Board of Executive Directors

For consideration

On or after 7 December 2016

PR-4457
22 November 2016
Original: Spanish
Public
Simultaneous Disclosure

To:	The Executive Directors
From:	The Secretary
Subject:	Paraguay. Proposal for a loan for the "Project for the Development of the Housing Finance Market in Paraguay"

Basic Information:	Loan type .... Global Credit Operation (GCR)
	Borrower .... *Agencia Financiera de Desarrollo*
	Amount .... up to US$30,000,000
	Source .... Ordinary Capital
Inquiries to:	Manuel Fernandini (telephone Country Office in Paraguay 595-21616-2000) or Ramón Guzmán (extension 3375)
Remarks:	This operation is not included in Annex III of document GN-2849, "2016 Operational Program Report", approved by the Board of Executive Directors on 3 March 2016. In Addition, its amount exceeds the ceiling established for Group D countries. Therefore, the operation does not qualify for approval by Simplified Procedure.
Reference:	GN-1838-1(7/94), DR-398-17(1/15), GN-2849(3/16), PR-4311(9/15), DE-82/15

PUBLIC
SIMULTANEOUS DISCLOSURE

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PARAGUAY

PROJECT FOR THE DEVELOPMENT OF THE HOUSING FINANCE MARKET IN PARAGUAY

(PR-L1140)

LOAN PROPOSAL

This document was prepared by the project team consisting of Manuel Fernandini (CMF/CPR), Project Team Leader; Ramón Guzmán (IFD/CMF), Project Team Co-Leader; Leticia Riquelme (CMF/CME); Eduardo Bogado (CSC/CPR); Edgardo Demaestri (IFD/CMF); Sebastián Vargas (IFD/CMF); Rodolfo Graham (LEG/SGO); Roberto Camblor (HUD/CPR); Alberto de Egea (FMP/CPR); Mariano Perales (FMP/CPR); and Cecilia Bernedo (IFD/CMF).

CONTENTS

Annexes	
Annex I	Development Effectiveness Matrix (DEM) – Summary
Annex II	Results Matrix
Annex III	Fiduciary Agreements and Requirements

Electronic Links

Required

1. Monitoring and Evaluation Plan
2. Environmental and Social Management Report

Optional

1. Economic Analysis of the Project
2. Central Bank of Paraguay (BCP): Statistical and Financial Bulletin. Data as of 31 March 2016
3. Central Bank of Paraguay (BCP): Statistical Annex to Economic Report, March 2016
4. Dirección General de Estadísticas, Encuestas y Censos (DGEEC). Principal Poverty and Income Distribution Results, 2015
5. DGEEC. Ongoing Employment Survey. Data as of the fourth quarter of 2015
6. Beatriz López and Roberto Camblor. Paraguay Technical Note: Urban Development and Housing. March 2014
7. DGEEC. Permanent Household Survey 2014
8. Secretaría Nacional de la Vivienda y el Hábitat (SENAVITAT). Paraguay's National Habitat and Housing Plan (PLANHAVI). November 2012
9. Demand Analysis – Data calculations for the program PR-L1140
10. Safeguard Policy Filter

ABBREVIATIONS

AFD	Agencia Financiera de Desarrollo [Development Finance Agency]
AFS	Audited financial statements
AMA	Área Metropolitana de Asunción [Asunción Metropolitan Area]
BCP	Banco Central del Paraguay [Central Bank of Paraguay]
DGEEC	Dirección General de Estadísticas, Encuestas y Censos [Statistics, Survey, and Census Bureau]
EPH	Encuesta Permanente de Hogares [Permanent Household Survey]
FFF	Flexible Financing Facility
IFI	Intermediary financial institutions
IMF	International Monetary Fund
IPS	Instituto de Previsión Social [Social Security Institute]
LIBOR	London Interbank Offered Rate
NPV	Net present value
OC	Ordinary Capital
PLANHAVI	Plan Nacional de Hábitat y Vivienda [National Habitat and Housing Plan]
SENAVITAT	Secretaría Nacional de la Vivienda y el Hábitat [National Secretariat for Housing and Habitat]
SHF	Sociedad Hipotecaria Federal [Federal Mortgage Society]

PROJECT SUMMARY

PARAGUAY
PROJECT FOR THE DEVELOPMENT OF THE HOUSING FINANCE MARKET IN PARAGUAY
(PR-L1140)

<table>
<tr><th colspan="5">Financial Terms and Conditions</th></tr>
<tr><td colspan="3" rowspan="3">Borrower and executing agency: Agencia Financiera de Desarrollo [Development Finance Agency]</td><th colspan="2">Flexible Financing Facility[a]</th></tr>
<tr><td>Amortization period:</td><td>23.5 years</td></tr>
<tr><td>Original WAL:</td><td>15.25 years[b]</td></tr>
<tr><td colspan="3" rowspan="3">Guarantor: Republic of Paraguay</td><td>Disbursement period:</td><td>5 years</td></tr>
<tr><td>Grace period:</td><td>7 years</td></tr>
<tr><td>Inspection and supervision fee:</td><td>[c]</td></tr>
<tr><th>Source</th><th>Amount</th><th>%</th><td>Interest rate:</td><td>LIBOR-based</td></tr>
<tr><td>IDB (Ordinary Capital):</td><td>US$30 million</td><td>100</td><td>Credit fee:</td><td>[c]</td></tr>
<tr><td>Total:</td><td>US$30 million</td><td>100</td><td>Approval currency:</td><td>U.S. dollars from the Ordinary Capital</td></tr>
<tr><th colspan="5">Project at a Glance</th></tr>
<tr><td colspan="5">Project objective/description: The project’s general objective is to help reduce Paraguay’s housing deficit by providing financing to financial intermediaries to facilitate construction financing and access to housing. Its specific objectives are to: (i) increase access to housing for emerging middle class families with incomes up to seven minimum salaries by providing (mortgage and nonmortgage) credit solutions; and (ii) increase housing construction by financing developers to boost the supply.</td></tr>
<tr><td colspan="5">Special contractual conditions precedent to the first disbursement of the loan: The project’s Operating Regulations have been approved and come into force in accordance with the terms and conditions previously approved by the Bank (see paragraph 3.2).</td></tr>
<tr><td colspan="5">Exceptions to Bank policies: None.</td></tr>
<tr><th colspan="5">Strategic Alignment</th></tr>
<tr><td colspan="2">Challenges:[d]</td><td>SI ☑</td><td>PI ☐</td><td>EI ☐</td></tr>
<tr><td colspan="2">Cross-cutting issues:[e]</td><td>GD ☐</td><td>CC ☐</td><td>IC ☐</td></tr>
</table>

(a) Under the Flexible Financing Facility (document FN-655-1) the borrower has the option of requesting changes to the amortization schedule, as well as currency and interest rate conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.

(b) The original weighted average life and grace period could be shorter, depending on the actual date on which the loan contract is signed.

(c) The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank’s lending charges, in accordance with applicable policies.

(d) SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

(e) GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. PROJECT DESCRIPTION AND RESULTS MONITORING

A. Background, problem addressed, and rationale

1.1 **Macroeconomic considerations.** Over the last 10 years, Paraguay has been characterized by a combination of economic stability and growth. Between 2005 and 2015, Paraguay grew at an average annual rate of 4.8%, spurred by the agroindustrial and services sectors, achieving per capita gross domestic product of US$4,000 in 2015, representing 48% of the region's average.[1] At the same time, total poverty nationwide exhibited a sustained downward trend, falling from 41.2% in 2007 to 22.2% in 2015.[2] In fiscal terms, after eight years of surpluses, the 2012 recession initiated a series of fiscal deficits that reached 1.8% of GDP in 2015.[3] To mitigate the growing deficit, the Fiscal Responsibility Law was enacted in 2013, establishing a 1.5% of GDP limit on the fiscal deficit in the preparation and approval of the country's General Budget. The Ministry of Finance projects that the 2018 fiscal debit will be held to about 0.5% of GDP.[4] Public debt in 2015 was 19.7% of GDP, below Argentina, Uruguay, and Brazil and above Chile. The growth outlook in 2016 points to a moderate rate of 3%[5] and analysis of the behavior of the Paraguayan economy between now and 2020 indicates a stable growth trajectory with annual economic growth averaging 3.5% and inflation rates anchored to the target rate of 4.5%.

1.2 **Growth and population distribution.** The country's total population is 6.9 million inhabitants.[6] During the decade 1992-2002, the population grew at an average rate of 2.2% per year, lower than the previous decade's rate of 3.2%. The growth rate in the decade 2002-2012 is estimated to have been 2.6%.[7] The population is mostly young, with 59% under 29 and 30% under 14,[8] indicating that there will be significantly increased pressure on services, housing, and job opportunities in upcoming years. Ninety-seven percent of the population lives in the eastern region, which covers 40% of Paraguay's territory. The remaining 3% live in the western region, which covers 60% of the country.[9]

1.3 During the period 1950-2012, Paraguay experienced a process of urbanization, with the urban population growing from 35% in 1950 to 67% in 2012.[10] The cities to which the rural population migrated were the Asunción Metropolitan Area (AMA),[11]

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1 International Monetary Fund (IMF) - World Economic Outlook, April 2016.

2 Principal Poverty and Income Distribution Results, 2015. Statistics, Survey, and Census Bureau (DGEEC).

3 Ministry of Finance – Financial Situation, December 2015.

4 Public finances report of the Republic of Paraguay 2016, Ministry of Finance.

5 Estimated 2016 GDP, April 2016, Central Bank of Paraguay (BCP).

6 Tryptic – 2015 Permanent Household Survey (EPH), DGEEC Publications.

7 In-house calculation based on information in the document *Evolución de la Población Total del Período 1950-2002* and the 2012 EPH.

8 In-house calculation based in information from the *Proyección de la Población Nacional, Áreas Urbana y Rural por Sexo y Edad*, 2000-2025. 2015 Revision.

9 In-house calculation based on information from the 2014 Statistical Yearbook. DGEEC.

10 *Ciudades intermedias y sustentabilidad urbana en Paraguay*, Vázquez, F.

11 This is the metropolitan area formed by the capital city of Paraguay, Asunción, with the cities on the periphery: Luque, Fernando de la Mora, San Lorenzo, Lambaré, Mariano Roque Alonso, Ñemby, Capiatá, Limpio, San Antonio, Villa Elisa, Itauguá, and Ypacaraí.

Encarnación, Ciudad del Este, and more recently other departmental capitals. Asunción, Paraguay's capital city, and its metropolitan area, is the country's largest and most populated urban agglomeration with some 2.5 million inhabitants. The AMA is very important in terms of urban development and housing because 36% of the country's population lives there.

1.4 **Housing deficit.** The country's economic and demographic growth in the last decade has produced a very dynamic real estate market with rising prices. However, it is concentrated among the sectors with greater buying power. The Plan Nacional de Hábitat y Vivienda [National Habitat and Housing Plan] (PLANHAVI)[12] estimated a total deficit of 1,324,634 homes in Paraguay for 2015, representing about 74% of the country's total households.[13] Of the total deficit, 13% is quantitative (demand for 155,800 homes) while 87% is qualitative (demand to expand and/or improve). It is estimated that 70% of the qualitative deficit corresponds to the demand for improvements.[14]

1.5 In conclusion, the quantitative deficit in the housing market is exacerbated because Paraguay characteristically has: (i) a high rate of annual demographic growth; (ii) a sustained process of urbanization; and (iii) a population structure that is mostly young, leading to a high rate of new households being formed.[15] These three elements have been producing sustained demand for new homes in all socioeconomic strata, particularly in urban centers, with demand highly concentrated in the AMA. The housing deficit increases as a consequence of demographic growth at an estimated rate of 2% per year.

1.6 **Causes of the problem.** The fundamental causes of the housing deficit should be sought in the population's limited ability to save (poverty) and the absence of a financial system that provides sufficient mortgage credit to the population and appropriate credit to housing promoters or developers.[16]

1.7 The 2015 Encuesta Permanente de Hogares [Permanent Household Survey] (EPH)[17] estimates that 22.2% of the population lives below the poverty line, although this percentage is higher among the rural population (32.49%) than the urban population (15.44%). The population's distribution by income deciles indicates that the first four deciles are on the edge of or below the absolute poverty line and families may thus find it difficult to save after covering their consumption needs. The personal savings rate does not become positive until the 7th income

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12 SENAVITAT. PLANHAVI.

13 Statistics, Survey, and Census Bureau. EPH 2015.

14 SENAVITAT. PLANHAVI.

15 The population under 15 represents 31.92% of the total population and, at the other extreme, the population over 64 represents 5.55%. The fertility rate is 2.70% (2012), which is high in comparison with neighboring or nearby countries such as Argentina 2.30%, Uruguay 2.00%, Colombia 1.90%, Chile 1.80%, and Brazil 1.80% (source: DGEEC and World Development Indicators).

16 Other structural factors (such as low population density/relative abundance of land, poor land use planning in the urban model combined with accelerated concentration of the population) or institutional factors (such as the slow operation of mortgage closings or the registration and titling apparatus), are additional difficulties, but they have not reined in the production and sale of homes to the same extent, that is, these favors have a greater impact on the quality of the city's development and on transaction costs.

17 DGEEC. *Principal Poverty and Income Distribution Results. EPH 2015.*

distribution decline.[18] It is noteworthy that only the population between the 7th and 10th income distribution deciles exceeds the monthly minimum salary of G 1,824,055 (equivalent to US$326). This obviously speaks to the profound inequality in the distribution of income in Paraguay, which is endemic in the region in any case.

1.8 Given its size, not only is the purchase of a home the most important investment decision most of the population makes, the ability to make that decision is also critically dependent on the availability of credit. Based on income distribution in Paraguay, according to the 2015 EPH,[19] only 40% of urban families receive monthly income above US$1,305, which would allow them to commit, for example, to making mortgage payments of US$40,000 over 20 years.[20] This means that the demand for credit provided by the banks is exclusively concentrated in the high income segments of the population, and the rest of the population needs financing with interest rates and payment terms tailored to their income flows.[21]

1.9 The limited supply of credit in the housing market is coupled with families' limited ability to save/purchase. Indeed, the other central cause for the persistent housing deficit lies in the Paraguayan financial system, which, like others in the region, has limited lending capacity. The supervised system consists of 17 banks and 11 finance companies.[22] Bank assets in May 2016 (US$19.2 billion) represent 96.0% of the system's total assets. The Paraguayan financial system is relatively liquid but lacks depth.[23] Of total bank assets, 64% (US$12.2 billion) corresponds to the loan portfolio. The banking portfolio is distributed primarily among agriculture (23.4%), wholesale trade (15.7%), and consumer goods (14.1%), while the housing portfolio accounts for only 2.7%. On average, this portfolio's delinquency rate is 3.06% in the private banking system.[24]

1.10 The principal reason for the banking sector's limited attention to the demand for housing credit is that it has limited medium- and long-term funding. This reflects structural factors such as the low level of long-term deposits, insufficient leveraging of those deposits, and an insignificant presence of money, debt, and capital

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18 Galdeman, N. *A Comparison of Saving Rates: Micro Evidence from Seventeen Latin American and Caribbean Countries* (IDB Working Paper Series IDB-WP-602). July 2015.

19 DGEEC. *Principal Poverty and Income Distribution Results – Permanent Household Survey (EPH) 2015.*

20 In-house calculations, assuming a maximum of 30% of income for the mortgage and an annual interest rate of 10%. That loan, at the constructed mean per meter price in the urban area could be used to purchase a home of between 60 and 75 square meters (loan to value between 80 and 100).

21 For example, according to the 2015 EPH, the average family income in the 10th decile of the income scale was approximately US$4,617 while the average in the 7th to 9th deciles (to be served by the project) is US$1,650. This indicates a significant income gap and the need for this sector to be served by a program that promotes access to housing.

22 The Superintendency of Banks of the BCP regulates and supervises most of the financial system. Unlike banks, finance companies have less regulatory capital and are financial intermediaries that do not offer current accounts and do not engage in foreign trade transactions.

23 The ratio of liquid assets to total assets in the system is 23% compared to 21% for Latin America and the Caribbean. In contrast, domestic credit provided by the Paraguayan financial sector amounted to 46% for 2016 (BCP Statistical and Financial Bulletin – May 2016) compared to 80% for the average in Latin America (World Development Indicators – July 2016).

24 BCP: Statistical and Financial Bulletin. Data as of 30 May 2016.

markets (see: BCP Financial Indicators Report 04/2016). Added to this is the incipient development of institutional investors needing to make long-term investments (pension fund administrators or life insurance companies). Paraguay has not implemented reforms in its pension systems to promote privatized management based on funds accumulated in individual accounts under a system that provides incentives for the proper management of funds and their accumulation over time. This deprives the country of important sources of funds to invest in long-term financial instruments, as has occurred in other countries of the region. In addition, the various institutions that manage pensions, like the Instituto de Previsión Social [Social Security Institute] (IPS) and pension funds,[25] do not have an institution that is responsible for regulating/supervising the system or appropriate investment rules, a deficiency that has not helped to produce conditions favorable to the investment of reserves. The fact that these retirement and pension funds were created by different laws also makes it difficult to coordinate among them.[26]

1.11 All these factors affect the ability to finance private investment in long-term assets and the system's inability to respond to the demand for housing credit is paradigmatic. The mortgage portfolio is small compared to that of other countries in the region: Paraguay 2.7%[27] compared to Colombia 13%,[28] Peru 15%[29] and Chile 25%.[30] Beyond the housing problem, an examination of the financial system's total portfolio by terms shows that 81.4% of the loan portfolio is concentrated in terms up to one year, 11.8% have terms between one and three years, and only 7% of the total have longer terms.[31] Naturally, low maturity transformation is not due only to the effect of the mismatch between balance sheet liabilities and assets, it also has to do with the relative perception of risk with respect to real estate and/or long-term credit in a country where banking crises are still retained in the sector's institutional memory (1995-2002).

1.12 On the housing supply side, in the absence of mortgage credit for the majority of the population (middle and lower class), the supply of homes is concentrated among those with the highest incomes, with payment in advance of or based on progress made in construction. The country has not developed direct financing for housing developers because they self-finance their projects or obtain funds backed by personal or corporate collateral and not a personal property security interest on the final value of their projects. This in turn has foreseeable consequences: (i) the supply is concentrated in single family homes on large lots, impacting urban land use and density; (ii) for the middle and lower middle class the supply is very limited and far removed from the urban centers, increasingly so as the price of land has

25 The funds manage pensions for specific types of employees who do not contribute to the IPS but rather to different pension systems (public employees pension plan, retirement and pensions fund for bank employees and the like, etc.).

26 El sistema de pensiones de Paraguay, Bernardo. N and Ortiz, E., CADEP, 2014.

27 See: BCP – Statistical Bulletins.

28 Financial Superintendency of Colombia - Evolution of the Loan Portfolio.

29 Superintendency of Banks, Insurance, and Pension Fund Administrators – Evolution of the Financial System.

30 Superintendency of Banks and Financial Institutions of Chile – Information on Housing Finance.

31 See: BCP – Statistical Bulletins.

been increasing in the boom years, supported by large demand in these sectors; (iii) for the majority of the population the housing solution means improving and expanding existing homes; and (iv) the housing supply rarely produces high-rise or higher density housing with suitable (price per m^2 and area) characteristics for the middle class, so that the builder's investment is higher and the commercial risks are higher as well.

1.13 **Need for bridge credit.** The lack of financing in the housing market is evident both in terms of credit to families and the supply of credit available to housing developers. Recently a focus group that the IDB conducted with housing developers and intermediary financial institutions (IFIs) in Paraguay confirmed that: (i) there is no supply of credit specifically designed for the housing promotion business, with conditions structured based on the flows and returns of each project; (ii) currently developers may only have access to personal or business credit products backed by personal and/or corporate collateral; and (iii) under current conditions the credit supply for the sector is at a rate between 16% and 18%. All this hampers the viability of a business model that must be supported by large investments with lower margins than those for individual homes, and ends up limiting the ability of entrepreneurs to provide new housing.[32]

1.14 Credit for housing developers or bridge credit is understood to mean medium-term financing for housing developers, promoters, and builders, whose objective is to build multifamily buildings, developments, and/or residential complexes. Although it may take different forms, it must have some minimum characteristics to be useful, such as: (i) partial financing of the project, with an advance; (ii) medium-term financing (usually up to 36 months); (iii) disbursement as progress is made in construction; and (iv) use as a bridge for amortizing the loan as each of the housing units is sold. It is important to note that in order for housing developers, promoters, and builders to be able to access bridge credit they must meet certain minimum requirements such as licenses, permits, and project authorizations, and a guarantee on the land where the project will be built.

1.15 There are several experiences in the use of this financial instrument in the region. The most successful cases include the Sociedad Hipotecaria Federal [Federal Mortgage Society] (SHF) in Mexico, which has channeled medium-term (two to three years) loans to housing developers for building residential complexes, purchasing commercial equipment, and improving groups of homes. SHF funds finance between 25% and 30% of the value of each project, while the developer finances the difference by providing the land (up to 20% of the project's value) and income from the advance sale of homes. In addition, SHF has a product whereby it guarantees the timely payment of housing developers who obtain loans from the commercial banking system. This product enhances the quality of the portfolio of construction loans granted by financial intermediaries, reducing credit risk and incentivizing credit in the sector.

1.16 **Recent public policy efforts.** Since 1990 the Paraguayan government has been channeling direct subsidies supporting the demand for housing among low-income sectors, with monthly family income up to five minimum salaries, initially through

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32 IDB. Focus group with financial institutions and developers, 31 May 2016.

the Consejo Nacional de la Vivienda [National Housing Council] (CONAVI) and since 2010 through the Secretaría Nacional de la Vivienda y el Hábitat [National Secretariat for Housing and Habitat] (SENAVITAT).[33] The main program[34] promoted by the SENAVITAT is the Fondo Nacional de Vivienda Social [National Low-income Housing Fund] (FONAVIS). It was created in 2009 to carry out a medium- and long-term government housing policy to provide access to housing for families with limited resources in the poor, extremely poor, and lower middle class strata (up to five minimum salaries of family income). This program offers different types of housing solutions such as: (i) home purchase; (ii) construction on one's own lot; and (iii) housing complexes or developments for organized groups. Based on family income, four levels of subsidies[35] are established for these solutions, ranging from 15% to 95% of the maximum amounts of investment in construction and land for each income level. The budget for this program in 2016 is US$54 million, which represents 38% of the total budget allocated to SENAVITAT.

1.17 **Recent efforts in middle income sectors.** Since 2006, the Government of Paraguay has been channeling financing for housing through the Agencia Financiera de Desarrollo [Development Finance Agency] (AFD), through first-tier private and state commercial banks. As of March 2016, more than 90% of the IFIs' available funds for financing mortgage credit for housing depends on the availability of funds from the AFD. These funds allow the IFIs to offer financing conditions that would not be available if the banking system had to rely on its own resources.[36]

1.18 **The Development Finance Agency.** The AFD is an autonomous, autarchic legal entity under public law. Its mission is to promote economic development and job creation by channeling medium- and long-term financing to the private sector through eligible IFIs.[37,38] It currently has 40 eligible IFIs (13 banks, 7 finance companies, 1 public financial entity, 12 multipurpose and savings cooperatives, and 7 multipurpose and production cooperatives). From June 2006 to June 2016, the AFD placed US$1.165 billion in the form of 54,710 loans in sectors including agriculture, industry, and housing.

1.19 The AFD's sectoral strategic objectives include development of the middle-class housing market.[39] It offers eligible IFIs three funding lines for housing credit with

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[33] The SENAVITAT replaced CONAVI in 2010. Its objective is "the management and implementation of policy on housing and related infrastructure for utilities, roads, and transportation, allowing universal access to decent housing, particularly for families with limited resources."

[34] The SENAVITAT has 10 housing programs: FONAVIS, Vy'a Renda, Pueblos Originarios, Viviendas Económicas, Coordinadora Ejecutiva para la Reforma Agraria (CEPRA), Programa de Crédito Hipotecario, Fondo de Crédito para Cooperativas (FONCOOP), Che Tapyi, Mercosur Róga – Fondo para la Convergencia Estructural del Mercosur (FOCEM), Atención a Repatriados (Mi país, mi casa).

[35] Level 1: between 3.5 and 5 minimum salaries (15% subsidy); Level 2: between 2 and 3.4 minimum salaries (40% subsidy); Level 3: between 1 and 1.9 minimum salaries (70% subsidy) and Level 4: less than one minimum salaries (95% subsidy).

[36] Information from the following banks: Itaú, Amambay, Visión, and Familiar in Paraguay, May 2016.

[37] Law 2640 creating the AFD, 21 July 2005.

[38] All eligible IFIs are regulated and supervised either by the BCP in the case of banks and finance companies or the Instituto Nacional de Cooperativismo del Paraguay [National Institute of Cooperativismo] (INCOOP) in the case of cooperatives.

[39] 2016-2018 AFD Strategic Plan.

terms up to 20 years: *Mi Casa* [My House] and *Mi Primera Casa* [My First House] (as part of their regular offering) and since 2015, *Primera Vivienda* [First Home] (a pilot credit line). The following table details the offerings:

Table 1. AFD products for housing finance

AFD product	Special conditions	Percentage to be granted	Cap (US$ thousands)	Use of funds	AFD rate to IFI	End rate to user (average)
Mi Casa	Up to 30% of family income	80% of the guarantee	120	Purchase, construction (not purchase of land)	8.25%	11.50% (free rate)
Mi Primera Casa	Income up to five minimum salaries. Up to 25% of family income	100% of the guarantee	45	Purchase, construction (purchase of land for up to 30% of the loan)	5.50%	10% (cap)
Primera Vivienda (pilot)	Income up to five minimum salaries. Up to 30% of head of household + spouse income	100% of the guarantee	46 (from 1 to 4 minimum salaries) 55 (more than 4 to 5 minimum salaries)	Purchase, construction (purchase of land for up to 35% of the loan)	4.50% 5.50%	7.50% (cap) 9.50% (cap)

1.20 The pilot program *Primera Vivienda* emerged in 2015 as an AFD effort to outline a financing solution for the middle class to address the growing housing deficit. As seen in the above table, its principal attribute is that the AFD channels funds to the IFIs at an adjusted interest rate, starting at 4.5%, allowing the IFIs to offer families loans under more favorable conditions. The results of this pilot program make it possible to consider creating a mortgage loan offering targeting income levels whose demands have not been met to date. As of April 2016, 718 operations had been approved for a total of US$22.5 million, and there is significant demand for these loans. The AFD proposes to relaunch *Primera Vivienda* as part of its regular loan offerings, merging it with *Mi Primera Casa* and incorporating the lessons learned from the pilot program: (i) an increased housing supply for the middle class must be promoted in the AMA; (ii) caps on the product should limit the loan amount but not the value of the home; and (iii) more than the interest rate, what is important for families is the availability of funding and adequate housing.

1.21 Although the AFD does not currently have a specific product for channeling bridge credit to developers, two of its business lending lines, *Propymes* and *Procrecer*, would be available to fund operations of this kind, although they have rarely been used for this purpose. In addition, the nature of these products is not adapted to the normal investment profile of a housing developer (high initial investment in land and construction, and buyers who need long-term financing). For this reason, the AFD, in coordination with SENAVITAT and Ministry of Finance authorities, has begun talks with the IFIs to explore the possibility of implementing financing that is better suited to the developers' needs. The Bank will support the AFD in the design of that product by: (i) providing technical assistance adapting experiences in other countries of the region;[40] and (ii) training loan officers in the process and monitoring of new financial products (CT/Intra: ATN/OC-15687-PR).

1.22 Lastly, the Congress recently approved the Law on the Promotion of Housing and Land Development,[41] which seeks to guarantee access to housing for low- and middle-income families, contribute with city planning, and reduce expansion of the urban footprint through densification. Although the law is broad and its enabling regulations will detail its implementation, it does establish key guidelines for the sector such as: (i) empowering SENAVITAT to coordinate and facilitate the participation of the sector's various public and private actors; (ii) seeking to boost the private supply of housing for the middle class; (iii) ensuring long-term funding; (iv) seeking to increase housing demand through an incentives system based on a model of savings + subsidy + loans; and (v) promoting the active participation of the financial system.

1.23 The new legal framework, coordination among the actors involved, and lessons learned from the *Primera Vivienda* pilot program are the centerpieces of the proposed intervention. The project would: (i) recalibrate the parameters of the *Primera Vivienda* product by incorporating the lessons from the pilot and adapting it to the new reality of prices per square meter; (ii) modify eligibility so that the offering is directed to producing the target housing; (iii) provide the AFD with sufficient funding to meet the demand; and (iv) supplement the intervention on the demand side by designing and offering a new financing product (guarantee or loan) for developers (see paragraph 1.21), in order to promote the construction of housing appropriate to the demand.[42]

1.24 **Solution proposed in the context of the Bank's relationship with the AFD.** The operation is in line with the new law mentioned above, injecting financial resources to develop supply and demand in the housing market. The Bank's support of the AFD will allow it to: (i) incorporate the lessons learned from the *Primera Vivienda* pilot in its regular offering of housing loans; (ii) increase its ability to offer mortgage and nonmortgage credit solutions to middle class families;[43] and (iii) develop and fund a new loan product for developers. Ultimately, the project also seeks to contribute to the legal objective of building credibility and confidence in the existence of actual housing demand and to help modernize the housing supply so that it serves the orderly growth of Paraguay's cities.

1.25 This operation thus represents a new development in terms of the support provided to the AFD through the Conditional Credit Line for Investment Products

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40 The services of an individual consultant have been contracted for the purpose and charged to the operation's budget.

41 Law 5638 of 22 June 2016.

42 Finally, these interventions may lead to a critical mass or volume of mortgage portfolio in the banks, allowing for the search for funding alternatives such as issuing mortgage guarantee bonds or other similar schemes.

43 The Technical Planning Secretariat for Economic and Social Development defines the middle class in Paraguay as constituting persons with monthly family income of US$1,350 to US$6,000, which is equivalent to a range of 4 to 18 minimum salaries and corresponds to income deciles 7, 8, 9, and part of 10 (decile 10 has monthly income of over US$4,300).

(CCLIP) PR-X1001 and its individual operations,[44] through which, in the last eight years, about US$75 million have been dedicated to financing construction and improving housing, regardless of the end user's profile. However, the new operation would provide housing financing targeted at the middle class and would develop and fund a new financial product for developers. It also complements operation 3538/OC-PR, which supports the SENAVITAT[45] in improving the housing conditions of the low-income population in the AMA, to the extent that it covers the absence of support for the middle class population.

1.26 There is rigorous empirical evidence of the positive impact of similar housing programs conducted in other countries of the region, notably in Cattaneo et al. (2009)[46] and Marcano and Ruprah (2007).[47] The first study finds evidence of positive impacts on the health of babies residing in housing that benefited from a soil improvement program in Mexico. In addition, the adult residents experienced improvements in their level of well-being, measured based on levels of satisfaction with their housing and quality of life, as well as lower levels of depression and stress. The second study, conducted for a housing program in Chile, found positive impacts on school attendance among children residing in housing that benefited from the program, and on access to services such as electricity, drinking water, and sewers. The study also did a cost-benefit analysis that yielded positive and significant net benefits (estimated at 0.16% of GDP in 2003).

1.27 **Analysis of demand and size of the project.** The size of the program is relatively small compared to the magnitude of the issue in Paraguay, so that resource demand risk is considered low:

a. If the entire demand credit component were used in purchase/mortgages, given an average loan of US$40,000, this component could finance approximately 500 homes, out of a potential demand of 25,800 in urban areas, corresponding to families in the 7th to 10th income deciles (with incomes of at least four minimum salaries, equivalent to US$1,305, sufficient to assume a debt of US$40,000).

b. If, on the other hand, the component were used exclusively for improvements or expansion, it could finance up to 1,333 operations averaging US$15,000, reaching the same number of families with fewer resources (5th to 7th deciles, with income from 2.5 to 4 minimum salaries, equivalent to US$815-US$1,305). In this case as well the number of interventions pales in comparison with the qualitative housing deficit.

c. As for the component intended for housing developments, it is expected to be able to finance between 300 and 600 homes based on whether or not there is free land made available by the Government of Paraguay. This would

44 The last operation in this line closed on 20 July 2016.

45 See paragraph 1.16 on SENAVITAT's complementary efforts to serve low-income segments.

46 Cattaneo et al (2009): "Housing, Health, and Happiness," American Economic Journal: Economic Policy.

47 Marcano, L. and Ruprah, I. An Impact Evaluation of Chile´s Progressive Housing Program, Inter-American Development Bank, Office of Evaluation and Oversight. Working Paper. Washington, D.C.

correspond to a limited number of loans, if we assume lots of 100 homes, as is customary in the SENAVITAT's low-income housing developments, and three to six loans would be approved in amounts between US$1 million and US$2.5 million each.

1.28 In both cases, the proposed project seeks to trigger a form of comprehensive action on the part of public and private actors involved in developing a housing finance system. In any case, this project assumes additionality of IDB funding to the AFD, in that: (i) it targets funding for the AFD on an underserved segment and expands its social impact; (ii) it does so by applying the subsidiarity principle in that there are no solutions to the long-term financing problem in the domestic market; and (iii) it does so using market mechanisms such as the credit systems of the commercial banks and other financial institutions, without distorting the price mechanism, seeking the coordination of development companies, the banks, and national and municipal government.

1.29 **Strategic alignment.** The project is consistent with the Bank's country strategy with Paraguay for 2014-2018 (document GN-2769), which sees promoting investment financing through the financial system as a strategic objective. Specifically, the strategic objectives of the Bank's intervention in the country will include, *inter alia*, the development of financial markets. The project is also consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008) and is directly aligned with the development challenges of social inclusion and equality, given that its components seek to finance housing for middle class households. The operation will also contribute to the Corporate Results Framework 2016-2019 (document GN-2727-6) through the results indicators on the number of households benefiting from housing solutions.

1.30 The project is consistent with the guidelines of the Urban Development and Housing Sector Framework Document (document GN-2732-2), primarily with reference to access to public and private financing for housing services. It is also aligned with the Sector Strategy on Institutions for Growth and Social Welfare (document GN-2587-2), specifically with the component on providing access to financial services for the majority. The operation is also consistent with the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-3), in developing interventions to promote access to financing.

B. Objectives, components, and cost

1.31 The project's general objective is to help reduce the housing deficit in Paraguay by funding financial intermediaries to facilitate construction financing and access to housing. Its specific objectives are to: (i) increase access to housing for emerging middle class families with incomes of up to seven minimum salaries by providing (mortgage and nonmortgage) credit solutions; and (ii) increase housing construction by financing developers to boost the supply. The project will have two components, the description and amounts of which are presented below. Those amounts are guidelines in the sense that the funds will be channeled based on demand toward either of the two objectives, and the entire loan amount could be used in one component, although this is not the expected result.

1.32 **Component 1. Housing credit solutions (approximately US$20 million).** This component, associated with the first specific objective, will make it possible to expand the limits of mortgage and nonmortgage credit so as to include underserved sectors, such as the emerging middle class. The funding the AFD will provide through eligible IFIs will make it possible to grant mortgage credit and regular credit, the conditions for which will be established in the project Operating Regulations.

1.33 **Component 2. Financing for developers (approximately US$10 million).** This component, associated with the second specific objective, will allow the AFD to activate bridge credit for construction, so as to generate more housing and help reduce the lack of supply in upcoming years. The financing (loan or guarantee) will be granted to developers through eligible IFIs or trusts or vehicles to which third parties contribute the land and capital needed. It will be granted to eligible multifamily projects according to the concrete technical criteria to be established in the project's Operating Regulations.

1.34 **Eligibility criteria and end beneficiaries of the Bank's funding.**[48] These will be as follows:

a. The component intended to cover the demand for housing will consist of funding channeled by the AFD through eligible IFIs (eligibility of IFIs will be determined based on the AFD's current solvency and risk parameters, adapted to the type of loan involved) to grant: (i) mortgage credit: directed to families with up to seven minimum salaries in monthly income, for loans (20 years, rate up to 10%) for up to US$65,000, securing up to 100% of the value of the home (the higher the value of the collateral or the home, the lower the Loan to Value (LTV) ratio will be. At current prices, a new house at this maximum price could have approximately 90 square meters, depending on location. The average mortgage is expected to amount to US$40,000, given the experience gained by the AFD since 2006. From the perspective of income distribution, families with the ability to assume this type of debt are in at least the 7th income decile, with income of four minimum salaries, equivalent to US$1,305; and (ii) regular credit: for improvements and expansions for the same families. The average loan size for improvement or extension could be US$15,000. These loans are accessible to families in income distribution deciles five and up, with income from 2.5 minimum salaries and up, equivalent to US$815. As for the distribution of funds between one or the other type of loan, the AFD will meet the demand from the IFIs as it arises. Nonetheless, the IDB funding is better suited to mortgage financing, given its term, than to credit for improvements (between three and seven years).

b. The component directed to promoting supply will consist of financing (loan or guarantee) granted to developers through eligible IFIs, trusts, or vehicles to which third parties contribute the land and capital needed. This financing will be granted to multifamily projects that contribute to orderly urban development and allow appropriate densification of the city (the specific

[48] The eligibility criteria for financial beneficiaries will be included in the Operating Regulations.

technical criteria will be established in the credit product manual). Thus, the beneficiaries will not be just the ultimate buyers of the home but also developers considered eligible based on the profitability of their project and their own technical and financial capacity to execute it. Such companies will see how access to credit will make higher investments feasible and allow them to meet existing demand for homes that are more affordable and better connected to the city center. Tentatively, US$10 million is assigned to this component. Depending on the method designed to channel these resources (characteristics of the bridge loan or guarantee or form of financing) and depending as well on the relative volume of demand between the two components, the AFD could assign these funds to the other types of credit and vice versa.

C. Key results indicators

1.35 The project's expected results are formulated in terms of the: (i) increase in the number of families in the 5th to 9th income distribution deciles who gain access to mortgage financing for housing as well as financing for improvements; (ii) number of homes purchased with project resources; (iii) number of homes improved with project resources; (iv) number of homes built through credit to developers; (v) number of homes built within the AMA with project resources; and; (vi) increase in mortgage portfolio of the Paraguayan financial system (see Results Matrix). The project's impact will basically be its contribution to reducing the (both quantitative and qualitative) housing backlog. The anticipated outcomes are based on an ex ante allocation of the loan by components and by operation subtype as per the attached matrix. Nonetheless, this allocation is subject to change based on revealed demand and the AFD's source of funds criterion for funding different types of operations, which may vary based on conditions in the financial market.

1.36 **Economic analysis.** The inputs for developing the economic analysis were obtained by using data from relevant AFD credit programs on the housing market in Paraguay, data from sector studies in the country, and data from the EPH. To estimate the economic benefit associated with actions implemented by the project, the analysis estimates gains in real estate values for families accessing credit facilitated by the project, gains for real estate developers who can now offer homes to an unserved demand segment, and gains in terms of savings in public investment as a result of promoting homes that adhere to appropriate urban growth standards.

1.37 Based on the projections developed, the net present value (NPV) of the annual flows of net benefits, discounted at a rate of 12%, is US$2.7 million. NPV proved to be robust against variations in the value of key parameters such as: (i) appreciation of the home during the period of analysis; (ii) the distribution among loans for home purchases or improvements; (iii) the percentage increase in the value of the improved home; (iv) the expected gains of the developers; and (v) the estimates in public investment needs, and others. The breakdown of the calculations and flows is found in the cost-benefit analysis of the project.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

2.1 The proposed project will consist of a general credit program for US$30 million, in the form of funds from the Flexible Financing Facility (FFF) of the Bank's Ordinary Capital, consistent with the options considered in that facility. The project will have the two credit components described and designed so that the AFD can provide a flexible response to developments in the construction and mortgage markets, and contribute to reducing the housing backlog in Paraguay.

Table 1. Project costs (in US$ millions)

Component	Source of funds	US$
Component 1. Credit solutions for housing	OC-FFF	20.00
Component 2. Financing for developers	OC-FFF	10.00
Total		**30,00**

2.2 **Collaboration between Divisions of the Bank.** This project was prepared through collaboration between the Capital Markets and Financial Institutions Division (IFD/CMF) and the Housing and Urban Development Division (CSD/HUD), which complements the latter's efforts in loan 3538/OC-PR (see paragraph 1.25).

B. Environmental and social risks

2.3 Pursuant to Directive B.13 of Operational Policy OP-703, the project does not require classification. The environmental and social impacts associated with the project will be a function of the component financed, and the highest risks are those associated with bridge loans. The direct impacts of the project are associated with the activities involved in construction and are mitigated by monitoring good construction management practices. The environmental and social risks associated with the bridge credit component, and to a lesser extent the individual mortgages project, will be varied in terms of their nature, intensity, duration, and significance and will be based on the type and location of the housing projects associated with the loans.

2.4 After due environmental and social diligence was performed, the Environmental and Social Management Report (ESMR) was updated and a list of requirements was prepared based on the application of local regulations and laws, the application of specific exclusion lists, and the development of specific operation manuals for the project's components. That list of requirements will be included in the project's Operating Regulations, thus ensuring that the project complies with the Bank's safeguards.

2.5 Impacts and risks will be managed by the AFD. It is important to emphasize that no additional financial or human resources are required for that management, in that the AFD will use its current institutional and management framework for this purpose. The Bank's principal environmental and social requirements for managing the impacts and risks of this project refer to the need for operations to comply with the laws and regulations on ecological management, urban development, and housing of SENAVITAT and the competent agencies, as well as with regulations on construction, drinking water, and water discharge in each municipio or state where a housing complex is located. Doing so will require reviewing and, if necessary, strengthening training programs for staff of the AFD and the IFIs, home appraisers or auditors, as well as the system for supervision of environmental and social aspects, which will be used to provide input for preparing the environmental and social compliance reports.

C. Fiduciary risks

2.6 The proposed project will be the seventh operation with the AFD.[49] Execution, reviews, technical and financial visits to the AFD and IFIs, as well as the audited financial statements (AFS) of previous Bank loans and of the AFD have demonstrated that the executing agency has a satisfactory level of development in terms of its fiduciary systems and has an appropriate environment of internal control, separation of duties, and accounting and monitoring systems for appropriate follow-up and execution of IDB-financed operations. Based on the above, the financial fiduciary risk for the execution of this operation is considered low and ex post review of the operation's disbursement documents is recommended.

D. Other project risks

2.7 **Economic environment risks.** These are considered low but are mentioned here given their importance. Based on observed GDP performance during 2015 and the relative uncertainty of the global outlook, it is estimated that Paraguay will continue to maintain moderate growth during 2017 and 2018 (3.0% and 2.9%, according to the IMF[50]). The two greatest downside risks would be a decline in economic activity due to a recession that is longer and more serious than expected in the region and/or a financial crisis that restricts credit available for the economy. In both cases, because the AFD plays a counter-cyclical role as a development bank, the preceding does not indicate a high impact risk in the project, so that in any case support for the construction sector will be critical, as will supporting demand for housing so that granting loans to higher risk segments of the population will be attractive for the various IFIs.

2.8 **Development risks.** On the housing supply side, the operation seeks to promote multifamily developments that contribute to orderly urban planning with the idea of densifying metropolitan areas, for which the IFIs and the AFD will seek to identify the existence of developments and affordable land and for which the developers should alter and modernize their construction technologies and adapt to a new business model. On the demand side, this change in model to a certain extent

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49 Four completed operations: Programmatic Public Financial Reform Operation (1682/OC-PR), and the CCLIP to Provide Financing to AFD (1968/BL-PR, 2150/BL-PR, 2640/OC-PR and 2639/BL-PR); and two approved operations pending disbursement: Program for the Financing of Paraguayan SMEs (3354/OC-PR-1/2/3), and First Program – Project to Improve and Expand Lending Products (3616/OC-PR).

50 Article IV Consultation, 2016, IMF, May 2016.

supposes a leap to a single family home culture. Bearing in mind these relative innovations for the IFIs, development banks, and the developers themselves, it cannot be ruled out that the trigger effect on the supply side will be somewhat delayed, depending on risk appetite, the economic juncture, and regulatory improvements that may counteract inertia in the banking system. Nonetheless, this risk is considered low, based on the relatively long execution period of IDB operations in the country, the existence of significant volumes of unfinished or abandoned homes in metropolitan areas of the country, the relatively small size of the loan compared to total housing needs, the structuring capacity of SENAVITAT projects, and the execution of planned training and dissemination activities.

2.9 **Sustainability of the results.** Given its limited amount, this project provides neither a definitive nor a sustainable solution to Paraguay's housing deficit problems, in the sense that the availability of mortgage credit for the middle class and the availability of credit for the construction of suitable housing will continue to depend on AFD credit lines in the near future. What the project does seek is to establish channels in the private financial system, through the IFIs, allowing for growth in the mortgage portfolio and the construction industry, based on sound banking practices and the existence of long-term funding. For the moment, that funding has a public source but in the future, should a good performance trend be consolidated in these portfolios, the private sector would totally or partially replace the source of these funds.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 **Borrower and executing agency.** The borrower will be the AFD, with the guarantee of the Republic of Paraguay. The AFD will act as the executing agency for the administration, execution, control, and monitoring of the operation's resources.

3.2 **Execution and administration.** The Bank will deliver the funds to the AFD. As a second-tier bank, the AFD will make the funds available to the IFIs that will lend them to meet the objectives of the operation, as per the project Operating Regulations, which will consist of the credit product manual. **A special contractual condition precedent to the first disbursement of the loan is that the project Operating Regulations have been approved and entered into force, according to the terms and conditions previously approved by the Bank.** The AFD will execute the project within the framework of its current organizational structure. The participation of the IFIs, as well as the eligibility of subloans and beneficiaries, will be detailed in accordance with current AFD policies and will be included in the project Operating Regulations.

3.3 **Disbursements and execution period.** The project funds will be committed and disbursed over a period of 60 months starting with the effective date of the loan contract. Disbursements, advances, and the related supporting documentation will be in accordance with document OP-273. Specifically, the loan funds will be disbursed through advances, reimbursements, or direct payments through requests submitted by the borrower, based on the agreement with the Bank to meet the liquidity needs required for project execution.

3.4 **Retroactive financing.** The Bank may retroactively finance and charge to loan funds eligible expenses incurred by the borrower prior to the loan approval date, up to the amount of US$6 million (20% of the proposed loan amount), provided they are related to subloans that meet requirements substantially similar to those established in the loan contract. Such expenses must have been incurred as from the approval date of the project profile (28 June 2016), but in no case will expenses incurred more than 18 months prior to the loan approval data be included.

3.5 Cumulative funds from recoveries of subloans granted using project funds that exceed the amounts needed to service the loan may only be used to grant new subloans that substantially adhere to the standards established in the contract for this operation, unless when eight years have elapsed since the last loan disbursement the Bank and the borrower agree to use the recoveries in some other way while not departing from the basic objectives of the loan, or to reduce the term of the loan.

3.6 **Financial statements.** The AFD will submit annual AFS on the project according to the terms of reference agreed upon with the Bank, and an annual AFS for the institution. The AFS will be issued by an audit firm considered eligible by the Bank and will be submitted within 120 days following the close of the fiscal year. The final AFS of the project will be submitted within 120 days following the date the final disbursement is made.

3.7 **Audit.** The project will be audited by the supreme audit authority or an independent audit firm considered eligible by the Bank, following the procedures established in the new audit guides in effect. It should be noted that previous projects with the AFD have been audited and opinions issued without significant comment.

B. Summary of results monitoring arrangements

3.8 **Reports.** Project execution will be monitored through semiannual progress reports from the executing agency to be submitted within 60 days following the end of each six-month period. The reports will use as a reference the commitments in the Results Matrix and the financial progress reports indicators in the General Conditions of the loan contract. In addition, the semiannual progress reports should include the update and monitoring of the project's Risk Matrix.

3.9 **Evaluation.** The project results will be evaluated through an ex post cost-benefit analysis reviewing the results related to: (i) credit solutions; (ii) homes built by developers; and (iii) homes built in areas prioritized for urban development (AMA) (see Monitoring and Evaluation Plan). Preparation of the evaluation will begin six months before the anticipated date for the close of the operation.

3.10 **Information.** The AFD will compile, store, and keep all the information, indicators, and parameters, including the annual plans and the final evaluation needed to prepare the project completion report.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	**Aligned**		
Development Challenges & Cross-cutting Themes	**-Social Inclusion and Equality**		
Regional Context Indicators			
Country Development Results Indicators	**-Households benefitting from housing solutions (#)**		
2. Country Strategy Development Objectives	**Aligned**		
Country Strategy Results Matrix	**GN-2769**	**Promote investment financing through the financial system. Foster greater financial inclusion.**	
Country Program Results Matrix		**The intervention is not included in the 2016 Operational Program.**	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	**Evaluable**	**Weight**	**Maximum Score**
	8.7		**10**
3. Evidence-based Assessment & Solution	**8.4**	**33.33%**	**10**
3.1 Program Diagnosis	**3.0**		
3.2 Proposed Interventions or Solutions	**2.4**		
3.3 Results Matrix Quality	**3.0**		
4. Ex ante Economic Analysis	**10.0**	**33.33%**	**10**
4.1 The program has an ERR/NPV, a Cost-Effectiveness Analysis or a General Economic Analysis	**4.0**		
4.2 Identified and Quantified Benefits	**1.5**		
4.3 Identified and Quantified Costs	**1.5**		
4.4 Reasonable Assumptions	**1.5**		
4.5 Sensitivity Analysis	**1.5**		
5. Monitoring and Evaluation	**7.8**	**33.33%**	**10**
5.1 Monitoring Mechanisms	**2.5**		
5.2 Evaluation Plan	**5.3**		
III. Risks & Mitigation Monitoring Matrix			
Overall risks rate = magnitude of risks*likelihood	**Low**		
Identified risks have been rated for magnitude and likelihood	**Yes**		
Mitigation measures have been identified for major risks	**Yes**		
Mitigation measures have indicators for tracking their implementation	**Yes**		
Environmental & social risk classification	**B.13**		
IV. IDB´s Role - Additionality			
The project relies on the use of country systems			
Fiduciary (VPC/FMP Criteria)	**Yes**	**Financial Management: Budget, Treasury. Procurement: Information System, Shopping Method.**	
Non-Fiduciary			
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project			
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan			

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

The project has the objective of reducing the housing deficit in Paraguay via the injection of $30 million in the housing sector for: (i) the provision of a credit line accessible to families from the emerging-middle-class with an income up to 7 minimum wages; as well as (ii) the provision of financing for housing developers to influence supply. The project document provides evidence of the scarcity of credit destined to mortgages. According to the National Plan of Housing (PLANHAVI for its initials in Spanish), the housing deficit is estimated at 74% of the country's homes. Of the financial system's total assets only 2.7% is destined to mortgage loans mainly accessible to higher income classes. According to the Housing Survey 2015, the average monthly income for families situated in the 7th-9th income deciles that the project targets is $1,650 in contrast to $4,617 for the 10th decile. Moreover, currently there is no line of credit designed for housing developers that does not rely on personal or corporate guarantees. The project will provide for the first time this type of bridge loan to develop housing with a cost in accordance to the income profile of the target beneficiary population.

The vertical logic is adequate and is substantiated by a pilot program. The cost/benefit analysis is also adequate. Amongst others, project outcome indicators include beneficiaries from the emerging-middle-class that acquire housing as well as the average value of improved homes. At project closure an ex-post cost benefit analysis will be conducted.

RESULTS MATRIX

Project objective:	The project's general objective is to help reduce Paraguay's housing deficit by providing financing to financial intermediaries to facilitate construction financing and access to housing. Its specific objectives are to: (i) increase access to housing for emerging middle class families with incomes up to seven minimum salaries by providing (mortgage and nonmortgage) credit solutions; and (ii) increase housing construction by financing developers to boost the supply.

EXPECTED IMPACT

Indicator	Unit	Baseline		Target		Means of verification	Observations
		Value	Year	Value	Year		
Expected impact							
Reduction of housing deficit in Paraguay.	Number of homes	0	2016	2500	2024	Administrative information from AFD and SENAVITAT estimates.	The current deficit is 1,198,479 homes. The project is expected to produce a demonstration effect in the financial system that reduces the deficit by a percentage higher than that directly attributable to the operation. In total the project is expected to reduce the housing shortage by 1,250 homes. The demonstration effect is expected to double that figure, for a reduction of 2,500 units.
Savings in public investment necessary to accommodate the expansion of the urban footprint in the Asunción Metropolitan Area (AMA).	US$ thousands	0	2016	315	2024	Estimates from the final evaluation and AFD administrative information.	The project is expected to help reduce the rate of growth in the urban footprint through the construction of densified housing. The estimated savings per m2 constructed is based on the study of the Emerging and Sustainable Cities Initiative for Asunción (see Economic Analysis).

Expected Outcomes

Expected outcomes	Unit	Baseline[1]		Intermediate target		Target		Means of verification	Observations
		Value	Year	Value	Year	Value	Year		
Expected outcome									
Number of families in 5th to 9th income distribution deciles who are served by the project.	Number of families	0	2016	250	2018	500	2020	Administrative Information: AFD Information System through administrative information gathered from the IFIs.	The project's beneficiaries are expected to be families belonging to the income distribution range that is not being sufficiently served by the financial sector.
Number of families with homes purchased through loans granted by the project.	Number of families	0	2016	150	2018	350	2020	Administrative Information: AFD Information System through administrative information gathered from the IFIs.	This indicator measures the number of families who purchase homes through funds corresponding to the project's first component. According to the economic analysis, the target is tied to the assumption that 70% of the funds in this component will be for this type of lending, with an average loan of US$40,000.
Number of families with homes improved through loans granted by the project.	Number of families	0	2016	150	2018	400	2020	Administrative Information: AFD Information System through administrative information gathered from the IFIs.	This indicator measures the number of families who make improvements to their homes using funds from the project's first component. According to the economic analysis, the target is tied to the assumption that 30% of the funds in this component will be for this type of lending, with an average loan of US$15,000.

[1] Although the program will retain the name of the AFD pilot, *Primera Vivienda*, it will be a new product, with new parameters and conditionalities that differentiate it from the original. For this reason, to avoid comparability problems, the baseline starts from zero for the project indicators.

Expected outcomes	Unit	Baseline[1]		Intermediate target		Target		Means of verification	Observations
		Value	Year	Value	Year	Value	Year		
Average increase in the value of homes improved through the project.	US$	0	2016	3,000	2018	6,000	2020	Administrative Information: AFD Information System through administrative information gathered from the IFIs.	This indicator will seek to measure the economic benefit derived from home improvements financed by the project.
Number of new multifamily homes constructed through loans granted to real estate developers.	Number of multifamily homes	0	2016	150	2018	500	2020	Administrative Information: AFD Information System through administrative information gathered from the IFIs.	This indicator measures the impact on the supply of multifamily housing in Paraguay. It will measure the number of multifamily homes constructed through lending to developers under the project.
Number of multifamily homes purchased or constructed through the project in the AMA.	Number of homes	0	2016	150	2018	400	2020	Administrative Information: AFD Information System through administrative information gathered from the IFIs.	This indicator measures the number of multifamily homes purchased or constructed within the AMA. The densification of this region is considered to have high priority, so an effort will be made to measure the project's contribution to this urban development objective.
Contribution to increasing the mortgage portfolio of the Paraguayan financial system.	Basis points	0	2016	8	2018	17	2020	Central Bank of Paraguay and Administrative information: AFD information system.	This indicator will seek to measure the project's contribution to expansion of the mortgage portfolio of the Paraguayan financial system.

OUTPUTS

Outputs	Estimated cost (US$)	Unit	Baseline	Year 1	Year 2	Year 3	Year 4	Final target[2]	Means of verification
Component I: Credit solutions for housing									
Annual number of housing loans granted through financial intermediaries.	US$20 million	Number of loans	0	100	150	200	300	750	Administrative Information: AFD Information System
	Annual cost:	US$ millions	0	2.66	4	5.33	8	20	
Component II: Financing for developers									
Number of loans granted to real estate developers.	US$10 million	Number of loans	0	1	1	2	1	5	Administrative Information: AFD Information System
	Annual cost:	US$ millions	0	2	2	4	2	10	

[2] Cumulative value over four years.

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Country:	Paraguay
Project number:	PR-L1140
Name:	Project for the Development of the Housing Finance Market in Paraguay
Executing agency:	Agencia Financiera de Desarrollo [Development Finance Agency] (AFD)
Prepared by:	Alberto de Egea and Mariano Perales – Fiduciary Specialists (FMP/CPR)

I. EXECUTIVE SUMMARY

1.1 The fiduciary management of the proposed project was evaluated based on the Proposal for Operation Development (POD), which defined its objective as helping to reduce the housing deficit in Paraguay by funding financial intermediaries to facilitate financing for construction and access to housing.

1.2 The AFD is the only second-tier public bank created by Law 2640/05 that makes its credit products available to the public exclusively through banks, finance companies, and authorized cooperatives. It does not lend directly to the end beneficiaries. AFD experience with this type of operation highlights a positive trend in the administration of the funds granted and thus confers sufficient required fiduciary reliability.

1.3 The project does not include financing from other multilateral organizations.

II. THE EXECUTING AGENCY'S FIDUCIARY CONTEXT

2.1 As the executing agency, the AFD has adequate systems for the fiduciary management of the funds allocated for intermediation loans. This is because based on technical and financial visits, audited financial statements (AFS) from previous programs, and the most recent official report on the internal oversight standard model for the second half of 2015, the AFD has demonstrated that it has an adequate level of internal oversight.

III. FIDUCIARY RISK EVALUATION AND MITIGATING ACTIONS

3.1 Given the AFD's successful experience executing operations with the IDB, the level of supervision required to comply with the Credit Regulations will be what is customary for the normal course of this operation.

IV. CONSIDERATIONS FOR THE SPECIAL PROVISIONS OF CONTRACTS

4.1 In order to streamline contract negotiations by the project team, primarily the Bank's Legal Department, included below are those agreements and requirements that should be considered in the special provisions:

a. **Project Operating Regulations.** The project Operating Regulations, which will consist of the credit product manual: (i) will be consistent with the rules and policies of the AFD and the Bank, as well as financial laws and practices in effect in the country; (ii) will summarize the principal characteristics of the project in terms of the use of funds, eligibility of subloans, and beneficiaries; (iii) will stipulate that failure to comply with its provisions will impede access to financing; (iv) its approval and entry into effect by the AFD to the Bank's satisfaction will constitute a condition precedent to disbursement of funds; and (v) any changes would require the no objection of the Bank. To determine the dollar equivalent of an expense incurred in local currency using loan funds, the same exchange rate as is used for converting funds disbursed in U.S. dollars to local currency will apply. For requests for reimbursement of expenses charged to the loan and recognition of expenses charged to the local counterpart, the exchange rate in effect on the date the request is submitted to the Bank will be used.

b. The project's financial statements will be prepared annually at the close of the fiscal year and will be submitted within the 120 days following that close. In addition, semiannual execution and financial reports will be submitted within 60 days following 30 June and 31 December of each year.

c. The financial statements of the AFD will also be annual.

d. For both financial statements, the audit firms responsible for those reports must be considered eligible by the Bank prior to preparing those audit reports.

e. The Bank may request an assurance audit as and when deemed necessary. It will not replace submission of the project's AFS.

f. All the subloans granted and charged against the loan must include conditions guaranteeing that the subborrower entities will comply with Bank policies in the area of prohibited practices as well as with the environmental and social safeguards.

V. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

5.1 The executing agency will not make procurements in this operation.

5.2 **Retroactive financing.** Considering that the global credit modality is involved, the Bank may retroactively finance and charge against loan funds eligible expenses incurred by the borrower prior to the loan approval date, up to US$6 million (20% of the proposed loan amount), provided they are related to subloans that meet requirements substantially similar to those established in the loan contract. Said expenses must have been incurred as from the approval date of the project profile (28 June 2016) but in no case will expenses incurred more than 18 months prior to the loan approval date be included.

VI. AGREEMENTS AND REQUIREMENTS FOR FINANCIAL EXECUTION

A. Financial management

1. Programming and budget

6.1 As an autonomous entity, the AFD has available funds provided by the State for its operations; however, the execution of those funds is discretionary consistent with the AFD's own needs.

6.2 By nature, the AFD is an autonomous, autarchic legal entity under public law, in accordance with Law 3330/07 "amending Articles 1, 3, 5, 6, and 14 of Law 2640/05." Its primary mission is to promote economic growth and job creation by channeling medium- and long-term financing to the private sector through banks, finance companies, and cooperatives (intermediary financial institutions – IFIs).

6.3 Budget programming, administration, and execution will be carried out by the Office of Administration and Finance under the zero-based budgeting system. In addition, its planning system is matched with the annual and multiyear placement plans. It should also be noted that the availability of the project's initial funds will be subject to ratification of the project by the Congress of the Republic before that budget is provided.

2. Accounting and information systems

6.4 Various actions were taken in 2010 to optimize operations in this area, including automation of processes, updating of the fixed assets information system module, and the integration of the institution's accounting system in the Public Accounting System (SICO) required by the Ministry of Finance.

6.5 The accural basis of accounting will be used. However, for reporting on projects partially financed by the IDB, accounting is done on a cash basis and according to national practices.

6.6 The AFD has an accounting system that generates the accounting and financial reports required in accordance with national regulations.

6.7 The reports related to the IDB forms are prepared using Excel spreadsheets, which are reconciled with country systems using external procedures.

3. Disbursements and cash flow

6.8 The AFD's Treasury Office is comprised of an operations assistant and a financial assistant, as well as a budget and financial planning manager. Together with the accountant they are part of the Office of Administration and Finance, which also has an administrative services manager.

6.9 The loan funds will be disbursed in a special account through advances governed by operational demands. Similarly, the AFD will use reimbursement of expenses incurred through direct payment for the operation. Actual demand for funds will determine the schedule for their execution.

6.10 The Bank may retroactively finance and charge to loan funds eligible expenses incurred by the borrower prior to the loan approval date, up to US$6 million (20% of the proposed loan amount), provided they meet requirements substantially similar to those established in the loan contract and consistent with the program

Operating Regulations. Said expenses must have been incurred as from the approval date of the Project Profile (28 June 2016), but in no case will expenses incurred more than 18 months prior to the loan approval date be included.

4. Internal control and internal audit

6.11 The basic objectives of internal control can be defined as follows:

g. Efficiency in the development of operations.

h. Obtaining reliable financial information.

i. Protection of the institution's assets.

j. Adherence to management's policies.

6.12 The Executive Branch General Audit Office, through the Institutional Internal Audit Office, monitors compliance with the Standard Internal Control Model of Paraguay, known as MECIP. At the end of 2015, it had a satisfactory rating; however, it has an improvement plan for 2016 in connection with the weaknesses established in the report.

5. External control and reports

6.13 The project will be audited by the supreme audit authority or an independent audit firm considered eligible by the Bank, following the procedures established in the new audit guides in effect. Earlier projects have been audited and opinions issued without significant comment.

6.14 Financing for the project audit is expected to be covered with AFD funds.

6. Financial supervision plan

6.15 Financial supervision will be conducted in three ways: (i) through control of the disbursement reports and review visits (ii) through scheduled on-site visits by the Bank; and (iii) through financial information from the financial statements and issuance of execution reports.

6.16 The AFD will be responsible for timely compliance with the clauses and agreements in the loan contract and for activities related to the project.

7. Other financial management agreements and requirements

6.17 N/A.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/16

Paraguay. Loan ____/OC-PR to the Agencia Financiera de Desarrollo
Project for the Development of the Housing
Finance Market in Paraguay

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Agencia Financiera de Desarrollo, as Borrower, and with the Republic of Paraguay, as Guarantor, for the purpose of granting the former a financing to cooperate in the execution of the Project for the Development of the Housing Finance Market in Paraguay. Such financing will be for an amount of up to US$30,000,000 from the Ordinary Capital resources of the Bank, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ___ __________ 2016)

LEG/SGO/CSC/IDBDOCS: 40635046
Pipeline No. PR-L1140