OFFICIAL USE ONLY
R2019-0085/1

April 11, 2019

Closing Date: Tuesday, April 30, 2019
at 6:00 p.m.

FROM: Vice President and Corporate Secretary

Kenya – Kenya Affordable Housing Finance Project

Project Appraisal Document

Attached is the Project Appraisal Document regarding a proposed loan to Kenya for a Kenya Affordable Housing Finance Project (R2019-0085), which is being processed on an absence-of-objection basis.

Distribution:
Executive Directors and Alternates
President
Bank Group Senior Management
Vice Presidents, Bank, IFC and MIGA
Directors and Department Heads, Bank, IFC, and MIGA

FOR OFFICIAL USE ONLY

Report No: PAD2889

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT APPRAISAL DOCUMENT
ON A
PROPOSED LOAN

IN THE AMOUNT OF EURO 219 MILLION
(US$250 MILLION EQUIVALENT)

TO THE

REPUBLIC OF KENYA

FOR A

KENYA AFFORDABLE HOUSING FINANCE PROJECT

April 9, 2019

Finance, Competitiveness And Innovation Global Practice
Africa Region

CURRENCY EQUIVALENTS

Exchange Rate Effective February 28, 2019

Currency Unit =	
US$1 =	100 KES
US$1 =	EUR 0.8758

FISCAL YEAR
July 1 – June 30

Regional Vice President:	Hafez Ghanem
Country Director:	Carlos Felipe Jaramillo
Practice Director:	Sebastian-A Molineus
Practice Manager:	Niraj Verma
Task Team Leader:	Caroline Cerruti

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
CBK	Central Bank of Kenya
CRRH	Caisse Régionale de Refinancement Hypothécaire
DA	Designated Account
DLI	Disbursement Linked Indicator
E&S	Environmental and Social
EEP	Eligible Expenditure Program
ERR	Economic Rate of Return
ESMS	Environmental and Social Management System
FM	Financial Management
GDP	Gross Domestic Product
GoK	Government of Kenya
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IFI	International Financial Institution
IFMIS	Integrated Financial Management and Information Systems
IFR	Interim Financial Report
IPF	Investment Project Financing
KES	Kenyan Shillings
KMRC	Kenya Mortgage Refinance Company
LIMS	Land Information Management System
M&E	Monitoring and Evaluation
MLPP	Ministry of Lands and Physical Planning
MRA	Master Refinance Agreement
MRC	Mortgage Refinance Company
NMRC	Nigeria Mortgage Refinance Company
NPL	Non-Performing Loan
NT	National Treasury and Planning
OAG	Office of the Auditor General
PA	Project Account
PIU	Project Implementation Unit
PML	Participating Mortgage Lender
POM	Project Operations Manual
PPSD	Project Procurement Strategy for Development
SACCOs	Savings and Credit Cooperatives
SASRA	SACCO Societies Regulatory Authority
SOE	Statement of Expenditures
STEP	Systematic Tracking of Exchanges in Procurement
TA	Technical Assistance
TMRC	Tanzania Mortgage Refinance Company
US$	United States Dollar
WAEMU	West Africa Economic and Monetary Union
WBG	World Bank Group

TABLE OF CONTENTS

DATASHEET

BASIC INFORMATION

Country(ies)	Project Name	
Kenya	Kenya Affordable Housing Finance Project	
Project ID	Financing Instrument	Environmental Assessment Category
P165034	Investment Project Financing	F-Financial Intermediary Assessment

Financing & Implementation Modalities

[ ] Multiphase Programmatic Approach (MPA)	[ ] Contingent Emergency Response Component (CERC)
[ ] Series of Projects (SOP)	[ ] Fragile State(s)
[✓] Disbursement-linked Indicators (DLIs)	[ ] Small State(s)
[✓] Financial Intermediaries (FI)	[ ] Fragile within a non-fragile Country
[ ] Project-Based Guarantee	[ ] Conflict
[ ] Deferred Drawdown	[ ] Responding to Natural or Man-made Disaster
[ ] Alternate Procurement Arrangements (APA)	

Expected Approval Date	Expected Closing Date
30-Apr-2019	30-Jun-2024
Bank/IFC Collaboration	Joint Level
Yes	Complementary or Interdependent project requiring active coordination

Proposed Development Objective(s)

The development objective is to expand access to affordable housing finance to targeted beneficiaries

Components

Component Name	Cost (US$, millions)
Support to the Kenya Mortgage Refinance Company	252.00

Technical Assistance	10.00

Organizations

Borrower:	Republic of Kenya
Implementing Agency:	Kenya Mortgage Refinance Company Kenya National Treasury and Planning Kenya Ministry of Lands and Physical Planning

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	262.00
Total Financing	262.00
of which IBRD/IDA	250.00
Financing Gap	0.00

DETAILS

Private Sector Investors/Shareholders

Equity	Amount	Debt	Amount
Non-Government Contributions	12.00	IFI Debt	250.00
Private Sector Equity	12.00	IBRD	250.00
Total	**12.00**		**250.00**

Expected Disbursements (in US$, Millions)

WB Fiscal Year	2019	2020	2021	2022	2023	2024
Annual	0.00	43.00	55.00	52.00	50.00	50.00
Cumulative	0.00	43.00	98.00	150.00	200.00	250.00

INSTITUTIONAL DATA

Practice Area (Lead)
Finance, Competitiveness and Innovation

Contributing Practice Areas
Social, Urban, Rural and Resilience Global Practice

Climate Change and Disaster Screening
This operation has been screened for short and long-term climate change and disaster risks

Gender Tag

Does the project plan to undertake any of the following?	
a. Analysis to identify Project-relevant gaps between males and females, especially in light of country gaps identified through SCD and CPF	Yes
b. Specific action(s) to address the gender gaps identified in (a) and/or to improve women or men's empowerment	Yes
c. Include Indicators in results framework to monitor outcomes from actions identified in (b)	Yes

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	Substantial
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Substantial
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Moderate
8. Stakeholders	Moderate
9. Other	
10. Overall	Substantial

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [✓] No

Does the project require any waivers of Bank policies?

[ ] Yes [✓] No

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01		✓
Performance Standards for Private Sector Activities OP/BP 4.03	✓	
Natural Habitats OP/BP 4.04		✓
Forests OP/BP 4.36		✓
Pest Management OP 4.09		✓
Physical Cultural Resources OP/BP 4.11		✓
Indigenous Peoples OP/BP 4.10		✓
Involuntary Resettlement OP/BP 4.12		✓
Safety of Dams OP/BP 4.37		✓
Projects on International Waterways OP/BP 7.50		✓
Projects in Disputed Areas OP/BP 7.60		✓

Legal Covenants

Sections and Description
Loan Agreement, Schedule 2, Section II: The Borrower shall furnish to the Bank each Project Report not later than forty five (45) days after the end of each calendar semester, covering the calendar semester.

Sections and Description
Loan Agreement, Schedule 2, Section 1.A.2. No later than twelve months after the Effective Date, the Borrower shall have recruited the consultants for purposes of carrying out the activities under Part 2 of the Project, in accordance with the Procurement Regulations, and under terms of reference, qualifications and experience satisfactory to the Bank.

Sections and Description

Project Agreement, Schedule, Section I.A.
No later than three (3) months after the Effective Date, the KMRC shall appoint and, thereafter, maintain, throughout Project implementation, a risk manager and an internal auditor, with qualifications, experience and under terms of reference acceptable to the Bank.

Conditions

Type	Description
Effectiveness	Loan Agreement. Article V. The Borrower shall have adopted the Project Operations Manual and the Project Implementing Entity shall have adopted the KMRC Operations Manual and the Project Operations Manual, in form and substance satisfactory to the Bank.
Type	Description
Disbursement	Loan Agreement, Schedule 2. Section III. Withdrawal of Loan Proceeds B. Withdrawal Conditions; Withdrawal Period. Under Category (1), until the Borrower has provided evidence satisfactory to the Bank that: (i) The Project Implementing Entity has been established, made operational, and capitalized in a manner satisfactory to the Bank, and the relevant licenses, permits, and approvals required for its operation have been obtained; (ii) the Subsidiary Agreement has been entered into in accordance with the provisions of Section I.C. of Schedule 2 to this Agreement, and the Bank has received a legal opinion(s) or certificate(s) satisfactory to the Bank confirming on behalf of the Project Implementing Entity and the Borrower that the Subsidiary Agreement to which each is a party has been duly authorized by, and executed and delivered on behalf of, the Project Implementing Entity and the Borrower and is legally binding upon such party in accordance with its terms.
Type	Description
Disbursement	Loan Agreement, Schedule 2. Section III. Withdrawal of Loan Proceeds B. Withdrawal Conditions; Withdrawal Period. Under Category (3) for Eligible Expenditures Program unless and until the Borrower has furnished evidence satisfactory to the Bank that: (i) the Borrower and the Project Implementing Entity have executed the Subsidiary Agreement, in accordance with Section I.C. of Schedule 2 of this Agreement; (ii) the Project Implementing Entity has been established, made operational, and capitalized in a manner satisfactory to the Bank, and the relevant licenses, permits, and approvals required for its operation have been obtained; and (iii) payments for Eligible Expenditures Program have been made in accordance, and in compliance, with the procedures set forth in the Verification Protocol and in the Borrower’s applicable laws and regulations; and (ii) the DLIs set forth in Schedule 3 for which payment is requested have been met and verified in accordance with the Verification Protocol.
Type	Description
Disbursement	Loan Agreement, Schedule 2, Section 1.D.

	Prior to the carrying out of any activities under Part 1(b) of the Project, the Borrower shall cause the Project Implementing Entity to (i) adopt and publish an Environmental and Social Risk Management Policy acceptable to the Bank and (ii) establish, and thereafter maintain through the period of implementation of the Project, an easily accessible grievance redress mechanism acceptable to the Bank, to address feedback and grievances relating to the Project. Prior to the carrying out of any activities under Part 1(b) of the Project, the Borrower shall cause the Project Implementing Entity to submit an acceptable capacity building plan on Applicable Environmental and Social Requirements for its staff and Participating Financial Institutions, and to designate an Environmental and Social Coordinator.

Type	Description
Disbursement	Loan Agreement, Schedule 2. Section III. Withdrawal of Loan Proceeds B. Withdrawal Conditions; Withdrawal Period. 1. Notwithstanding the provisions of Part A above, no withdrawal shall be made: (a) for payments made prior to the Signature Date, except that withdrawals up to an aggregate amount not to exceed Euro15,000,000 may be made for payments made prior to this date but on or after January 1, 2019, for Eligible Expenditures under Categories (2) and (3).

I. STRATEGIC CONTEXT

A. Country Context

1. **After multiple headwinds dampened growth in 2017, a nascent rebound in economic activity in Kenya is gaining momentum**. Economic growth decelerated to a 5-year low of 4.9 percent in 2017 due to poor rains, slowdown in credit growth to the private sector and election-induced uncertainty. Growth recovered to 5.7 percent in 2018 and is projected to steadily rise to 6.0 percent by 2020. The dissipation of political uncertainty and the recovery in the global economy is supporting a rebound in business sentiment. Downside risks include weak private sector credit growth, fiscal slippages, rising trade tensions and sharp increase in oil prices.

2. **The Government of Kenya (GoK) has outlined four big priority areas for the next five years ("the Big Four")**. These are food security, affordable housing, manufacturing, and universal health coverage. For affordable housing, the GoK expects to deliver 500,000 new affordable housing units by 2022.

3. **With limited fiscal space, support from the private sector is needed to reach the Big Four**. The Government is on course with its fiscal consolidation plan however public debt remains high in a context of weak revenue collection. The fiscal deficit narrowed from 8.8 percent of Gross Domestic Product (GDP) in 2016/17 to 6.8 percent in 2017/18. Public debt decreased as a share of GDP from 57.5 percent in June 2017 to 57.3 percent in June 2018**.** Total revenue to GDP (including grants) fell from 18.9 percent in 2016/17 to 17.6 percent in 2017/18.

4. **Poverty incidence in Kenya is below the average in sub-Saharan Africa**. Strong growth in the last decade led to a decrease in the national poverty rate from 46.8 percent in 2005/06 to 36.1 percent in 2015/16. Poverty is concentrated in the North East and in rural areas. With Kenya moving to middle-income status, issues of shared prosperity and decent living conditions are becoming more prominent.

B. Sectoral and Institutional Context

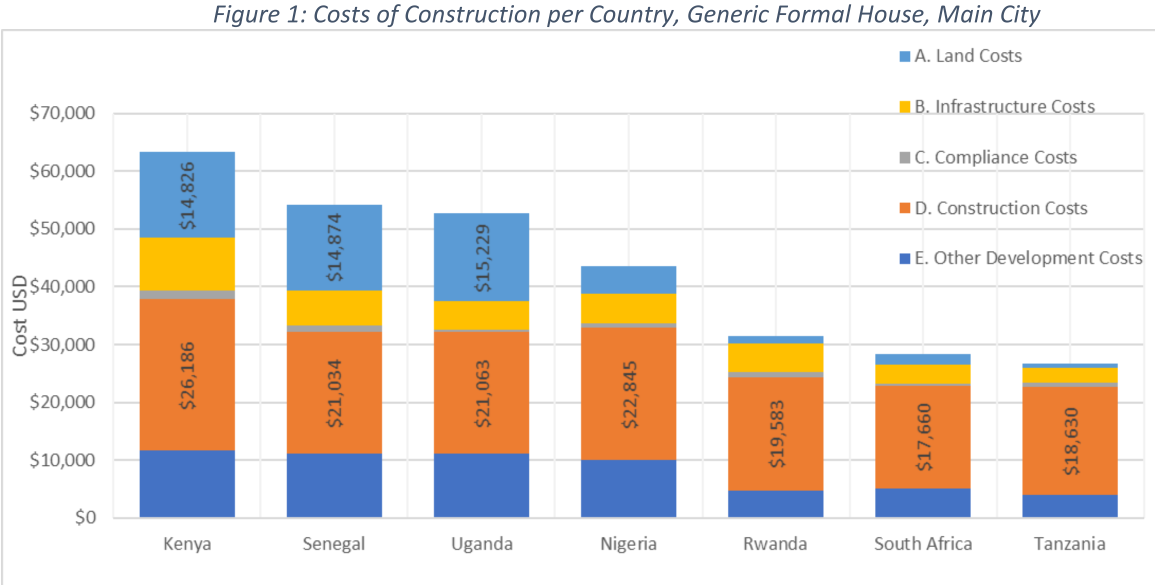
5. **Kenya' s population is young and urbanizing rapidly, putting strong pressure on housing needs**. Three quarters of the population is below 35 and the country is urbanizing at a rate of 4.3 percent per year. Urban centers face a shortage of 200,000 housing units annually whereas only 50,000 new housing units are being constructed every year. An estimated 61 percent of urban households live in slums (compared to 50 percent in Nigeria, 23 percent in South Africa).[1] This elevated rate is mostly due to overcrowding and lack of access to basic services. In urban centers, 56 percent of households live in one single room, and only 19 percent own their home (Kenya National Bureau of Statistics, 2018).

6. **Urban housing is not affordable**. This stems from the cost of financing, the short loan tenors and the high cost of properties. Commercial banks have only 26,000 mortgage loans outstanding of an average amount of KES 11 million (US$110,000). The interest rate cap in 2016 coupled with decreasing asset quality (overall non-performing loan ratio of 12 percent) led banks to tighten their credit standards and offer variable rate loans. Savings and Credit Cooperatives (SACCOs) are estimated to provide almost 90 percent of the total housing finance but they are highly constrained by the short-term nature of their deposit liabilities. Though SACCOs' interest rates are relatively low at 12 percent, their loans do not generally go beyond five years. As a result, most urban households rent, or build incrementally with repeat loans.

[1] World Bank, Kenya Urbanization Review (2016), Kenya Economic Update (April 2017).

7. **High property costs stem from the cost of land and construction, and inefficient property registration (Figure 1)**. Although the price of the cheapest newly built house by a private developer was about US$17,000 in 2015, the average value of a 3-bedroom property can reach US$140,000[2] as developers have focused on the high-end market. Annual median urban household income is about US$6,000 (using GDP consumption data) which points to affordable house prices of around US$18,000 (three times the income as a rule of thumb). Land and infrastructure cost account for 30 to 40 percent of private developments. Kenya has one of the highest construction costs in Africa due to the import of cement and steel and their associated levies. The lengthy property registration process and constraints on sub-division increase the property cost and are a disincentive for formal financing: the cost of a property is on average 10 percent higher when purchased by a mortgage loan than by cash.

Figure 1: Costs of Construction per Country, Generic Formal House, Main City



Source: Center for Affordable Housing Finance (CAHF), 2015-2016

8. **The GoK's Affordable Housing strategy includes five pillars**. The affordable housing strategy of the GoK targets households with monthly incomes up to KES 150,000 (US$1,500) and unit prices up to KES 3 million (US$30,000); the Project uses the same reference points.

(i) **Unlocking land for affordable housing supply:** Land with proximity to services (transport, jobs, schools) and infrastructure is a critical enabler to affordable homes. The GoK intends to make serviced land available to private developers and enter into public-private schemes to support the supply of affordable homes on a large scale. It is surveying parcels of public land to assess whether they are properly registered and can be suitable for public-private arrangements and has prioritized 44 locations for large-scale developments.

(ii) **Providing bulk infrastructure:** The GoK is committed to servicing parcels of land by providing bulk infrastructure (water, sewage, power, access roads) to attract the private sector. It is supporting rapid

[2] Hass Consult, House Price Index, Fourth Quarter 2017

mass transit systems around key urban areas, starting with Nairobi; and planning to simplify the building code and streamline permit application to support affordable housing supply.

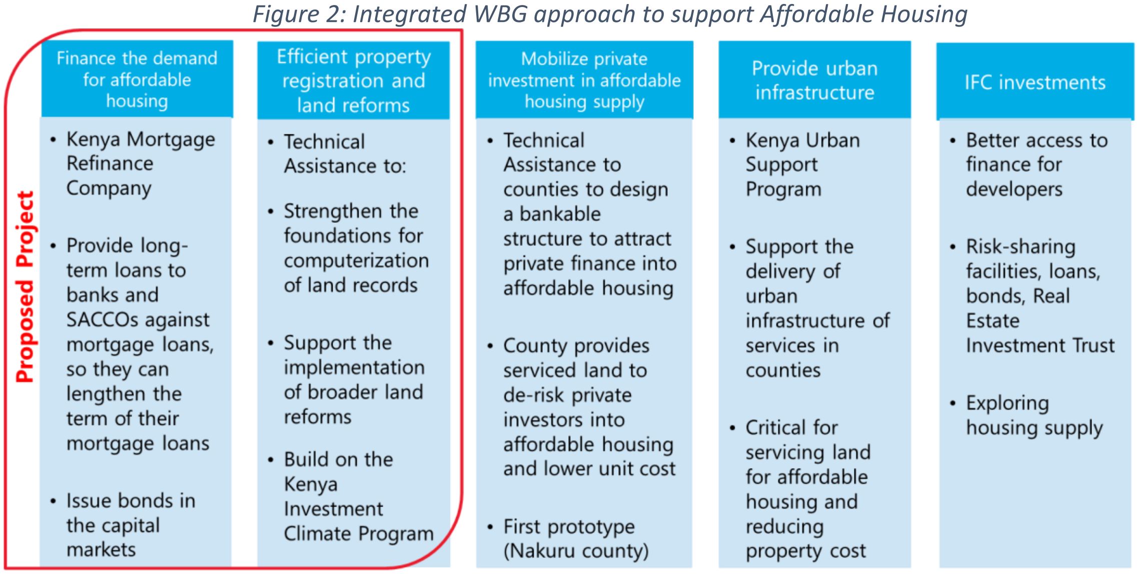
(iii) **Reducing development cost:** The GoK intends to incentivize large-scale developments to reduce cost as well as the use of alternative building materials and construction techniques. The corporate tax rate of developers who construct at least 100 units per year was lowered to 15 percent in the 2018/19 budget.

(iv) **Financing:** The GoK has set up the Kenya Mortgage Refinance Company (KMRC), a public-private company that will provide long-term funding to financial institutions to extend loan tenors. KMRC is a wholesale financial institution which will issue bonds in the local capital markets, and with the proceeds, extend long term loans to financial institutions, secured against mortgages. The National Treasury and Planning (NT) will own up to 20 percent of KMRC and the remainder will come from development finance institutions, Kenyan banks and SACCOs. To finance supply, the GoK has created a National Housing Development Fund to act as an aggregator of demand and support savings.

(v) **Enabling environment:** The GoK is planning to enable legislation to facilitate and computerize property registration; sectional titling; strategic land acquisition; and prohibit land speculation.

9. **This Project supports the GoK's strategy on two fronts: expanding affordable housing finance via the provision of long-term funding and strengthening property registration.** It is part of an integrated approach of the World Bank Group (WBG) to support affordable housing, which also includes: (i) technical assistance to design public-private schemes to provide affordable housing in counties, funded by a DFID trust fund. Work is ongoing with one county government to design a bankable and scalable structure to attract private investors into affordable housing. Other counties are interested in replicating this initiative (Annex 2). The success is predicated on the availability of fully secured and serviced land, as well as the proximity of such land to social services; (ii) Delivery of improved services and urban infrastructure in counties via the Kenya Urban Support Program (P156777); and (iii) IFC interventions, with a focus on expanding developer finance. Figure 2 illustrates this integrated approach. An upcoming Development Policy Operation also supports policies in the housing supply sector and the regulations for KMRC.

Figure 2: Integrated WBG approach to support Affordable Housing



C. Relevance to Higher Level Objectives

10. **The Project supports the Maximizing Finance for Development Agenda**. KMRC's long-term funding to financial institutions will incentivize them to provide more long-term loans to their clients. The GoK's initial contribution of KES 1 billion (equivalent to US$10 million) into KMRC is expected to catalyze US$12 million of private sector equity. KMRC's bond issues are expected to mobilize private funds from institutional investors through the capital market, as shown by other mortgage refinance companies: for instance, since inception in 2012, the West Africa Mortgage Refinance Company (CRRH) has issued about US$240 million worth of bonds becoming the largest issuer in the local capital market. Strengthening the foundations for faster and more reliable land transactions through computerization will increase investment into housing and boost the mortgage market.

11. **The Project will help boost shared prosperity.** It addresses the rapid urbanization visible through slums in main urban centers and will have four types of impact. (i) Increase in access to housing finance: by lengthening loan tenors, the Project could triple the proportion of urban households having access to a mortgage (Annex 3); (ii) Inclusive finance: a distinctive feature of KMRC compared to its peers is to serve microfinance banks and SACCOs, which target low-income borrowers (microfinance banks have 2 million clients with an average deposit of US$182, a proxy for monthly income). KMRC's long term loans will allow SACCOs and microfinance banks to grow more sustainably, since today their funding relies on short-term deposits; (iii) Economic externalities: investment into affordable housing has a strong multiplier effect across the economy given the number of linked sectors, raw material, construction sector, finished goods or financial services (Annex 4). The Project could help support 132,000 new jobs. Homeownership also prevents vulnerable households from falling into poverty by providing an asset that can be leveraged to obtain credit; and (iv) Social externalities: better housing conditions improve health and educational outcomes. In Mexico, the Piso Firme program replacing dirt floor infected by worms with concrete resulted in a 20 percent reduction of incidence of anemia in children under 6 and higher language scores of 30 percent in toddlers. Studies in the US show that for children in families with incomes less than 150 percent of the federal poverty line, homeownership raises educational attainment, earnings and welfare independence in young adulthood (Yun 2017).

12. **The path to expand housing finance down market will be progressive**. Financial institutions progressively move to lower income and loan size segments as experience and comfort develops with this product, and digital innovation strengthens the credit assessment of long-term loans for households in the bottom 40 percent. The India Low-Income Housing Finance Project (P119039, Box 1) shows that reaching down-market requires time, appropriate underwriting techniques and supportive institutions.

Box 1: Expanding India's Low-Income Housing Market

India has made tremendous strides over the past 30 years in expanding housing finance. It created a legal and institutional framework that has supported growth and expansion, and the housing finance market is approaching US$250 billion. Historically, as little as 2-3 percent of mortgage credit was going to low income segments. This trend has changed dramatically in recent years with an expansion of lending in the affordable housing sector as lenders have embraced new underwriting techniques and better risk management. Additional impetus was provided by the Government's "Housing for All by 2022" Program which sought the expansion of housing finance to middle and low-income households, especially those working in the informal sector. The World Bank supported this agenda with a Low-Income Housing Finance Project in 2013 (P119039), a US$100 million credit line to the National Housing Bank to refinance mortgage loans to low-income households working in the informal sector. The results of the Project as of December 2017 are:
- About 15,000 mortgage loans have been refinanced;
- 82 percent of the refinancing is to borrowers working in the informal sector;
- The average household annual income is US$2,753 or the equivalent of US$7.5 a day. This shows that commercial credit can be extended to low-income borrowers without creating a sub-prime problem.
- The average interest rate is 14.8 percent, which shows that longer maturities at such rate are better than alternatives such as repeat short-term loans or credit from money lenders.

The mortgage refinance available from National Housing Bank facilitated the creation of Affordable Housing Finance Companies, which are non-deposit takers extending mortgage finance to urban workers using field-based credit assessment. Their loan book grew from US$160 million in 2013 to US$4 billion in 2017, and they have facilitated the ownership of more than 200,000 affordable homes. IFC provided equity and debt to several of these companies as well as advisory services.

The India case provides a few lessons for Kenya. First, the expansion of mortgage finance to households with low-income and those in the informal sector takes time and requires lenders to develop appropriate underwriting techniques. Second, it requires a strong enabling environment (for instance, the foreclosure act allowed these companies to enforce property collateral to recover on unpaid loans). Third, it requires strong institutions that can foster competition. National Housing Bank was set up in 1988 as part of an integrated approach to housing which covered funding needs, institutions, housing supply as well as legal and regulatory framework.

II. PROJECT DESCRIPTION

A. Project Development Objective

PDO Statement

The development objective is to expand access to affordable housing finance to targeted beneficiaries.

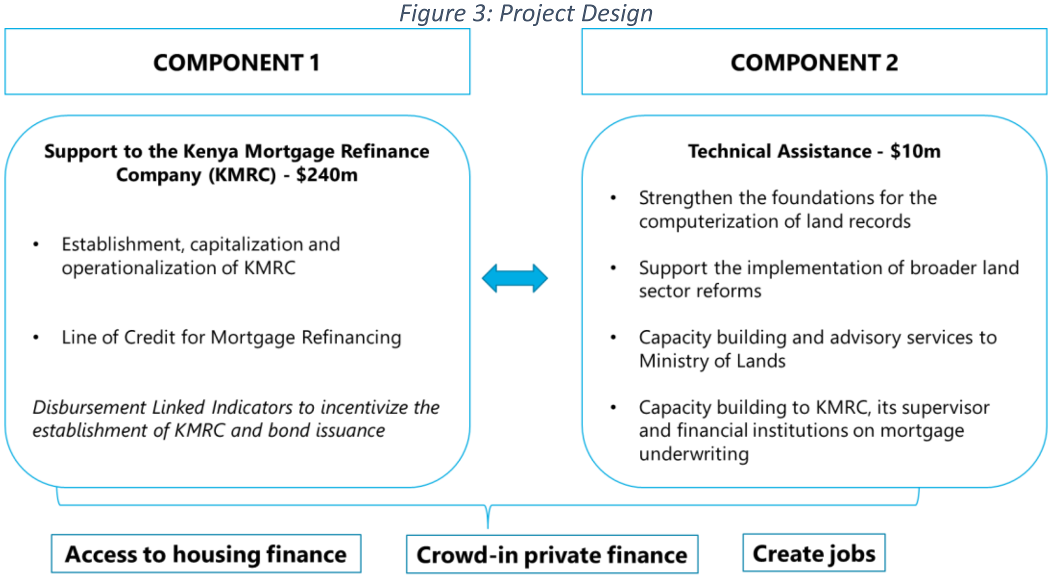
For this Project, targeted beneficiaries are the same as per the GoK's Affordable Housing Strategy, defined as households with a property valued below KES 3 million (US$30,000), which translates into a monthly household income up to KES 150,000 (US$1,500). Since property prices are higher in Nairobi Metropolitan region, the Project will accept loan values up to KES 4 million (US$40,000) for Nairobi Metropolitan (counties of Nairobi, Kajiado, Kiambu, Machakos).

PDO Level Indicators

Number of affordable mortgage/ housing loans refinanced by KMRC
Volume of bonds issued by KMRC

B. Project Components

Figure 3: Project Design



Component 1: Support to the Kenya Mortgage Refinance Company (KMRC) (Total Cost US$252 million, IBRD financing US$240 million equivalent or EUR 210.2 million)

13. **This Component will support the establishment, capitalization and operationalization of KMRC.** KMRC is modelled after other mortgage refinance companies supported by the WBG (e.g. in West Africa, Tanzania, Pakistan), but its distinctive feature will be to serve SACCOs and microfinance banks as well as commercial banks. KMRC will be a majority-private company supervised by the Central Bank of Kenya (CBK), and by the Capital Market Authority for its bond issuances. Annex 5 summarizes KMRC business and operationalization plan.

14. **KMRC will contribute to developing the mortgage and housing finance markets.** Key benefits include: (i) provision of long-term funds so that lenders can match their assets and liabilities; (ii) better affordability of mortgage loans as financial institutions extend the maturity of their loans; (iii) creation of a safety net to the financial system as banks and SACCOs know they have a source of liquidity when they need it, which incentivizes them to produce long-term loans; (iv) enhanced competition, by removing long-term funding as a barrier to entry in the mortgage market (especially relevant for SACCOs); and (v) deepening of the private bond market as KMRC becomes a regular issuer.

15. **The governance of KMRC will conform to international standards**. KMRC's Board is expected to include independent members as well as representatives from banks, SACCOs and GoK. KMRC will be subject to CBK's guideline on corporate governance which requires among others fit and proper criteria, annual performance evaluation of the Board and declaration of interests.

16. **Significant progress has been made in the establishment of KMRC**. The Company has been registered, and NT has appointed interim management and capitalized the institution. Twenty-one financial institutions have confirmed interest in participating. The CBK Act has been modified to allow supervision of mortgage refinance companies by the CBK. KMRC regulations are in the process of being gazetted. KMRC's key policies and procedures (KMRC Operations

Manual) have been approved by interim management and are pending KMRC Board approval. Interim staff in the areas of credit, operations, financial analysis/accounting and legal services have joined KMRC.

(i) Component 1(a): Establishment, capitalization and operationalization of KMRC (Total cost US$62 million, IBRD financing US$50 million equivalent or EUR 43.8 million)

17. The GoK will ensure that KMRC is legally established and capitalized to start operations. Disbursement will be made against Disbursement Linked indicators (DLIs). NT has provided initial capital to KMRC of KES 1 billion (US$10 million / EUR 8.8 million equivalent, broken down into equity and Tier 2 capital / subordinated debt) which will mobilize US$12 million equity equivalent from private investors. NT will provide additional subordinated debt of EUR 8.8 million equivalent in KMRC's first year of operations and EUR 26.2 million equivalent upon KMRC's issuance of a bond in the local capital market.[3] The subordinated debt will be invested in safe and income-generating securities to build KMRC's capital and income, provide a cushion for lending to SACCOs/microfinance banks, and raise investors' confidence. KMRC's business plan shows that the institution is profitable.

DLIs	Description	Amount	Outcome	Indicative Target date
DLI 1: The Project Implementing Entity is legally established, and has the required regulatory capital and approvals to start operations	The Borrower has established, operationalized and capitalized the Project Implementing Entity (KMRC) and the Project Implementing Entity has received the relevant licenses, permits and approvals required to start operations.	EUR 8,800,000	KMRC can start operations	By June 2019
DLI 2: The Borrower has provided Tier 2 Capital to the Project Implementing Entity	The Borrower has executed a Subordinated Debt Agreement with the Project Implementing Entity pursuant to which EUR 8,800,000 equivalent has been paid to the Project Implementing Entity.	EUR 8,800,000	KMRC's capital is stronger and allows it to prepare for bond issue	By February 2020
DLI 3: The Borrower has provided additional Tier 2 Capital to the Project Implementing Entity	Upon completion of a bond issuance by KMRC, the Borrower has executed an updated Subordinated Debt Agreement with the Project Implementing Entity pursuant to which EUR 26,200,000 equivalent has been paid to the Project Implementing Entity.	EUR 26,200,000	KMRC's capital base is stronger and allows it to continue its bond issuance program	By February 2022

(ii) Component 1(b): Line of Credit for Mortgage Refinancing (total cost US$190 million, IBRD financing US$190 million equivalent or EUR 166.4 million)

18. To kick start the affordable mortgage market, while building KMRC's capacity to issue bonds, IBRD will provide a credit line to KMRC through NT to refinance affordable housing loans. KMRC will extend loans to banks and SACCOs that meet strict eligibility criteria, and such loans will be secured against eligible mortgage/housing loans. Eligibility criteria for financial institutions include: licensed and regulated entity; compliance with prudential requirements; unqualified audit for the most recent financial year; minimum capital adequacy ratio and liquidity ratio; resources committed to the housing lending program; regular onsite inspections, in addition to having made an equity contribution into KMRC – these are spelt out in the Project Operations Manual (POM) and are consistent with World Bank's policy and guidance on Financial Intermediaries.

[3] Kenya has recently issued a framework for green bonds. KMRC expects about a quarter of its bonds to be green bonds, supporting residential mortgage loans on energy-efficient homes.

19. **The loans provided as collateral to KMRC under the credit line will have to meet eligibility criteria**. Consistent with the GoK's strategy, under the Project, the focus will be on loan values below KES 3 million (US$30,000) or KES 4 million for Nairobi Metropolitan (Nairobi, Kajiado, Kiambu, Machakos), which translates into a monthly household income of up to KES 150,000 (US$1,500). Given that this is an unexplored market segment, in case of insufficient demand below the KES 3/4 million threshold, and to support a blending of the portfolio, up to 20 percent of the credit line may be used for refinancing loans above this threshold. All loans will be screened for environmental and social (E&S) risks and will have to meet risk management criteria such as: maximum payment to income ratio; insurance on the property; maximum loan to value ratio; borrowers' continued performance to service the loan. Since SACCOs and microfinance banks are not extending mortgage loans but short-term housing loans, they will be able to pledge other collateral (government securities, cash) for a limited time while they convert their portfolio into mortgage loans.

20. **The pricing of the IBRD-supported credit line to financial institutions will be market based.** Since there is currently no market for mortgage refinance, the following formula will be used for pricing KMRC loans to financial institutions: IBRD rate plus risk premium plus KMRC's administrative cost. NT will receive the funds at IBRD cost in Euros and will pass these funds to KMRC in local currency at a fixed rate. The fixed interest rate will allow the expansion of housing finance down-market since households with modest incomes do not have the capacity to manage interest rate variations. NT will assume the foreign exchange risk. KMRC will add an administrative cost of up to 1 percent, which is in line with other mortgage refinance companies. The pricing formula and eligibility criteria are detailed in the POM reviewed by the Bank.

21. **In addition to the affordable credit line, KMRC will develop a second mortgage refinance window at market rates**. This line would be funded primarily by bonds, with the proposed support of African Development Bank (AfDB)'s credit line and is estimated to finance about 3,000 mortgages within the life of the Project.

Component 2: Technical Assistance (total cost US$10 million, IBRD financing US$10 million equivalent or EUR 8.8 million)

22. **Kenya has embarked on substantial improvements of its historically disenfranchising land management system**. The 2009 National Land Policy represented a landmark development, the product of a long consultative process over many years, and which is considered the turning point of Kenya's transformative land reforms. The policy identifies the critical land issues facing the country and presents a set of proposals for legislative action and administrative reforms to bring out desired land reforms. A key legal reform was the consolidation of 11 Land Acts into four 2012 Acts (Land Act, Land Registration Act, National Land Commission Act and Community Land Act) which now form the backbone of land management in Kenya.

23. **However, critical bottlenecks remain, like a cumbersome property registration system which constrains private sector engagement**. It takes an average of 49 days to register property and the cost in Kenya is much higher than neighboring countries (about 6 percent of the property value versus 0.1 percent in Rwanda). There is a lack of trust in a paper-based system with perceived corruption. Improving the property registration process will help develop the mortgage market and crowd-in private finance. It will also support revenue-generation: recent computerization reforms in Uganda moved monthly land-related revenue generation from US$100,000 in 2012 to US$3 million in 2016/17.

24. **The Project will provide technical assistance (TA) to support the Ministry of Lands and Physical Planning (MLPP) improve property registration.** The technical assistance will support MLPP in its ambitious computerization program. The MLPP aims to computerize the 58 land registries in the 47 counties within four years (property registration is not a devolved function) and specific MLPP budget lines have been assigned to computerization. The component will provide TA that will improve the foundation and quality of the ongoing land computerization project. It will provide capacity building to the staff of the registries and MLPP on computerization. This TA is closely coordinated with the Kenya Investment Climate Trust Fund (IFC P603298) whose key outputs included reforms of the legal and regulatory framework for land registration and enhancement of construction permit electronic systems.

25. **This Component will also support the implementation of key legislations and regulations that have been enacted to fast track effective property registration.** A key legislation is the Sectional Properties Act which simplifies the property registration process for multi-story units that private developers have stated as a key constraint to their cash flows. The effective implementation of the Act will allow private developers to get titles for individual units in a multi-story building, and consequently to sell units faster. The Project will support the development of training material and capacity building of land registrars, surveyors, private developers, property professionals and the public on using the Act to register property.

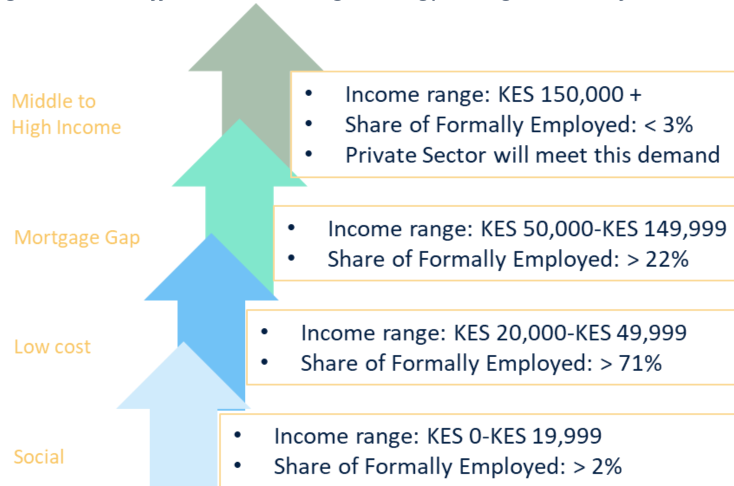
26. **This component will also support the MLPP address structural constraints in the existing land management system in Kenya**. Land registration reforms will improve the transactions of existing land records. However, legal, regulatory, administrative and institutional constraints maintain the persistent land tenure insecurity and inequity. An assessment will be done to comprehensively document the constraints and from this assessment, a roadmap (strategic plan) will be developed to guide the MLPP in its reforms to improve the equitable use of land for all Kenyans.

27. **The TA will also support Component 1 and Project management**. Activities will support the operationalization and pipeline development of KMRC; and capacity building of KMRC, its supervisors and financial institutions to improve mortgage underwriting practices. Consultants may also be hired to augment existing capacity within the implementing agencies. The TA will also support the development of an effective communication strategy by KMRC to create awareness, change peoples' negative perception of mortgages in Kenya and build citizen's trust.

C. Project Beneficiaries

28. **The primary beneficiaries of this Project are Kenyans who are unable to access long-term housing finance**. The Project primarily targets households with monthly incomes up to KES 150,000 (US$1,500) using the loan amount of below KES 3 million (US$30,000), in the "mortgage gap" and "low-cost" categories identified by the GoK, representing about 95 percent of the formally employed population (Figure 4). Since property prices are higher in Nairobi Metropolitan region, the Project will accept loan values up to KES 4 million (US$40,000) for Nairobi Metropolitan (counties of Nairobi, Kajiado, Kiambu, Machakos). Interviews conducted in counties show that many workers with modest incomes (such as hospitality and service employees), are formal employees with long-term contracts. The Project targets the growing population of urban workers who are credit worthy but cannot access mortgage loans.

Figure 4: GoK Affordable Housing Strategy – targeted beneficiaries

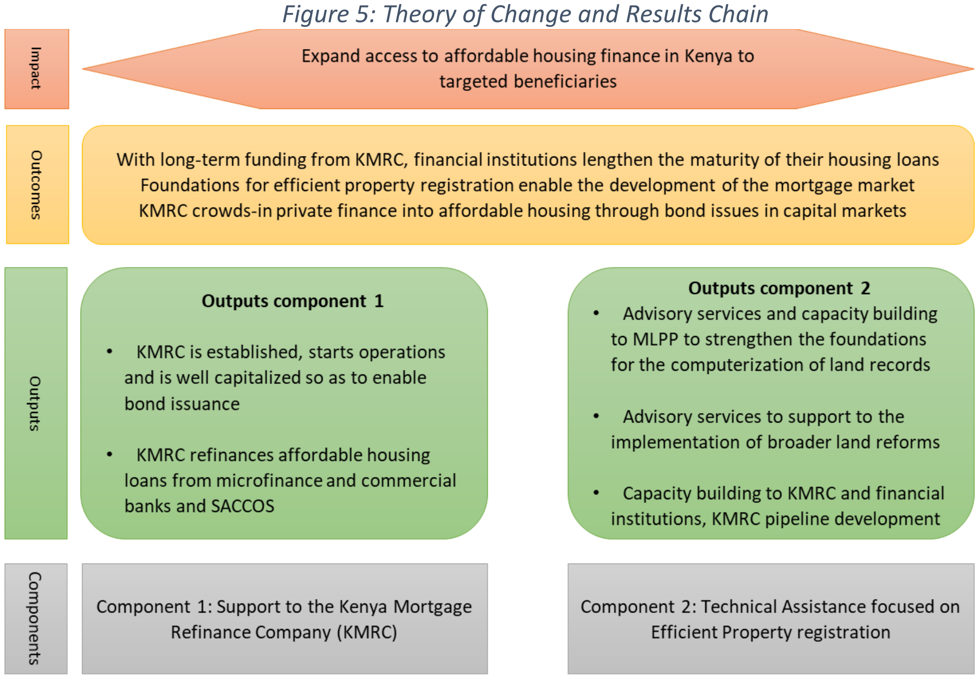


Source: World Bank based on State Department of Housing and Urban Development

29. **Other direct beneficiaries of this Project will be the key stakeholders associated with the affordable housing value chain.** This includes the MLPP, county registries, and commercial / microfinance banks and SACCOs participating into KMRC which will benefit from capacity building under Component 2.

D. Results Chain

Figure 5: Theory of Change and Results Chain



E. Rationale for World Bank Involvement and Role of Partners

30. **The WBG has a well-recognized expertise with mortgage refinance companies (MRCs).** IFC and IBRD supported these institutions in Egypt, Jordan, Tanzania and Nigeria, and more recently in West Africa and Pakistan (Annex 7). A project in Rwanda (P165649) seeks to create the foundations for a new MRC. Uganda and Central Africa are interested in exploring the concept. Over the years the design of these projects has been improved to ensure that MRCs could be sustainable by issuing bonds and could increase their outreach to non-banks.

31. **Other development partners are willing to support KMRC**. AfDB is considering providing Tier 2 capital, a guarantee on bond issue, and funding to the refinance windows. IFC is considering an equity investment into KMRC within its broader strategy for the sector.

Box 2: IFC strategy on Affordable Housing in Kenya

IFC has had a long-standing integrated approach to affordable housing in Kenya which comprises:
- Support to local developers with direct financing or advisory services, leveraging the US$300 million platform created with CITIC Construction to develop affordable housing in Sub-Saharan Africa, starting with Kenya as a pilot country. A key aspect is to invest in developers, industrial building manufacturers in partnership with development finance institutions and banks whilst providing support in terms of Green Buildings, community engagement and governance.
- Lines of credit to local banks to expand developer finance including to IFC existing clients.
- Risk-sharing facilities to local banks with advisory services to de-risk lending to developers.
- Investment in KMRC to expand mortgage refinancing.

These efforts mirror an initiative underway in Cote d'Ivoire, where both IDA and IFC invested in the regional mortgage refinance company (CRRH), and IFC is now moving to provide Advisory Services to local lenders on housing finance, as well as local currency senior loans to local banks to on-lend to developers. Three developers have been assessed with a strong pipeline and solid track record. IFC will encourage the use of its Affordable and Socially Sustainable Housing tool to support the construction of more efficient affordable homes.

F. Lessons Learned and Reflected in the Project Design

32. **Lessons learned are based on a 2016 Independent and Evaluation Group (IEG) report.[4]** MRCs take time to operate up to their potential but can have a strong impact in the early years by kick-starting the mortgage market (Tanzania) and building the capacity of financial institutions (Nigeria). Stable macro-conditions are a pre-requisite for developing housing finance and a functioning bond market is a pre-condition for a refinancing facility. The macroeconomic conditions in Kenya appear to be supportive and the capital market is well developed with a large base of institutional investors (pension funds, insurance companies) interested in long-term high-quality paper.

33. **Crowding-in private sector finance is critical to leverage limited WBG resources**. This Project will support KMRC's bond issuance through capitalization and start of operations. KMRC's bonds will mobilize long-term institutional investors into affordable housing through low-risk securities. Empirical evidence suggests that MRCs can support private sector investment through supply side reforms. In Nigeria, the MRC entered into agreements with states which committed to

[4] World Bank Group Support for Housing Finance, IEG, 2016.

improve the court system for the creditors' rights, and to lower transaction cost and time for titling; in Tanzania, it supported the acceleration of titling through subdivision.

34. **Land administration reforms should be coupled with long-term finance to boost the mortgage market**. Experience from other World Bank projects shows that it is possible to spearhead land reforms through computerization. In one country, registering the sale or purchase of a property went down from 52 days in 2013 to 30 days in 2018. However, the mortgage market did not take off because of the lack of a source of long-term funds. This reinforces the design of the Project which seeks to develop the long-term housing finance market while setting the foundations for efficient property registration.

35. **Adequate targeting matters**. IEG found that effectiveness could not be measured in various housing finance projects (Brazil, West Bank Gaza) because they lacked definitions of intended targets. The Project's target beneficiaries are the same as per the GOK's strategy, and the size of the loan will be used as a proxy for the monthly household income.

III. IMPLEMENTATION ARRANGEMENTS

A. Institutional and Implementation Arrangements

36. **Implementation arrangements focus on speed and accountability.** NT will implement Component 1(a) and a private entity, KMRC, will implement Component 1(b) through a subsidiary agreement with NT. Under Component 2 MLPP will be the implementing agency for all technical assistance relating to land/property (e.g., property registration, implementation of the Sectional Properties Act) and will manage contract and technical implementation, while the NT will be the implementing agency for technical assistance to KMRC and project management. Since the MLPP is new to World Bank fiduciary processes, the NT would carry out the fiduciary aspects of all initial consultancy contracts in Component 2 as the Project builds the fiduciary capacity of MLPP. To ensure accountability, NT has appointed a senior official as Coordinator for the Project, a senior Accountant with access to the integrated financial management and information systems (IFMIS) and a Procurement Officer experienced in World Bank procedures. MLPP has appointed a senior officer to ensure ownership of Component 2's activities that benefit the MLPP. These appointments are documented in the POM.

B. Results Monitoring and Evaluation Arrangements

37. **The Project Coordinator will report on the Monitoring and Evaluation (M&E) framework.** KMRC will track PDO indicators, as well as indicators on gender and on citizen engagement, via a survey of beneficiaries by mid-term review to check whether their access to housing finance has improved with KMRC's intervention. This survey of beneficiaries will also provide data on beneficiaries' income segment and on whether some short-term loans may have been converted into mortgage loans. KMRC will develop reporting/representation mechanisms to collect and monitor information on beneficiaries of affordable housing loans by income category/segment, and disaggregation of KMRC's refinancing by new vs roll-over of existing loans/mortgages. Component 2 (Technical Assistance) could support this if needed.

38. **A verification protocol has been developed for the achievement of the DLIs (Section VI).** Since DLI targets are readily examinable, NT will furnish the supporting documents to the World Bank but will not appoint an independent verification agent.

C. Sustainability

39. **The Project includes mechanisms to enable the provision of long-term housing finance beyond its completion.** It will be implemented by a new entity (KMRC) which will remain in operation after completion and is expected to be adequately capitalized to sustain operations over time. It mobilizes private finance by: (i) using the leverage of mortgage refinancing facilities, which typically refinance up to 20 percent of the mortgage market but incentivize long-term lending by being available to lenders when liquidity conditions tighten and (ii) ensuring a constant stream of bond issues once conditions are deemed conducive to raise funds via the capital market.

40. **The credit line will fulfil a temporary function.** It will allow KMRC to start operations and will strengthen and develop the mortgage finance market by creating incentives for lenders to issue mortgage loans to targeted households. Many lenders will have to upgrade their underwriting systems, risk management, customer outreach and infrastructure to extend mortgages to targeted beneficiaries. Once the credit line is fully utilized, KMRC will seek to fund its activities through bond issuance. The same design has been used in the India Low Income Housing Finance Project (P119039), the Tanzania Housing Finance Project (P117242) and the West Africa Economic and Monetary Union Affordable Housing Finance Project (P161658).

IV. PROJECT APPRAISAL SUMMARY

A. Technical, Economic and Financial Analysis

41. **The Project brings important economic additionality to the housing finance market.** It is predicated on KMRC "raising the bar". Currently, many personal loans are used for housing but do not provide an affordable solution given their short-term nature. With KMRC and more efficient property registration, financial institutions would gradually convert these loans into long-term mortgage loans. In five years of operations, KMRC is expected to refinance about 30,000 affordable housing loans and 3,000 market-rate mortgages helping to provide better shelter to about 132,000 people assuming an occupancy of four people per household. The provision of public financing is justified by the need to expand housing finance to targeted households by lengthening loan maturities.

42. **The Project would generate a positive Economic Rate of Return (ERR) of 35 percent.** The economic analysis is built as a financial analysis, with the estimated difference in cash flows to beneficiaries accounted for as cash flows to the Project. The ERR is calculated on the basis of the cost of US$190 million (IBRD credit line) versus the cash flows from increased mortgage lending and refinancing by KMRC. A discount rate of 15 percent is applied to the calculation. The ERR assumes a 6 percent per annum growth in the mortgage market and a 5.2 percent average GDP growth per year between 2019-2028. The calculation yields an ERR of 35 percent and a Net Present Value of US$104 million over ten years.

43. **The design of KMRC is consistent with the World Bank's policy and guidance on Financial Intermediaries**. KMRC will be regulated and supervised by the Central Bank of Kenya and its governance will conform to international standards. KMRC will be market-oriented and majority private-owned. Financial institutions will have to meet strict eligibility criteria to access mortgage refinance from KMRC, and the loans posted as collateral will also be subject to eligibility criteria. The operationalization of KMRC is well advanced: the Company has been created and capitalized, and has an interim management team (Annex 5 details the operationalization steps).

B. Fiduciary

(i) Financial Management

44. **The financial management (FM) assessment was carried out in June 2018 in accordance with the World Bank Directive:** Financial Management Manual for World Bank Investment Project Financing (IPF) Operations issued February 4, 2015 and effective from March 1, 2010; and the World Bank Guidance: Financial Management in World Bank Investment Project Financing Operations Issued and Effective February 24, 2015. The assessment covered the six key FM elements of budgeting, funds flow, accounting, internal control, financial reporting and auditing arrangements.

45. **General FM Arrangements.** The financing instrument for Component 1(a) is an IPF with DLI hence the disbursement of World Bank funds will be determined by both the achievement and verification of results (indicators), as well as provision of eligible expenditures under the Eligible Expenditure Program (EEP) agreed with the World Bank. Component 1(b) is a standard IPF supporting a credit line for mortgage refinancing. Component 2 is a standard IPF which will provide TA funds. NT will implement Component 1(a), Component 1(b) will be implemented by KMRC and NT will be responsible for FM for Component 2. NT is assessed as having adequate FM capacity to implement the Project. NT has designated a senior Ministry accountant as the Project accountant. KMRC will also designate a Project accountant. The Bank will provide regular FM capacity building through training to the Project accountants. NT has developed and will implement a comprehensive FM Procedures Manual as part of the POM, which covers all components. NT's Internal Audit Department will conduct annual risk-based fiduciary review of the Project. A copy of the internal audit report accompanied with time-bound action plan will be submitted to the Bank.

46. **Eligible Expenditure.** The Eligible Expenditure Program (EEP) for the DLIs in Component 1(a) will include the capitalization of KMRC by NT. The eligible expenditures for Component 1(b) will be the refinancing of housing/mortgage loans by KMRC.

47. **Capacity.** The NT is currently handling three active World Bank projects with a dedicated Project Implementation Unit (PIU) and is assessed as having adequate capacity to manage the Project. All three received clean/unqualified audit reports. The quarterly Interim Financial Report (IFR) and annual audited financial statements are submitted to the World Bank on a timely basis. There is a challenge of FM capacity at the NT PIU because the existing three projects are managed by the same project accountant. This will be addressed by designating a separate senior accountant for this Project.

48. **Disbursements Arrangements.** There are challenges of inadequate budget allocation, slow exchequer releases, insufficient government counterpart funds, in-country funds flow delays in transfer of funds from the Designated Account (DA) in NT to the Project Account (PA) in implementing agencies, which could adversely affect disbursement and overall Project implementation. These are Portfolio-level challenges which are being addressed as part of the financial management dialogue between the World Bank and NT. The Project will adopt the transaction-based SOE disbursement method.

49. **Funds flow and Budget Arrangements.** Disbursement under DLI 1 under Component 1(a) will be made to GoK exchequer account (through a special account) on achievement of the relevant DLI and submission of the EEPs. NT will provide sufficient annual budget and timely exchequer releases to finance the activities required for the achievement of the respective DLIs. IBRD disbursements to NT for Component 1(a) - DLIs 2 and 3 and Component 1(b) - credit line will be

made via hard currency denominated DA account opened in CBK. The funds will be transferred to a local currency commercial bank account in KMRC within 30 days. NT will open another hard currency denominated DA and local currency PA in CBK for Component 2.

50. Financial Reporting and Audit. The Project will provide IFRs to the World Bank on half-yearly basis. Audited financial statements will be submitted to the World Bank for each component as follows: Component 1- entity audited financial statements for KMRC; Component 2- Project-specific audited financial statements. Component 2 may be used to strengthen the financial reporting and audit capacity for the Project if needed.

51. Conclusion of the FM Assessment. The results of the assessment indicate that the overall FM arrangements satisfy the World Bank's minimum requirements and are therefore adequate to provide, with reasonable assurance, accurate and timely information on the status of the Project as required by the World Bank. The initial FM risk is assessed as Substantial with the residual risk for the Project being Moderate.

(ii) Procurement

52. Procurement Framework. Procurement under the Project will be carried out in accordance with the "The World Bank Procurement Regulations for IPF Borrowers, dated July 2016 and revised in November 2017 and August 2018", (Procurement Regulations). This will however not apply to procurement under Component 1 which will support the capitalization of KMRC and refinance loans made by eligible financial intermediaries to private borrowers. The Project will be subject to the World Bank's Anti-Corruption Guidelines, dated October 15, 2006 and revised in January 2011 and as of July 1, 2016.

53. Profile of Procurement Activities. Activities include consultant contracts to improve the foundations and the quality of the ongoing land computerization project, to support the implementation of key legislations and regulations to fast track effective property registration, and to prepare a land sector strategy. The Project will provide capacity building to the staff of the registries and MLPP on computerization and implementation of key legislation. A portion of the technical assistance will provide capacity building to KMRC, its regulators, and to financial institutions to comply with KMRC refinance criteria. Small contracts of low value may also be procured to support project management and administration.

54. Strategy. The Project Procurement Strategy for Development (PPSD) established that the legal framework and regulations for guiding the procurement processes for government financed procurement activities are in place. The PPSD forms the basis for the procurement plan. It established that while NT had the requisite experience in the implementation of procurement in World Bank financed operations, other World Bank projects managed by NT had been affected by procurement delays. Consultants needed to support Component 2 (Technical Assistance) will be recruited within 12 months of effectiveness.

55. Procurement Risks. The key issues and risks concerning procurement for implementation of the Project include procedural challenges that comprise: (i) procurement process taking longer time arising from need for internal approvals in NT; (ii) procurement capacity limitations; (iii) procurement process delays during bids/proposals evaluation and subsequent signing of contracts; (iv) opportunities for improvement of procurement record keeping and management; (v) procurement planning and monitoring; (vi) contract management; and (vii) procurement oversight.

56. **Risk Rating and Mitigation Measures.** Procurement risk is rated "Substantial" given NT's track record in managing procurement. Risk mitigation measures will include: (i) employment of a procurement officer in the implementation team with appropriate skills and experience in World Bank financed operations; (ii) training and capacity building of the officer in World Bank procurement procedures; (iii) Contract Management Plans for the consultant contracts with clear staff roles and responsibilities; (iv) effective use of Systematic Tracking of Exchanges in Procurement (STEP) as a procurement tracking and monitoring tool; and (v) continuous improvement in procurement record keeping and management.

C. Safeguards

57. **OP/BP 4.03 (World Bank Performance Standards for Private Sector Activities) is applicable to the Project in lieu of the World Bank's safeguard policies.** OP/BP 4.03 is well suited for the Project given that it will constitute private sector activities and is executed through a wholesale financial institution (KMRC) and retail primary mortgage lenders (PMLs), which are commercial private sector financial institutions and cooperatives (SACCOs). The Project is a Financial Intermediary (FI) and is categorized as FI-2. OP/BP 4.03 is applicable to project components and activities which have E&S risks and impacts, i.e. line of credit under Component 1(b). Component 1(a) and 2 are not expected to have any E&S risks and impacts.

58. **Given the nature of the Project, the approach to E&S risk management is designed around a screening process by PMLs (banks and SACCOs), with verification by KMRC.** E&S screening will be after the loans have been issued and application of risk mitigation measures in accordance with the screening outcomes for specific E&S issues associated with the properties financed and end-borrowers in accordance with Applicable E&S Requirements. The following Applicable E&S Requirements are included in the Project financing agreement: (i) applicable E&S national and local laws and regulations of Kenya[5] and, (ii) an exclusion list specific to housing finance that specifies circumstances in which housing loans will not be eligible for KMRC refinancing based on associated E&S issues that present unacceptable risks. Additionally, a set of screening criteria has been built around key E&S risk areas that PMLs should be aware of and include in their analysis of housing loans as part of their credit risk analysis.

59. **Pursuant to OP/BP 4.03, E&S risks for the Project will be addressed through putting in place and continually strengthening a formal Environmental and Social Management System (ESMS).** This would enable the Project to meet Applicable E&S Requirements. KMRC has prepared an institutional E&S policy and procedures[6] which has been reviewed by the World Bank and will be approved by KMRC's Board and publicly disclosed. E&S requirements have been integrated in KMRC's Master Refinance Agreement.[7] KMRC has prepared a capacity building plan for its PMLs, and will ensure that PMLs have adequate screening processes and implementation capacity to identify and manage key identified E&S risks and impacts. Component 2 will support strengthening of PMLs' capacity on E&S risk management as needed.

60. **Citizen Engagement.** As part of its M&E activities, KMRC will conduct client surveys with primary and secondary level beneficiaries. Particular attention will be devoted to feedback from middle/low-income borrowers, especially

[5] This would include, among others, an E&S assessment required under GoK (National Environment Management Authority) regulations for any new housing construction schemes or, where applicable, incremental construction schemes, National Land Commission documents, and required country permits.
[6] Titled "Environmental and Social Risk Management Policy".
[7] The Master Refinance Agreement is the umbrella Legal Agreement between KMRC and PMLs which sets out the terms and conditions for accessing KMRC's refinance facilities. Subsequently, KMRC and PMLs sign Participating Agreements for each loan.

women. KMRC will discuss with the PMLs how to address the feedback provided by the ultimate beneficiaries and provide evidence of responses triggered by the feedback. The following indicator is included in the Project M&E framework: "Percentage of project beneficiaries who feel project activities reflected their needs (end target is 80 percent)".

61. Handling Grievances. The ESMS will incorporate a grievance mechanism that will accept and address concerns regarding KMRC's lending operations in a manner accessible and understandable for affected parties. KMRC has prepared such a mechanism at its level and it will be adopted by its Board alongside E&S policy and procedures. PMLs will also have capacity to address grievances at their level and this aspect will be included in capacity building efforts.

62. Gender. There is a gender gap in access to housing loans. A survey of six major financial institutions interested in using KMRC showed that 30 percent of housing loans' borrowers are women, versus 70 percent of borrowers being men. The project aims to address this gender gap in access to housing loans, by increasing the percentage of female housing loan borrowers of loans refinanced by KMRC by 10 percentage points. This will be done by building the risk assessment of financial institutions to support their efforts to lend more to female home-owners, and by peer learning experience with institutions that actively target women borrowers. In terms of monitoring, the following gender-disaggregated indicator is included in the project M&E framework as an intermediate indicator: "percentage of housing loans refinanced by KMRC extended to women (end target is 40 percent)." This indicator will be monitored throughout the life of the project on semi-annual basis.

63. In accordance with World Bank OP 4.03, the requirements of OP/BP 7.50, Projects on International Waterways, and those of OP/BP 7.60, Projects in Disputed Areas, may be applicable to any World Bank-supported private sector activity in addition to OP/BP 4.03. Since it is not expected that any activities under this Project will involve international waterways or disputed areas, the policies will not be triggered. Any activity impacting international waterway or disputed territories will be excluded from the Project.

(i) World Bank Grievance Redress Service

Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

V. KEY RISKS

64. The overall project risk is rated **substantial** due to political and governance, macroeconomic, sector strategies and policies, fiduciary and institutional capacity for implementation risks.

65. **Political and governance (substantial).** There are challenges in land governance in Kenya. The process of computerization of land records will increase transparency but may be resisted by stakeholders. The World Bank has not worked with the MLPP before. In early 2018, the Law Society of Kenya sued the MLPP over online land transactions; since then they have agreed to form a taskforce to elaborate joint guidelines. Mitigating factors include the high political priority of affordable housing and the strong support from the Presidency on computerization. The performance contract between the Presidency and the MLPP focuses on the computerization of land registries.

66. **Macroeconomic (substantial)**. The interest rate cap and high sovereign bond yields provide a challenging environment for KMRC. While the cap is in place, commercial banks may not expand into affordable housing finance. A Kenyan court has recently declared the interest rate cap as unconstitutional and has provided lawmakers a window of 12 months to make appropriate amendments. High government bond yields make KMRC bonds uncompetitive as pricing would be above the cap and above SACCOs' interest rates. The IBRD credit line will allow KMRC to kick-start operations, but sustainability is predicated on KMRC being able to issue bonds in year 3 of the Project. Thus, a DLI incentivizes bond issuance. The Project is predicated on a better management of the GoK's sovereign debt in the medium term to allow KMRC to issue bonds at competitive rates. GoK's ongoing reforms to reduce the fiscal deficit and enhance the management of public debt is key to lowering benchmark interest rates.

67. **Sector Strategies and Policies (substantial).** Lack of formal housing supply at the price point of the credit line (below KES 3 million or KES 4 million for Nairobi Metro) could undermine KMRC. This risk (Affordable Housing Policies) is mitigated by an ambitious plan from the GoK to deliver new affordable housing units over four years. Faster property registration will allow developers to reduce their unit cost. Another risk is elite capture whereby the GoK's strategy may end up benefiting the elites and not the intended beneficiaries. For the Project, this will be mitigated by KMRC putting in place mechanisms to monitor the ultimate beneficiaries of the proceeds of the financing.

68. **Fiduciary (substantial).** NT's procurement management challenges could lead to implementation delays, and the financial management capacity of its PIU is limited because three projects are managed by the same project accountant. This will be addressed by appointing a dedicated accountant to the Project, and a procurement officer experienced in World Bank procurement procedures.

69. **Institutional capacity for implementation (substantial).** KMRC will be a new financial institution and will need time to build a track record. This is mitigated by the interest confirmed from 21 institutions to invest in its capital, and by the significant work done so far to operationalize KMRC. KMRC will refinance mortgage loans, however there is a poor perception of mortgages in Kenya. The technical assistance will support the development of an effective communication strategy by KMRC to create awareness, change peoples' negative perception of mortgages in Kenya and build citizen's trust.

VI. RESULTS FRAMEWORK AND MONITORING

Results Framework
COUNTRY: Kenya
Kenya Affordable Housing Finance Project

Project Development Objectives(s)

The development objective is to expand access to affordable housing finance to targeted beneficiaries

Project Development Objective Indicators

Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Support to the Kenya Mortgage Refinance Company							
Volume of bonds issued by KMRC (Amount(USD))		0.00			50,000,000.00	100,000,000.00	150,000,000.00
Number of affordable mortgage / housing loans refinanced by KMRC (Number)		0.00	5,000.00	10,000.00	18,000.00	27,000.00	30,000.00

Intermediate Results Indicators by Components

Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Support to the Kenya Mortgage Refinance Company							
Percentage mortgage / housing loans refinanced by KMRC extended to women		0.00	40.00	40.00	40.00	40.00	40.00

Indicator Name	DLI	Baseline	Intermediate Targets				End Target
			1	2	3	4	
(Percentage)							
Average maturity of new mortgage loans refinanced by KMRC in the year (Years)		0.00	3.00	4.00	6.00	8.00	10.00
Percentage of Project beneficiaries who feel project activities reflected their needs (Percentage)		0.00		50.00		80.00	80.00
Volume of mortgage lending (Amount(USD))		2,230,000,000.00		2,505,628,000.00			3,160,000,000.00
Percentage of Non-Performing Loans in the residential mortgage sector (Percentage)		12.20	10.00	9.00	8.00	7.00	6.00
Volume of affordable housing and mortgage loans refinanced by KMRC (Amount(USD))		0.00	37,500,000.00	75,000,000.00	135,000,000.00	202,500,000.00	225,000,000.00
Technical Assistance							
Four strategies/studies/roadmaps completed and adopted by MLPP (Number)		0.00	1.00	2.00	3.00	4.00	4.00

Monitoring & Evaluation Plan: PDO Indicators					
Indicator Name	**Definition/Description**	**Frequency**	**Datasource**	**Methodology for Data Collection**	**Responsibility for Data Collection**
Volume of bonds issued by KMRC	Volume of bonds issued by KMRC (amount in local currency translated in US$). The correct indicator would be 15 billion KES.	Annual	KMRC	KMRC financial statements	KMRC
Number of affordable mortgage / housing loans refinanced by KMRC	This indicator monitors the number of affordable housing/mortgage loans refinanced by KMRC (i.e. of an amount below KES 3 million, or KES 4 million in Nairobi Metropolitan). Further disaggregated data will be collected as needed.	Annual	KRMC operations reports	KMRC	KMRC

Monitoring & Evaluation Plan: Intermediate Results Indicators					
Indicator Name	**Definition/Description**	**Frequency**	**Datasource**	**Methodology for Data Collection**	**Responsibility for Data Collection**
Percentage mortgage / housing loans refinanced by KMRC extended to women	Proportion of housing/mortgage loans submitted as collateral to KMRC that are extended to women or joint ownership	Annual	KMRC	KMRC operations report	KMRC
Average maturity of new mortgage loans refinanced by KMRC in the year	This indicator tracks the average maturity of new mortgage loans submitted	Annual	KMRC	KMRC. Measurement at the end of each calendar year.	KMRC

	to KMRC as collateral in a specific year. It is an indicator of flow, not stock. It will provide an indication of how successful KMRC is in lengthening mortgage loan tenors.				
Percentage of Project beneficiaries who feel project activities reflected their needs	Percentage of project beneficiaries surveyed by KMRC and primary mortgage lenders who feels that project's activities reflected their needs	This will be done via survey of project beneficiari es, indicatively after year two and year 4. Timing will depend on how KMRC's activities develop. KMRC will discuss with the PMLs how to address the feedback provided by the	KMRC and PMLs	Survey of borrowers implemented by KMRC and PMLs	KMRC and PMLs

		ultimate beneficiaries.			
Volume of mortgage lending	Volume of mortgage lending in the Kenyan market. End target assumes a growth of 6% every year, above inflation but moderate due to the interest rate cap. In 2017, growth was 1.5 percent (2017 was the year when the cap was in force for a full year).	Annual	CBK annual supervision report - residential mortgage market survey	CBK annual supervision report - residential mortgage market survey	KMRC
Percentage of Non-Performing Loans in the residential mortgage sector	NPLs to gross mortgage loans in the residential mortgage sector (overall sector)	Annual	CBK annual supervision report - residential mortgage market survey	CBK annual supervision report -residential mortgage market survey	KMRC
Volume of affordable housing and mortgage loans refinanced by KMRC	Volume of affordable housing and mortgage loans in KES translated in USD, cumulative. Indicator in KES in final year would be KES 23 billion.	Annual	KMRC Operations Report	KMRC	KMRC
Four strategies/studies/roadmaps completed and adopted by MLPP	Four studies and advice designed to improve the quality of the foundations of the MLPP's computerization	One-time measure	Ministry of Lands and Physical Planning	Ministry of Lands and Physical Planning	Ministry of Lands and Physical Planning

	of property registration are completed and adopted by MLPP. Indicative timeframe: Year 1: Land Information Management System (LIMS) and Roadmap. Year 2: Land sector strategic assessment. Year 3: Business Process mapping. Year 4: Public information and sensitization program on land laws.				

Disbursement Linked Indicators Matrix

DLI 1	The Project Implementing Entity is legally established, has the required regulatory capital and approvals to start operations			
Type of DLI	**Scalability**	**Unit of Measure**	**Total Allocated Amount (USD)**	**As % of Total Financing Amount**
Process	No	Amount(USD)	10,000,000.00	3.82
Period	**Value**		**Allocated Amount (USD)**	**Formula**
Baseline	0.00			
June 2019			10,000,000.00	
February 2020			0.00	
February 2022			0.00	

DLI 2	The Borrower has provided Tier 2 Capital to the Project Implementing Entity			
Type of DLI	**Scalability**	**Unit of Measure**	**Total Allocated Amount (USD)**	**As % of Total Financing Amount**
Output	No	Amount(USD)	10,000,000.00	3.82
Period	**Value**		**Allocated Amount (USD)**	**Formula**
Baseline	0.00			
June 2019			0.00	
February 2020			10,000,000.00	
February 2022			0.00	

DLI 3	The Borrower has provided additional Tier 2 Capital to the Project Implementing Entity			
Type of DLI	**Scalability**	**Unit of Measure**	**Total Allocated Amount (USD)**	**As % of Total Financing Amount**
Outcome	No	Amount(USD)	30,000,000.00	11.45
Period	**Value**		**Allocated Amount (USD)**	**Formula**
Baseline	0.00			
June 2019			0.00	
February 2020			0.00	
February 2022			30,000,000.00	

Verification Protocol Table: Disbursement Linked Indicators	
DLI 1	The Project Implementing Entity is legally established, has the required regulatory capital and approvals to start operations
Description	The Borrower has established, operationalized and capitalized the Project Implementing Entity and the Project Implementing Entity has received the relevant licenses, permits, and approvals required to start operations.
Data source/ Agency	NT
Verification Entity	NT
Procedure	*Supporting documents:* • Copy of KMRC license by CBK. • KMRC Bank Record showing funding provided by National Treasury and Planning
DLI 2	The Borrower has provided Tier 2 Capital to the Project Implementing Entity
Description	The Borrower has executed a Subordinated Debt Agreement with the Project Implementing Entity pursuant to which EUR 8,800,000 equivalent has been paid to the Project Implementing Entity.
Data source/ Agency	KMRC
Verification Entity	NT
Procedure	*Supporting documents:* • Letter from NT indicating that it has provided Tier 2 capital to KMRC • Copy of Subordinated debt agreement amended, signed by KMRC and NT
DLI 3	The Borrower has provided additional Tier 2 Capital to the Project Implementing Entity
Description	Upon completion of a bond issuance by KMRC, the Borrower has executed an updated Subordinated Debt Agreement with the Project Implementing Entity pursuant to which EUR 26,200,000 equivalent has been paid to the Project Implementing Entity.
Data source/ Agency	KMRC

Verification Entity	NT
Procedure	*Supporting documents:* • KMRC prospectus and subscription of the bond issue. • Letter from NT confirming payment of additional subordinated debt • Copy of subordinated debt agreement amended, signed by KMRC and NT

ANNEX 1: Implementation Arrangements and Support Plan

A. Implementation Arrangements

1. **The Borrower is the Republic of Kenya, represented by the National Treasury and Planning (NT)**. A private entity, KMRC, will implement Component 1(b) through a subsidiary agreement with NT. NT will implement Component 1(a). MLPP will be the implementing agency for Component 2 for all technical assistance relating to land/property/housing (e.g., property registration, implementation of the Sectional Properties Act) and will manage contract and technical implementation, while the NT will be the implementing agency for technical assistance to KMRC and project management. Since the MLPP is new to World Bank fiduciary processes, the NT would carry out the fiduciary aspects of all initial consultancy contracts in Component 2 as the project helps build the fiduciary capacity of MLPP.

2. **To facilitate project implementation, a detailed POM has been prepared**. It spells out the implementation arrangements, including the eligibility criteria for financial institutions and loans; fiduciary and E&S risk management arrangements; project audit requirements, including the terms of reference (TOR) for the project audit; disbursement arrangements; the IFR formats; monitoring and evaluation framework etc. It provides guidance for each responsible agency on the procedural aspects of the Project. It also includes the organizational chart of Project implementation. KMRC has prepared its own manual of policies and procedures (KMRC Operations Manual) which has been approved by the interim management. The policies related to credit risk, E&S, and risk management, will govern the refinancing of housing/mortgage loans under the credit line and have been reviewed by the World Bank.

3. **The implementation team will be organized as follows**. A senior officer from NT has been appointed as the Coordinator for the Project. This officer will provide all the documentation required to effect disbursements, including certification of eligible expenditures by the Principal Secretary (PS) and verification of the achievement of the DLIs. The Coordinator will be assisted by a senior accountant with access to IFMIS, and by a Procurement Officer with experience in World Bank procurement procedures. These officials, together with the senior officer from MLPP who will oversee the activities of Component 2 that benefit the MLPP, will form the Project Implementation team.

4. **The Project will be integrated in the GoK's high-level implementing arrangements for the Affordable Housing Strategy.** The Presidential delivery unit chairs a taskforce of Cabinet Secretaries to review progress on the strategy, and the State Department of Housing and Urban Development chairs the technical group in charge of implementation. NT and MLPP will report on progress made under the Project to the technical group.

B. Financial Management

5. **An FM Assessment was conducted in June 2018.** The results of the assessment indicate that the overall FM arrangements satisfy the World Bank's minimum requirements and are therefore adequate to provide, with reasonable assurance, accurate and timely information on the status of the project as required by the World Bank. The initial FM risk is assessed as Substantial with the residual risk for the Project being Moderate.

6. **Budgeting.** The project funds will be factored in the national annual budget under NT. There will be a budget line under NT for Component 1 IBRD transfers to KMRC through NT. NT will also open an IBRD budget code under the development budget for Component 2. The FM assessment revealed the challenges of funds absorption which include: inadequate budget allocation, insufficient government counterpart funds, delays in capturing project activities in supplementary budget and delays in releasing funds. These are portfolio-level challenges being addressed as part of the financial management dialogue between the World Bank and NT.

7. **Eligible Expenditure and Disbursement Categories.** The Eligible Expenditure Program (EEP) for the DLIs in Component 1 (a) is the capitalization of KMRC by NT. The evidence of EEP for capitalization will be provided by NT and confirmed by the World Bank reviewing all relevant payment information supporting the capitalization of KMRC. This information will be provided with the verification report for the DLI to support the disbursement. This information will also separately be confirmed in the annual audited financial statements of KMRC submitted to the World Bank. The eligible expenditures for the Component 1(b) i.e., credit line will be the refinancing of housing/mortgage loans by KMRC, and the eligible expenditures for Component 2 will be the payment of inputs. Disbursement categories and allocation for each category are set out in Table 1.1 below.

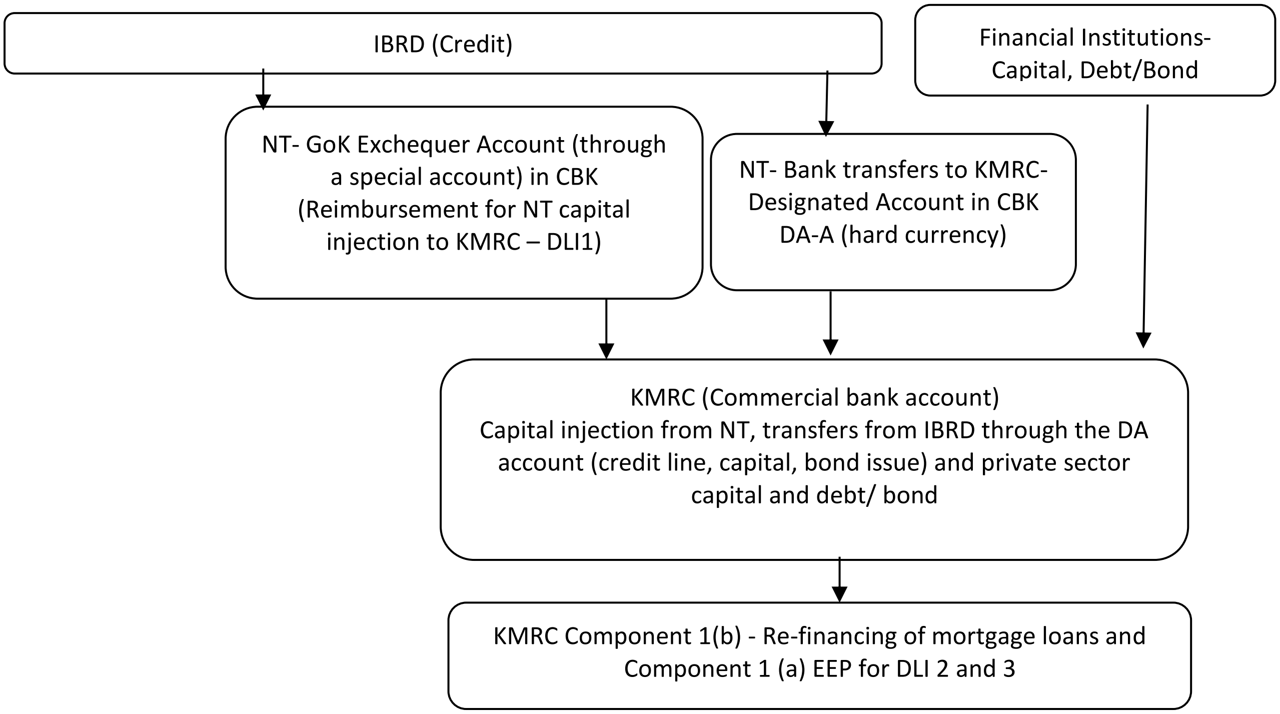
Table 1.1: Disbursement Categories and Allocations

Category	Amount of the Loan Allocated	Percentage of Expenditures to be financed (inclusive of Taxes)
(1) Mortgage Refinancing under Part 1(b) of the Project	EUR 166,400,000	100%
(2) Goods, non-consulting services, consulting services, Training and Incremental Operating Costs for Part 2 of the Project	EUR 8,800,000	100%
(3) Eligible Expenditure Program under Part 1(a) of the Project	EUR 43,800,000	100% of each DLI Amount (or such lesser percentage as represents the total Eligible Expenditures incurred by the Borrower under the Eligible Expenditure Program as of the date of withdrawal).
TOTAL AMOUNT	**EUR 219,000,000**	

8. **Retroactive financing.** Retroactive financing may be provided up to an aggregate amount not to exceed EUR 15,000,000 for Eligible Expenditures under Categories (2) and (3) for payments made prior to the Signature Date of the Financing Agreement but on or after January 1st, 2019 as long as project implementation arrangements agreed with IBRD, including fiduciary and environmental and social risk management procedures as applicable, have been used and inter alia the activities financed by retroactive financing are related to the development objectives and are included in the Project description.

9. **Funds flow arrangements.** The Project will adopt the SOE method of disbursement for both the standard IPF project activities and DLI components.

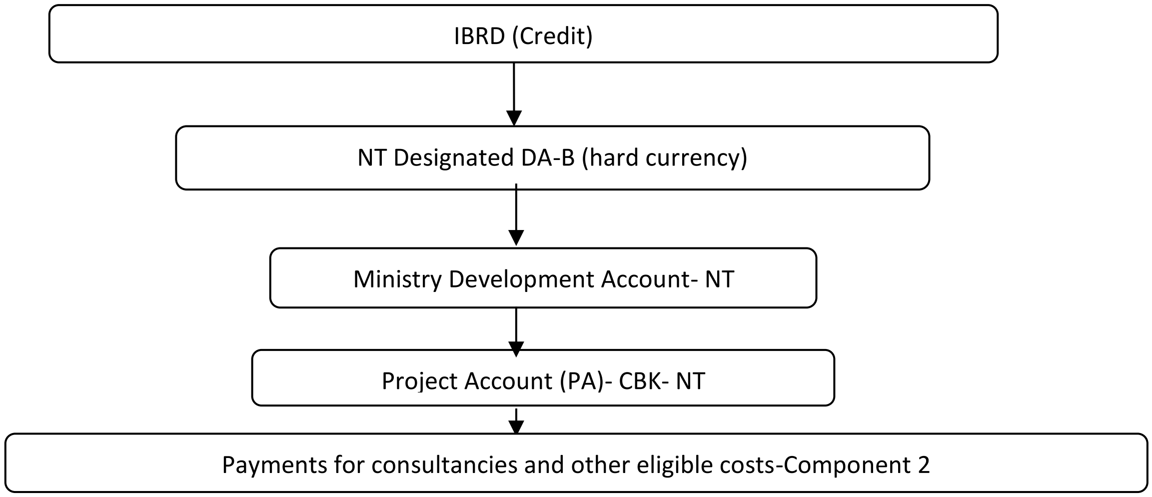
Funds Flow Chart- Component 1 (IPF with DLIs and credit line)



(i) For Component 1 (a), the World Bank will reimburse NT for the GoK capital injection to KMRC under DLI-1. These funds will be deposited into the Exchequer account (through a special account) in the CBK. NT will open a hard currency denominated Designated Account (DA-A) to which IBRD disbursements will be made. The DA-A may be used by NT to make advance EEP-related payments. These payments will be considered as eligible expenditure upon submission of the required documentation and achievement of the DLIs as per the verification protocol. Similarly, the disbursement of funds relating to the credit line (Component 1(b)) will be made to NT through the same DA. The funds will be transferred, within 30 days, by NT from the DA to a local currency bank account opened by KMRC in a commercial bank acceptable to IBRD.

(ii) For Component 2, NT will open a hard currency denominated DA (DA-B) to which the IBRD funds will be deposited and transferred to a local currency Project Account (PA) to facilitate payments. NT would also be able to make payments using the reimbursement and direct payment method of disbursement.

Funds Flow Chart- Component 2- Standard IPF



10. Accounting arrangements. NT has adequate accounting capacity and uses IFMIS which will be supplemented by manual project accounting system. This is deemed adequate. The funds under Component 2 may be used for further strengthening of the Project accounting function. NT has designated a senior Project accountant to handle the accounting and financial reporting requirements. KMRC will also designate a project accountant to handle the FM arrangements related to the Project.

11. Internal controls. The internal control arrangements for NT are deemed to be adequate with a well-staffed internal audit department. This department will conduct annual risk-based audit of the Project to ensure that any material FM risks are identified and promptly addressed. The internal audit function may be strengthened using funds under Component 2. The internal audit reports will be submitted to the World Bank with time-bound action plans addressing the risks identified (jointly agreed upon by the Project team and the auditors). The cost of the review will be financed out of Project funds. NT will implement a FM Procedures Manual (part of the POM) to ensure comprehensive internal control procedures.

12. Financial Reporting. The implementing agencies have adequate capacity to meet the World Bank's financial reporting requirements for quarterly IFRs and annual audited financial statements. NT will submit the entity audit report for KMRC and audited project financial statements for Component 2. The audit reports with the management letters will be submitted to the World Bank within six months after the year end. The IFR will be prepared by NT every six months (June and December) and will be submitted to the World Bank within 45 days after the end of each semester. The annual financial statements will be submitted to the auditors no later than three months after the year end (31 December for KMRC, 30 June for NT). The format of the IFR and the annual financial statements will be the standard templates already agreed by the World Bank and NT for World Bank projects.

13. Audits. The annual project audit for NT under Component 2 will be conducted by the OAG which has the required technical capacity and independence. KMRC will be audited by a private audit firm approved by the CBK. The World Bank will clear the terms of reference for the audits. The audit reports and management letters will be submitted to the World Bank within 6 months after the end of the financial year. The Project audit reports will be publicly disclosed in line with the World Bank Access to Information Policy. The audit reports are expected to be submitted to the World Bank on a timely basis. The OAG has proved to have sufficient capacity to submit project-specific audit reports on time.

Table 1.2. Financial Management Action Plan

	Action	Due Date
1.	Opening of designated (DA) and project (PA) accounts and communicating the details of the bank account and signatories to IBRD for Components 1 and 2.	Immediately on signing of the Financing Agreement
2.	Strengthening of the FM function using Project funds under Component 2 as needed.	Continuous
3.	Training project FM staff on World Bank Financial Management and Disbursement Guidelines.	Annually
4.	Risk-based on-site fiduciary review by GoK internal auditors.	Annually

C. Procurement

14. Procurement Framework. Procurement under the Project will be carried out in accordance with the "The World Bank Procurement Regulations for IPF Borrowers, dated July 2016 and revised in November 2017 and August 2018" (Procurement Regulations). This will however not apply to procurement under Component 1 which will support the capitalization of KMRC and refinanced loans made by eligible financial intermediaries to private borrowers. Procurements for the project will be subject to the World Bank's Anti-Corruption Guidelines, dated October 15, 2006 and revised in January 2011 and as of July 1, 2016.

15. The PPSD prepared in August 2018 confirms that the legal framework and regulations for guiding the procurement processes for government financed procurement activities are in place. It forms the basis for the Procurement Plan to implement Component 2. The Procurement Plan will be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity. The Project will use the STEP, a planning and tracking system, which will provide data on procurement activities, establish benchmarks, monitor delays and measure procurement performance.

16. Procurement Activities. Consulting services to be procured under Component 2 include consultancies to improve the foundations and the quality of the ongoing land computerization project, to support the implementation of key legislations and regulations to fast track effective property registration, and to prepare a land sector strategy. The Project will provide capacity building to the staff of the registries and MLPP on computerization and implementation of key legislation. A portion of the technical assistance will provide capacity building to KMRC, its regulators, and to financial institutions to comply with KMRC refinance criteria. Individual consultants and/or support personnel may also be hired to augment existing capacity within the implementing agencies in accordance with the provisions of Para 7.32 of Procurement Regulations. Consultants needed to support Component 2 (Technical Assistance) will be recruited within 12 months of effectiveness.

Box 1: Summary of PPSD

The project procurement will be carried out by a Project Implementation Team established at the NT. The Project will follow the Procurement Regulations for IPF Borrowers dated July 2016 and revised in November 2017 and August 2018, except Component 1 which will finance the capitalization of KMRC and the refinancing of loans to private borrowers through eligible financial intermediaries. The Project will also be subject to the World Bank's Anticorruption Guidelines, dated October 15, 2006 and revised in January 2011 and as of July 1, 2016.

The approach and methods for all the consultancy services and capacity building contracts will follow standard approaches and methods (approved selection methods and market approach options in the regulations). No activity is envisaged to require a departure from the set method thresholds, need for additional oversight or OPRC review thresholds. In addition, Beneficial Ownership will not apply to this project.

Since the project implementation does not involve high value and complex contracts, a short form of PPSD has been prepared. The activities identified for implementation during the first 18 months of project implementation comprise of consultancy assignments for baseline surveys, policy development and regulation, development of information management systems, capacity needs assessments, public information sensitization programs, strategy development and capacity building among others. The PPSD established that the supply market for such services in Kenya is largely sufficient and therefore little or no supply market risk for the identified procurement activities. However, due to the relatively weak contract management capacity and internal approval and administrative processes, there are risks associated with implementation delays and value for money. The staff seconded to the PIU however, have the requisite competencies and experience necessary to implement the project. Below are the risks mitigation measures that are proposed:

Item	Issue/Risk	Recommended Mitigation Measures	Due Date
1	Limited procurement capacity at the PIU	Employment and/or secondment of a procurement officer with requisite experience on Bank financed operations to the PIU	Completed
2	Weak contract management capacity	Development of Contract Management Plans with KPIs for complex and high value contracts with clear staff roles and responsibilities	Before award of contracts
3	Procurement monitoring and reporting	Effective use of STEP for procurement tracking and monitoring	Throughout the implementation period

17. Procurement Risks. The World Bank has conducted a Procurement Capacity Assessment of NT, completed the Procurement Risk Assessment and Management System and included the resultant information into the PPSD. The key issues and risks concerning procurement for implementation of the Project include procedural challenges that comprise: (i) procurement process taking longer time arising from need for internal approvals in NT; (ii) procurement capacity limitations; (iii) procurement process delays during bids/proposals evaluation and subsequent signing of contracts; (iv) opportunities for improvement of procurement record keeping and management; (v) procurement planning and monitoring; (vi) contract management; and (vii) procurement oversight.

18. Risk rating and mitigation measures. Based on NT's track record in managing procurement, procurement risk is rated "Substantial". Risk mitigation measures will include: (i) engaging a procurement officer in the implementation team with appropriate experience in Bank financed operations; (ii) capacity building of the officer in Bank procurement procedures; (iii) Contract Management Plans for consultant contracts with clear staff roles and responsibilities; (iv) effective use of STEP as a procurement tracking and monitoring tool; and (v) improvement in procurement record keeping and management.

D. Environmental and Social (including safeguards)

19. Key E&S Risks and Approach to Mitigation. E&S risks associated with housing finance may include inappropriate development location, poor building design and construction practices, prior or upcoming resettlement or illegal forced evictions, locations hazardous for human habitation or prone to natural disasters, impacts on biodiversity and cultural heritage, lack of access to basic services, and impacts on vulnerable groups within communities. Some of these risks can result in damage or loss of the property or injury for residents.

20. E&S risk management requirements will apply to Component 1 (b). Components 1(a) and 2 are not expected to have any E&S risks and impacts. E&S impacts would be expected to occur before housing loans are originated by PMLs and subsequently refinanced by KMRC. Nevertheless, these impacts can pose credit or reputational risks to KMRC and

PMLs. Therefore, the primary method to manage the risks would be ex-post screening by PMLs, with verification by KMRC, against Applicable E&S Requirements (i.e. relevant national laws and regulations, List of Excluded Activities) for the properties considered for financing.

21. Design of Environmental and Social Management System (ESMS). According to the requirements of OP/BP 4.03, KMRC must have an institutional E&S policy, procedures, and internal capacity, which together shall constitute an ESMS at its level. E&S aspects will be implemented in a coordinated manner with the lending procedures that will be institutionalized in KMRC's operating rules and manuals. Specifically, the core applicable E&S requirements incorporated in KMRC's E&S policy form part of KMRC eligibility criteria and have been included in the Master Refinance Agreement. PMLs shall adequately screen transactions for key E&S risks and represent to KMRC in writing that such screening was completed for all transactions submitted for refinancing (including any retroactive financing) and that no activities ineligible on E&S grounds are included in the portfolios provided for refinancing (i.e., that the loans comply with national laws and regulations, and they do not finance activities on the exclusion list). This screening process together with capacity to carry it out consistently will constitute the ESMS at the PMLs' level.[8] KMRC would verify this representation during the normal course of verification activities performed on PMLs. A specific level of compliance with the representation form, proportionate to PML's capacity, will be required to obtain KMRC refinancing. Any gaps will be addressed by a time-bound action plan that will specify how and when PMLs shall improve their E&S systems and capacity to continue to be eligible for KMRC refinancing. Subsequent refinancing payments will be made upon completion of specific actions to reach required capacity on E&S screening for housing loans. This will be documented in the respective Participating Agreements between KMRC and the financial institutions.

Table 1.3. E&S Action Plan

	Action	Due Date	Responsibility
1.	KMRC to prepare and submit to the Bank an acceptable E&S policy and procedure (including a grievance mechanism that will address E&S related complaints)	Completed	KMRC
2.	KMRC Board to approve the E&S policy and procedure and disclose it on KMRC website	Prior to carrying out any activities under Component 1(b)	KMRC
3.	KMRC to submit to the Bank an acceptable E&S capacity building plan for its internal staff and PMLs	Completed	KMRC
4.	KMRC will integrate applicable E&S requirements (specifically compliance with national regulations and the list of excluded activities) into the Master Refinance Agreement	Completed	KMRC
5.	KMRC to submit annual E&S performance report to WB	Annual (within 45 days after the end of the calendar year)	KMRC
6.	KMRC to designate an E&S coordinator	Prior to carrying out any activities under Component 1(b)	KMRC
7.	KMRC to conduct E&S training for the PMLs	Ongoing	KMRC
8	KMRC will establish and maintain an easily accessible grievance redress mechanism.	Prior to carrying out any activities under Component 1(b)	KMRC

[8] This is stated in the Loan Agreement as follows "*a customized ESMS prepared and implemented at the level of Eligible Participating Financial Institutions in accordance with the relevant regulations of the Borrower and the Applicable Environmental and Social Requirements and adequate capacity within KMRC and Eligible Participating Financial Institutions to develop and maintain adequate policies, procedures, organizational structure, budget, and capacity for identifying, managing, monitoring, and reporting on risks and impacts of activities under supported under Part 1(b) of the Project*".

ANNEX 2: Unlocking the Supply of Affordable Housing in Kenya

1. **On December 12, 2017, the Government of Kenya (GOK) unveiled the "Big Four" economic transformation agenda** which identifies four priority initiatives to be implemented between 2018 – 2022, core among them being the delivery of 500,000 affordable housing units in major urban areas. Fiscal constraints, however, prohibit the GOK from intervening directly in the production of new housing. The State Department for Housing and Urban Development estimates the delivery of the program at about US$21.3 Billion. The country's entire budget for the 2017/2018 financial year was US$26.2 Billion. Solutions, therefore, will need to rely upon private sector capital and delivery.

2. **To de-risk the initiative, the GOK has committed to use its critical non-cash resources** i.e. land and the ability to strategically plan, entitle it and deliver infrastructure and social services to it - estimated as approximately 10-40 percent of a project cost - to leverage private sector investment, development expertise and experience. To support the government in moving this thinking into action, in January 2018, the World Bank Group engaged one County Government in initiating a pilot project. This is particularly relevant as the recognition that county governments and secondary cities are a key partner in the affordable housing agenda is evident in the government's roadmap which envisages the bulk delivery from these areas.

3. **Intensive due diligence resulted in the design of a prototype.** The due diligence focused on the characteristics and constraints of the proposed project; namely People (End Users); Place (the existing and planned physical environment); Payments (project and end user financing, cost recovery, profitability); Portal (the development and managing entity); and, Production (the method and process for implementation). The team engaged directly with major local employers, SACCOs and cooperatives representing some 40,000 employees with the aim of establishing 'anchor clients' to confirm the end user group demand and affordability. The prototype would require the county to establish a Special Purpose Vehicle into which the allocated serviced land would be valued as Government's equity contribution to the partnership to attract private investment in the delivery of new affordable housing units. The Special Purpose Vehicle will then be held responsible for planning, sales & marketing, developing and managing the estate ensuring long-term sustainability and value appreciation of the living environment.

4. **From a feasibility perspective, the resultant model successfully leverages serviced public land to attract private capital towards affordable housing delivery** that: (a) meets both the affordability limitations and the adequacy requirements of end-users; (b) fulfills an investor's profit objectives in a sustainable manner; and, (c) provides an off-balance sheet solution to the government i.e. imposes no direct fiscal liability. To test the viability of this innovative concept, the County plans to engage the market in a formal "Request for Investment" procedure, upon their conclusion of perfecting the title on the land.

5. **Real impact in housing, however, will not come from addressing one community in one area, but from creating a robust scheme which can be launched in counties/cities** across the country and attract a larger pool of the domestic market for job creation, mobilization of local currency and long-term finance from institutional investors. The design of the prototype, which could prove to be a catalytic demonstration pilot, therefore focuses on scale, sustainability and continuity. It is against this core ability that the team has, in parallel, been pursuing the identification of additional suitable sites on which the model can be refined as part of the generation of a sustainable pipeline. A second county has been selected for which feasibility assessment is ongoing in three urban centers.

6. **Even with this positive development**, reaching the target goal of 500,000 houses by 2022 will require scale, but scale embedded in local communities and one which adopts to local demand, preferences and constraints. The model, therefore, champions the concept of "massive small" i.e. many, small scale initiatives that address scale, together.

ANNEX 3: Affordability Analysis

1. **The methodology used to estimate housing affordability is based on taking the GDP consumption component and applying the income distribution curve to it in order to produce actual KES numbers**. In calculating these numbers and getting the shape of the income distribution curve, the 2015-2016 Kenya Integrated Household Budget Survey data was used to get the proportion of total income for each decile. A 100 KES / US$ exchange rate was used for the calculation and Kenya's 2017 urban population was estimated at 13,029,800 people, out of a total population of 49,699,862 inhabitants.

2. **Current house prices are unaffordable for most urban residents in Kenya.** The Kenya Economic Update April 2017 edition estimated the cheapest newly build house at approximately KES 1.7 million or US$17,000. Assuming prevailing financing conditions from SACCOs (3 years maturity and 12.5 percent interest rate), about 20 percent of urban households would be able to afford such property. There is however a scarcity of properties available at this price point in urban centers.

3. **It is expected the Project will help increase affordability significantly relative to the status quo.** By lengthening the mortgage maturities from 3 to 15 years and by keeping the interest rate at 12.5 percent, while assuming a mortgage of KES 1.5 million (US$15,000), a payment to income ratio of 40 percent and a loan-to-value ratio of 90 percent, the Project expects to make homes affordable to approximately 55 percent of urban households, as illustrated in Table 3.1 below. This represents a significant improvement in the current affordability threshold.

Table 3.1. Affordability Table

Cost of Home (KES)	1,700,000	1,700,000	1,700,000
Loan Amount (KES)	1,530,000	1,530,000	1,530,000
Annual Interest Rate	12.50%	12.50%	12.50%
Loan duration (in years)	3	7	15
Payment per Period	51,184.05	27,419.49	18,857.59
Minimum Monthly Salary Required	127,960.12	68,548.74	47,143.97
Income percentile which can afford mortgage (Urban)	20%	41%	55%

	3 years	5 years	7 years	10 years	15 years	20 years	25 years	30 years
5.00%	22%	38%	50%	59%	66%	70%	73%	75%
7.50%	21%	36%	47%	56%	62%	65%	67%	68%
10.00%	21%	33%	44%	52%	58%	61%	62%	63%
12.50%	20%	31%	41%	49%	**55%**	57%	58%	58%
15.00%	19%	29%	37%	45%	51%	53%	53%	54%
17.50%	18%	27%	34%	41%	46%	48%	49%	49%
20.00%	18%	25%	31%	37%	42%	43%	44%	44%
22.50%	17%	24%	29%	33%	37%	38%	39%	39%
25.00%	17%	23%	27%	30%	33%	33%	34%	34%
27.50%	16%	22%	25%	28%	29%	30%	30%	30%
30.00%	15%	20%	23%	25%	27%	27%	27%	27%

4. **While there are difficulties in accurately measuring these numbers due to challenges in data availability and accuracy, the Project will contribute to expanding access to affordable housing in Kenya.** Indeed, as in many other African countries, Kenya has a high Gini coefficient (0.408), meaning the country is characterized by high inequality. Therefore, even small changes in affordability can have dramatic effects in terms of expanding access to affordable housing. Mortgage markets expand gradually, as financial institutions develop risk management systems to serve groups with lower and informal incomes that would otherwise not qualify for long-term loans.

ANNEX 4: Economic and Financial Analysis

1. **The Project brings important economic additionality to the housing finance market.** It is predicated on KMRC "raising the bar". Currently, many personal loans are used for housing but do not provide an affordable solution given their short-term nature. With KMRC and more efficient property registration, financial institutions would gradually convert these loans into long-term mortgage loans. KMRC is expected to increase the number of mortgages in Kenya by 14.6 percent per year. In five years of operations, KMRC would refinance about 30,000 affordable housing loans and 3,000 market rate mortgages (the latter with support of AfDB credit line) helping to provide shelter to about 132,000 people assuming an occupancy of four people per household.

2. **Maximizing Finance for Development.** The Project is expected to leverage significant private capital through KMRC's bond issues. This is predicated on fiscal consolidation in Kenya and a decrease in the sovereign debt yield. Over five years, the US$45 million of IBRD-supported subordinated debt to strengthen KMRC's capital would help raise about US$150 million of bonds, a leverage ratio of 3.3 times. Over ten years, cumulative bonds issuance of KMRC is estimated to be US$562 million, which would represent a leverage ratio of 12.5 times.

3. **Impact on jobs.** Housing construction has an important economic multiplier through job creation, including in related sectors along the supply chain, from developers to construction material businesses and commercial activities around new housing. Research shows that affordable housing is more labor-intensive than high-income housing.[9] In Colombia, it is estimated that every US$10,000 spent on housing creates 5 additional jobs. In India, each housing unit is estimated to create 1.5 direct and 8 indirect jobs and in South Africa, 5.6 additional jobs. Based on the estimated number of mortgages that will be refinanced by KMRC, and assuming an average rate of 4 jobs created per housing unit built, the project may help create approximately 132,000 jobs during the first five years.

4. **Economic Rate of Return (ERR) analysis.** The economic analysis of this project is built as a financial analysis, with the estimated difference in cash flows to beneficiaries accounted for as cash flows to the project. The ERR is calculated on the basis of the cost of US$190 million (credit line) versus the cash flows from increased mortgage lending and refinancing by KMRC. A discount rate of 15 percent is applied to the calculation. The ERR assumes a 6 percent per annum growth in the mortgage market and a 5.2 percent average GDP growth per year between 2019-2028. The calculation yields an ERR of 35 percent and a Net Present Value of US$104 million over ten years.

5. **Indirect socio-economic benefits**. Studies show that the construction sector has significant input-output multipliers, with the input multiplier ranging from 1.03 to 1.53 and the output multiplier ranging from 1.7 to 2.3. An input multiplier of 1.3 means that if the construction sector increases its demand for primary inputs such as labor and materials by US$1 million, the economy's consumption of primary inputs increases by US$1.3 million. An output multiplier of 2.0 means that a US$1 million increase in the construction sector's final output will increase total economic output by US$2 million. Assuming a conservative output multiplier of 1.5, the Project would increase total economic output by approximately US$650 million over the first five years. Home ownership increases the health and welfare of its occupants, especially when the alternative is living in slums, and is associated with positive social externalities, including greater participation in community organizations, better maintenance of properties, commitment to stay longer in the community, higher academic achievement and reduced behavioral problems among children. Lastly, as housing assets are leveraged to generate income, home ownership can be instrumental for social security in the case of the elderly.

[9] Erbas and Nothaft (2002). On India: Sangeeth Ram, McKinsey, Presentation to the World Bank Global Housing Conference, May 2012

ANNEX 5: Summary of KMRC Business Plan and Steps for Operationalization

1. **A detailed business plan for KMRC was prepared in July 2018**. This plan was based on an onsite survey of housing loans from 18 financial institutions. 152,381 housing loans were reviewed, amounting to KES 202 billion (US$2 billion). The survey found that despite the small number of mortgage loans, financial institutions had extended many short-term personal loans for incremental housing. 45 percent of the loans surveyed had a maturity of less than 3 years, and 90 percent had an original principal amount of less than KES 3 million (US$30,000). The survey confirmed the existence of a critical mass of loans for KMRC refinance operations.

2. **The business plan was updated in February 2019 and included in the Information Memorandum released to KMRC prospective shareholders.** The business plan assumes that KMRC will start operations by refinancing affordable housing loans (below KES 3 million; KES 4 million for Nairobi Metropolitan) with the IBRD credit line and will use a mix of AfDB credit line and bonds to develop the market rate business. KMRC would add 50 bps above its funding cost. KMRC market share of the housing finance market is assumed to be conservative at 6 percent of affordable housing loans and 2.5 percent of market rate loans. The tables below present the assumptions and main results of the financial model.

Table 5.1: main assumptions

Variables	Conservative	Base	Optimistic
Annual growth rate of KMRC			
KMRC penetration of affordable loans	5.4%	6%	7%
KMRC penetration of market-rate loans	2.3%	2.5%	3.5%
Rate of penetration growth	4%	6%	6%
Steady state penetration rate	10%	12%	20%
Pricing (spread on funding costs)			
Market housing loans	0.5%	0.50%	1.0%
Affordable loans	0.25%	0.50%	1.0%
Tenor(years) of Subordinated Term Loan	15	15	15

Source: KMRC Information Memorandum

Table 5.2: Projected KMRC Key Performance Indicators

Key Indicators	First five years
Housing Loans Refinanced (Number of Loans)	
Affordable	30,704
Market Rate	3,348
Housing Loans Refinanced (Value)	
Affordable	KES 22.69 Billion
Market Rate loans	KES 28.05 Billion
Bonds issued	KES 15.00 Billion

Source: KMRC Information Memorandum

Table 5.3: Statement of projected comprehensive income

(KES Million)	2019	2020	2021	2022	2023
Interest income	839	1,298	2,638	3,585	4,269
Interest expense	(348)	(692)	(1,699)	(2,454)	(2,922)
Net Interest income	**491**	**605**	**939**	**1,132**	**1,347**
Other income	-	-	-	-	-
Total operating income	**491**	**605**	**939**	**1,132**	**1,347**
Operating expenses	(125)	(133)	(180)	(204)	(218)
Finance costs	-	-	(95)	(116)	(116)
Other Expenses	(48)	(52)	(55)	(59)	(63)
Profit before tax	**318**	**421**	**609**	**753**	**949**
Tax credit	(93)	(126)	(183)	(226)	(285)
Profit for the year	**225**	**294**	**426**	**527**	**665**

Source: KMRC Information Memorandum

Table 5.4: Statement of projected financial position

(KES Million)	2019	2020	2021	2022	2023
Assets					
Cash & cash equivalents	1,254	2,367	3,323	3,363	1,300
Mortgage Refinance Loans:					
Affordable loans balance	2,544	5,471	8,948	13,113	13,479
Market rate loans balance	2,400	5,038	9,203	12,946	17,490
Investment securities (available for sale)	4,500	5,500	9,500	9,500	9,500
Property & Equipment	36	35	34	33	32
Total assets	**10,734**	**18,410**	**31,009**	**38,956**	**41,801**
Liabilities					
Bonds issued balance	-	-	4,186	7,849	11,065
Borrowings:					
IBRD credit line	3,710	7,734	11,285	15,443	14,807
AfDB credit line	2,299	4,657	5,091	4,691	4,291
Sub-debt	1,500	2,500	6,500	6,500	6,500
Total liabilities	**7,509**	**14,891**	**27,062**	**34,483**	**36,663**
Shareholders' equity					
Share capital	3,000	3,000	3,000	3,000	3,000
Retained earnings	225	520	946	1,473	2,138
Total equity	**3,225**	**3,520**	**3,946**	**4,473**	**5,138**
Total liabilities and equity	**10,734**	**18,410**	**31,009**	**38,956**	**41,801**

Source: KMRC Information Memorandum. This assumes an AfDB credit line of about US$60 million supporting the market rate segment, and subordinated debt of about US$20 million complementing IBRD financing. All credit lines and bonds are amortizing.

3. **The business plan shows that KMRC would be profitable.** The subordinated debt would build the capital and income of KMRC in early years, and the credit lines would allow KMRC to start its business. The projections assume that KMRC would be a lean institution with a limited number of staff. The disbursement projections reflect the business plan and have been discussed with KMRC's interim management.

4. A detailed action plan to operationalize KMRC has been prepared.

	Action	Description	By whom	Status / Expected Completion	Completion expected by
1	KMRC Capitalization	NT pays its contribution to KMRC	NT	Completed.	April 2019
		Subordinated debt agreement and subsidiary agreement between KMRC and NT are drafted	Transaction Advisor	In progress. Draft of Subsidiary Agreement submitted to World Bank. Expected signing of the two agreements by end of June 2019.	
		Finalize the contributions of KMRC's shareholders and raise the initial capital	Transaction Advisor	Transaction Adviser to mobilize shareholders to pay capital. Offer closed on March 29, 2019.	
		Legal opinion on KMRC pledging mechanism is issued	Transaction Advisor	In progress	
		Shareholders pay their capital to KMRC	Shareholders	Capital structure and shareholder register to be finalized in April 2019.	
2	KMRC Board	Based on the shareholders' contributions, finalize the KMRC Board composition	Shareholders	Will be done once shareholders pay in capital	End of April 2019
3	KMRC Regulations	Central Bank of Kenya (CBK) gazettes KMRC regulations	CBK	Regulations submitted to the Office of the Attorney General for Review	End of April 2019
4	KMRC License	KMRC applies to CBK for a license to operate as a financial institution	KMRC	Application for license to be sent to CBK once regulations are in force and KMRC Board is in place	June 2019
		Obtain license from CBK to be able to start operations	KMRC	CBK to issue license 60 days after application (expected: June 2019)	
5	KMRC management (including CEO)	KMRC appoints CEO	NT	Interim CEO appointed in August 2018	September 2019
		Board recruits KMRC long-term management	KMRC Board	Manpower for KMRC will be funded by the project (Component 2) while KMRC recruits its long-term staff	
6	KMRC staffing	KMRC appoints key staff	KMRC, NT and shareholders	Completed. Staff in the areas of credit operations, financial analysis/accounting and legal services have joined.	Sep 2019
		KMRC appoints a risk manager and internal auditor	KMRC	Within 3 months of effectiveness	
		KMRC to designate an E&S coordinator	KMRC	Expected completion: May 2019	
7	KMRC Policies and Procedures	Key policies and procedures including E&S policy, are approved by KMRC Board	KMRC Board	Draft completed. Approval by KMRC Board expected in May 2019	May 2019

	Action	Description	By whom	Status / Expected Completion	Completion expected by
8	Master Refinance Agreement (MRA)	Integrate applicable E&S requirements (specifically compliance with national regulations and the list of excluded activities) into the MRA	Lawyer supporting KMRC	Completed.	May 2019
		Dissemination of MRA to KMRC prospective shareholders and finalization of MRA	KMRC and shareholders	Completed	
		KMRC executes MRA with shareholders	KRMC	Pending the legal advice on the MRA	
9	Project Operations Manual	Operations manual including the financial management, procurement, and pricing of the line of credit is finalized	NT	Draft Completed. To be approved by NT and KMRC's Board.	Expected by early May 2019.
10	Project Safeguards Arrangements	KMRC to prepare and submit to the Bank an acceptable E&S policy and procedure (including a grievance mechanism that will address E&S related complaints)	KMRC	Completed	May 2019
		KMRC to submit acceptable E&S capacity building plan for its internal staff and PMLs	KMRC	Completed	
		Approval and disclosure of E&S policy by KMRC	KMRC	Expected to be done in May2019 after appointment of KMRC Board.	

ANNEX 6: Proposed Technical Assistance for Ministry of Lands and Physical Planning

TA Area 1: Supporting the Ministry improve the quality of the foundations of their computerization of property registration

The Ministry of Lands and Physical Planning (MLPP) has embarked on an ambitious computerization program where it aims to computerize the 58 land registries in the 47 counties within four years (property registration is not a devolved function) and specific MLPP budget lines have been assigned to this program. This TA area aims to improve the quality of the foundations of the land computerization project.

Tasks include:

1.1. Implementation of the recommendations of the e-conveyance Task Force;

1.2. Baseline study and Conceptual Design of an integrated Land Information Management System (ILIMS) and Roadmap. This would include all modules of the system (registration and cadastre, physical planning, valuation, adjudication, administration, other public services, banks, access of information, system security etc.). LIMS Implementation Plan (priorities and phases, module based). Gap analysis and recommendations;

1.3. Support to the Ministry on System Security Development including the development of Information Security Policy, regulation and other documentation (including the recommendations on all security controls implementation according to the national law, international standards and best practices);

1.4. Business Process mapping and Reengineering to support integrated LIMS and Data Modelling for the integrated LIMS (including for all components of the system);

1.5. Capacity needs assessment at national and county level and an implementation Plan for the LIMS;

1.6. A Conceptual Design and implementation plan for LIMS Data Centre, including technical and security specifications and design of premises upgrade;

1.7. Development of Technical Specifications and Requirements for the LIMS as part of bid documentation

TA Area 2: Assessment and Development of a Land Sector Strategic Plan and Roadmap

Kenya embarked on substantial improvements of its historically disenfranchising land management system when the landmark document, the 2009 National Land Policy, was finalized. The Policy is the product of a long consultative process over many years, and which is considered the turning point of Kenya's transformative land reforms. The policy identifies the critical land issues facing the country and presents a set of proposals for legislative action and administrative reforms to bring out desired land reforms. This TA area aims to support these reforms to improve the equitable use of land for all Kenyans.

Tasks include:

2.1. Assessment of the land sector in the context of implementation of the National Land Policy and the required laws and regulations;

2.2. Institutional assessment of the National Land Commission;

2.3. Preparation of a 10-year Land Sector Strategic Plan and Road Map to optimize land use and enhance land rights through harmonized planning, adjudication, surveying, valuation and registration of rural and urban lands;

2.4. Strategy for Base Mapping and establishment of Kenya Geodetic Reference Frame with implementation plan and cost estimation;

2.5. Capacity assessment and plans to implement the land sector strategic plan;
2.6. Detailed budget estimates to implement the land sector strategic plan and exploration of sources of financing.

TA Area 3: Support to fast tracking current land reforms
Over the past nine years, reforms have been initiated to support the policy objectives of the National Land Policy. While key legislation and regulations have been enacted and gazetted, much remains to implement these legislations and regulations and to update supporting instruments so that they align with the National Land Policy. This TA area will strengthen the policy and legislative framework and support the implementation of this framework. Examples of support in this TA area include:

3.1. Review and support to updating policies such as the National Land Policy and supporting policies including Valuation Policy;
3.2 Review of outdated Acts and regulations which may constrain equitable access to land (Land Survey Act, Rating Act, Valuation for Rating Act, Tenants at Will, etc);
3.3. Support to the implementation of key Acts and regulations that improve tenure security and the mortgage market, such as the Land Act, the Land Registration Act, Sectional Properties Act, Community Land Act, etc;
3.4. Support to the production of various manuals and handbooks that remain outdated or do not exist, such as Land and Cadastral Survey Manual, Physical Planning Handbook for counties, etc.;
3.5. Preparation of a Public Information and Sensitization Program to raise awareness on the land laws and regulations in government agencies and the public.

ANNEX 7: Mortgage Refinance Companies in Africa[10]

1. **The WBG has three ongoing operations with MRCs in Africa**. In Tanzania, IDA provided a credit line to Tanzania Mortgage Refinance Company (TMRC) in 2011, and additional financing subject to TMRC raising a bond, which it did successfully in 2018. IFC is preparing an equity investment in TMRC and a program of bond purchases. In Nigeria, IDA provided Tier 2 capital in 2014 tied to Nigeria Mortgage Refinance Company (NMRC) raising bonds. In the West Africa Economic and Monetary Union (WAEMU), IDA provided in 2017 a mix of Tier 2 to strengthen the capital of CRRH, and credit line to incentivize a move to lower income groups. IFC invested equity and purchased bonds of CRRH to lengthen their tenor from 10 years to 12 and 15 years. The design of KMRC draws from these experiences particularly on the funding (both credit line and sub-debt), governance (lean board) and outreach to non-bank financial institutions.

2. **Stable macroeconomic conditions are key to the success of an MRC**. In Tanzania and Nigeria, the MRCs took time to issue bonds due to unfavorable macro conditions and high yields on government securities. As a result of the currency peg between the Franc CFA and the euro, WAEMU has benefitted from low inflation and interest rates. This has allowed CRRH to issue 8 successive bonds at a low yield below 6 percent since inception.

3. **MRCs have helped deepen their housing finance market**. In Tanzania, the number of banks offering mortgage loans increased from 3 in 2010 to 31 in 2017, and tenors increased from 7 to 20 years. In Nigeria, NMRC spearheaded uniform underwriting standards for mortgage, which encouraged competition. In West Africa, CRRH has refinanced 33 banks and is preparing to open a refinance window for non-banks financial institutions.

Tanzania: TMRC (2010)	• Number of mortgage lenders in the market increased from 3 in 2010 to 31 in 2017 • Mortgage tenors extended from 7 to 20 years • Interest rates decreased from 22-24% in 2010 to 15-19% in 2017 • TMRC refinanced 13 banks for an amount equivalent to 24% of total mortgage debt outstanding • 3 private bond placements with pension funds. Bond issue of TZS 12 bn (US$5.2m) in June 2018 oversubscribed.
WAEMU: CRRH (2012)	• Shareholders: 54 commercial banks (increase from 23 at inception), IFC, Shelter Afrique and West Africa Development Bank • 8 bonds issues since 2012 (10, 12 and 15-year in 2018). Issues priced below WAEMU government bond yields • 33 banks refinanced in 8 countries • Mortgage tenors lengthened to at least 15 years • US$155 million IDA operation to move down market and extend mortgage refinance to microfinance institutions
Nigeria: NMRC (2013)	• Obtained licence in February 2015 • 22 investors: 20 lenders with 60.3% of capital; Ministry of Finance with 17%; Social Security fund with 22.7% • Adopted Uniform Underwriting Standards • US$250 million IDA loan for sub-debt • First 15-year bond issue in July 2015 of N8 bn (US$40 m) • May 2018: 2nd 15-year bond issue of N11 bn (US$31M)- 74 bps above government. 70% of investors are pension funds

[10] Tanzania Housing Finance Project (P151220); Nigeria Housing Finance Development Program (P131973); WAEMU Affordable Housing Finance Project (P161658).

ANNEX 8: Kenya Financial Sector Overview

1. **The Kenyan financial sector has undergone two difficult years, with growth in private sector credit falling significantly since the interest rate cap amendment in September 2016.** As of December 2018, credit growth stood at 2.4 percent, well below its ten-year average of about 19 percent. In real terms the growth in credit is negative. The Banking Amendment Act No. 3 of 2016 caps the maximum interest rate charged for a credit facility in Kenya by the banks at no more than 4 percent above the base rate set by the CBK; and provided a floor for the deposit rate held in interest earning accounts to at least 70 percent of the CBK base rate. In August 2018, the interest rate floor was repealed but the cap was maintained by Parliament. A Kenyan court has recently declared the interest rate cap as unconstitutional and has provided lawmakers a window of 12 months to make appropriate amendments.

2. **Kenya's Government debt is crowding out the private sector.** The debt is now at 57 percent of GDP, as a result of government borrowing to finance the fiscal deficit**.** In a context of government's continued reliance on the local market to finance a large budget deficit, the interest rate cap has contributed to a shift to public sector lending at the expense of private sector lending.

Banking sector

3. **Kenya is one of the most densely-served African countries, with 42 banks for a population of about 49.7 million people.** It is expected that the banking sector will consolidate in the next years. The CBK categorizes Kenyan banks in three tiers based on their total net assets. Tier 1 is comprised of the largest eight banks, accounting to a 66 percent share of the market. Tier 2 banks are medium-sized lenders and own 26 percent of the market share. Tier 3 banks have just 8 percent market share. In 2017, the Tier 1 banks held 43 million deposit accounts, which amounted to 93 percent of the total and 6.8 million loan accounts, or 95 percent of the total.

4. **On a weighted average basis, return on assets declined following the introduction of the cap, particularly in tier 3 banks.** For the banking sector, return on assets declined from 3.3 percent in December 2016 to 2.7 percent in December 2017 (most tier 3 banks had flat or negative ratios). NPL ratio increased from 9.2 to 12.2 percent in the same period. Core capital ratio for the sector was well above the minimum requirement at 16.5 percent at end 2017.

5. **Progress made in expanding financial inclusion in Kenya to average about 82 percent of the adult population is attributed to rapid innovation by the private sector in collaboration with the public sector.** However, further effort is required to address the rural-urban divide. In 2016, formal financial inclusion in rural areas stood at 69 percent compared to 86 percent for urban areas. Banks penetration has grown in the last 10 years, driven by branch expansion, bank agent services, and mobile bank solutions. About 72 percent of Kenya's population access financial services from mobile vs. 39 percent who access banks directly. According to the 2017 Findex database, almost 60 percent of the population (15 years+) reported using a mobile money account compared to 6 percent in Nigeria, 19 percent in South Africa, 39 percent in Tanzania, 2 percent in India and 21 percent in Sub-Saharan African countries (excluding high income).

Housing Finance

6. **The housing deficit in Kenya is large and growing.** There is an estimated housing shortfall of 2 million units, and the additional 500,000 new city dwellers every year aggravate a situation where 61 percent of urban households live in slums (compared to 50 percent in Nigeria and 23 percent in South Africa). Given Kenya's growth and urbanization rates, the problem will only become more acute over the next decades.

7. **The formal housing finance market is small.** The mortgage industry is growing rapidly and becoming increasingly competitive, but it has focused so far on the high-end market. Mortgage debt represented 3.6 percent of GDP, based on

CBK data as the end of 2017 but with only 26,000 outstanding mortgages from commercial banks. In South Africa by comparison mortgage debt to GDP was 30 percent. Many households use short-term personal loans to finance their home mostly from microfinance banks and SACCOs.

8. **Housing finance in Kenya remains below its potential because of several constraints.** The 2017 Residential Mortgage Market Survey revealed that high cost of houses, high interest rates on mortgages, high incidental cost of mortgages, low levels of income, difficulties with property registration and titling, and lack of access to long term finance are the major inhibiting factors to the growth of the Kenyan mortgage market. Furthermore, there is little standardization of loan underwriting, documentation, or servicing procedures.

SACCOs

9. **Savings and Credit Cooperatives (SACCOs) form a vital part of Kenya's financial system. SACCOs are non-profit financial cooperatives owned by their members and governed by a member-elected board of directors.** SACCOs are formed around a common bond, such as shared industry or location but many of the leading SACCOs have opened the common bond (i.e. anybody can become a member). SACCOs fall under the government's regulatory framework and are formal financial institutions. They fall into two categories: deposit-taking and non-deposit taking. Deposit-taking (DT) SACCOs are prudentially regulated by an independent statutory agency known as the SACCO Societies Regulatory Authority (SASRA). Non-deposit taking SACCOS are not prudentially regulated.

10. **The sector is much smaller in asset size than the commercial banks – accounting for an estimated 10 percent of the assets in deposit-taking intermediaries – however SACCOs' penetration is far greater.** In rural areas, many farmers depend on their SACCOs for credit and payment services. More than one-third of Kenyans rely on informal sources of savings and credit and it is estimated that two-thirds of the Kenyan population directly or indirectly benefits from a SACCO, not only in the agricultural sector, but in all sectors of the economy. As member-owned institutions they provide an important alternative institutional form to banks. These are usually group schemes, which help families cope with short-term risk and invest in their longer-term aspirations. SACCOs offer services that cannot be found elsewhere and are particularly relevant to women and people in rural areas. Given their non-profit status and the nature of the guarantees they take (personal guarantees from other members), SACCOs can make loans at lower rates than the commercial banks.

11. **Prior to the interest rate cap, the SACCO sector's weighted average interest rate was 12 percent while commercial banks' rate was 18.3 percent (December 2015).** In addition to high interest rates, the customer perception is that banks charge more fees, adding to the overall cost of borrowing. SACCO loans are easier and faster to access, with a quicker turnaround time than banks. The processing period for a loan disbursement from a SACCO can be one to two days, compared to as long as six weeks at a commercial bank. Land and housing are the most important sector financed by SACCOs with 36 percent of their total loan portfolio (SASRA survey 2018), reaching 60 percent for large urban SACCOs.

12. **As of December 2017, SASRA was supervising 174 SACCOs.** 146 were complying with the prescribed core capital to total asset ratio of 10 percent. The sector's NPL ratio was 6.1 percent, above the 5 percent maximum ratio recommended by the World Federation of Credit Unions. The loan to deposit ratio was 108 percent, which underscores the severe liquidity constraints of the sector. As a result, SACCOs are very interested in KMRC's refinancing which will be subject to meeting strict eligibility criteria. Technical assistance to strengthen SASRA's supervisory and enforcement capacity is ongoing under the Financial Sector Support Project (P151816).