESIA is complete and has been disclosed on NHB's website.

Annex 1: Results Framework and Monitoring
INDIA: LOW INCOME HOUSING FINANCE

Table 3: Results Framework and Monitoring

Project Development Objective (PDO): To provide access to sustainable housing finance for low-income households, to purchase, build or upgrade their dwellings.

PDO Level Results Indicators*	Core	Unit of Measure	Baseline	Cumulative Target Values**					Frequency	Data Source/ Methodology	Responsibility for Data Collection	Description (indicator definition etc.)
				2014	2015	2016	2017	2018				
The increased number of primary lenders (eligible for refinance from NHB) active in the EWS and LIG[38] segments	☐	Number of financial institution targeting Low Income Households	5 HFCs 10 MFIs 10 Banks 0 Others **25 QPLIs**	25	29	31	33	35	Annual	NHB	NHB	
The increased volume of lending in the EWS and LIG income segments by primary lenders which are refinanced by NHB.***	☐	Percent growth year on year	100%	110%	120%	130%	140%	150%	Annual	NHB	NHB	
The annual percentage increase in the number of borrowers in the EWS and LIG income segments receiving loans from primary lenders which are refinanced by NHB.***		Percent growth year on year	100%	110%	120%	130%	140%	150%	Annual	NHB	NHB	
The percentage of replacements of non-performing with performing sub-loans by the QPLIs required for pools of loans which have been refinanced		% Loans	1.0%	1.10%	1.20%	1.30%	1..40%	1.50%	biannual	NHB	NHB	

[38] Up to Rs 16,667 per month

by NHB.												
INTERMEDIATE RESULTS												
Intermediate Result (Component One):												
NHB issues specific guidelines for sustainable lending to target segments, per the segmentation in Table 2.	☐	# guidelines to fit quads in Table 2		G-lines issued for right-side Quadrants per Table 2								
Intermediate Result (Component Two):												
Pilots launched	☐	# pilots launched		Pilot 1 and 2	Pilot 3 and 4							
Intermediate Result (Component Three):												
Technical assistance is implemented according to agreed business plan.	☐	# staff dedicated to Project	(PIU) 5 part time	TBD	TBD	TBD	TBD	TBD				

***Please indicate whether the indicator is a Core Sector Indicator (see further http://coreindicators)**
****Target values should be entered for the years data will be available, not necessarily annually.**
***** Not all PLIs on NHB's Panel have the systems in place to robustly report on borrowers' income level. In case of PLIs with data gaps, 90% of their loans below Rs 5 lakh would be taken as a proxy. PLIs refinanced under the Project need to produce borrowers' income level.**

Annex 2: Detailed Project Description

Component I, *Capacity Building* (US$2.0 million funded by IDA)

92. Under this Component activities will be financed to strengthen the capacity of NHB, Qualified Intermediary Institutions, and QPLIs. This will be achieved by using consultants' services and engaging in Pilots with state/municipality agencies, experts and practitioners and selected QPLIs. The aim will be to develop new financial products, loan standards, risk management tools, and financial literacy and consumer protection capacity. In addition, Pilots will be designed, launched and monitored. Building upon and complementing NHB's monitoring and evaluation (M&E) systems and processes, this component will also support an impact assessment to independently assess the social and household level impact of the Project. NHB will provide US$2.5 million in parallel financing covering capacity building within NHB with regard to low-income housing finance. Also, NHB's financing will facilitate the roll out (including training) of new tools, instruments, norms and guidance within NHB and to qualifying intermediary institutions and PLIs.

(a) Capacity to appraise and serve low-income and informal income/dwellings households

93. As in many countries, there is a gap in India in the range of housing loans offered by the financial sector: microfinance for housing is available, but because of its characteristics – with a loan size of typically Rs 50,000 (~US$920) to Rs 100,000 and high interest rate (over 20 percent) – it is restricted to very small investment. Secured housing finance starts – in the best of cases – with loan amount above Rs 300,000. No financial solutions exist in between, which affects millions of households. This is the space where intermediate loan products can be developed, for higher amounts and lower cost than micro-credits, but without mortgage liens, an ineffective security in this loan and property range.

94. This Component will help develop prudential lending standards to serve more vulnerable categories, for instance: define repayment limits depending on revenue level, family size, loan profile, etc.; set minimum down payment norms; require lenders to assess undocumented income, and to demonstrate capacities to this end; require the use of one of the credit bureaus, and, in the case of institutions that are not affiliated to the credit information platforms, require the access to credit history with MFIs. The implementation of such standards will be supervised by NHB.

(b) Expanding the coverage of credit bureaus

95. Expansion of current coverage of credit bureaus to be more inclusive of borrowers on informal incomes to help mitigate the risk of over-indebtedness. There are, for instance, two credit bureaus with scale in India: CERSAI, a formal mortgage registry, and CIBIL, which covers other forms of charge as well. Enhancements to these systems are underway, with assistance from IFC Advisory. This Component will finance consultants' services to:

a. identify gaps and solutions in credit reporting for use by QPLIs which seek refinance from NHB under this project; and,
b. develop a complement to the CERSAI and CIBIL platforms for informal segments.

(c) Financial literacy and counseling and consumer protection capacity

96. Low income generally goes with little familiarity with financial products and their implications. It is critical, to avoid replicating a sub-prime type of process, that all borrowers are well aware of their financial obligations, the constraints and the risks they may entail. Under this component, consumer information and disclosure norms[39] will be developed, and housing finance / mortgage literacy and awareness approaching for the Project's target income groups will be developed and rolled out at the QPLI level.

(d) Design, Implementation Support and M&E of Piloting

97. Under Component II, small scale Pilots will be conducted between NHB, experts and practitioners and QPLIs to test and prove sustainable business models, and related norms and guidelines, to overcome the challenges of dwelling informality. Component (I) finances the design/development, implementation support, and M&E of:

a. new types of housing loans that can be given in informal settlements, resulting in new norms and guidelines;
b. new forms of tenure that can be extended for in-situ housing (working with Governments/Municipalities), encouraging one of the most efficient and economical ways for low-income households to acquire adequate housing through granting of some form of tenure to in-situ settlements;
c. 'alternative' collateral that can be used for smaller loans for incremental housing purposes[40] as well as security (other than mortgages) that can be used for somewhat larger, longer term loans. New types of loans that cannot be secured by primary mortgages will imply the use of security methods alternative to mortgages, such as pledged savings, salary assignment, awards to regular payers, third or group party guarantees, pledge of movable goods, etc. NHB will take the lead to develop such products and encourage its piloting by QPLIs (under Component II).
d. The nature and scope of the subsequent Pilots will be defined after the first two Pilots.

(e) Impact assessment

98. Building upon and complementing NHB's M&E, this component will support an impact assessment to independently assess the social and household level impact of the Project.

(f) *NHB's parallel financing: Staffing, roll out, training and Operating Costs*

99. NHB will provide parallel financing for enhanced staffing, roll out (including training) as well as cover Operating Costs. The development of an up to now hugely underserved market segment requires an adjustment of NHB's capacity, as well as that of the Qualified Intermediary Institutions, and QPLIs. NHB's mandate has been up to now to promote the development of the mortgage market as a whole, especially through specialized HFCs. This objective has been mostly achieved. Addressing the market failure to provide finance for the housing of the low-

[39] For example, contracts have to be simple and in the borrowers' language
[40] SEWA Bank experience shows that many of these smaller, short term loans can be treated as any other micro-finance loan.

income and informal sector households, although not a new strategic orientation, requires revisiting NHB's resources in terms of size. Supporting small lenders and small size loans imply more work; skills lending standards setting, support to building norms; processes include support to grassroots FIs, refinancing of alternatively secured loans that imply new PLI qualification criteria, risk management policy, etc.

100. A time and cost bound business plan including this redeployment has been adopted by NHB. The Project will support its implementation as far as the promotion of low-income housing finance is concerned. Creating new capacity among financial institutions to serve low-income households involves a large diversity of situations: MFIs developing a new business line, newly created HFCs that have the necessary skills, well-established HFCs or banks willing to enter unknown commercial territory, etc.

101. Also, NHB's contribution will facilitate the roll out (including training) of new tools, instruments, norms and guidance (as developed under this component) within NHB and to Qualified Intermediary Institutions and PLIs.

Component II: ***Financial Support for Sustainable and Affordable Housing*** (US$97 million funded by IDA)

102. This Component will finance NHB to refinance, directly or indirectly through Qualified Intermediary Institutions, low-income housing loans made by QPLIs to Primary Borrowers to purchase, build or upgrade their dwelling. NHB takes the corporate credit exposure on the eligible primary lenders according to its policies and procedures. NHB has recently prepared a refinancing scheme for secured low-income housing loans to borrowers with formal and informal incomes. NHB will develop guidelines (to be formulated and reflected in the Project's Operations Manual) for the provision of alternatively secured housing loans to formal and informal borrowers. Refinancing guidelines to cover the right side quadrants will be prepared during the first year of the Project. Technical support will be used to innovate and mitigate the higher risk associated with the right side quadrants in Table 2. Retroactive financing will only cover loans which are eligible under NHB's lending criteria and are acceptable to the Bank (as described in the Project's Operations Manual) and have been disbursed since Project appraisal.

103. Refinancing on a Pilot basis will test innovations in loan products and processes suited to informal settlements as designed under Component I. The use of Component II for Pilots will be based on studies, an understanding of the legal and regulatory context and collaboration with state agencies to ensure that NHB provides appropriate guidelines. The Project's Operations Manual defines the volume and process for Pilot refinancing.

104. NHB will be the apex institution managing the Project, including this Component (II). NHB has the Government's mandate as the sole apex financial institution to promote, supervise and provide wholesale refinance for housing loans. NHB projects that by March 2015, its portfolio will have increased by approximately US$5 billion.[41] Over sixty percent of the underlying loan collateral refinanced by NHB is under Rs 5 lakh (~US$9,200) per loan in size. It

[41] See Annex 8, Baseline Survey of Primary Lenders (HFCs)

is also the same loan size that the Project will use initially as a proxy for the upper bound on underwriting the borrower's income under the Project. In larger urban areas, this loan size can afford only incremental housing, such as a new roof. In smaller towns such a sum may offer to buy a house. Monitor demonstrates that there are approximately 63 million[42] households in urban India which constitute demand for housing finance in the income range eligible under this Project.[43]

105. **NHB's Eligibility Criteria for QPLIs:** The design of this Component calls for on-lending through sound Qualified Primary Lending Institutions which have executed the 'Memorandum of Agreement' with NHB. This agreement is the contract for NHB's refinancing product with QPLIs. The certification process and continued participation in refinance from IDA funds throughout the Project will be based on NHB's risk management policy, which is consistent with international and national norms. This Component will refinance portfolios of sub-loans, up to 100 percent of value. NHB's refinancing will be done on a portfolio basis, according to NHB's guidelines.

106. NHB has rigorous eligibility criteria for primary lenders seeking to draw refinance; such criteria currently include:

a. Attain the minimum internal credit rating of 'C' to be eligible for financing from NHB. For this purpose, NHB has developed an internal credit rating model. In addition, HFCs are required to fulfill the following criteria:
b. Invest at least 75 percent of capital employed for long term finance for housing.
c. Have net owned funds of not less than Rs 10 crore.
d. Comply with provisions of the NHB Act, 1987 and the Housing Finance Companies (NHB) Directives, 2001 as amended.
e. Net non-performing Assets to net advances ratio of not more than 2.50 percent.
f. Capital adequacy ratio of 12 percent (NHB's regulatory norm).
g. Satisfactory financial performance according to supervision reports from NHB or other appropriate supervisor.
h. Three years audited financial statements, unqualified, annual audits.

107. NHB has eligibility criteria for MFIs and NGOs which seek to draw 'pre-finance'[44] from NHB. These PLIs, according to current criteria, should:

a. Have been in operation for at least three years.
b. Lend to primary borrowers which have successfully paid off at least three credit cycles with the MFI.
c. Recovery efficiency should exceed 95 percent.
d. If mortgage security is not possible, seek other security such as a third party or group guarantee.
e. Loan size limit: Rs 250,000 for new dwelling; Rs 100,000 for incremental housing.

[42] See Annex 11, Assessment of Supply and Demand for Low Income Housing Finance.
[43] See Annex 12, NHB Today.
[44] NHB recognizes that the smaller PLIs, primarily MFIs, do not have the balance sheet to originate and then distribute. Instead, NHB advances the funding to the MFI before it originates the retail mortgages.

108. Upon origination of the retail mortgages by microfinance institutions, the 'pre-finance' is transformed into a 'refinance' product, which becomes – at that time – eligible for Refinancing under this component.

109. Failure by a QPLI to meet these requirements and/or take remedial actions where needed would result in suspension of new commitments. If left unaddressed within a period set in the judgment of NHB, this may result in termination of eligibility for refinance.

110. In order to improve readiness for implementation and avoid delays, the financial institutions which are NHB's priority QPLIs for implementation of the Project have been identified, assessed and deemed likely to be eligible to access the financing under this Component. There are about 21 PLIs which use NHB's refinance product, and about 37 PLIs (including 20 MFIs or affiliates) which fund with NHB's pre-finance product. Of those PLIs, the subset which lends to households with informal income includes 5 PLIs which fund with refinancing and 20 which fund with pre-financing. There is no data on those MFI type PLIs which lend against 'alternative forms of collateral' (not secured lending). New QPLIs will be approved by NHB[45] during the Project.

111. NHB's Eligibility Criteria for Qualified Intermediary Institutions are essentially similar as its criteria for QPLIs. There are two additional eligibility requirements for Qualified Intermediary Institutions. First, since Qualified Intermediary Institutions will function at the wholesale level, they will need to demonstrate robust existing relationships with relevant QPLIs, including MFIs. Second, NHB will seek the World Bank's no objection before committing to refinance any Qualified Intermediary Institutions' loan portfolios.

112. Table 4 shows the segmentation of lower income households under Component II of the Project by the (in)formality of the borrower's income and the (in)formality of the dwellings. Initial allocations of Component II across these segments for the Project have been agreed, and are subject to change based on the Project's studies, pilots or any other factors upon review and mutual agreement by NHB and the Bank during the Project period and will be formulated and reflected in the Project's Operations Manual (POM).

Table 4: Segmentation of Project Component II by formality of income and property[46]

	Formal Dwelling	**Informal Dwelling**
Formal Sector Income	*Secured loans for home purchase or construction to salaried borrowers.*	*Loans secured using alternative collateral for home purchase or construction to salaried borrowers.*
Informal Sector Income	*Secured loans for home purchase or construction to informal sector borrowers.*	*Loans secured using alternative collateral for home purchase or construction to informal sector borrowers.*

[45] See Annex 12, NHB Today, for a description of NHB's risk management model.
[46] With a maximum borrower income across all 4 quadrants of Rs 200,000 per annum, equivalent to Rs 16,667/month.

113. **Project Primary Borrowers** will include low-income households as defined in Table 4 above. More specifically, the main criteria are as follows:

a. Income level of the primary borrowers: The Project took guidance from GoI's definition of 'Economically Weaker Section' (EWS) and 'Lower Income Group' (LIG).[47] These define urban low-income households for targeting of government programs. The upper limit for LIG has recently been reset by GoI to less than or equal to Rs 200,000 per year per household. The eligible income of the Project's Primary Borrowers will not exceed the income ceiling of Rs 200,000 per annum (or Rs 16,667 monthly income equivalent).[48] Informal sector income is defined as income from primary borrowers in the unorganized sector, which consists of all unincorporated enterprises owned by individuals or households engaged in the sale and production of goods and services operated on a proprietary or partnership basis with less than ten total workers, or borrowers who are self-employed. For the Project, the estimate of informal sector income for each borrower is determined by the QPLI in its underwriting process.
b. Size Limit on Sub-Financings: Housing loans made by QPLIs to primary borrowers (Sub-Financings) will be a maximum amount of Rs 500,000[49] (~US$9,100) and below, to be reviewed and amended according to mutual agreement between NHB and the Bank and reflected in the Project's Operations Manual.
c. Prudent lending requirements: (i) minimum down payment, typically 20 percent;[50] (ii) inclusion of simply stated income in loan applications, and evidence of income assessment by the lenders in case of non-salaried borrowers; (iii) verification of other obligations to avoid pushing borrowers in over indebtedness thanks to credit checks with Indian credit bureaus, and the history and debt situation of MFIs' customers, as the case may be.
d. Title requirements: two types of criteria will apply depending on the legal situation and nature of loans. (i) For secured mortgage loans, presumptive title formally registered will be required, subject to NHB's policy. (ii) When secured lending is not feasible, lenders will have to verify that their borrowers enjoy a minimum right of tenure in order to avoid legal challenge and loans to be lost following the eviction of borrowers. To be reviewed and amended according to mutual agreement between NHB and the Bank and reflected in the Project's Operations Manual.
e. Urban context: the Project is about offering options that are not widely available to slum and other sub-standard housing dwellers in an urban context. It is a demand driven approach, which excludes the provision of finance in forced resettlements.

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[47] The income ceiling is based upon the GoI memorandum on 'Revision of Income Ceilings for Economically Weaker Section (EWS) and Low Income Group (LIG),' dated November 14, 2012, indicating that the income ceilings for EWS and LIG have been revised upwards to Rs 100,000 per annum for EWS and Rs 200,000 per annum for LIG. This compares to the Rs 15,000 per household per month income cap in place during Project preparation. It is consistent with rising incomes and inflation since the threshold was set. To reflect new realities, this income targets can change upon mutual agreement between the Bank and NHB and be reflected in the Project's Operations Manual.

[48] Under the Project, 'household' income will be equated as borrower's income, including spouse. This simplifying assumption recognizes that QPLIs cannot and do not collect data on a household basis.

[49] in 2013 Rupees

[50] PLIs are currently required by regulation to limit loans to value ratios of a maximum of 80 percent. On the PLI loans to the primary borrowers, the remaining 20 percent may be financed in cash or in kind by the sub-borrower or by third party sources.

Investments in such housing Projects will not be eligible. To be reviewed and amended according to mutual agreement between NHB and the Bank and reflected in the Project's Operations Manual.

f. Procurement procedures: The component is a FIL with the low-income households as the ultimate sub-borrower. Purchases of works, goods and services will be for small amounts, typically range from several hundred to several thousand US$ equivalent (in a minority of cases). The IDA Credit will not be used to refinance the purchase of raw land. Regarding construction safety in seismic zones, self-constructed, incremental improvements above a single level (vertical build) will not be eligible for refinancing under the Project, unless structural soundness is acceptable to the PLI's engineer, according to the Environmental and Social Assessment due diligence matrix.

114. The Project design at this stage does not envisage any further targeting of primary borrowers other than described above, and will be driven by market considerations, credit worthiness of sub-borrowers, and presence of QPLIs on the ground. Nevertheless, QPLIs will also be encouraged to stimulate demand where the likelihood of success is the greatest and expected rates of return highest. This would include inter alia urban and areas where: (a) poverty is high and concentrated; (b) economic activities are relatively vibrant and the poor are likely to have reliable sources of income; (c) urban renewal plans are being implemented in poor areas[51] so as to improve access to basic infrastructure, strengthen property rights and issue land titles, etc.; (d) the policy environment at urban level addresses issues raised in the outset of the PAD and is conducive to success; (e) potential for economies of scale exists; and (f) the zone is a PLI's target areas, as per its business plan. In order to ensure that the Project works well in the first year of implementation, a number of states (e.g. Rajasthan) in which the housing authorities have been more progressive in providing affordable serviced land for low-income, residential use will be prioritized by NHB for refinancing of QPLIs under the Project.

115. **On-lending arrangements***:* The IDA refinancing will be made available in US$ by the GoI to NHB under terms and conditions identical to that of borrowing from IDA. The resources will be on-lent to QPLIs in local currency and at variable rates based on a margin that reflects cost of these funds, foreign exchange risk/hedging cost and other expenses as well as a small management fee of one percent to cover NHB costs. Sub-Financings (loans from QPLIs to the eligible Primary Borrowers) will be in local currency with a fixed or variable interest rate, as determined by the QPLI. No interest subsidy is envisaged for the Primary Borrowers under the Project, even if some Primary Borrowers may benefit from interest rebates under existing GoI schemes. More detailed information on onlending arrangements is provided below.

116. **Proposed IDA Funding**[52]: Under component II for low-income housing finance, the IDA credit will be flowing to NHB through GoI. The cost to NHB will inter-alia include interest payable to World Bank, and the cost of hedging the currency risk. The total cost to NHB will be approximately 7.25 percent p.a., subject to market conditions, especially the premium for SDR hedging. The net end to end cost benefit under IDA funding will be about 2.5-3 percent, and

[51] Information about and coordination with relevant government and donor initiatives will thus be essential.

[52] These estimates are based on the present market conditions and the actual cost to NHB and the Primary Lending Institutions and Beneficiaries will depend on the market condition at that time.

fixed rate. NHB can use these savings to cover higher operating costs, fund capacity building and/or pass on to the QPLIs. The QPLIs can keep this benefit to compensate due to small loan size. The end cost to the primary borrowers will be market rates.

Component III, *Project Implementation* (US$1 million, funded by IDA)

117. A Project Implementation Unit (PIU) will be set up within NHB to help implement the Project, carry out monitoring and evaluation, be responsible for legal issues and grievance redressal, overseeing and monitoring the social and environmental 'due diligence' (including conducting annual third party audits of QPLIs), keeping the Project's Operations Manual updated, and financial management and carry out any procurement necessary under the Project. Low-income housing expertise will also be added to the PIU to provide technical inputs to the procurement of consultants' services under Component I. The PIU will be staffed by a combination of reassigned and new NHB staff and consultants' services. NHB will provide parallel financing of US$0.5million covering NHB staff for PIU management, M&E, legal, grievance redressal, and financial management functions as well as tasks including the organization of training, roll out of social and environmental guidelines (e.g. literacy training). External communications on the Project would also be covered by NHB staff. Lastly, NHB would also take on responsibility for dissemination and communication activities under its own budget, such as conferences or workshops.

Annex 3: Implementation Arrangements

Institutional and Implementation Arrangements

118. NHB will be the implementing agency for all three Components of the Project.[53] A PIU composed of the appropriate mix of management capacity, one procurement specialist, one social and one environmental expert, and an appropriate mix of staff to fill M&E, legal, grievance redressal, training coordination and financial management functions as well as senior specialists will be responsible for the day-to-day running of the Project. It will draft the Terms of References (TORs) to commission consultants' services to deliver the activities of the Capacity Building Component and complement NHB staff in the PIU. Other development partners have expressed interest in supporting similar demand side low-income housing projects, with NHB as the implementing agency. In this case, as discussed with NHB, DfID and KfW, a single PIU would be the preferred option.

119. To enhance distribution of housing finance under this project, NHB can work with Qualified Intermediary Institutions, which are institutions refinancing underlying loan transactions between QPLIs and Primary Borrowers. Some of the Primary Lending Institutions on NHB's Panel have relationships with specific segments of PLIs (primarily MFIs). As Qualified Intermediary Institutions, these QPLIs take up a wholesaler role, in which the flow of funds would go from NHB to a Qualified Intermediary Institution to QPLIs to Primary Borrowers.

120. There are other banks and institutions which have relationships with specific segments of PLIs, which NHB will work with as technical partners or service providers. For example, SIDBI is a successful state owned apex financial institution, which channels funds to MFIs and SMEs. NHB will partner with appropriate institutions to enhance distribution of housing finance under this project, given their relationships with MFIs or other entities who touch the target households under this project.

Governance and Accountability Action Plan (GAAP)[54]

121. NHB's Corporate Governance environment is defined in the NHB Act, 1987 read with the NHB General Regulations, 1988 and NHB Employees (Discipline and Appeals) Regulations, 1994. The overall management vests with the board of directors. The NHB Act read with the NHB General Regulations define the composition of the Board,[55] the term of office of the

[53] The ownership of NHB, which is a subsidiary of, and is regulated by, RBI, is expected to change in the near term. NHB currently regulates and supervises HFCs. Before Parliament is an amendment to the NHB Act which would transfer ownership of NHB from RBI to the Ministry of Finance (MoF), which would resolve the conflict of interest of RBI as both the owner and regulator of NHB. In addition, NHB will supervise HFCs; RBI will regulate HFCs. This will resolve the conflict of NHB being both the promoter and regulator of HFCs. The ownership of NHB, which is a subsidiary of, and is regulated by, RBI, is expected to change in the near term. NHB currently regulates and supervises HFCs. Before Parliament is an amendment to the NHB Act which would transfer ownership of NHB from RBI to the MoF, which would resolve the conflict of interest of RBI as both the owner and regulator of NHB. In addition, NHB will supervise HFCs; RBI will regulate HFCs. This will resolve the conflict of NHB being both the promoter and regulator of HFCs.

[54] See Annex 9, for the full GAAP.

Chairman and Managing Director (CMD) and other directors, frequency of the board meetings, and the board process. The tenure of the Directors (other than the CMD) is generally three years. Three committees of the Board have been constituted and are functional. Executive Committee (EC) has the powers to transact all usual business of NHB except matters that have to be dealt with by the Board. Primarily, the EC approves all financial proposals, reviews various reports including control returns and the MIS and approves the appointment of the internal/concurrent auditors. The EC comprises of 5 Directors – the CMD, 2 Directors from RBI, 1 Directors from GoI and 1 Independent Director. Audit Committee and Remuneration Committee: that decides the incentive for the CMD in terms of the direction of the GoI.

Results Monitoring and Evaluation

122. **NHB will maintain robust monitoring and evaluation systems**. The management information processes of the Project will be part of the PIU's responsibilities, but will rely upon NHB's existing systems. The Monitoring System will track performance indicators, scheduling and implementation related data, and expenditure as shall be agreed within the framework of the annual work plan and budget. NHB will provide quarterly implementation reports. The team responsible for the M&E system of this Project will be composed of two staff, will report to the Chairman and Managing Director, and will work closely with the PIU. The complete Results Framework is provided in Annex I.

123. **The project will conduct an Impact Evaluation**, with the objective of determining whether the low-income households who borrow from the QPLIs are better off thanks to access to finance under the Project (and are not worse off due to over-indebtedness) compared to similar households who had no access to formal low-income housing finance. As part of the evaluation, beneficiaries will be surveyed before and after they receive assistance under the project to assess changes in their housing situation and other relevant outcome indicators, such as possibly health indicators and employment and income-earning opportunities.

Sustainability

124. This Project is designed to be sustainable by designing a replicable financing model and building the capacity of the wholesale and retail lenders. New loan standards and technical assistance products will provide guidance to the market on ways to include informal borrowers and informal dwellings in formal finance. Long-term effect of the project will be to bring the MFI/NGOs (alternatively secured lenders) up market and HFCs and banks (secured mortgage lenders) down market to serve the previously underserved segments of the market.

Financial Management

125. **Overall Conclusions from Financial Management Assessment**: The Project will be implemented by a financial intermediary, NHB, which will provide funding support to eligible QPLIs (directly or through Qualified Intermediary Institutions (QIIs)) by way of refinancing of their housing loans to eligible end borrowers. NHB would be the nodal agency responsible for overall Project Financial Management (FM) arrangements. A FM assessment of NHB, conducted in accordance with Bank's Operational Policy 10.02, indicates that NHB has robust FM systems

and defined systems for controls and oversight, including ensuring end use of funds over the loans provided to PLIs. The present FM systems at the level of the principal implementing entity (NHB) are adequate for financial reporting and oversight on the Project funds. Accordingly, the guiding principle would be that Project FM arrangements would rely on and be aligned with the systems established within NHB, including NHB's oversight mechanisms for assurance on end use of funds by the PLIs. The Project's FM arrangements including funds flow, accounting and reporting, controls, disbursement, and auditing have been outlined in a Project Operations Manual (POM).

126. NHB's main responsibilities/accountabilities under the Project will include FM functions, managing the finances in respect of the Capacity Building and Project Implementation components of the Project, accounting, providing financial reports in the formats agreed, and providing overall fiduciary assurance over proper and efficient use of the proceeds. For coordination, NHB will designate an officer of the rank of Deputy General Manager and above to be the dedicated nodal person for the Project, who will be supported by a FM officer from within NHB.

127. NHB's capacity to appraise the FM systems of the PLIs was also assessed. NHB appraises the FM systems of the PLIs in general and the Management Information Systems (MIS) and internal audit systems in particular. About 95 percent of the present refinancing portfolio of NHB is directed towards HFCs that are under regulatory supervision of NHB and SCBs that are under regulatory supervision of the RBI[56] and the balance to cooperative and other institutions. HFCs and SCBs generally have adequate FM arrangements. It is expected that NHB would focus on PLIs serving the housing finance needs of low-income households and will increase lending to PLIs including HFCs and SCBs, MFIs, NGOs and cooperative agencies under the Project. NHB's present exposure to MFIs and NGOs is limited and therefore there is a need to develop and operationalize guidelines and operating parameters in order to scale up under the Project.

128. NHB has developed a Special Refinance Program for Urban Low Income Housing, approved by its Board, applicable to lending in respect of formal dwelling segment (left side of the Project indicative allocation quadrants). During project implementation, NHB will develop the financing programs for the informal dwelling segment (right side of the Project indicative allocation quadrants) based on consultations with stakeholders and the pilots. The programs will be reviewed by the Bank for acceptability and controls and included in the POM. For the sub-loans under the Project, NHB would appraise the FM arrangements in the PLIs and detail the conclusions in the appraisal note put up to the competent authority for sanction. These procedures are already imbibed in NHB's appraisal systems. In case of any material weaknesses in the PLI's ability to account for and report upon Project funds, NHB would agree with the PLI a timed-lined action plan that would form part of the terms and conditions of the sanction of the sub-loan to the PLI.

[56] Additionally listed HFCs and SCBs are also monitored by the Securities and Exchange Board of India

Budgeting and Counterpart Funding

129. DFS, which is NHB's administrative line department, will have to make an annual allocation in its Demand for Grants to pass-on to NHB the IDA funds for the Project as per standard procedures of the GoI. NHB will also seek an advance, on the basis of forecasts for six months, and thereafter seek reimbursement from the World Bank through IFRs. The modalities for passing project funds from GoI to NHB on back-to-back arrangements and other terms including interest rate, foreign currency risk will be captured in a subsidiary lending agreement.

Flow of Funds

130. DFS will receive funds from IDA and will pass these on to NHB which will be deposited in a bank account designated by NHB. NHB would use these funds for meeting the expenditure for Project activities under the institutional capacity building and piloting activities and for extending refinancing – directly or indirectly through Qualified Intermediary Institutions – to eligible PLIs as sub-loans based on their approvals appraised in accordance with the Project's Refinance Policy. Releases to Qualified Intermediary Institutions or QPLIs will be based on actual list of end primary borrowers which meet the eligibility criteria as described in the agreed POM.

Accounting

131. NHB would account for all sources and uses of Project funds under the three components on its existing SAP in accordance with its extant accounting system, policies and procedures which is documented in an Accounts Manual. NHB follows accounting on commercial principles which is based on accrual and double-entry system under defined chart of accounts and accounting policies following applicable accounting standards issued by the Institute of Chartered Accountants of India and prudential norms stipulated by RBI. The IDA credit and the assets created/expenditure incurred would be allocated in separate general ledger codes to facilitate capturing the sources and uses of Project funds and which will also help in distinguishing transactions from other credit lines.

Internal Controls and Internal Audit

132. NHB has a formal system of internal controls characterized by Board approved policies supported by manuals; approved comprehensive delegation of powers, segregation of responsibilities through functionally dedicated departments; decisions taken through various committees; centralized payments through Mumbai and centralized accounting at Delhi; a system of periodical reporting to the Board/committee and RBI. These have been assessed to be satisfactory and would be applied to the Project also. The Refinance Policy of NHB details the approval process for sub-loans to PLIs.

133. NHB has Board approved policies and procedures for management of risks faced by financial institutions including credit, liquidity, interest rate and foreign exchange risks. NHB has instituted formal systems for identification and management of risks through risk management committees (there is an apex level Risk Management Advisory Committee and

other domain specific committees) and periodic reporting to the Board and its committees and RBI on all functions of NHB as a financial institution. NHB follows the prudential norms prescribed by RBI that include norms for resource raising, disclosure in the annual financial statements, credit exposure limits and identification, income recognition and asset classification of Non-Performing Assets (NPAs) and provisioning thereon and provisioning on investments.[57]

134. Internal Audit in NHB is under the Risk Management Department and is outsourced to private audit firms appointed by the Executive Committee. There is an Internal Audit Manual containing suggested checklists and sample coverage for all operations of NHB. Internal audit covers the head office quarterly and Mumbai office on a monthly basis. There is an Audit Committee of the Board that has oversight over internal and external audit functions. Internal audit would cover the Project transactions in accordance with the terms of reference to be agreed with the Bank in the POM. These reports would be made available to the Bank on request and could also be reviewed during missions. In case the internal auditors make any adverse comment in respect of the Project transactions, NHB will forthwith inform the Bank along with a timed-line plan for its resolution.

Controls over Loans from NHB to primary lenders

135. A Board approved policy governs refinancing and separate sub policies for different categories of borrowers are in place for NHB's existing lending operations. The policy lays down the procedures of appraisal, sanctions and monitoring as well as eligible PLIs and purposes. The policy is administered by Refinance Department and Direct Finance Operations Department. NHB has established an adequate and elaborate system of appraisal and monitoring, including Internal Risk Rating[58] and Credit Inspection.[59] Appraisal is centralized at the head office and all refinance proposals need sanction of the Internal Credit Committee/Executive Committee, as per Board approved delegation of powers[60] depending upon the quantum of loan sanctioned. End use of funds is ensured through a combination of utilization reports certified by the borrower or annual/bi-annual certification of end use and eligibility of loans by the borrower's statutory auditors, flagging of specific individual loan accounts/earmarking a pool of loans, and Credit Inspection. These systems would be adopted for the sub-loans. NHB has developed a Special Refinance Program for Urban Low Income Housing, approved by its Board, that will be applicable to the Project for proposals with underlying formal dwelling, under NHB's overall Refinance Policy. Based on the Pilots, capacity building and/or stakeholder consultations, NHB will develop the scheme for proposals with underlying informal dwelling that will be reviewed by the Bank and included in the POM during project implementation.

136. Additionally, in respect of a QPLI to whom a sub-loan under the Project is proposed to be extended, NHB would specifically appraise the adequacy of the FM arrangements of the QPLI and detail the conclusions in the appraisal note put up to the competent authority for sanction, particularly in case of PLIs approaching for the first time to NHB for financial assistance. NHB

[57] These are available in the form of Master Circulars issued by RBI
[58] Internal Risk Rating is done by the Risk Management Department through a Rating Committee and is independent of the credit department.
[59] Conducted by the Refinance Operations Department annually
[60] In case of any deviation in the proposal from the Board approved policy, the proposal goes to the Board for sanction

would define the contours of an adequate FM system, which would include the following suggested parameters: (i) availability of up to date audited accounts; (ii) no significant unresolved observations from the earlier and current audit reports;[61] (iii) existence of an established and defined accounting system maintained on principles generally accepted in India; (iv) a defined and working internal control system; (v) an established system of internal audit;[62] and (vi) defined and operational fund tracking and end-use reporting mechanisms from MIS. In case of any material weaknesses in the PLI's FM systems, NHB would agree with the QPLI a timed-lined action plan that would form part of the terms and conditions of the sanction of the loan to the PLI. Each QPLI would provide a list of end primary borrowers to whom the QPLI has extended loans out of the sub-loans. This would be audited by the statutory auditors of the QPLI certifying that the cases covered meet the eligibility criteria.

137. These aspects are currently assessed by NHB for its existing lending proposals and would specifically be covered. Supporting loan documentation, including appraisal notes, sanction letters, end-use certificates, visit reports, and other documentation will be retained by NHB and made available to the Project external auditors during their audit and to the Bank for review during Project implementation support missions.

Financial Reporting

138. The reporting framework for the Project will consist of a quarterly IFR prepared by NHB in a pre-agreed format and submitted to the Bank within 45 days from the close of the quarter. The IFR format is included in the POM. IFRs will be prepared based on NHB's mainstream FM and MIS systems. Expenditure to be reported will be the actual amount of sub-loans disbursed to the PLIs, and other Project expenditure incurred and paid for (that is, advances and liabilities will not be claimed as expenditure). The IFRs will include, at a minimum, the following aspects for the period under reporting and cumulative to date: sources and application of Project funds component-wise; cash forecasts for following six months, list of sub-loans to the QPLIs giving details such as the names of QPLIs, date of sanction and each disbursement, amount released, and type and purpose of the facility (segment-wise for each of the four segments in the Project indicative allocation quadrant). Besides, to establish the usage of funds for intended purposes, complete lists of the end primary borrowers of all PLIs covered under the reporting period and reported in the IFR will be appended to the IFR. *For the Project, NHB would ensure that all QPLIs/QIIs submit complete list of end borrowers to support this aggregated reporting.* NHB will also prepare annual Project Financial Statements (PFS) and have these audited by independent auditors.

External Audit

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[61] Additionally, Regulatory Inspection Reports conducted by NHB in case of HFCs; Annual Financial Inspection Reports conducted by RBI in case of SCBs; Annual Inspection Reports of NABARD in case of cooperative banks would be reviewed

[62] For existing PLIs with more than three years of operations, an internal audit system will be required. For relatively new PLIs, if an internal audit system does not exist, a clear time-bound plan to establish this will be required.

139. The PFS will be audited by independent auditors acceptable to the Bank[63] and in accordance with terms of reference to be agreed with the Bank. The fee for Project audit will be reimbursable under the Project if procured in accordance with agreed procurement arrangements and as decided by NHB The Project auditors will provide their professional opinion on the true and fair view of the financial statements and additional opinion on (i) adequacy of the Project accounting and internal control systems, (ii) adequacy of documentation to support claims to the Bank, (iii) eligibility of expenditures, (iv) end use of funds by undertaking a detailed review of the sub-loans advanced to QPLIs; and (v) whether procurement made by NHB under the Project is as per agreed norms/Bank guidelines. The auditors will also submit a Management Letter with each audit report.

140. NHB will put up the audited Project financial statements before its Audit Committee/Board and place these on its website. NHB will also share the entity audited annual financial statements with the Bank. The following audit reports will be monitored in the Bank's Audit Reports Compliance System (ARCS) (Table 5).

Table 5: Audit Reports

Agency	Audit Report	Auditor	Due Date
NHB	Audit Report of the Project Financial Statements for each financial year	Independent auditors acceptable to the Bank	Within six months from the close of the financial year
Department of Economic Affairs (DEA)	Special Account	Comptroller & Auditor General of India	September 30

FM Supervision Plan

141. The Project would need a high degree of supervision during the initial stages of implementation, particularly in terms of application of agreed FM arrangements and compliance with the POM. During implementation support missions, the Bank team will review a sample of PLI cases included under the Project.

A. Disbursements

142. NHB will seek an initial advance on the basis of cash forecast (following six months) and thereafter a rolling advance will be provided on the basis of quarterly IFRs which will depict actual expenditures under the project and cash forecasts, from the Bank through the office of CAAA, GoI.

[63] The entity financial statements of NHB are audited by a private audit firm (chartered accountants) appointed by RBI. NHB may propose its statutory auditors as the Project auditors or appoint another private audit firm (in accordance with Bank guidelines). In both cases, the auditors should be acceptable to the Bank.

Expenditures Eligible for Disbursement

Table 6: Eligible Expenditures

Component	Eligible Expenditure	Conditions for Eligibility for Disbursement
Component 2	Amount of sub-loans actually made to eligible QPLIs/QIIs during a reporting period	The Sub loan facility is appraised, sanctioned and disbursed as per the POM; the funding to QPLIs/QIIs is recorded in the books of account of NHB under account codes pre-defined for the Project. NHB will maintain subsidiary records for each sub-loan. Monitoring end use of funds and compliance with the terms of sanction will continue to be undertaken on an ongoing basis by NHB as per Refinance Policy. NHB would provide to the Bank complete list of end primary borrowers against which the QPLIs/QIIs have availed the loan facility.
Component 1 (Capacity Building) and 3 (Project Implementation)	Expenditure incurred and paid for	Expenditure should be duly approved as per NHB's delegation of authority, evidenced by supporting documentation, be incurred for the Project, should not have been claimed from any other source, and recorded in the books of account under account codes pre-defined for the Project.

143. *Retroactive Financing* will be available as per Bank guidelines, to the extent of 10% of the IDA Credit in respect of refinance cases made by NHB between close of appraisal (i.e. February 25, 2013) and a day prior to signing of the legal agreements. NHB will submit a separate stand-alone IFR certifying the actual eligible expenditure incurred/sub-loans made on the Bank Project. NHB will ensure and certify that the due diligence of the QPLIs/QIIs included in this IFR has been done in terms of the POM and that the QPLIs/QIIs have met the minimum access criteria for eligibility for obtaining finance from NHB, before funds were released to them.

144. IDA funds will be disbursed against eligible expenditure through the following categories subject to the allocated amount and the disbursement percentage as indicated in the Project Operations Manual (regarding the initial allocation of Project Component II by formality of income and property) and the table below.

Table 7: Categories of Eligible Expenditures

Disbursement Category	Amount of the Credit Allocated (million US$)	Amount of the Credit Allocated (expressed in SDR)	% of expenditures to be Financed (inclusive of taxes)
Refinancing under Component 2	97	64,120,000	100%
Goods, works, and consultants' services and training and Operating Costs under Component 1 and 3	3	1,980,000	100%

B. Procurement

145. Procurement for the proposed Project would be carried out in accordance with the World Bank's 'Guidelines: Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers' dated January 2011 (Procurement Guidelines); and 'Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers' dated January 2011 (Consultant Guidelines) and the provisions stipulated in the Financing Agreement.

146. For each contract to be financed by the Credit, the different procurement methods or consultant selection methods, the need for prequalification, estimated costs, prior review requirements, and time frame are agreed between the Borrower and the Bank Project team in the Procurement Plan. The Procurement Plan will be updated at least annually or as required to reflect the actual Project implementation needs and improvements in institutional capacity.

147. **Procurement Plan and Procurement Arrangements**. Procurement Plan for the first 18 months of the Project, has been prepared by NHB, and is attached as Annex 6. This plan will be updated annually to reflect the latest circumstances. All the Procurement activities will be carried out by the NHB.

148. Procurement of Works: If by mutual agreement between NHB and the Bank, works are to be procured under the Project, then procurement arrangements will be made at that time.

149. Procurement of Goods: Goods procured under this Project would be for small value and may include office equipment, computer system etc. While some software being proprietary in nature will be procured by direct contracting, other goods and software will be procured by National Competitive Bidding (NCB), and shopping and or using Directorate General of Supplies & Disposals (DGS&D) rate contract within shopping threshold.

150. The NCB Standard Bidding documents of the Bank as agreed with GoI task force (and as amended from time to time) will be used for Procurement of all NCB Goods. Presently there are no large value procurement proposed and hence no International Competitive Biddings (ICBs) are planned.

151. Selection of Consultants: For selection of institutional Consultants for providing services, the Project will use Quality and Cost Based Selection (QCBS), Quality Based Selection (QBS), Selection based on Consultants' Qualification, Fixed Budget Selection (FBS), Least Cost Selection (LCS), Single Source Selection (SSS), and Selection of Individual Consultants as appropriate, subject to approval by the Bank.

152. Short lists of consultants for services estimated to cost less than US$800,000 or equivalent per contract may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines. The Bank's Standard Request for Proposal Document (SRFP) will be used as a base for all procurement of consultancy services to be procured under the Project.

153. Training: Training will cover study tours, workshops, training for staff, etc. These shall be carried out in accordance with Project implementation plan prepared by NHB and agreed with the Bank.

154. The procurement of any goods and consulting services from any government department/agency which does not fulfill provisions of Para 1.10 (b) of Procurement Guidelines and Para 1.13 (b) of Consultant Guidelines, if any, will not be eligible for the Bank financing. Also procurements from IFC would not be financed from the Project funds. During implementation if such requirements arise, those will be financed from the Government's own resources.

155. Under Component 2, which is the bulk of the Project funding, this constitutes refinancing by NHB to primary lenders and entities who will on lend to the individual primary borrowers small loans (around Rs 2 - 5 lakh) for use in their small project of upgrading, maintenance, or new construction works or the purchase of a dwelling. The QPLIs have internal control mechanisms to verify that the funds are used for the intended purposes and properly established as part of financial audits.

156. The houses are constructed following direct cash transfer to the primary borrowers and no procurement is involved.

Assessment of the agencies' capacity to implement procurement

157. All the procurement would be carried out by the NHB.

158. **Given the low capacity and overall risk environment in Government**, the procurement risk (prior to mitigating measures) is assessed as 'High', which will be changed to 'Moderate', depending on the risk mitigation measures implemented by NHB. The mitigation measure includes the inclusion of an external procurement professional in the PIU. The procurement plan for the Project has been finalized. It will be updated at least annually (or as required) to reflect Project implementation needs and improvements in institutional capacity.[64]

159. **Prior-Review Thresholds**: The following methods of procurement and prior review thresholds shall be used for procurement under the Project (Table 8). It has been agreed that if a particular invitation for bid comprises of several packages, lots or slices, and invited in the same invitation for bid, then the aggregate value of the whole package determines the applicable threshold amount for procurement and also for the review by the Bank.

Table 8: Procurement Guidelines

Category	Method of Procurement	Threshold (US$ Equivalent)	Prior Review threshold***

[64] More details are available in the Project files.

Works	NCB	> USD 50,000	First contract irrespective of value and all contract more than USD 250,000
	Shopping	Up to USD 50,000	First contract irrespective of value
	Direct	As per Para 3.7 of the Bank Guidelines, wherever agreed and with prior agreement with the Bank irrespective of value	All contracts irrespective of value
Goods and Non-consultant services	ICB	>1,000,000	All Contracts
	LIB	wherever agreed and with prior agreement with the Bank	All Contracts
	NCB	1,000,000 or less	First 2 contracts irrespective of value and all contracts more than 500,000
	Shopping	Up to 30,000	NA
	DC	As per Para 3.7 of the Bank Guidelines, wherever agreed and with prior agreement with the Bank irrespective of value	All contracts estimated to cost more than USD 5,000
Consultants' Services	QCBS/QBS/ FBS/LCS	As per requirement Shortlist may comprise national consultants only if estimated cost Up to 800,000	First two contracts irrespective of value and all contracts more than USD 500,000
	SSS	with prior agreement of the Bank	All contracts irrespective of value estimated to cost more than USD 10,000
	Individuals	No limit	All contracts estimated to cost 100,000
	Use of NGO	As per Para 3.16 of Guidelines	
	CQS	Up to 300,000 per contract	

*** *The Prior review thresholds will be reviewed during the implementation of the Project and based on the assessment the thresholds would be modified suitably.*

160. Complaint Handling Mechanism: To deal with the procurement complaints received by NHB, a complaint handling mechanism for the Project will be developed and published in the website. On receipt of complaints, immediate action will be initiated to acknowledge the complaint and redress in a reasonable time frame. All complaints will be dealt at levels higher than that of the level at which the procurement process was undertaken. Any complaint received will be forwarded to the Bank for information and the Bank will be kept informed after the complaint is redressed.

Risks and Mitigation Measures:

161. Procurement risk for the Project is assessed as 'High', to be changed to 'Moderate' given implementation of the following measures (agreed) to mitigate the risks:

a. A Procurement Specialist will be hired by NHB full or part time, depending on need. Prior and post review arrangements will be put in place with enhanced monitoring arrangements including establishment of a Procurement MIS. A Complaints and Dispute Resolution Mechanism will be developed and put in place as part of the Procurement system.
b. Disclosure: The following documents shall be disclosed on the NHB website [if there is no website then, in the notice board of agencies]: (i) procurement plan and updates, (ii) invitation for bids for goods and works for all ICB (if any) and NCB contracts, (iii) request for expression of interest for selection/hiring of consulting services, (iv) contract awards of goods and works procured following ICB/NCB procedures, (v) list of contracts/purchase orders placed following shopping procedure on quarterly basis, (vi) short list of consultants, (vii) contract award of all consultancy services, (viii) list of contracts following DC or CQS or SSS on a quarterly basis, and (xi) action taken report on the complaints received on a quarterly basis.
c. The following details shall be sent to the Bank for publishing in the Bank's external website and United Nations Development Business (UNDB): (a) invitation for bids for procurement of goods using ICB procedures (if any), (b) request for expression of interest for consulting services with estimated cost more than US$ 300,000, (c) contract award details of all procurement of goods and works using ICB procedure, (d) contract award details of all consultancy services with estimated cost more than US$ 300,000, and (e) list of contracts/purchase orders placed following SSS or CQS or DC procedures on a quarterly basis. Further NHB will also publish in their websites, any information required under the provisions of suo moto disclosure as specified by the Right to Information Act (RTI).

162. **Post Review by the Bank**: All contracts not covered under prior review will be subject to post review during supervision missions, and/or review by consultants to be appointed by the by Bank.

163. **Frequency of procurement supervision:** Given the small number of contracts and the general risks involved, a minimum of two implementation support missions a year is planned. In addition, the Bank will also carry out an annual ex-post review of procurement that falls below the prior review threshold. The Bank will also carry out small thematic and focused Missions depending on the need and as required with agreement from the Project.

C. Environmental and Social (including safeguards)

164. This is a category FI project. The Social and Environment Assessment (SEA – Social and Environmental Assessment) provided guidance to ensure that the proposed objectives, components, strategies and activities of the Project are socially-sound and acceptable to key stakeholders, particularly the poor and vulnerable economic groups that are its key focus. The SEA contains an analysis of the current housing options of these low-income groups, the need for and availability of housing finance to them, the housing improvements they are likely to make, and a typology of housing situations based on title, tenure, right to sell, and zoning. The

SEA also includes a stakeholder analysis and profiles of potential borrowers among vulnerable groups. It identifies the social risks to the project (including those mentioned in para 84 and others such as over-indebtedness, social exclusion, criminality and rent-seeking behavior), and suggests risk mitigation measures. The consultants reviewed and analyzed current finance-related policies for this sector, MFI regulations and Code of Conduct, the Project Finance Policy of NHB, and guidelines, norms and practices followed by PLIs to provide housing finance to the targeted primary borrowers (EWS and LIG). The SEA included a large survey of stakeholders and several stakeholder consultations whose involvement has helped to develop operational guidance for Project design, implementation, and M&E. The consultants suggested design features for the proposed Project, including implementation arrangements, organizational responsibilities and institutional capacity building requirements, and M&E processes, and actions that need to be taken during implementation to ensure social sustainability.

165. The PIU in NHB will have at least one Social Specialist who will be responsible for overseeing and monitoring the social 'due diligence' of the Project. This would be done by (i) ensuring implementation by PLIs of guidelines; (ii) capacity building of PLIs, and by PLIs of borrowers (financial literacy training); (iii) regular periodic interactions/meetings with all PLIs, and Qualified Intermediary Institutions, to review the problems they face and their constraints; (iv) regular quarterly reporting of progress, issues identified and solutions implemented; these reports will be made available to the Bank during six-monthly Implementation Support missions.

166. **Social Safeguards. OP 4.10** is not triggered as the Project would refinance housing loans extended by PLIs to urban individuals. While some individuals may be identified as 'tribal' in the Indian context on the basis of cultural identity or language, at least one of the four characteristics defining Indigenous Peoples in O.P. 4.10, i.e., 'collective attachment to geographically distinct habitats or ancestral territories...and to the natural resources...' would not apply to such borrowers, and most likely the characteristic of customary institutions would also not be in place. **O.P. 4.12** is also not triggered as no involuntary resettlement is expected as the housing loans would be provided to individuals who have evidence of tenure and are voluntarily making improvements to their dwellings. Bank funds would not lead even indirectly to slum clearance for construction as the credit would only be used by NHB to refinance PLIs making housing loans to individuals. As part of prudent lending practices NHB's loan appraisal guidelines to PLIs call for them to ensure that no one would be displaced on account of construction undertaken with the loans. This provision will be included in capacity building of PLIs and financial literacy of borrowers. Evidence of tenure will be required to support finance for renovation or expansion of current dwellings (incremental housing). The provision of refinancing of loans to people who are known to have been involuntarily resettled to their current location in the past, or of loans to finance construction in settlements which are, according to the PLI's risk management, likely to be involuntarily resettled in the near future, will not be permitted.

Annex 4: Operational Risk Assessment Framework (ORAF)

Appraisal and Post Appraisal Package Version[65]

Table 9: ORAF

Project Development Objective(s)	
To provide access to sustainable housing finance for low-income households to purchase, build or upgrade their dwellings.	
PDO Level Results Indicators:	• The increased number of primary lenders (eligible for refinance from NHB) active in the EWS and LIG segments. • The increased volume of lending in the EWS and LIG income segments by primary lenders which are eligible for refinance by NHB. • The annual percentage increase in the number of borrowers in the EWS and LIG income segments receiving loans from primary lenders which are eligible for refinance by NHB. • The percentage of replacements of non-performing with performing sub-loans by the QPLIs required for pools of loans which have been refinanced by NHB.

Risk Category	Risk	Risk Rating[66]	Risk Description	Proposed Mitigation Measures	Timing for Mitigation:

[65] This is the version that should be used for Appraisal stage for Track 2 as well as for seeking clearance by management for Track 1 to move forward with negotiations.

	Rating	Explanation			Prep/Implementation[67]	
1. Project Stakeholder Risks						
1.1 State governments, Self Help Groups and their Federations, Microfinance Institutions -- Housing Microfinance Providers 1.2 Low Income Households, informal sector households	M	1.1 Possibility of debt waiver, given legacy of interference; high impact (due to harm to credit culture)	1.1 Due to local political dynamics, competing sources of credit may force out formal housing finance channels. 1.1 State level loan repayment waivers risk harming the culture of repayment that is the backbone of access to finance by low-income and economically weak households 1.2. Their informality, mobility, and migration into urban areas, into slums and informal settlements. Long-term Financial/mortgage products must be developed that will address the difficulty of assessing their credit worthiness and the volatility of income.	1.1 Build market infrastructure to reduce the incidence of over-indebtedness, define prudent lending standards, monitor individual lenders' performance with incentive to keep quality of lending high-for instance, impact on borrowing rights with NHB. 1.1 Coordinate with other providers and state authorities to build awareness of benefits of new products. 1.2 Capacity building component will develop appropriate lending instruments for LIG and EWS in collaboration with suitable primary lenders		X
2. Operating Environment Risks						
2.1 Country[68]	L	The short term outlook is rocky; investment has fallen and asset quality in the banks has deteriorated in the last six months. The medium term	The Indian economy recovered from the slowdown of FY2009-10 with strong GDP growth over April-September 2010. The agricultural sector bounced back strongly following the good 2010 monsoon, and the industrial sector registered double-digit growth for three consecutive quarters. Inflation came down to 7.5 percent in November 2010 but then accelerated again to	Huge pent up demand for housing finance in low-income segments. Regular revisions of household income and loan cap are necessary to mitigate the fact that housing prices may rise faster than household incomes.		x

[66] This section is part of the deliberative process and will be available in the system but not in the final documentation. The document will reflect all other aspects which will be disclosed.
[67] Please see paras. 14-16 of the guidance note for details on filing in timing for mitigation measures.
[68] Please see paras. 6 and 8 of the guidance note for details on completing this section.

		outlook for India is positive. The recovery since 2008 has relied on domestic demand. India's macro-economic policy framework has been adequate to respond to the global financial crisis and the stage is set for return to high growth rates.	8.4 percent in December. The current account deficit in FY2009-10 was the largest ever (in US$ terms) and the monthly deficit widened further in 2010, but the trend then reversed with import growth slowing and export growth accelerating in September-December 2010. On the fiscal side, both revenue and expenditure in FY2010-11 are likely to be higher than envisaged at the time of the budget, and the targeted central government deficit of 5.5 percent of GDP is likely to be met. Massive windfall revenues from wireless spectrum auctions and buoyant tax revenue are likely to be offset by two supplementary spending bills. Monetary policy tightening continued with increases in policy rates. Looking forward, GDP growth appears to be back to the pre-crisis trend and could be around 8.5-9 percent in FY2011-12. Uncertainties persist on inflation, which reflects domestic supply constraints, including on food items, as well as global supply-demand conditions. Unusually high global liquidity and low interest rates could drive speculative bubbles which could again lead to inflationary pressures in India. Inflation in housing prices will complicate targeting of primary borrowers if we target income levels.			
2.2 Institutional (sector & multi-sector Level)	H	2.2 Mainstream financial institutions have	2.2 Unable to provide enhanced institutional capacity for housing finance appropriate for low-income	2.2 Package of demand side initiatives: capacity building and long term finance for financial institutions, incentives for	x	x

		failed to target low-income households, and inclusion requires new products and institutional arrangements.	households.	targeting LIG households via Component II, and market infrastructure necessary for sustainable housing finance.		
2.2.1 Market incentives are absent to develop adequate housing that is affordable for LIG	H	2.2.1 If supply of housing is unresponsive to effective demand, then Component II will not disburse.	2.2.1 No supply of housing available that LIG households can afford. Stimulating demand contributes to higher prices (due to inelasticity of supply).	2.2.1 a) NHB to coordinate with state housing authorities which are providing supply for purchase by low-income households; b) Identify formal supply for LIG where serviced land is affordable and close to livelihoods, most likely in tier 2, 3, 4 cities; c) NHB to assist PLIs with campaign towards the developer industry regarding the new housing finance options available to LIG.		x
3. Implementing Agency Risks (including FM & PR Risks)						
3.1 Capacity: NHB, participating primary lenders, qualified intermediary institutions, state housing authorities.	M-L	3.1 Limited experience and standards of NHB and primary lenders in the target income segments.	3.1 Cost of outreach and credit risk in LIG income segment. While NHB has less experience in LIG and informal sectors, and will be taking on the role of knowledge partner to primary lenders engaged with these borrowers.	3.1 NHB has the mandate to promote low-income housing finance. Capacity building in NHB, QIIs and PLIs under Project Component I. IFC to provide NHB with training modules to be delivered in partnership to primary lenders. WB/Urban to provide technical assistance to State Housing Agencies on behalf of NHB.		x
3.11 Capacity of Housing Microfinance and other primary lenders	M	3.11 EWS is a new income target for NHB and many of them do not provide housing loans	3.11 NHB fails to build additional capacity and knowledge to support primary lenders which target EWS (for the purchase, construction or upgrade of largely informal dwellings), informal sector borrowers.	3.11 Capacity building and partnerships with state housing agencies which are most proactive in providing affordable land (e.g. Rajasthan).	x	x
3.2 Governance	M-L	3.2 NHB management is experienced in supervision of HFCs, but will	3.2 NHB retains role of supervisor (not regulator) of housing finance companies (HFCs). This may cause a conflict of interest with NHB's promotional role for housing	3.2 NHB is supervised by RBI. NHB's supervision role is acceptable practice given that RBI expressly delegates supervision and enforcement of HFCs to NHB.		x

		be adding PLIs with other licenses to their partner institutions.	finance, which has included equity stakes in a few small HFCs (since sold off).			
3.3 Fraud & Corruption	M-L	3.3 NHB has limited control over final use of funds.	3.3 WB funds go to middlemen, organized crime, or other illegal players in the property markets.	3.3 1) NHB refinance loans are secured by collateralized portfolios, which NHB monitors. 2) issue lending standards and monitor implementation (actual lending activity, NPLs, etc).	x	x
4. Project Risks						
4.1 Design	M	4.1 Low impact, high likelihood that the income qualification and suitable housing collateral (legal settlements) are incorrect due to lack of formal information.	4.1 Because the Project financial components are targeting in part informal households, there is the risk that the end use of WB credit line component will inadvertently goes towards financing ineligible collateral (shelter in illegal settlements) or the wrong primary borrowers (higher income households). 4.1 MFI providers of Housing Microfinance (for incremental housing improvements) do not require collateral and select clients on the basis of assessed income, character, savings and repayment history. Some MFIs do not require fee simple land title to qualify their borrowers for loans. NHB cannot refinance loan collateralized by 'informal' property, without proper authorization and titling.	4.1 NHB to supervise compliance and uses income proxies acceptable under the Project. NHB will sharpen its eligibility criteria and monitoring of the portfolios submitted for refinance, against loans standards. Project component I provide financing for enhancing capacity of PLIs to appraise and serve low-income and informal income/dwellings households and NHB's role in supervising this.		x
4.2 Social & Environmental	M	4.2 Outreach to previously excluded households causes a high level of pioneer	4.2. Over-indebtedness, affordability-based lending, and financial illiteracy.	4.2. Develop market infrastructure (e.g. credit information) and training modules for PLIs. 4.2. Social and Environmental Assessment has carry out stakeholder consultations and		X

		risks.		develop a baseline and a framework for social and environmental risk mitigation. 2) NHB requires building quality norms as eligibility criteria for refinance.		
4.3 Project & Donor	L	4.3 Multi-disciplinary challenge solved by participation from different parts of the Bank and commitment to joint PIU and donor coordination.	4. 3 Housing finance challenges for low-income households is part of a Gordian knot, including failures in land planning, titling, utilities, informality, lack of information, etc.	4.3 WBG multi-sectored approach: IFC, FP, WBI, Urban and CGAP. Other development partners have expressed interest in supporting similar demand side low-income housing projects, with NHB as the implementing agency. In this case, as discussed with NHB, DfID and KfW, a single PIU would be the preferred option.		X
4.4 Delivery Quality	M-I	4.4 Adding new PLIs to NHB's client base.	4.4 PLIs may have unsustainable business models and will not be able to scale inclusion of low-income households.	4.4 NHB is already very selective in licensing HFCs eligible to its refinancing window. It supervises HFCs and will set lending norms which must be followed by all PLIs which seek refinance from NHB but would become market standards.		X
4.5 Product Suitability	M	4.5 EWS (largely for incremental housing) is a significant part of the Project.	4.5 EWS households are not bankable with long term, relatively high value and high cost debt obligations due to income volatility, job mobility and expenditure shocks. There may not be demand by intended primary borrowers for long term financial obligations.	4. 5 This Project is about expanding the access to finance. Only creditworthy households with verified capacity to repay are financed. This deepening will be helped by product innovation (e.g. linking debt with savings); market infrastructure; fixed rate, lower cost debt obligation. Rental housing solutions where debt not appropriate to needs of beneficiary. Develop strategy and Projects in financial literacy and capability of the prospective borrowers with a focus on avoiding over indebtedness as well as initiatives to support repayment once loans have been made.	x	
4.6 Informality of borrowers' income	M	4.6 A significant part of our target income group is informal (no	4.6 Failure to overcome information asymmetry to assess income and total debt obligations of low-income households.	4.6 Underwriting capability by utilizing local knowledge of customers, their livelihoods and their actual income is the franchise value of select primary lenders. GOI's financial inclusion Project is		X

		income verification, no tax receipts, no residency verification).		designed to provide informal households with identity and links to formal sector financing (unique identifier, revised KYC, no frills bank accounts). Training modules for primary lenders.		
4.7 Informality of borrowers' dwelling	H	A significant part of target borrowers have no formal dwelling	Failure to design guidelines for informal dwelling quadrants due to the understanding of the legal and regulatory context, policies of state governments and urban local bodies, extant government approvals, inputs from the stakeholders or any other factors. Then right side quadrants of Component II will not disburse.	The NHB and the World Bank will review and mutually agree on any changes to the initial, tentative allocations of Component II across the quadrants (reflected in the POM), based on the Project's studies, Pilots, an understanding of the legal and regulatory context, policies of state governments and urban local bodies, extant government approvals, inputs from the stakeholders or any other factors.		X
4.8 Enforceability	M	4.8 Slow courts and inadequate procedures obviate timely enforcement.	4.8 Housing collateral unenforceable by the courts in case of default, leading to losses for lenders and for NHB.	4.7 The Indian banking industry is overall satisfied by the out-of-court foreclosure procedure in place since the SERFAESI Ordinance of 2002. The standards to beset by NHB will include loss mitigation and recovery measures adjusted as needed to the low-income segments. Adequate credit underwriting, supported by training from NHB. Accurate credit reporting serves as disincentive to default.	x	

A - Proposed Rating before Decision Meeting[69]:

Project Team	Risk Rating: Preparation	Risk Rating: Implementation	Date	Comments
Overall Risk	H	M	February 2012	

Final Decision Meeting Rating:

Appraisal Decision Chair	Risk Rating: Preparation	Risk Rating: Implementation	Date	Comments
Overall Risk	Moderate	Substantial	January 29, 2013	

[69] For Track II Operations only.

Annex 5: Implementation Support Plan

167. The Project includes implementation support through a dedicated Project Implementation component. The Capacity Building component also includes implementation support, namely for the Pilots. In addition, the Implementation Support Plan will cover the following areas with the following intensity and focus.

Area	Intensity & Focus
Financial Management	The Project would need a high degree of FM supervision during the initial stages of implementation, particularly in terms of application of agreed FM arrangements and compliance with the Project Operations Manual. For instance, NHB will share with the World Bank for prior review documentation of the first refinancing applications by QPLIs of over US$1 million which are eligible under each of three of the quadrants in Table 2: (i) lower left, (ii) upper right and (iii) lower right. Subsequently, during implementation support missions, the Bank team will review a sample of QPLI cases included under the Project.
Procurement	Given the small number of contracts and the general risks involved, a minimum of two implementation support missions a year is planned. In addition, the Bank will also carry out an annual ex-post review of procurement that falls below the prior review threshold. The Bank will also carry out small thematic and focused Missions depending on the need and as required with agreement from the Project.
Safeguards	The PIU in NHB will have at least one Social Specialist and Environmental Specialist who will be responsible for overseeing and monitoring the Social and Environmental Due Diligence (SEDD) of the Project. This would be done by (i) ensuring implementation by QPLIs of guidelines; (ii) capacity building of QPLIs, and by QPLIs of borrowers (financial literacy training); (iii) regular periodic interactions/meetings with all QPLIs, and QIIs, to review the problems they face and their constraints; (iv) regular quarterly reporting of progress, issues identified and solutions implemented; these reports will be made available to the Bank during six-monthly Implementation Support missions. The application of SEDD and compliance with the SEDD shall be certified on a semi-annual basis and/or at the time of refinance requests by QPLIs and NHB will conduct by a 3rd party audit on SEDD compliance by QPLIs and report to the World Bank.
Sectoral	Technical expertise and implementation support will be critical to support NHB in developing guidelines for the right side quadrants of Table 2, which will bee based on studies, Pilots, an understanding of the legal and regulatory context, policies of state governments and urban local bodies, extant government approvals, inputs from the stakeholders or any other factors. The team can support this process by providing technical support as well as use its convening power.
Thematic	The Bank and IFC work in different income segments, and play complementary roles in housing finance. To ensure complementarity, during implementation support, World Bank/IFC cooperation will be critical. Other development partners have expressed interest in supporting similar demand side low-income housing projects, with NHB as the implementing agency. In this case, as discussed with NHB, DfID and KfW, a single PIU would be the preferred option, and joint implementation support could be explored.

Annex 6: Procurement Plan

I. General

Project information:

Country:	India
Borrower:	Government of India
Project Name:	Low Income Housing
Responsible Agency:	National Housing Bank

Bank's approval Date of the procurement Plan: March 15, 2013

Period covered by this procurement plan: 18 months

II. Goods and Works and non-consulting services

Table 10: Goods and Works and Non-Consulting Services

Category	Method of Procurement	Thresholds (US$ Equivalent)
Goods and non consulting services	ICB	>1,000,000
	LIB	Whenever agreed and with prior approval of the Bank
	NCB	Up to 1,000,000
	Shopping	Up to 30,000
	Direct Contract	As per para 3.7 of GL
Works	NCB	> USD 50,000
	Shopping	Up to USD 50,000
	Direct	As per Para 3.7 of the Bank Guidelines, wherever agreed and with prior agreement with the Bank irrespective of value

Pré-qualification. Not Applicable

Procurement Packages with Methods and Time Schedule:

168. No works are expected to be procured under the Project. Should the need arise to procure works, NHB and the Bank will discuss those needs and come to an agreement on the procurement.

169. Goods procured under this Project would be for small value and may include office equipment, computer system etc. while some software being proprietary in nature will be procure by direct contracting, other goods and software will be procured by National Competitive Bidding (NCB), and shopping and or using Directorate General of Supplies & Disposals (DGC&D) rate contract within shopping threshold.

170. In the case of contracts subject to prior review, before agreeing to (a) a material extension of the stipulated time for performance of a contract; or (b) any substantial modification of the scope of services or other significant changes to the terms and conditions of the contract; or (c) any variation order or amendment (except in cases of extreme urgency) which, singly or combined with all variation orders or amendments previously issued, increase the original contract amount by more than 15 % ; or (d) the proposed termination of the contract, the Borrower shall seek the Bank's no objection. For post review contracts the amendments for increasing the cost beyond 15 % of original contract value or extension of time shall be informed to the Bank promptly.

171. **Prior Review Threshold:** Selection decisions subject to Prior Review by Bank as stated in Appendix 1 to the Guidelines Procurement of Goods, Works and Non consulting services.

Goods

- First two contracts for irrespective of value and all contracts more than USD 500,000
- Direct contracts for estimated to cost more than USD 5,000

Works

- First NCB contract irrespective of value and all contract more than USD 250,000
- Direct contracts irrespective of value

172. **Any Other Special Procurement Arrangements:**

a) The bid evaluation will be carried out as per agreed timeline in the Procurement Activity Schedule.

b) Goods estimated to cost less than USD 1,000,000 equivalent per contract may be procured under contracts awarded on the basis of National Competitive Bidding procedures as per paragraph 3.3 and 3.4 of the Procurement Guidelines and the following additional provisions:

- Only the model bidding documents for NCB agreed with the Government of India Task Force (and as amended from time to time) shall be used for bidding.
- Invitations to bid shall be advertised in at least one widely circulated national daily newspaper, at least 30 days prior to the deadline for the submission of bids.
- No special preference will be accorded to any bidder either for price or for other terms and conditions when competing with foreign bidders.
- Except with prior concurrence of the Bank, there shall be no negotiation of price with the bidders, even with the lowest evaluated bidder.
- Extension of bid validity shall not be allowed without the prior concurrence of the Bank (i) for the first request for extension if it is longer than four weeks; and (ii) for all subsequent requests for the extension irrespective of the period (such concurrence will be considered by the Bank only in cases of Force Majeure and circumstances beyond the control of implementing agency).

- Rate contracts entered into by Director General of Supplies & Disposals (DGS&D) will not be acceptable as a substitute for NCB procedures. Such contracts will be acceptable for any procurement under shopping procedures.
- Two or three envelope system shall not be used.

III. Selection of Consultants

173. **Prior Review Threshold**: Selection decisions subject to Prior Review by Bank as stated in Appendix 1 to the Guidelines Selection and Employment of Consultants:

The Bank will prior review for Consultancy services contracts above US$ 500,000 (for firms) and US$ 100,000 (for individuals). In addition, all consultancy contracts to be issued on single-source basis exceeding US$ 10,000 in value to consultancy firms shall be subject to prior review. In case of single source contract to individuals, the qualifications, experience, terms of reference and terms of employment shall be subject to prior review. All contracts below the prior review threshold will be subject to periodic post review on a sample basis.

174. The method of consultancy selection would be as follows:

Table 11: The Method of Consultancy Selection

Method of Procurement	Threshold (US$ Equivalent)
(a) Quality and Cost Based Selection	No threshold
(a) Quality Based Selection	No threshold As per consultant guidelines Para 3.2 to 3.4
(b) Selection Made Under a Fixed Budget	No threshold As per consultant guidelines Para 3.5
(c) Least Cost Selection	No threshold As per consultant guidelines Para 3.6
(d) Selection Based on Consultant's Qualifications	< 300,000
(e) Single Source Selection	As per Consultant Guidelines Para 3.8 and 3.9
(f) Selection of Individual Consultants	No threshold As per consultant guidelines Para 5.1 to 5.6

175. Each case of consultant firm costing more than US$ 10,000 to be hired on single source selection basis, (including the packages given in the Procurement Plan), will require prior agreement with the Bank for which the Project shall submit the justification required to meet the provisions of Paras 3.9 and 3.10 of the Bank's Consultant Guidelines.

176. Similarly each case of individual consultant to be hired on single source selection basis, (including the packages given in the Procurement Plan), will require prior review and prior agreement with the Bank for which the Project shall submit the justification required to meet the provisions of Paras 5.4 and the Bank's Consultant Guidelines.

177. The Request for Expression of Interest for consultancy services estimated to cost above US$300,000 equivalent per contract for firms shall be advertised in UNDB online and DgMarket and in accordance with other provisions of Para 2.5 of the Consultant Guidelines.

178. **Short list comprising entirely of national consultants**: Short list of consultants for services, estimated to cost less than $800,000 equivalent per contract, may comprise entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Consultancy Assignments with Selection Methods and Time Schedule

Table 12: Consultancy Assignments

S. No.	Description of Assignment	Estimated Cost US$ in million	Selection Method	Review by Bank (Prior / Post)	RFP issued Date	Expected Awards date
1	2	3	4	5	6	7
1	Social Expert	0.200	Individual Consultant (IC)	Prior	May-2013	Sept-2013
2	Environmental Expert	0.200	IC	Prior	May-2013	Sept-2013
3	LIHF Expert	0.200	IC	Prior	May-2013	Sept-2013
4	Procurement Expert	0.050	IC	Prior	May-2013	May-2013
5	Third Party Audits (E&S)	0.350	QCBS	Prior	Jan-2014	May-2014
5	Capacity to appraise and serve low-income and informal income / dwellings households	0.150	QCBS	Prior	May-2013	November-2013
6	Expanding the coverage of credit bureaus	0.250	QCBS	Post	May-2013	November-2013
7	Financial literacy and counseling and consumer protection capacity	0.200	QCBS	Post	June-2013	November-2013
8	Piloting	0.900	QCBS	Prior	Sept-2013 (TOR by June 30, 2013)	November-2013
9	Impact assessment	0.500	QCBS	Prior	Sept-2013	November-2013

Annex 7: Trends in Mortgage Finance in India

179. Mortgage finance has witnessed steady growth in recent years due to supportive fiscal, monetary and legal policies coupled with easy liquidity in the financial system, competitive environment and growing middle class population[70].

180. In 2012, the total outstanding amounts of the housing loans held by Indian financial institutions amounted to around Rs 6,89,701 crores (US$125.4 billion). SCBs held around 56 percent of the Housing Loan Outstanding, and HFCs held the remaining 44%.

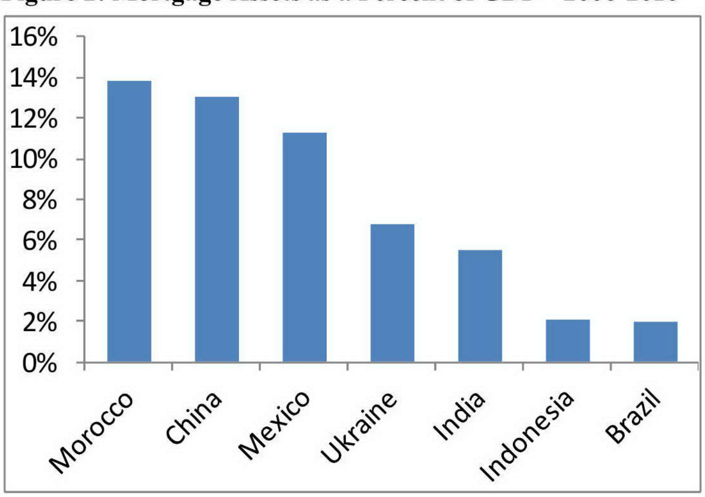
Table 13: Respective Housing Loan Outstanding held by SBCs and HFCs 2008 to 2012

Year	Housing Loan Outstanding with SCBs		Housing Loan Outstanding with HFCs		Total	
	(Rs. Cr.)	(US$ Bn.)	(Rs. Cr.)	(US$ Bn.)	(Rs. Cr.)	(US$ Bn.)
2012	3,88,020	70.55	3,01,681	54.85	6,89,701	125.40
2011	3,46,110	62.92	2,47,781	45.05	5,93,891	107.97
2010	3,00,930	54.71	2,04,992	37.27	5,05,922	91.98
2009	2,84,750	51.77	1,26,823	23.05	4,11,574	74.82
2008	2,48,434	45.16	1,09,221	19.85	3,57,655	65.01

1 USD= Rs. 55/-

181. After a significant increase in 1990s and early 2000s, the Mortgage Debt to GDP ratio has stabilized at around 6 percent, which puts India in the lower range compared to other emerging economies as illustrated in the following chart. This figure can also be compared with Mortgage Debt to GDP ratios in developed countries, which are usually over 40 percent.

Figure 2: Mortgage Assets as a Percent of GDP – 2006-2010



70 Sridhar S., et. al., 'Report of the committee to explore, examine and recommend setting up of a micro dedicated micro finance company with a focus on micro-housing finance,' Report of a Committee set up by the Ministry of Housing and Urban Poverty Allievation, Governement of India, 2010.

182. The recent growth of the Indian Housing Finance sector has been mainly driven by the growing number of high volume lending above Rs. 1 million per loan. For SCBs, the percentage of housing loan outstanding in the loan categories above Rs. 10 lakhs has increased from 34.87 percent in 2005 to 52.5 percent in 2010. In the case of HFCs, the same percentage has moved from 41.28 percent in 2005 to 70.36 percent in 2008.

Table 14: Size-wise Housing Loans outstanding of SCBs 2005 – 2010

Year	2005		2010	
Loan Category	%Accounts	%Amount	%Accounts	%Amount
Up to Rs. 25000	5.6	0.23	3.86	0.1
Rs. 25000 to 200000	44.83	13.49	31.5	5.7
Rs. 200000 to 500000	32.03	28.47	32.5	21.7
Rs. 500000 to 1000000	12.21	22.94	18.2	27.7
Over 1000000	5.33	34.87	14	54.2

Source: RBI, Basic Statistical Returns of Scheduled Commercial Banks in India, 2005 and 2010 reports.

Table 15: Size wise Housing Loans outstanding of HFCs 2009 – 2011

	Percentage to Outstanding Housing Loan Portfolio (% of Amount)	
	2009	**2011**
Up to Rs. 50000	1.73%	0.05%
Rs. 50001 to Rs. 100000	2.59%	4.10%
Rs. 100001 to Rs. 300000	7.04%	3.81%
Rs.300001 to Rs. 500000	11.68%	8.24%
Rs. 500001 to Rs. 1000000	17.24%	16.87%
Over Rs. 1000000	59.71%	66.92%

Microfinance and housing finance.

183. Total outstanding microfinance loans amounted to about Rs. 35,939 crore (around US$ 4 billion) at the end of March 2009[71]. Anecdotal evidence shows that a significant portion of Micro-finance loans are used by the borrowers for home purchase and/or repairs[72]. Longer term lending in this segment remains limited. NHB does engage with some microfinance lenders and has thus far sanctioned loans amounting to around Rs 97.42 crore as at June 2012, for the financing of 30,210 urban and rural housing/sanitation units.

Estimation of affordability

184. It is possible to provide a range of estimates of what type of apartment a Household with a given monthly income can afford in the formal housing market through a mortgage similar to

[71] Source : Sridhar et. al. (2010)
[72] SEWA Bank stated that an estimated 40% of its loans were being used for home improvements including structural improvements, repairs, expansion, and connection to utilities. (Statement at a Low Income Housing Finance practitioners meeting organized by the World Bank).

the ones currently offered by the housing finance industry. The following assumptions are proposed for the use of this estimation:

- The minimum price per square foot of formal finished housing is estimated at Rs. 1000
- The maximum Loan-to-Value Ratio is set at 80 percent.
- The fixed interest rate on the housing loan is set at 12 percent.
- The maximum Equated Monthly Installment between 30 and 40 percent of the Household Income

185. Based on the assumptions listed above, it is possible to estimate a ratio between the Household monthly income and the maximum amount of loan, and the maximum value of the property it can afford, depending on the proposed loan tenor. For a Loan tenor of 15 years, it is estimated that a Household can afford to purchase a property worth 42 times its monthly income. For a loan tenor of 20 years, this ratio increases to 45, and 47 if the loan tenor is increased.

186. The table below provides estimates of the minimum monthly household income required for the purchase of homes with values between Rs. 200,000 and Rs. 500,000, based on different assumptions on the type of Housing Finance loans available.

187. It appears that the current type of property available can be affordable for households with a minimum monthly income between Rs.8,500 and Rs.15,500 depending on the assumptions. Namely, a household with an income of Rs.8,511 can afford a property costing Rs. 400,000 provided a 25 year loan with an EMI to Income ratio on 40 percent. On the other end of the spectrum, assuming a property cost of Rs.500,000, with an EMI to income ratio capped at 30 percent and the tenor of the loan limited at 15 years, the minimum monthly income required for purchase of the property is estimated to be Rs.15,652.

Table 16: Affordability Range based on Household Monthly Income

Assumptions						
Loan tenor (Y)	15	20	25	15	20	25
EMI to Income Ratio	30%	30%	30%	40%	40%	40%
Value to Income Ratio	32	34	36	42	45	47
House value (Rs)	Minimum Household Income Required (Rs./Month)					
200,000	6,250	5,882	5,556	4,762	4,444	4,255
300,000	9,375	8,824	8,333	7,143	6,667	6,383
400,000	12,500	11,765	11,111	9,524	8,889	8,511
500,000	15,625	14,706	13,889	11,905	11,111	10,638

188. Technical Assistance to NHB on ‘Expanding the Housing Finance Market to Cover Lower Middle Income Segments in India’, funded by the FIRST Trust Fund, has identified that private sector developers have been building housing at rates of between Rs.800 to 1,000 per square foot in vibrant neighbourhoods within one hour of the city centre in most Metros, Tier I and Tier II towns. The smallest units they are currently building are 450 to 500 square feet.

apartments costing Rs.400,000 to Rs.500,000. The report also identified the opportunity for developers to build cheaper apartments, e.g., 200- 350 square foot apartments at Rs.200,000 to Rs.320,000, provided adequate financing instruments are there to provide low-income household access to housing finance and create an effective demand for this type of goods. Recent updates of this work indicate that prices are rising faster than incomes, putting formal housing out of reach of households who earn Rs.15,000 per month in large and medium size cities. Rising costs of inputs and demand from middle income families for flats originally targeted to low-income households have given developers significant pricing power. This is a dynamic market, and prices in smaller towns are still within reach of the Project's income targets.

Annex 8: Base Line Survey of Primary Lenders (HFCs)

189. A Base Line Survey was conducted by collecting data from 11 HFCs for total outstanding loans of Rs.6,520.73 crore. Borrowers have been segregated under six categories depending upon the loans availed by them, starting from borrowers availing loans of up to Rs.50,000; up to Rs. 1 lakh; up to Rs. 3 lakhs; up to Rs. 5 lakhs; up to Rs. 10 lakhs and over Rs. 10 lakhs. Each category of the borrower has further been segregated by income level, source of income, security provided for the loan and purpose of the loan.

Income Level of the Borrowers

190. Under income level borrowers have been categorized under three categories: i.e. borrower having annual income up to Rs. sixty thousand, from Rs. sixty thousand to Rs. one lakh twenty thousand and third category up to Rs. one lakh eighty thousand. Borrowers having annual income of over Rs. one lakh eighty thousand have been excluded under this categorization.

Source of Income

191. Under the source of income borrowers have again been categorized under three categories i.e. salaried, non-salaried Income Tax Return (ITR) and non-salaried non ITR. Salaried class can be said to be borrowers from formal sector while non-salaried borrowers who file ITR can be termed as borrowers such as professionals/ self-employed with ascertainable source of income such as rent from property, income from business activity etc. Non-salaried non ITR borrowers mainly consist of informal sector borrower with low and fluctuating income, such as daily wage laborers, Taxi drivers, vegetable vendors, etc. whose income cannot be ascertained through any document.

Purpose of Loan & Security

192. Purpose of the loan has been captured under three segments i.e. purchase loan, construction loan and upgrade loan. Loans have further been categorized by the security available: i.e. mortgage & not mortgage loans (alternatively secured).

Analysis of Data

193. Analysis of the sample data reveals that of total outstanding loans, Rs. 3,222.26 crore is outstanding under loans up to Rs, 5,00,000/- thus constituting 49% of the total sample survey. The sample survey shows that about 61% of the borrowers have salary income, while 24% of the borrowers have Income Tax Return as proof of income other than salary while the remaining 15% of the borrowers do not have salary income or any other documented proof of income.

Market Projection

194. Outstanding housing loans as on March 31, 2010 disbursed by HFCs & Banks stood at Rs.469,000 crore, which as per our internal assessment is expected to grow to about Rs.943,000

crore by March 31, 2015 i.e. at CAGR of 15%. Outstanding housing loans as on 31.03.2012 stood at Rs.610,225 crore, growing for the last two years has been at about 14% per annum. Based on the base line survey findings total outstanding disbursement of under Rs. 5 lakhs, loans to non-salaried non ITR borrower can be estimated at about Rs.40,000 crore which is expected to grow to about Rs.65,000 crore by March 31, 2015.

195. Similarly total outstanding disbursement of under Rs. 5 lakhs loans to non-salaried ITR borrower can be estimated at about Rs.48,800 crore which is expected to grow to about Rs.75,000 crore by March 31, 2015 (delta is Rs.26,200 crore or US$ 5,240 million).

Table 17: Sample Data Collected from10 HFCs

Particulars	Category	**Loan Size** (in Rupees)						
		Up to 50000	50001 to 100000	100001 to 300000	300001 to 500000	500001 to 1000000	Over 1000000	Total
Income	EWS: Up to Rs.60000	3.07	31.98	910.73	1179.69	1370.88	452.25	3948.61
	LIG: Rs.60001 to Rs.120000	1.09	5.50	263.53	190.54	60.22	236.16	757.05
	LIG+Rs.120001 to Rs.180000	0.72	3.49	115.73	516.19	767.01	176.95	1580.08
	Total	**4.89**	**40.96**	**1289.99**	**1886.42**	**2198.12**	**865.36**	**6285.74**
Income Source	Salaried	3.21	23.41	813.95	1216.31	1383.22	566.33	4006.43
	Non Salaried ITR	0.45	4.47	193.29	349.57	462.96	586.43	1597.17
	Non Salaried Non ITR	0.28	3.69	148.43	276.26	361.61	126.87	917.14
	Total	**3.94**	**31.57**	**1155.66**	**1842.14**	**2207.78**	**1279.64**	**6520.73**
Purpose of Loan	Purchase	1.92	17.35	689.92	1194.31	1650.51	797.37	4351.37
	Construction	2.47	19.68	550.75	667.47	563.78	311.31	2115.47
	Upgrade	0.29	1.70	14.38	12.31	9.79	15.44	53.90
	Total	**4.68**	**38.73**	**1255.04**	**1874.09**	**2224.07**	**1124.11**	**6520.73**
Security	Mortgage	4.91	41.20	1292.37	1894.99	2238.61	1047.49	6519.56
	No Mortgage	0.00	0.00	0.00	0.02	0.75	0.40	1.17
	Total	**4.91**	**41.20**	**1292.37**	**1895.01**	**2239.36**	**1047.89**	**6520.73**
Bad Loans		0.20	0.72	15.95	13.64	7.82	8.46	**46.79**

Annex 9: Governance and Accountability Action Plan

I. NHB's Corporate Governance

196. HB's Corporate Governance environment is defined in the NHB Act, 1987 read with the NHB General Regulations, 1988 and NHB Employees (Discipline and Appeals) Regulations, 1994. The overall management vests with the board of directors. The NHB Act read with the NHB General Regulations define the composition of the Board, the term of office of the Chairman and Managing Director (CMD) and other directors, frequency of the board meetings, and the board process. The tenure of the Directors (other than the CMD) is generally three years. Three committees of the Board have been constituted and are functional. Executive Committee (EC) has the powers to transact all usual business of NHB except matters that have to be dealt with by the Board. Primarily, the EC approves all financial proposals, reviews various reports including control returns and the MIS and approves the appointment of the internal/concurrent auditors. The EC comprises of five directors – the CMD, two Directors from RBI, one Director from GoI and one Independent Director. Audit Committee (see table below) and Remuneration Committee: that decides the incentive for the CMD in terms of the direction of the GoI.

197. Overall, the corporate governance systems in NHB compares well with the mandatory Corporate Governance guidelines issued by the Department of Public Enterprises (DPE) for central public sector enterprises[73] (considered as a model). In the following table, the key components of the DPE guidelines on corporate governance and the present status in NHB are presented.

Table 18: Governance Systems

Guidelines		Status in NHB
Board of Directors	Board of directors shall have an optimum combination of functional, nominee and independent directors.	The current strength of NHB's Board is 12. (a) CMD/MD; (b) 2 experts in housing, architecture, engineering etc; (c) 2 experts with experience in working with institutions providing funds for housing or housing development; (d) 2 Directors of RBI (f) 3 Directors from amongst the officials of the GOI; and (g) 2 Directors from amongst the officials of the State Government.
	The number of functional directors (including CMD/MD) should not exceed 50 percent of the actual	Other than the CMD, there are no functional directors.

[73] These Guidelines are not applicable to NHB. However, these have been used as a point of reference to review the status of Corporate Governance in NHB.

Guidelines		Status in NHB
	strength of the board.	
	At least one third of the board members shall be independent directors.	There are 4 independent directors equivalent to 1/3rd of the Board's strength
	The number of nominee directors shall be restricted to a maximum of two.	All Directors are appointed by GoI or RBI as per NHB Act. Therefore, this number exceeds that prescribed in the DPE guidelines. 2 Directors can be elected by shareholders other than RBI, GoI and entities controlled by GoI; since RBI is the only shareholder, elected Directors are not in place.
Audit Committee of the Board (ACB)	Qualified and independent audit committee shall be set up giving the terms of reference. The audit committee shall have minimum three directors as members. Two thirds of the members of audit committee shall be independent directors. The Chairman of the audit committee shall be an independent Director.	NHB has a functioning Audit Committee with defined terms of reference. The ACB comprises of 5 members – 2 directors from RBI, 1 director from GoI and 2 independent directors (experts). The Chairperson and 2 expert members are independent equivalent to 2/5th of the total members; hence this is not in compliance with DPE code.
	All members of audit committee shall have knowledge of financial matters of company and at least one member shall have good knowledge of accounting and related financial management expertise.	Members of the ACB are knowledgeable in financial matters or accounting or financial management. The present members comprise of a Dy. Governor and a Director from RBI, 1 IAS officers from GoI and 2 experts in the fields of housing, architecture, engineering etc; or in working with institutions providing funds for housing or housing development.
	Detailed and elaborate role has been prescribed for audit committees including, financial performance, reporting and disclosures; internal control mechanisms (including	Detailed role and powers of the audit committee have been specified covering these areas. The ACB's reviews include (a) the regulatory inspection reports of HFCs, (b) the

Guidelines		Status in NHB
	internal audit); compliance with audit observations (internal as well as statutory); whistle blower mechanism etc.	internal audit reports, (c) internal controls including housekeeping and reconciliation and adequacy of accounting functions, (d) working results and accounts of NHB, (e) the observations of RBI contained in the Annual Financial Inspection Report, (f) statutory audit report and its compliance and (g) information security policy implementation.
	Audit committees should meet at least four times in a year and not more than four months shall elapse between two meetings	The ACB has met 6 times during 2009-10 and 2010-11 and 5 times during 2011-12.
Risk Management	Risk management strategies and their oversight should be one of the main responsibilities of the board and management. The board should ensure the integration and alignment of the risk management system with the corporate and operational objectives and also that risk management is undertaken as a part of normal business practice and not as a separate task at set times. The company shall lay down procedures to inform board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risks through means of a properly defined framework. Procedure will be laid down for internal risk management	NHB has Board approved policies and procedures for management of risks faced by financial institutions including credit, liquidity, interest rate and foreign exchange risks. NHB has instituted formal systems for identification and management of risks through domain specific risk management committees (there is an apex level Risk Management Advisory Committee) and periodic reporting to the Board/board committees and RBI on all functions of NHB as a financial institution. NHB follows the prudential norms prescribed by RBI that include norms for resource raising, disclosure in the annual financial statements, credit exposure limits and identification, income recognition and asset classification of NPAs and provisioning thereon and provisioning on investments[74] These policies and practices are imbibed as part of the normal business

[74] These are available in the form of Master Circulars issued by RBI

Guidelines		Status in NHB
	also. Disclosure on risks and concerns should from part of Director’s report.	practices of NHB with set timelines. The Board reviews all the policies at least once every year. A brief note on risk management is provided in the Annual Report
Report, compliance	The guidelines provide a list of minimum information that is required to be placed before the board. The list includes quarterly results for the company and its operating divisions or business segments.	Information to the Board is presented in the manner (Calendar of Items) recommended by RBI. There is periodical reporting on all aspects of functions of NHB to the Board including quarterly operating results, functioning of all departments, action plans, budgets, accounts, compliance with the policies, risk profile, financial sanctions beyond approved policy, delegated powers exercised and annual report on frauds.
	The guidelines provide a list of items to be included in the report on corporate governance in the annual report of companies. The company is also required to obtain a certificate from either the auditors or practicing company secretary regarding compliance of conditions of corporate governance as stipulated in the guidelines.	There is no separate report on corporate governance in the annual report, though there is a separate section discussing briefly the corporate governance aspects. A certificate on compliance with the conditions of corporate governance is presently not obtained.

II. Housing Finance Companies

2.1 The Companies Act

198. In India, Companies Act, 1956 (1 of 1956) is the most comprehensive piece of legislation that empowers the Central Government to regulate the formation, financing, functioning and winding up of companies. The Act contains the mechanism regarding organizational, financial, managerial and all the relevant aspects of a company. It empowers the Central Government to inspect the books of accounts of a company, to direct special audit, to order investigation into the affairs of a company and to launch prosecution for violation of the Act. These inspections are

designed to find out whether the companies conduct their affairs in accordance with the provisions of the Act, whether any unfair practices prejudicial to the public interest are being resorted to by any company or a group of companies and to examine whether there is any mismanagement which may adversely affect any interest of the shareholders, creditors, employees and others. Recently, the Ministry of Corporate Affairs presented the Companies Bill, 2011 to the Parliament, which aims to improve corporate governance by vesting greater powers in shareholders.

2.2 2.2 The National Housing Bank Act, 1987

199. **2.2.1** The National Housing Bank (NHB) has been established to operate as a principal agency to promote housing finance institutions both at local and regional levels and to provide financial and other support to such institutions, under the National Housing Bank Act, 1987 (No. 53 of 1987). Housing Finance Company (HFC) has been defined as a company incorporated under the Companies Act, 1956 which primarily transacts or has as one of its principal objects, the transacting of the business of providing finance for housing, whether directly or indirectly. HFCs being specialized companies in providing housing financial services to public come under the regulatory ambit of NHB. Accordingly NHB, having considered it is necessary in the public interest, to regulate the housing finance system of the country on sound and healthy lines, has issued the directions, guidelines, circulars to HFCs.

- Housing Finance Companies (NHB) Directions, 2010 include matters relating to acceptance of deposits by HFCs, prudential norms for income recognition, accounting standards, asset classification, provision for bad and doubtful assets, capital adequacy and concentration of credit/ investments to be observed by HFCs, and matters to be included in the Auditors Report by the auditors of such HFCs and matters ancillary and incidental thereto and amended the said Directions from time to time. Constitution of audit committee for corporate governance also forms part of the Directions.
- Know Your Customer Guidelines and Anti Money Laundering Standards framework approved by HFC's Board to know/understand their customers and their financial dealings better, which in turn help them to manage their risks prudently. The four key elements covered are Customer Acceptance Policy; Customer Identification Procedures; Monitoring of Transactions; and Risk management.
- Fair Practices Code formulation with the approval of HFC's Board to provide for transparency in transactions between the HFC and the end users, and also to provide for well informed business relationships.
- HFC's Board approved Guidelines for Asset Liability Management System implementation to evolve into a strategic tool for effective management by addressing the risks in a structured manner with a more comprehensive Asset-Liability Management (ALM) practices.

200. **2.2.2** NHB levies penalties on HFCs, on their major contravention of the NHB Act, Directions and other related provisions, with an advice to disclose them in their Annual Report in order to bring the discipline in the system.

201. **2.2.3** *Registration:* An entry level regulation is achieved through a system of registration of housing finance companies, in terms of Section 29A of the NHB Act, 1987. No housing finance institution which is a company shall commence or carry on the business of housing finance institution without (a) obtaining a Certificate of Registration (COR) from NHB, and (b) having the net owned fund of Rupees Ten crore (Rs.10 crore). However, the housing finance companies already registered with NHB are permitted to carry on the business of housing finance institution, provided they achieve the minimum net owned fund of Rupees Seven crore (Rs.7 crore) by June 30, 2013 and Rs. Ten crore (Rs.10 crore) by March 31, 2014. There are 56 HFCs operating in India with NHB having been granted CORs, and out of which 18 have permission to accept public deposits.

202. **2.2.4** *Supervision:* NHB supervises the functioning of HFCs through oversight and monitoring mechanisms of off-site surveillance, on-site inspections, market intelligence, and regulators' coordination.

- Off-site surveillance includes receipt of returns through on-line as well as physical forms, and their compilation, scrutiny, follow-up, and analysis. This information is being used for policy planning by various Government and Central Bank. The details of returns are as follows –
    - Schedule I - Annual Return on deposits, loans, financial details;
    - Schedule II – Half Yearly Return on prudential norms;
    - Schedule III – Quarterly Return on statutory liquid assets.
- On-site inspection are undertaken to know that HFCs are adhering to provisions of the NHB Act, Directions, Guidelines and Circulars, issued by NHB from time to time.
- Market Intelligence is undertaken through Regional and Regional Representative Offices to gather information and obtain feedback from outside sources, regarding functioning of HFCs.
- Involved in the regulators' coordination processes for collective action through participation in the State Level Coordination Committees, organized by the Central Bank to avoid any systemic problem.
- Coordination with Financial Action Task Force to combat money laundering, the financing of terrorism and proliferation of weapons of mass destruction, through Central Bank.

2.3 2.3 The Securities and Exchange Board of India Act, 1992:

203. The SEBI Act, 1992 monitors and regulates corporate governance of listed companies in India through Clause 49 of the Listing Agreement. This Clause is incorporated in the listing agreement of stock exchanges and is compulsory for the companies to comply with its

provisions. The Clause 49 mainly modified the definition of independent directors, strengthened the responsibilities of audit committees and improved quality of financial disclosures.

III. Micro Finance Institutions

204. **3.1** Over the last few years, the micro finance sector has emerged as the largest congregation of microfinance leaders from within and outside India. Micro finance Institutions (MFIs) are slowly bringing the poor, especially women, into the formal financial system and enabling them to access credit and fight poverty. As on March 31, 2010 around ₹14,000 crore bank loan outstanding from 1,659 MFIs (source: NABARD, Annual Report 2010). Out of 1,659 MFIs, around 10% of the MFIs are providing micro housing loan to their members. NHB has extended the financial assistance to 30 MFIs for on-lending to SHG/JLG members for micro housing loan.

205. **3.2** Effective governance is one of the critical factors for success of any microfinance institution in India. The MFIs which are not-for-profit organization, are not governed by any regulations, whereas they are registered under the legal acts viz., Cooperative Societies Act, 1860, Indian Trust Act, and Companies Act, 1956 in case of Section 25 companies. The MFIs are following the code of conduct for their operations and they have laid down the clear objectives and goals for the benefit of their members and society.

206. **3.3** NHB's is selecting the MFIs based on the management strength, governance of the MFI, organizational structure, coverage, various products offered to their members, etc. The Bank also conducts the market intelligence survey about the operations of the MFI and obtains the credit reports from the bankers and financial institutions. The credit history of the MFIs is also verified through credit reports obtained from CIBIL. In addition to the above, the Regional Representative Offices of the Bank are doing the due diligence, before sourcing the project. As a part of appraisal system, NHB is also doing Internal Credit Rating of the Agency to assign the risk, based on the set criteria.

207. **3.4** The proposed Micro Finance Institutions (Development and Regulation) Bill, 2011 has a mandate for specify norms for corporate governance to be observed by MFIs. The governance including model codes for conduct of business of MFIs.

I.V. Grievance redressal:

208. NHB runs a robust grievance redressal policy and mechanism (detailed on its website) which cover including grievances against lower tier financial institutions, i.e. HFCs received from borrowers or other stakeholders. Such complaints can relate to 'levy of pre-payment charges, non-refund of processing fees, arbitrary increase in rates of interest, non-sanction of loan, failure to return original documents after repayment of the loans, takeover of possession without following due procedures, etc.' But 'complaints are also received against HFCs from the general public in connection with their activities and operations.'

209. NHB acts as an appellate authority on grievances against HBCs. Not only will NHB's 'Complaint Redressal Cell play a facilitative role by taking up the complaints with the concerned

HFC', even though 'rates of interest including any increase or reduction therein, pre-payment or loan closure charges, loan disbursals, recovery on defaults in payments and other covenants in the loan agreement are not usually being regulated by NHB [and] a loan transaction is essentially a contract between the lender and the borrower' as per its policy. But plaintiffs can also refer their complaints to the Chief Grievance Redressal Officer of NHB, or even its Chairman & Managing Director of NHB in case he is not satisfied with the response obtained from the incriminated HFC.

210. It is not clear though whether NHB grievance redressal policy and mechanism extend to primary lenders, such as micro finance institutions. So this GAAP will introduce the following provisions to ensure the effectiveness of NHB grievance redressal mechanism for project implementation:

1) It is agreed that grievances related to primary lenders will be effectively handled under NHB grievance redressal mechanism;

2) Access to NHB grievance redressal mechanism will be facilitated by ensuring that any borrower as well as concerned NGOs/CSOs (acting on their behalf as well as for public interest) are fully informed about it; online filing of grievances will be made available for the same purpose;

3) NHB will share with Bank staff its reports to NHB Board or Executive Committee on how complaints related to project implementation have been handled so that NHB and the Bank can jointly discuss how to address systemic issues pertaining to project implementation reflected by individual or collective grievances. Such a discussion will be scheduled during supervision missions.

V. Anti-corruption:

211. As any other nationwide public entity, NHB exercises a vigilance function, preventive and punitive, through its Vigilance Unit headed by a Chief Vigilance Officer (CVO). Allegations of corruption can be addressed to the CVO by phone or email but cannot be anonymous or lodged against private individuals. Consequently, NHB has no jurisdiction on allegations of corruption against primary lenders staff, which should qualify as private corruption. This is a legitimate limitation of NHB's vigilance responsibility, which can only be mitigated by ensuring that borrowers' grievances against primary lenders would be handled by NHB. But since, under its preventive role, NHB CVO is meant to make 'suggestions/recommendations to [NHB] management to develop systems and procedures' to prevent corruption, he will be asked to extend the reach of his recommendations to the risk of corruption at the level of primary lenders so that NHB management and Bank staff can discuss possible measures to mitigate such risk during project implementation.

Annex 10: Consultations with Practitioners

212. During the preparation of the Project, consultations were held with practitioners were held on several occasions (see Table 17). The practitioners consulted included:

- Developers building low-income housing
- NGOs and MFIs providing loans to borrowers (generally informal) for both incremental housing and mortgages
- Housing finance companies providing mortgages
- Architects and urban planners

Table 19: Consultations Held

Date	Title	Organizer	Participants	Topics
June 16, 2010	Practitioners' Meeting	World Bank	Low-Income Housing Finance Cos.	Housing finance for informal sector borrowers
January 11, 2011	Roundtable on Low Income Housing	World Bank	Government, HFCs, PLIs, NGOs, Developers, Urban Planners	Housing finance
May 11, 2011	Customer Insights on Low Income Housing	NHB-Monitor	Government, HFCs, PLIs, NGOs, Developers	Segmentation of the low-income housing market
September 12, 2011	Consultations on Housing Finance	NHB/WB	Representatives of 12 NGOs/MFIs	Low income, informality, and incremental housing
September 24, 2011	HFCs and Informal Sector Housing	NHB/WB	Representatives of 5 HFCs	Serving informal borrowers
October 7, 2011	Housing Finance: Emerging Contours	NHB, CAFRAL	Government, HFCs, PLIs, NGOs, Developers, Urban Planners	Evolution of the housing sector, housing finance, affordable housing
January 11, 2012	Consultation with PLIs	WB	MFIs, NGOs, Coop Banks, NHB	Informality in housing finance
September 5, 2012	Consultation with PLIs and NGOs	NHB	MFIs, NGOs, Coop Banks, NHB	Low income, informality, and incremental housing

213. The consultations influenced the design of the Project in several ways over time. Initially, there was a concern that constraints in the supply of low-income housing were the main issue and there would be limited need/demand for housing finance (to assist on the demand side) until supply constraints were addressed. The initial consultations provided confirmation that, while supply constraints were significant, there was nonetheless a supply of low-income housing, especially in secondary cities (Tier II and Tier III), and there were lending institutions serving this market. These lending institutions comprised low-income housing units of HFCs as well as MFIs and NGOs.

214. A second concern was that expanding housing finance with limited supply would drive up prices, thus making low-income housing unaffordable to low-income households. Consultations, together with research, indicated that the supply of low-income housing was large enough relative to the additional housing finance provided and price responses unlikely. Recent research indicates that developers which are targeting low/moderate income buyers now have significant scope to raise prices during the sales period for each Project; pricing of formal housing is moving faster than incomes of formal sector households. This is not due to demand stimulation, but instead to the vast speculative demand by mid-market customers for small flats which they consider to be a one way bet and store of value. So the only market failure in the formal borrower/formal housing segment, is affordability, not inclusion.

215. PLIs serving low-income households indicated various needs: longer-tenor finance, capacity building, and market infrastructure, particularly instruments such as a credit information bureau or mortgage repository to help prevent multiple lending against the same property and multiple loans to the same borrower, similarly to what is being done for general microfinance loans. A relaxation of regulatory norms, such as capital requirements and NPA norms, was advocated by some, while there was debate on whether a government guarantee, such as the one recently proposed by MoHUPA, would help market development or do more harm than good by reducing the cost to borrowers of defaulting.

216. There was much discussion on how to serve two segments of the market that are underserved: households with informal sources of income seeking loans to (a) buy a house, and (b) make incremental investments in an existing house. Two main issues have been discussed at length. First, borrowers with informal sector jobs lack income proof and require specific assessment methodologies. Institutions that serve several financial needs for these clients, such as MFIs, could be well-placed to assess the risks they pose and provide housing finance. The assessment of risk by a refinancing agency such as the NHB could then rest not on the riskiness of individual mortgages but of the corporate credit risk of the MFI.

217. Second, financing for incremental investments in housing would need to require some form of tenure rights on the house. Tenure rights are not a black-and-white concept in India, with a continuum of options ranging from formal title to various forms of proof of residency. The nature of the settlement also matters, with some degree of assurance that it would not be removed necessary to justify incremental housing investments and the related loans. The consultations have made it clear that limiting loans to those with clear titles would exclude most potential primary borrowers. They also provided many examples of ways in which the legality of a settlement could be assessed under different state and local laws.

218. A concern that emerged during consultations related to the quality of construction in incremental housing, which is often poor and exposes residents to severe risks in the case of natural calamities. As a result, work was commissioned on low-cost housing construction standards and possible technical assistance support to self-builders that could help reduce these risks.

219. Main conclusions of Final Consultation:

- The details of what loans would be refinanced will matter greatly. If the bar is too high, there will be limited loans.
- The regulatory environment in which MFIs and HFCs can lend and NHB can refinance needs to be clarified, particularly vis-a-vis alternatively secured loans and loans for housing in informal/un-regularized settlements.
- The operation should support various pilots.
- The income criteria for formal housing loans will be reviewed.
- The safety criteria will be reviewed.
- Capacity building would not be limited to NHB but would also be provided to PLIs.

Annex 11: Assessment of Demand and Supply for Low Income Housing Finance

Table 20: Assessment of Demand and Supply for Low Income Housing Finance

Income	**EWS: Rs. 0 – 5,000 (25m HH)**		**LIG: Rs. 5,000 – 10,000 (25m HH)**	
Type of Income	Formal (6m HH) Informal (19m HH)		Formal (6m HH) Informal (19m HH)	
Type of Construction	Incremental Housing in Slums (often 'un-notified') (18m HH)	Government Provided EWS & LIG (25m HH)	Incremental Housing in Slums (often 'notified') (7m HH)	Incremental Housing in Low Income Neighbourhoods (LIN) (8m HH)
Loan Size	EMI up to Rs. 500[75] for tenure of 2 years – total loan size to about Rs. 9,000	Expected to pay Rs. 20,000 – 50,000 as contribution towards home	Loan of Rs. 30,000 – 80,000 at interest rate of 18-22% over 3-5 years	Loan of Rs 80,000 – 120,000 at interest rate of 18% over 5 – 7 years[76]
PLI Interest	Many Urban MFIs (UMFI) reluctant to lend due to lack of stability. HFCs unwilling to lend. [1]	Some UMFIs & HFCs willing to service segment but expressed concern on repayment; interested in NHB loan guarantee. [2]	Most UMFIs interested but concerned about lack of clear title. [2]	Most UMFIs and some HFCs interested with less concern about lack of clear title. [3]
Supply	Poor quality of housing, mostly temporary structures. Self-built structures are mostly ground floor, though in mega cities, double story are seen. Often no basic services other than electricity. No toilets. Average plot size very little, irregular plots, narrow streets. Sanitation and leakages main problems. For interested MFI's some opportunity to support individual upgradation as long as the existing units are safe and no vertical building will be encouraged in any way **(C1)** In-situ redevelopment is probably the best option. NGO's can facilitate and lead this kind of intervention. [A]	Significant focus for government though there has been a history of limited delivery. Supply is difficult to estimate but might be 50,000 – 250,000 homes over next 3-4 years. [B]	Poor quality of housing, temporary and permanent self-built structures, ground and G+1 stories. Majority of the structures unsafe. Variable access to basic services, rarely sewage system in place. Average plot size and standardization vary. Opportunity to deliver financial and technical assistance **(C2)** in some favorable settlements and cities to support incremental housing. Plots will need to be of a minimum size. Existing structures to be verified before disburse any loan that will lead incremental vertical building. [B]	Average quality of housing, majority are perman't structures. Units can be up to G+2 stories (mega and tier I cities). Self-built structures, quality varies. Decent access to basic services, Average plot size and regularity vary. Given the average decent house sizes and regularity of plots, good opportunity to deliver financial and technical assistance to support incremental housing. Existing structures to be verified before disburse any loan that will lead incremental vertical building. [C]

Legend - PLI Interest

Low Interest [1]	Some Interest [2]	Interest but few concerns [3]	High Interest [4]

Legend – Supply **Low Potential** **Some Potential** **High Potential**

[75] While Urban MFIs were willing to lend them more, customers paying more than Rs. 500 towards EMI would be left with very little buffer in case of emergencies, hence this amount is used here

[76] Given current funding, HFCs are comfortable giving 7 year loans, Urban MFIs will be comfortable giving loans of up to 5 years.

Table 2: Assessment of Supply and Demand for Low Income Housing Finance

Table 21: Assessment of Supply and Demand for Low Income Housing Finance

Income	**LIG+: Rs. 10,000 – 15,000 (13m HH)**			**Rs. 15,000 – 25,000 (9m HH) Income exceeds target for Bank Funding**	
Type of Income	Formal (3m HH) Informal (10m HH)			Formal (2m HH) Informal (7m HH)	
Type of Construction	Incremental Housing in Low Income Neighborhoods (6m HH)	Formal Housing		Formal Housing	
		Self-Construction (2m HH)	Flat Purchase (5m HH)	Self-Construction (1mn HH)	Flat Purchase (3 mn HH)
Loan Size	Loan of Rs. 1.2 – 1.8 lakhs at interest rate of 18% over 5 – 7 years	Can afford 35-40% of MHI as EMI. Loan of Rs. 2.8 – 4.5 lakhs	Can afford 35-40% of MHI as EMI. Loan of Rs. 2.8 – 4.5 lakhs	Can afford 35-40% of MHI as EMI. Loan of Rs. 4.5 – 7.5 lakhs	Can afford 35-40% of MHI as EMI. Loan of Rs. 4.5 – 7 lakhs
PLI Interest	Most UMFIs and some HFCs interested with less concern about lack of clear title. [3]	Few HFCs present due to low economic value & difficulty in monitoring. [2]	HFCs very interested in serving formal sector. Some HFCs catering to informal sector also present. [3]	High interest from HFCs to finance this segment especially those who already have land. [4]	High interest from HFCs and banks to serve formal sector. Some HFCs catering to informal sector also present. [4]
Supply	Average quality of housing, majority are permanent structures up to G+2 stories. Self-built structures, quality varies. Decent access to basic services, Average plot size varies as does its regularity. Given the average decent house sizes and regularity of plots, good opportunity to deliver financial and technical assistance to support incremental housing. Existing structures to be verified before disburse any loan that will lead incremental vertical building.[B]	Only for those who had bought / inherited land previously. Low supply going forward due to high land prices. [A]	Market catalyzed at price point of under Rs. 6 lakhs in 2009-10 but limited supply going forward due to rising land & construction prices. [B]	Present in smaller cities where cheaper land is available. Some potential, but may be limited given rising land prices.[B]	Private sector catering to this market (<Rs. 10 lakhs) with increasing supply over the last 2-3 years. Large developers who conducted pilots are now launching further Projects. 11,000 units expected in 2012 from just 4 developers.[C]

Legend - PLI Interest

Low Interest [1]	Some Interest [2]	Interest but few concerns [3]	High Interest [4]

Legend - Supply

Low potential [A]	Some Potential [B]	High Potential [C]

Notes to Tables 1 and 2:

- 31. Incremental housing across all segments will only be applicable to those with tenure rights ('right to use') satisfactory to NHB and PLIs.
- 32. There may be an overlap between those interested in incremental housing and EWS & LIG housing as even those with their own homes may opt for government housing.
- 34. 10-30% of cost of the house, which could vary from Rs. 2-4 lakhs, and may be dependent on income level.
- 35. For 5-10k in slums, 15-20% of income, EMI 1200, 3 yrs @ 22% = 30k, EMI 2000, 5 yrs @ 18% is 80k. For LIN, 15-25% of income. EMI 2000, 5 yrs at 18% is 80k , EMI 2500, 7 years 18%, 120k.
- As of June, 2012.

Annex 12: NHB Today

220. NHB has successfully supported development of the mid-market mortgage industry, which is now predominately private. In addition to this middle market business, NHB's Board has decided to refocus its portfolio on PLIs which serve the housing finance needs of low-income households. NHB's Board has approved a business plan which reflects this transition.

221. NHB currently functions as a second tier liquidity facility providing short and long term refinance of banks and HFCs collateralized by their housing loan portfolios. Created in 1988, NHB has been a catalyst for the development of housing finance in India. It regulates and supervises the HFCs, provides loans to its clients funded by bonds issued both domestically and globally and functions as an APEX housing finance institution providing leadership and support of a wide variety of housing finance Projects. And it has a diversified funding base. It increasingly accesses the local bond market with an AAA rating to raise funds.

222. At small scale, NHB pre-finances[77] MFIs and NGOs which target informal borrowers in various parts of the country for both self-built housing and improvements, and formal housing. The volume is small; from 2004-to date, NHB has refinanced 25,000 units through these first tier lenders for a total portfolio of about USD 20 million. NHB's lending to MFIs is secured by a claim (hypothecation) on the MFI's loan book, requires that the MFI use mortgage instruments on the retail loan where possible (but allows for alternatively secured loans as well), requires that the retail borrower has successfully repaid at least three lending cycles with the MFI, as well as a group guarantee on a housing related loan. Currently, when NHB refinances a portfolio of loans for a primary lender, its staff check the loan files for evidence that the retail borrower has adequate property rights and that construction approved by building inspectors as required by the relevant authority. Under the Project, NHB will issue guidelines which allow for prudent lending in the informal spaces, including tenure and titling noted herein.

223. Throughout its history NHB has operated in a conservative and low risk manner. It provides loans to registered and regulated financial institutions, backed by portfolios of home loans. It provides some Project finance to state agencies, backed by state guarantees. It administers subsidy Projects on behalf of the GoI but does not itself provide subsidies. Its credit risk is low reflecting its corporate lending to financial institutions and the collateral that is pledged to support such lending. Its interest rate risk is low reflecting almost exclusive use of adjustable rate financing. It operates on a very efficient basis with a low expense to revenue ratio.

224. NHB's five-year business plan envisions a significant expansion in the breath of its activities. In particular it will strive to substantially increase its funding of LIG formal and informal housing through lending to newly created HFCs and MFIs, increase its construction finance to private/public agencies targeting LIG borrowers, promote rural housing, and greatly expand its research and training capabilities.

[77] NHB 'prefinances' MFIs and NGOs, which is different from the refinance it provides to Housing Finance Companies. The difference is that NHB funds the MFIs/NGOs before the retail level loans are originated.

225. The expansion of NHB's activities during the five year plan period has the potential to significantly increase NHB's risk, both credit and operational. Thus the implementation plan needs to focus on identifying the resources, both human and other, necessary to implement in a safe and sound manner.

NHB Business Plan

226. NHB's vision is to promote expansion of housing finance, consistent with stability, to more effectively meet the housing needs of all segments of the population with a focus on low and moderate-income housing. It seeks to actualize this vision through 4 broad areas of activity: (i) Financing; (ii) Development of Market Infrastructure; (iii) Expanding the scope of low and moderate income housing [support]; and (iv) Supervision of the HFCs and housing finance system.

227. NHB has a target of at least 50 percent of its annual funding towards low and moderate-income housing. This is a major change in focus as to date NHB's clients have mainly targeted middle and upper income formal sector borrowers. To achieve this goal NHB will need to bring new lenders into the market and work with lenders to create new products and underwriting techniques appropriate for LIG and informal borrowers.

228. In order to accomplish its mission NHB's business plan envisions the expansion of current activities in refinance and construction finance, greater coordination of subsidy flows from various levels of government, setting up mortgage guarantee and securitization companies, expanding its regional branch network, setting up a Training and Research Institute and possibly developing credit enhancement and risk mitigation measures to facilitate expansion of both the primary and secondary mortgage markets.

229. NHB's refinance function will be expanded to include new lenders, in particular Regional and Rural Banks (RRBs), MFIs and new HFCs. This will entail new policies and procedures appropriate for different types of institutions (particularly non-bank financial institutions) lending to a different class of borrower (informal with irregular and/or undocumented income; lower income). NHB has developed guidelines for lending to MFIs – however these guidelines are untested, in particular with regard to MFIs engaged in new types of lending (longer term housing loans) and risk (credit, liquidity and interest rate).

230. NHB has a target of 40 percent of its funding going to rural areas. Much of this lending will take place through RRBs and MFIs and necessitate a significant expansion of its regional network in order to market to, underwrite and monitor new lenders.

NHB Capacity Assessment

231. NHB is short-staffed for its current functions. It is sanctioned for 122 staff but currently has only 88 full time employees. The main line functions of Refinance, Project Finance and Treasury all reported a shortage of staff. NHB plans to hire 17 staff by the end of its fiscal year at June 30. According to the head of Human Resources (HR) most of the recruits will be recent

college graduates.[78] It is imperative that NHB fill its vacant positions before taking on major new responsibilities.

232. Currently 4 out of 7 General Manager Positions are vacant as are 5 out of 14 Assistant General Managers. NHB plans to fill these positions by December either through promotions or outside hire. Their preference is to promote from within. It should be noted that many of NHB's senior staff are near retirement creating the need for institution succession planning.

233. To support the five year plan NHB plans to increase staff to 174 on a phased basis. Refinance is Projected to have 13 (vs. 7 current); Project finance 6 from 5 current; regulation and supervision 20 from 9 current; Risk Management 7 from 6 current; Planning and Research 9 from 3 current. Regional representative offices are slated to expand from 16 to 25. Corporate Finance from 6 to 23 (need explanation – other functions probably include). There are 6 slots for new initiatives, 6 for rural housing and 7 for the price index.

234. NHB is subject to GoI compensation policies. It is difficult to hire experienced staff for technical positions as the private sector typically pays up to double what NHB can offer. For that reason NHB also experiences significant turnover in junior staff. They can hire contractors for up to 3 years at higher salaries. No clerical or support staff are hired on a permanent basis (all contract).

235. The refinance function is well defined with an excellent track record. They have well developed policies and procedures for qualifying new financial institution borrowers, disbursing funds and receiving documentation for safekeeping, setting borrowing limits, conducting needs based supervision (quality control review of loan file sample; review of accounting and underwriting) and reporting. The department is sanctioned for 12 but has only 7 full time staff.

236. NHB has begun to reach out to new types of lenders. They have 3 new clients that focus on informal borrowers. In order to begin refinancing their lending, NHB reduced their rating time from the normal 3 years to 1-2 years. They require sponsor guarantees and set low exposure limits to reduce their risk.

237. The big challenge for the refinance function is to be adequately staffed to take on new clients, many of which may be in rural areas. This will necessitate hiring at both the home office and regional office levels. NHB will have to train its new hires – particularly those involved in qualifying and supervising new types of institutions such as MFIs.

238. NHB plans to increase its decentralization, with a significant portion of new hires over the five year plan located in its regional offices (currently seven are open with two more planned for later this year and an additional four offices during the five year plan). Only Mumbai, which handles disbursements, has more than 2 staff. The regional staff will also need to be more specialized. The plan envisions regional staff conducting off-site supervision, loan underwriting, Project finance review, inspection and appraisal, training courses and workshops, state policy formulation, and marketing.

[78] This goal may be challenging as well. See the April 5 Wall Street Journal report on India colleges. http://online.wsj.com/article/SB10001424052748703515504576142092863219826.html

239. The Project finance function administers NHB's acquisition, development and construction business. This lending has been reduced in recent years (~$300 million outstanding) but still involves more than 35 active Projects in 10 states that average 1000 dwelling units per Project. This type of lending is risky (even with state agency guarantees) and resource intensive. NHB staff Project demand, check technical specifications and cost estimates, create cash flow forecasts, release funds in phases after on-site inspections. They outsource some of the work by having external appraisers and engineers review the plans and opine on value and outside legal counsel review the Project.

240. NHB is clearly short-staffed for this function with only 5 home office staff supported by the regional offices that do all the on-site inspections. There is no full time in-house appraiser. NHB needs to hire additional staff to support their current portfolio and yet more staff to support planned expansion. Some specialized staff may also be needed – an engineer and appraiser for example.

241. There have been no defaults on the Project finance portfolio, in large part due to the fact that the loans have been to state agencies which have guaranteed the Project or secured by a first mortgage on the land (loan to cost ratios of 50-60 percent). The risk of this activity is likely to increase as NHB has begun lending to PPPs (developer and state agency) without a guarantee. They also plan to provide construction loans to MFIs who work with NGOs and self-help groups that may have limited experience in managing construction Projects.

242. The Project finance group also supervises the mortgage-backed securities portfolio [transactions in which NHB has served as trustee, Special Purpose Vehicle (SPV), and guarantor]. Investor servicing is retained by the originator and audited. NHB has loan portfolio credit risk but are well protected through over-collateralization and originator retention of first loss securities. NHB reviews servicers, performance information, and trusts (reconciling payments) and receives monthly reports. They also conduct due diligence on new issues. They have recommended spinning off this function to a separate group. There are four staff in this area with one planned hire.

243. The Treasury function handles funding and liability management including exchange risk hedging, bond issuance, bank loans and short-term investment management. They appear to have well developed guidelines, policies and procedures. There is daily reporting of transactions and updating of cash flow forecasts and forex positions. They produce daily and annual cash flow forecasts and have daily investment committee meetings. The run liquidity and interest rate gap reports and a monthly portfolio mark to market. They have little interest rate risk with average asset duration of 3.1 years and average liability duration of 2.9 years. The Treasury function reported it needs to hire at least one additional staff and that the current senior staff are too involved in day to day work to focus on strategy.

244. The Research function has three full time staff involved in business planning and market research. They produce the Annual Report and other required reports. They have conducted impact studies of the rural housing fund and housing microfinance. They conduct semi-annual meetings with the industry, attend international meetings, and answer state and national policy questions. Given the significant emphasis on training and development there clearly needs to be

additional staff in this function including specialists in research and evaluation. Some of the research needs can be outsourced to universities.

245. The Regulation and Supervision (R&S) function supervises 54 HFCs. 20 of which can issue deposits and are identified as sensitive companies. There are 9 staff in the head office with some support from regional office staff. R&S review applications for new HFC licenses and conducts off-site and on-site supervision of existing HFCs. Off-site supervision consists of review of monthly, quarterly and annual reports from HFCs. Interactions with other regulators on the national and state level, money laundering reporting and capacity building through auditor training. All deposit taking HFCs are reviewed on-site annually – other HFCs have on site reviews every two years. The typical review takes 7 to 21 days with 2-4 staff. Supervisory staff conducts file review of a sample of loans, check financial and risk reports, internal controls and current trends. Typical problems are margin squeeze due to high cost of funds and increasing competition from non-HFC lenders. HFCs are rated annually from A through D – currently 65-70 percent are rated A with none rated D. The regulation function is slated to shift to RBI later this year.

246. The Risk Management function is key to the successful operations of NHB. The Risk Management group creates rating models for use by Refinance and Project Finance (including tailored models for rural banks and MFIs). The Board reviews umbrella risk policies annually and receives quarterly detailed risk profiles from Risk Management. NHB has never had a default on a refinance loan – its main concern about HFCs is geographical concentration. It conducts large loan reviews (500 crore borrowers moving down to 250 crores). There is a rating model for Project finance that concentrates on company credentials and obtaining a mortgage. There are no specific risk management guidelines (loan to cost or loan to value) – all loans are individually reviewed. Internal Audit reports quarterly to the Audit Committee of the Board and conducts daily audits of the Treasury function. RBI conducts a statutory audit and financial inspection. Risk Management prepares a monthly interest rate sensitivity analysis. There are six staff in the Risk Management group. [Need to obtain and review risk management reports].

247. The IT platform is scheduled to be upgraded this year to the latest version of SAP which supports all their core business processes. The upgrade will allow NHB to deploy the business Intelligence solution for analysis of internal and external data. They are planning to implement a document management system that would digitize all reports and integrate with SAP. The Bank has an intranet system that connects all offices with the data center. It has a central file repository that links the bank with the HFCs allowing electronic data and report submission as well as enabled access to data to build internal reports. NHB has a well-developed housing information portal with individual, client, investor Mortgage Backed Securities (MBS) and developer access. They also support the Asian Housing Finance Organization portal. They need to build a Project finance data storage and access capability.

248. The preliminary assessment is that NHB performs its core functions very well. However it is considerably short-staffed which could undermine future performance. NHB is proposing to take on significant new responsibilities and risks in the future. Attracting and retaining well-qualified staff is one of its major priorities.

249. NHB has rigorous eligibility criteria for primary lenders seeking to draw refinance. They are adequate for disbursements under the IDA line of credit. HFCs should:

- **a.** invest at least 75 percent of capital employed for long term finance for housing
- **b.** have net owned funds of not less than Rs. 10 crores
- **c.** comply with provisions of the NHB Act, 1987 and the Housing Finance Companies (NHB) Directives, 2001 as amended
- **d.** net nonperforming Assets of the HFC should not be more than 2.5 percent of the net advances
- **e.** attain the minimum standard rating to be eligible for financing from NHB. For this purpose, NHB has developed an internal credit rating model.

250. NHB has eligibility criteria for microfinance institutions and NGOs which seek to draw pre-finance from NHB. These PLIs should:

- **a.** Have been in operation for at least three years;
- **b.** Lend to primary borrowers which have successfully paid off at least three credit cycles with the MFI;
- **c.** Have an NPL ratio of less than 5 percent;
- **d.** If mortgage security is not possible, seek other security such as a third party or group guarantee.

Table 22: NHB's Refinance performance in 2011-12

S. No.	Loan Slabs	HFCs	SCBs	RRBs	Others (UCBS)	Total Disbursements (% To S. N. 6)
1.	Upto Rs. 2 Lakh	691.25	364.94	54.23	5.43	1115.85 (7.75%)
2.	Rs. 2 Lakh- Rs 5 lakh	1179.45	2525.49	31.36	56.41	3792.71 (26.36%)
3.	Rs. 5 Lakh- Rs 15 lakh	2156.54	3738.92	57.45	21.48	5974.39 (41.52%)
4.	Above Rs. 15 Lakh	1274.89	2222.07	-	10.00	3506.97 (24.37%)
Total		5302.13	8851.42	143.04	93.32	14389.91 (100%)

Table 23: NHB's Asset Quality

S. No.	Year ended 30th June (Amt. In Rs. Crore)	2009	2010	2011	2012
1.	Gross Loan Assets	16,851	19,837	**22543**	**28490**
1.1	*Year on Year Growth*	----	*17.7 %*	*13.6 %*	***26.4%***
2.	Gross Non Performing Assets	Nil	Nil	Nil	**3.56**
3.	Collection Efficiency	100 %	100 %	100 %	**99.99%**
4.	Gross NPA to Gross Loans	0 %	0 %	0 %	**0.01%**
5.	Net Non Performing Assets	Nil	Nil	Nil	**3.03**

- As per RBI directives, Subscription to SRHD (Special Rural Housing Debentures) of ARDB has been shown as a part of investment rather in loan assets from the year 2011 onwards. Accordingly figures for the year 2011 has been reclassified.

Table 24: NHB's Financial Performance 2010 – 11

S. No.	Year ended 30th June (Amt. In Rs. Crore)	2009	2010	2011	2012
1.	Authorized & Paid –up Capital	450	450	450	**450**
2.	Reserves & Surplus	1,792	2,072	2,352	**2,739**
3.	Net Owned Fund	2,230	2,485	2,770	**3,154**
4.	CRAR (%)	18.19	19.59	20.64	**19.82**
5.	Profit after Tax	236	280	279	**387**
6.	Net profit Per Employee	2.62	3.15	3.21	**4.07**

Table 25: NHB's Borrowings Outstanding

S. No.	Year ended 30th June (Amt. In Rs. Crore)	2009	2010	2011	2012
1.	Bonds and Debentures	3,582	8,352	9,767	**12,493**
2.	Borrowing from RBI	4,006	24	21	**18**
3.	Loan from Banks/FIs	3,070	5,190	5,252	**3,638**
4.	Deposits from Bank under RHF	1,760	3,764	5,778	**8778**
5.	Public Deposits	321	372	**249**	**219**
6.	Commercial Paper	1,948	47	0	**489**
7.	Other Borrowings	1,608	1,035	**390**	**611**
8.	Borrowings outside India	435	401	395	**557**
Total		16,730	19,185	21,852	**26,803**
Year on Year Growth		---	14.7 %	13.9 %	**22.7%**

Annex 13: Affordable Housing Projects by the Government of India

251. **JNNURM.** The Jawaharlal Nehru National Urban Renewal Mission (JNNURM) was launched in December 2005 as a flagship Project of the GoI aimed at creating economically productive, efficient, equitable, responsive and inclusive cities. The JNNURM was designed to extend over the 2005-2012 period and has been organized in four schemes: The Urban Infrastructure & Governance (UIG) and Basic Services to the Urban Poor (BSUP), applicable to 65 cities of national importance, and Urban Infrastructure Development Scheme for Small and Medium Towns (UIDSSMT) and Integrated Housing & Slum Development Project (IHSDP) applicable to other cities and towns. UIG and UIDSSMT are managed by the Ministry of Urban Development (MoUD) and focus on the development of city-wide infrastructure, whereas BSUP and IHSDP are managed by the Ministry of Housing and Urban Poverty Alleviation (MoHUPA) and focus on housing and provision of basic amenities to the urban poor.

252. As of September 30, 2011, an amount of Rs. 23,184.66 crore (around US $ 5.15 billion) had been budgeted in terms of Central assistance to the states and Urban Local Bodies (ULBs) under the BSUP and IHSDP. The main use of these funds is for the construction of finished housing for EWS and LIG groups. As of September 30, 2011, the sanctioned amounts corresponded to a total of around 1.44 million housing units to be built (1.02 million under BSUP and 0.42 million under IHSDP). Although the central budget made available for the Projects has been almost fully committed, the number of houses completed still represents a fraction of the number of houses sanctioned (one third for BSUP and around one fourth for IHSDP). More significantly, only about half of the houses built under BSUP and around two thirds of the houses built under IHSDP were occupied as of September 30, 2011.

Table 26: Status of implementation of BSUP and IHSDP, September 30, 2011

	BSUP	IHSDP	Total
Budget provision (Rs. Crore)	16,356.35	68,28.31	23,184.66
Approved cost of Projects (Rs. Crore)	28,897.16	10,762.32	39,659.48
Central Assistance Released (Rs. Crore)	7,182.89	4,376.72	11,559.61
Number of Houses Sanctioned	1,020,083	542,128	1,562,211
Number of Houses Completed	339,664	145,715	485,379
Number of Houses Occupied	178,439	97,431	275,870
Number of Houses Under Construction	191,201	132,441	323,642

253. **The RAY Project**, was approved by the Cabinet on June 2, 2011. The main objectives of the Project are to: (i) bring existing slums within the formal system and enable them to avail of the same level of basic amenities as the rest of the town; (ii) redress the failures of the formal system that lie behind the creation of slums; and (iii) tackle the shortages of urban land and housing that keep shelter out of reach of the urban poor and force them to resort to extra-legal solutions in a bid to retain their sources of livelihood and employment. Under the RAY Project, the GoI would provide 50 percent grant financing for slum upgrading, slum redevelopment and construction of housing conditional on a set of reforms, including:

- Legislation providing property rights for all slum dwellers,

- The continuation of the three pro poor reforms of JNNURM (earmarking of budget for basic services for urban poor, provisions of basic service, tenure and housing for the poor, earmarking of 20-25 percent of developed land in housing Projects for EWS/LIG with a system of cross-subsidies)
- Reforms to the rental and rent control laws;
- review and amendment to the legislation, rules and regulations governing urban planning and development structures and systems towards an adequate response to the demands, process and pace of urbanization

254. **The Interest Subsidy Scheme for the Housing of the Urban Poor (ISHUP).** Launched by MoHUPA during 2008-09, it provides a 5 per cent interest subsidy on a loan up to Rs.100,000 for EWS and LIG households. Under the scheme, EWS households have been defined as households having an annual income up to Rs.1,00,000 and LIG households are defined as households having annual income between Rs.1,00,001 to Rs.2,00,000. The borrowers under the scheme must belong to the EWS or LIG, and must have a plot of land for the construction, or have identified a purchasable house. The scheme initially relied on the intercession of State Governments/ULBs to identify eligible borrowers with land, help them with preparation of papers and liaise for them with the lenders. However, it appears that a relatively small number of loans have benefitted from the Scheme compared to estimated potential. Potential reasons for this situation include: (i) imperfect coordination between the mechanism for identification of eligible borrowers followed by State Governments and ULBs on one side, and the PLIs underwriting standards on the other side, and (ii) the definition of the scope of the Project, both in terms of loan amount and households income, which does not match the market segment the PLIs are currently familiar with. The Scheme has been extended for the FY 2012-13, and its implementation mechanism has been revised to allow the PLIs to certify the income of potential borrowers. This change, along with increased awareness of State and Local Governments and PLIs, is expected to lead to increased disbursements under the Scheme.

255. **1% interest subsidy scheme for housing loans upto Rs. 15 lakhs.** This scheme was created in October 2009 at the initiative of the Ministry of Finance, Government of India, in order to stimulate demand for credit for housing in the middle & lower income segment of population in the country. The scheme consisted in an interest subvention of 1 percent on all individual housing loans of upto Rs. 10 lakh, provided the cost of the unit does not exceed 20 lakh. For FY 2011-12 the Scheme has been extended for housing loan upto Rs.15 lakh, where the cost of house does not exceed Rs. 25 lakh. The scheme is implemented through SCBs and HFCs with NHB as the nodal agency. It is estimated to have disbursed around Rs 300 Cr. / year in FY10-12 and FY11-12.

256. **Credit Risk Guarantee Fund Trust for Low Income Housing matches the lending criteria of this project.** Pursuant to the Union Budget announcements in FY 2010-11 and 2011-12, the Credit Risk Guarantee Fund Trust for Low Income Housing was set up & registered by the Government of India on 1st May, 2012 through the Ministry of Housing and Urban Poverty Alleviation (MoHUPA). The National Housing Bank (NHB) will be managing the Fund Trust and will facilitate and oversee the implementation. The scheme has since been notified in the Gazette of India (July 7-13, 2012) and is effective from June 21, 2012.

257. Under the Scheme, the Fund will provide credit risk guarantee to the lending institutions against their housing loans up to Rs. 5 lakhs for new or existing borrowers in the EWS/LIG categories, without requiring any collateral security and/or third party guarantee. The extent of Guarantee Cover to be provided under the Scheme is 90% of the amount in default in respect of loan amount up to Rs. 2 lakh and 85% of the amount in default for housing loan above Rs. 2 lakh to Rs. 5 lakh. The lending institutions eligible under the Scheme of the Fund Trust include Scheduled Commercial Banks, Regional Rural Banks, Urban Co-operative Banks, NBFC-MFIs, Apex Cooperative Housing Finance Societies registered under the State Co-operative Societies Act and Housing Finance Institutions registered with National Housing Bank (NHB).

Intended Benefits of the guarantee cover provided by Fund Trust include:

258. To the lenders: their credit risk will get transferred to the Trust which will lead to the reduction in their risk weighted assets. This in turn will provide the needed capital relief as there will be lesser capital requirement for CRAR with reduction in risk weighted assets.

259. To the borrowers: the provision of guarantee under Fund Trust will enhance the credit worthiness of EWS and LIG borrowers, which should encourage lenders to lend to this segment. Further, it is expected that in addition to the increased availability and accessibility of loans to this segment, the rate at which the loans will be available will also come down due to reduced risk & lesser capital requirements for lenders.

260. **State Level Activities by Urban Local Bodies**. Housing schemes that are formulated by governments in terms of their respective housing policies are intended to be carried out under the control and supervision of their respective ULBs. The role of the ULBs would be, among others, as follows:

1. ULBs would ensure the following:
    - either government land or acquired land is made available for construction of EWS/LIG/MIG housing;
    - first preference is given for construction of affordable housing (for EWS, LIG and MIG);
    - subsidy received from Government of India as per policy is used;
    - the quality of works as per guidelines issued by the Government of India for affordable housing under PPP is maintained;
    - handed over property to urban poor is insured;
    - eligible primary borrowers are chosen to whom the flats are allotted and sold;
    - at the time of handing over the property, the beneficiary becomes the registered applicant of the society which will maintain the common services. Beneficiary should also deposit the one time security deposit for the same;
    - the scheme is sanctioned within the prescribed time;
    - building plans are approved expeditiously;
    - external development works are taken up and completed in a time bound Project and in pace with the internal development works; and

- original allotment letter is mortgaged to the bank/financial institution by the beneficiary while borrowing from a bank or financial institution for buying his house/flat.

2. **ULBs would appoint a nodal officer** for coordination of various activities of the Project with banks/financial institutions, primary borrowers and other departments.

3. ULBs would provide comfort to banks/financial institutions who have granted loans to the primary borrowers through assurance of take-over of the defaulter's unit and repayment of housing loan. The unit can be allotted to another beneficiary against payment.

4. ULBs would guide the urban poor in execution of the relevant deeds on priority.

5. ULBs would make endeavor to organize camps to ensure that loans are sanctioned to primary borrowers by banks/financial institutions and interest subsidy is also availed by primary borrowers.

6. ULBs would take up acquisition of land for allotment to private developer for housing scheme under the policy.

Annex 14: Role of Housing Finance in 'formalization' process

261. **Access to secure shelter** is often a precondition for access to other benefits, such as livelihood opportunities, public services, and credit. Tenure therefore forms the foundation on which any effort to improve living conditions for the poor has to be built. The most common single approach adopted to date in addressing tenure-related problems in developing countries is to provide settlers with individual land titles, with the following objectives:

- to provide the most secure form of tenure available
- to enable households to use their property titles as collateral for loans to improve the house
- to help local authorities increase the proportion of planned urban land and deliver services more efficiently
- to enable local governments to integrate informal settlements into the tax system
- to improve the efficiency of land and property markets.[79]

262. However, experience shows that this approach of providing individual titles has, for most part, not achieved the above objectives. *De facto* tenure has often proved to be as effective as *de jure* tenure, but much easier to implement and more suitable to the social and cultural context.

- In Egypt, 60 percent of all housing is provided by accretion of rights over time. This could include receipts for the payment of property taxes or service charges.
- In Columbia, legislation entitles all citizens to obtain public services (water, sewage, drainage, solid waste collection, electricity, telephone, gas) so long as they can prove their residency through a range of intermediate tenure systems, including 'Declaration of Possessions', 'buying and selling rights for future use', and 'communal tenancy'.
- In Burkina Faso, Benin, and Senegal, adaption of customary practices have enabled poor households to acquire *de facto* and ultimately *de jure* rights in the form of 'housing permits' or 'occupancy permits'.
- The CCRU ('Concession of the Real Right to Use') in the Brazilian cities confers legal security of tenure without a full transfer of freehold title.
- The Community Land Titles in Kenya combine the advantages of communal tenure (of the land) with the market-oriented individual ownership (of the structure).
- Cooperative housing in South Africa provides households with security of tenure and communal ownership of the land in ways intended to discourage speculation.[80]

263. These alternatives to the individual (freehold) land title offer poor households entry points to land and housing markets that avoid the social, economic, and environmental penalties of illegality. Moreover, increasing the perception of tenure security (*de facto* tenure security) before moving slowly toward formal, legally protected tenure security (*de jure* tenure security) is ideal because change rarely ever happens easily or quickly. By establishing a threshold of tenure security, these solutions achieve many benefits, including allowing residents to spend less time defending their rights and more time in productive activities, and encouraging families to invest in and improve their housing.[81]

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[79] Payne, Geoffrey (Ed.). Land, Rights, and Innovation: Improving tenure security for the urban poor, ITDG Publishing, 2002.
[80] *Ibid*
[81] Habitat. 'Strategies that Improve Tenure Security'

264. As Geoffrey Payne aptly states, 'Secure tenure is often the means to an end, not an end in itself. ... Legality is important, but legitimacy is all.'[82] Any form of tenure that will protect them from forced evictions and legitimize them as citizens is sufficient to encourage them to invest in improving their homes. The majority are prepared to build without holding title to their land… Although there is no doubt that legalization is sometimes necessary to provide assurance to particularly insecure settlers, the direction of causality is often reversed. Not infrequently, it is housing investment that brings about the granting of legal title.[83] Moves to more formal systems of tenure are advisable, but need to be made at a rate consistent with social and cultural norms as well as institutional capacity.

265. To this effect, it is critical to improve their access to finance through the strengthening of financial institutions to deliver un-secured or semi-secured loans for housing improvement or construction. There is evidence across India that in the absence of loan products specifically designed for home improvement, many borrowers take microfinance loans at high interest rates, and short tenures, to make improvements to their homes. The RAY Project is expected to enhance tenure rights countrywide, which will inevitably increase the demand for and ability of settlers to access such loans. The proposed Housing Finance Project will address this demand for financing, through the provision of small loans (as eligible for NHB's refinance). In other words, it will support incremental forms of finance – housing micro-loans – that could be made affordable to lower income clients and facilitate their home improvement processes.

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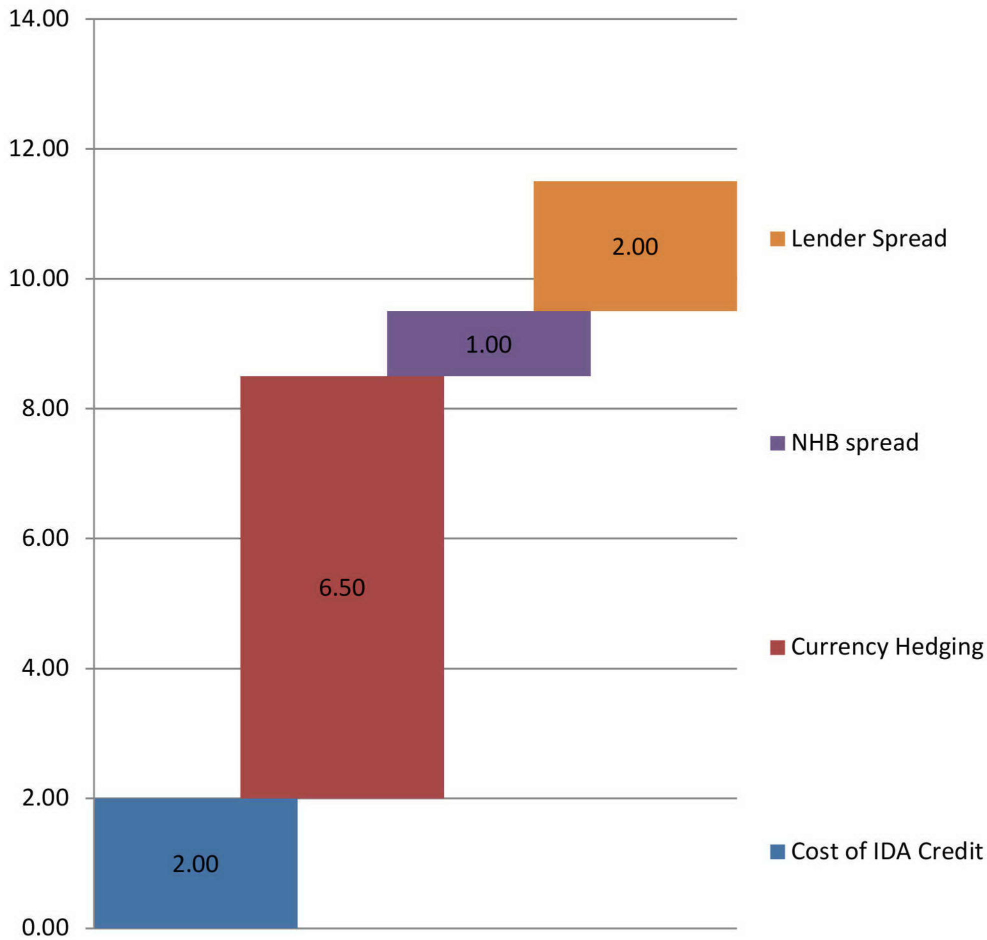
http://www.habitat.org/gov/suppdocs/chapter4_strategies_that_improve_tenure_security.pdf
[82] Payne, Geoffrey (Ed.), 'Land, Rights, and Innovation: Improving tenure security for the urban poor,' ITDG Publishing, 2002.
[83] Hirschman, A.O., 'Getting ahead collectively: grassroots experiences in Latin America,' Pergamon Press, 1984; and Razzaz, O.M., 'Examining property rights and investment in informal settlements: the case of Jordan,' *Land Economics* 1993 (69), 341-55.

Annex 15: Funding Costs at Each Level of the Financing Chain



266. **Current Funding Costs (before the IDA credit)**: NHB is a significant issuer in the Indian corporate bond market, and enjoys an AAA rating. The present cost curve for NHB funding reflects a flat interest rate curve in the rupee bond market at around 9.65 percent per annum. NHB takes a one percent margin in its refinancing of PLIs. PLIs take approximately 4 percent margins, resulting in an indicative +-11.5 percent cost to the primary borrowers, at a floating rate for a 10 year term.

267. **Proposed IDA Funding**: Under the Project for low-income housing finance, the IDA credit will be flowing to NHB through GoI. The cost to NHB will inter-alia include interest payable to IDA, and the cost of hedging the currency risk. The currency risk will be from SDRs into Rupees. The cost of a hedge does fluctuate and has been between 4 per cent and almost 7 per cent. The higher it is, the more pressure is put on the lender spread to maintain affordability of the loan for the end user. It is estimated that the proposed IDA credit in SDRs will have interest cost to GoI of about 2.0 percent per annum. The cost of hedging will be around 4.50 percent per annum. The total cost to NHB will be approximately 8.5 percent per annum, subject to market conditions, especially the premium for SDR hedging.

268. **NHB can allocate** the cost savings (about 0.15 per cent to 3 percent per annum, fixed rate) from the IDA credit as compared to their funding in the bond market towards (1) higher

operating costs associated with lending to MFIs and NGOs; (2) costs of capacity building (Component 1 of the Project); or (3) to the PLIs. NHB typically takes a one percent spread above its cost of funds when refinancing PLIs. Under the Project, NHB management has the discretion to set this margin, and the PLIs have the discretion to allocate any margin benefit passed to them to compensate for the higher cost of lending to lower income, informal sector borrowers, and the higher cost per loan due to small loan size. Lending by the PLIs to the actual primary borrowers will be at market rates. The above rates are expected to be fixed for the entire tenor of the loans (i.e. 15-20 years). This assumption depends on the depth of the interest rate swap market.

269. **While the proposed lending by World Bank is for twenty five years**, it is assumed that cost curve is flat starting from first year. Similarly, the cost curves for primary lending institutions and primary borrowers are also assumed to be the same from first year onwards, even though the period of their loan is for a higher tenor.

NOTE: The above estimates are based on the present market conditions and the actual cost to NHB and the PLIs and Primary borrowers will depend on the market condition at that time.

Annex 16: Team Composition

World Bank Group staff and consultants who are working on the Project:

Table 27: Team Composition

Team Composition			
Name	*Title*	***Role*	*Unit*
Michael Markels	Lead Financial Sector Specialist	Task Team Leader	SASFP
Bertine Kamphuis	Private Sector Development Specialist	Team Member	SASFP
Simon Walley, Olivier Hassler (Retired)	Housing Finance Program Co-ordinator	co-Task Team Leader	FCMNB
Subrata Dutta Gupta	Housing Specialist	Housing Specialist	IFC
Richard Clifford In Memoriam	Consultant	Consultant	SASDU
Augustin Maria	Urban Specialist	Urban	SASDU
Giovanna Prennushi	Lead Economist	Economic Analysis	PREM
Manoj Jain	Lead Financial Management Specialist	Financial Management and Corporate governance	SARFM
Puneet Kapoor	Financial Management Consultant	Financial management and Corporate Governance	SARFM
Arun Kumar Kolsur	Senior Procurement Specialist	Procurement	SARPS
Meera Chatterjee	Senior Social Development Specialist	Social Safeguards	SASDS
Sita Ramakrishna Addepalli	Environmental Specialist	Social Safeguards	SASDI
Vikram Raghavan	Senior Counsel	Legal	LEGES
Andre Herzog	Senior Urban Specialist	WBI	WBIUR