

FOR OFFICIAL USE ONLY

R127-19
Corrigendum 1
26 November 2019

Corrigendum to Document R127-19 Proposed Loans and Technical Assistance Grant Mortgage Market Sector Development Program (Uzbekistan)

The following change was made in a linked document of the above document to reflect the correct information.

- (i) Linked Document 10: Attached Technical Assistance Report, Appendix 2

Replaced hyperlink of the list of link documents

"<http://www.adb.org/Documents/RRPs/?id=51348-001-3>" with

"<http://www.adb.org/Documents/LinkedDocs/?id=51348-001-TAReport>"



FOR OFFICIAL USE ONLY

(For consideration by the Board on or about 28 November 2019)

R127-19
7 November 2019

Proposed Loans and Technical Assistance Grant Mortgage Market Sector Development Program (Uzbekistan)

1. The Report and Recommendation of the President (RRP: UZB 51348-001) on the proposed loans and technical assistance grant to Uzbekistan for the Mortgage Market Sector Development Program is circulated herewith.
2. This Report and Recommendation should be read with *Country Operations Business Plan: Uzbekistan, 2019–2021*, which was circulated to the Board on 7 December 2018 (DOC.IN.451-18).

For Inquiries: Peter Marro, Central and West Asia Department
(Ext. 5762)
Patricia Rhee, Office of the General Counsel
(Ext. 1508)



Report and Recommendation of the President to the Board of Directors

Project Number: 51348-001
November 2019

Proposed Loans and Technical Assistance Grant Republic of Uzbekistan: Mortgage Market Sector Development Program

Distribution of this document is restricted until it has been approved by the Board of Directors. Following such approval, ADB will disclose the document to the public in accordance with ADB's Access to Information Policy after excluding information that is subject to exceptions to disclosure set forth in the policy.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 11 October 2019)

Currency unit	–	sum (SUM)
SUM\$1.00	=	\$0.00010612
\$1.00	=	SUM9,422.77

ABBREVIATIONS

ADB	–	Asian Development Bank
CBU	–	Central Bank of Uzbekistan
ESMS	–	environmental and social management system
FIL	–	financial intermediation loan
GDP	–	gross domestic product
HAU	–	Housing Assistance Unit
IMF	–	International Monetary Fund
MOF	–	Ministry of Finance
MRC	–	mortgage refinancing company
PAM	–	project administration manual
PBL	–	policy-based loan
PFI	–	participating financial institution
SDP	–	sector development program
SOE	–	state-owned enterprise
TA	–	technical assistance
UMRC	–	Uzbekistan Mortgage Refinancing Company

NOTE

In this report, “\$” refers to United States dollars.

Vice-President Director General Director	Shixin Chen, Operations 1 Werner E. Liepach, Central and West Asia Department (CWRD) Tariq H. Niazi, Public Management, Financial Sector and Trade Division, CWRD
Team leader	Bobir Gafurov, Senior Private Sector Development Officer, Uzbekistan Resident Mission (URM), CWRD Peter Marro, Principal Financial Sector Specialist, CWRD
Team members	Marian Therese Bartolome, Senior Operations Assistant, CWRD Catherine Debalucos, Associate Project Analyst, CWRD Begzod M. Djalilov, Senior Economics Officer, URM, CWRD Joao Farinha Fernandes, Senior Financial Sector Economist, CWRD Stephanie Kamal, Public Management Specialist, CWRD Patricia Rhee, Principal Counsel, Office of the General Counsel Priyanka Sood, Senior Financial Sector Specialist, CWRD
Peer reviewer	Donald Lambert, Principal Private Sector Development Specialist, Southeast Asia Department

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

CONTENTS

	Page
PROGRAM AT A GLANCE	
I. THE PROPOSAL	1
II. THE PROGRAM	1
A. Rationale	1
B. Program Description	4
C. Value Added by ADB	6
D. Development Financing Needs and Investment and Financing Plan	7
E. Implementation Arrangements	9
III. ATTACHED TECHNICAL ASSISTANCE	10
IV. DUE DILIGENCE	10
A. Economic and Financial Viability	10
B. Sustainability	11
C. Governance	12
D. Poverty, Social, and Gender	12
E. Safeguards	13
F. Summary of Risk Assessment and Risk Management Plan	13
V. ASSURANCES AND CONDITIONS	14
VI. RECOMMENDATION	14
APPENDIXES	
1. Design and Monitoring Framework	15
2. List of Linked Documents	18
3. Development Policy Letter	19
4. Policy Matrix	22

PROGRAM AT A GLANCE

1. Basic Data		Project Number: 51348-001	
Project Name	Mortgage Market Sector Development Program	Department/Division	CWRD/CWPF
Country	Uzbekistan	Executing Agency	Ministry of Finance
Borrower	Government of Uzbekistan		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=51348-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=51348-001-PortAtaGlance		
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Finance	Housing finance		200.00
		Total	200.00
3. Operational Priorities		Climate Change Information	
✓ Addressing remaining poverty and reducing inequalities		Climate Change impact on the Project	Low
✓ Accelerating progress in gender equality			
✓ Strengthening governance and institutional capacity			
Sustainable Development Goals		Gender Equity and Mainstreaming	
SDG 1.4		Some gender elements (SGE)	✓
SDG 5.c			
SDG 10.3			
SDG 11.1		Poverty Targeting	
		General Intervention on Poverty	✓
4. Risk Categorization:	Complex		
5. Safeguard Categorization	Environment: FI-C Involuntary Resettlement: FI-C Indigenous Peoples: FI-C		
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		200.00	
Sovereign SDP - Program (Concessional Loan): Ordinary capital resources		50.00	
Sovereign SDP - Project (Regular Loan): Ordinary capital resources		150.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		200.00	
Note: An attached technical assistance will be financed on a grant basis by the Technical Assistance Special Fund (TASF-6) in the amount of \$800,000.			
Currency of ADB Financing: US Dollar			

I. THE PROPOSAL

1. I submit for your approval the following report and recommendations on a proposed (i) policy-based loan (PBL) and (ii) financial intermediation loan (FIL) to the Republic of Uzbekistan for the Mortgage Market Sector Development Program. The report also describes proposed technical assistance (TA) for Implementing the Mortgage Market Sector Development Program, and if the Board approves the proposed loans, I, acting under the authority delegated to me by the Board, approve the TA.

2. The program aims to establish a new institutional framework and financing mechanism to promote market-based mortgage finance in Uzbekistan, expand the availability of residential mortgage products, and bring product innovation to the banking sector. Measures supported by the FIL will enable banks to access long-term funding, promote competition, and remove inefficiencies and distortions in the housing finance market. The PBL will support the Government of Uzbekistan in reforming its housing policy and subsidy framework to ensure an efficient use of public resources and achieve the fiscal sustainability of housing subsidies. The proposed transaction TA will help implement the program.

II. THE PROGRAM

A. Rationale

3. **Macroeconomic context.** Since 2017, Uzbekistan has undertaken critical reforms, which have sustained a gross domestic product (GDP) growth above 5% in 2018.¹ The country moved to a more liberal exchange rate and trade regime in 2017 and is undertaking major fiscal reforms. Substantive progress has also been achieved through ongoing structural and institutional reforms. The government is keen to continue its reform agenda, but it remains challenging. To sustain high growth and to make the private sector the primary driver of growth, the government has prioritized the restructuring of state-owned enterprises (SOEs), public finance management reforms, including ad hoc transfers from the state budget to SOEs, and finance sector development.

4. **Sector development context.** Access to affordable and long-term mortgage finance is needed to meet the growing housing demand, which is the result of population growth and years of underinvestment in the housing sector.² Uzbekistan needs to produce 145,000 new housing units per year until 2040 to keep up with new household formation and replace old housing stock, with most new housing needed in urban areas. This figure is well above current production figures; the housing shortfall is therefore increasing annually despite the government's involvement to address it. In the past, the government initiated a number of housing subsidy programs mostly administered by state-owned commercial banks to improve the housing conditions in the country.³ However, the inefficiently structured and targeted subsidies are costly for the government and are

¹ This is despite adverse weather conditions for agriculture and ongoing reform challenges such as tariff adjustments of utilities and institutional restructuring of the energy sector.

² The Asian Development Bank (ADB) estimates a need of 100,000 units per year until 2040 to deal with population growth, based on secondary source estimates of square meters per person needed, while also taking into account slowing population growth and decreasing household size. In addition, the country would need an estimated 45,000 units per year until 2040 to decrease substantially the current housing deficit because of overcrowding and poor housing conditions.

³ Uzbekistan has 21 different government housing subsidy programs targeting, for instance, the rural and urban population, young families, teachers, military personnel, and public sector employees.

not conducive to the development of market-based solutions by focusing solely on a limited number of households and products.⁴

5. **Core development problem.** The government acknowledges that it lacks a comprehensive housing policy and subsidies framework. The existing housing finance programs are not effectively coordinated in terms of design, targeting, and use of subsidies, resulting in inefficient use of limited fiscal resources.⁵ The government also recognizes the need to gradually replace or phase out the existing programs and move to a market-based mortgage finance mechanism in addressing the housing needs of the population.

6. **Low mortgage finance intermediation by banks dominated by state housing programs.** The mortgage loan portfolio of Uzbek banks has increased steadily during 2013–2018, as reflected by the high compound annual growth rate of all bank mortgage loan portfolios of 31.4% and growth in the total gross loan portfolio of banks of 36.8% during this period. As of the end of 2018, the total mortgage loan portfolio had grown to SUM13.8 trillion. However, these figures still only represent 8.3% of banks' total loans outstanding and 3.4% of the GDP.⁶ Since 2007, most state housing programs have been mainly delivered by public banks.⁷ Six public banks issued 92% of all mortgage loans under the government's rural and urban housing programs (i.e. at subsidized rates). As a result, of the 39,556 mortgage loans issued in 2018, 75% by number, and 72% by volume, of loans were issued under the various state housing programs.⁸

7. **Lack of access to long-term funding and underdeveloped capital markets.** All commercial banks are constrained by the lack of access to long-term funding (beyond 1 year). This results in banks' aversion to fund residential mortgages and leads to limited experience and insufficient internal capacity to properly design, analyze, price, and service mortgage loans. The capital market in the country is underdeveloped and illiquid. There is no active bond market to mobilize long-term financing from institutional investors, such as pension funds or insurance companies. Despite the sizable mortgage loan portfolio in public banks, these mortgage loans cannot be used by the banks for the issuance of corporate bonds or mortgage-backed securities because of the highly subsidized interest rates. New instruments such as long-term saving plans for households are also absent.

8. The proposed sector development program (SDP) aims to develop a market-based residential mortgage market by (i) designing and implementing a new housing policy, reforming housing subsidies, and reviewing the legal and regulatory framework; (ii) strengthening the institutional framework to administer housing policy and subsidies by establishing a Housing Assistance Unit (HAU) in the Ministry of Finance (MOF); and (iii) making long-term fixed-rate local currency funds available to banks to enable them to expand their range of residential mortgage

⁴ Most programs focus on housing construction, with interest rate-based subsidies, while no options are provided for small renovations or purchase of existing housing units.

⁵ According to ADB's calculations, the cost to the government of the finance subsidies to banks and lost tax revenues of the various subsidies is about 79% of the cost of a house produced under the subsidy programs or SUM110 million for a SUM140 million house. If construction costs increase, housing prices and the costs of the subsidies will also increase.

⁶ These indicators are very modest compared with more mature markets—the percentage of mortgage loans to the total loan portfolio in banks in the United States and most European countries is about 50%. The ratio of mortgage loans to GDP in selected countries of the Commonwealth of Independent States is about 5.6% in the Russian Federation and 12.1% in Georgia. Housing Finance Information Network. www.hofinet.org.

⁷ Public banks here are referred to as commercial banks with substantial government ownership and/or control.

⁸ Central Bank of Uzbekistan (CBU). Statistics. <http://www.cbu.uz/en/statistics> (accessed 4 October 2019).

loan products through the establishment of the Uzbekistan Mortgage Refinancing Company (UMRC).⁹

9. **Consistency with Asian Development Bank strategy and country strategy.** The program is consistent with the Asian Development Bank (ADB) country partnership strategy for Uzbekistan, 2019–2023,¹⁰ which supports inclusive and sustainable economic growth through financial market development, access to finance, private sector development, and domestic resource mobilization. The program is included in ADB's country operations business plan for Uzbekistan, 2019–2021,¹¹ and will be the first SDP in the country. In late 2017, ADB provided knowledge support TA to conduct detailed diagnostics of the housing finance sector, which led to a comprehensive government reform program. The program supports key operational priorities of ADB's Strategy 2030¹² such as making cities more livable, addressing remaining poverty and reducing inequalities, accelerating progress in gender equality and strengthening governance and institutional capacity.

10. **Government's reform agenda.** Based on ADB's advice and preparatory work, the government prepared a comprehensive presidential decree to reform the mortgage finance sector, which was signed on 13 May 2019.¹³ The decree establishes a strategic road map for the development of the mortgage market, including reforms to the existing housing policy and subsidies framework, over the period of 2019–2021. The government plans to gradually reduce its direct role in providing long-term funding for residential mortgage finance, remove interest rate subsidies and other distortions in the finance sector, reform the regressive subsidy framework, and establish efficient administrative mechanisms. Over time, the government plans to enable the operations of new institutions and to replace the current inefficient and costly subsidy programs with transparent and efficient subsidies to make residential mortgages more affordable to low- and middle-income families.

11. **Rationale for a sector development program.** The SDP modality is justified because the sector requires both a policy reform component and an investment component (supported by the FIL), which are interlinked. The PBL will focus on reforms that are necessary for creating the enabling environment for an effective and efficient mortgage finance market. The FIL will help establish a new type of financial institution (i.e., the UMRC) with private sector participation and make long-term funds available to banks. Initially, the UMRC will use ADB resources and subsequently access the capital market by issuing bonds (i.e., once the domestic capital markets are sufficiently developed). Therefore, the program will ensure that (i) reforms to improve market intermediation are pursued continuously, (ii) government housing policies and subsidy programs are streamlined to effectively support low- and middle-income borrowers, and (iii) much-needed long-term financing to banks is provided to expand the range of market-based mortgage products. These measures will enable banks to access long-term funding, promote competition, and remove market inefficiencies and distortions.

⁹ Overall, the supply side of the mortgage market infrastructure in Uzbekistan is stronger than in many countries of similar income level and is conducive to the development of housing finance. ADB's analysis shows that the main supply-side elements are in place and functional to support the key priority areas for reform (supported under output 1) aimed at accelerating the development of housing finance.

¹⁰ ADB. 2019. *Country Partnership Strategy: Uzbekistan, 2019–2023—Supporting Economic Transformation*. Manila.

¹¹ ADB. 2018. *Country Operations Business Plan: Uzbekistan, 2019–2021*. Manila.

¹² ADB. 2018. *Strategy 2030. Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

¹³ <http://www.lex.uz/docs/4337779>

B. Program Description

12. The program is aligned with the following impact: living standards improved for the population of Uzbekistan.¹⁴ The program will have the following outcome: availability of affordable market-based residential mortgage credit increased.¹⁵ The outcome will be achieved by establishing the premise for improved access to long-term market-based funding and enhanced development of competitive housing finance products, as well as reforming the inefficient housing subsidy framework and some of its programs.

13. The program will have three outputs. The multitranche PBL will primarily support reforms under outputs 1 and 2.¹⁶ The PBL comprises 13 policy actions under tranche 1 and 14 policy actions under tranche 2. The FIL will focus on delivering output 3 of the program.

14. **Output 1: Policy, regulatory, and legal framework for the mortgage finance industry strengthened.** The government will revise and strengthen the existing housing policy and subsidy framework, which is presently distorting the financial system (i.e., government housing programs are provided at below-market rates, crowding out market funding and pricing). Activities include review of the existing, and establishment of better targeted, subsidy programs that reach lower-income households. Some of the changes under tranche 1 of the PBL are aimed at reducing excessive subsidies and their regressive nature.¹⁷ Policy actions under tranche 2 of the PBL will further deepen these reforms to enhance the fiscal sustainability and effectiveness of pro-poor targeting.¹⁸ The transition, which the UMRC will facilitate, toward stronger private sector participation in the development of the housing sector will be supported by (i) introducing a new category of financial institutions specializing in mortgage refinancing activities, (ii) mandating the Central Bank of Uzbekistan (CBU) to supervise and regulate this new category of financial institutions, and (iii) developing new regulations on mortgage lending to induce sound lending practices by banks.

15. **Output 2: Housing finance strategy and subsidy framework strengthened.** Tranche 1 of the PBL will establish the institutional mechanisms required to effectively implement and rationalize the government's housing subsidy framework. The government will establish the HAU to coordinate all existing housing policies and subsidy programs.¹⁹ In the initial phase, the HAU will take stock of the existing government housing programs and redefine the eligibility criteria for beneficiaries, review the housing policy framework, and agree on a road map that sets out priorities for the required legal and policy reforms. Ultimately, the HAU will become a single point

¹⁴ Government of Uzbekistan. 2017. *2017–2021 National Development Strategy*. Tashkent.

¹⁵ The design and monitoring framework is in Appendix 1.

¹⁶ The PBL will also support some of the activities under output 3 such as the incorporation of UMRC, preparation of a supervisory and regulatory framework for companies specializing in mortgage refinancing activities and amendments to the capital market regulations governing the procedures for institutional investors to invest in bonds issued by companies such as UMRC.

¹⁷ For instance, by introducing a gradual step-up process for increasing the interest rates for housing loans rather than the current scheme where interest rates stay at 7% for the first 5 years and then jump to the CBU refinancing rate (currently 16%), which creates a payment shock for mortgagors. Other changes include the revision of the amortization schedule to fixed monthly repayments (annuity scheme) in line with international norms, and the introduction of new lending products in the form of small loans for home repairs and improvements.

¹⁸ The government has eliminated some tax exemptions for existing and new housing subsidy programs starting in 2020. The presidential decree requires the elimination of all value-added tax benefits from 1 January 2020 onwards and the commissioning of an assessment study to evaluate the impact on the economy and state budget with respect to a gradual phaseout of deduction of interest and principal payments from the income tax base of the homeowner beneficiaries, the elimination of property tax deductions for all owners of housing units, and tax incentives to construction companies and suppliers.

¹⁹ The decision to establish the HAU in the MOF was based on the MOF's capacity, mandate, and past experience.

of contact for all housing programs and subsidy schemes, with the objectives of reducing the excessive burden on the public budget and improving efficiency and sustainability. The HAU will also increase coverage by developing innovative and new housing finance solutions and instruments (such as the up-front and one-time subsidy schemes for low-income beneficiaries, and rental programs in the housing sector).

16. The following actions will be carried out by the government under tranche 2 of the PBL to facilitate implementation of outputs 1 and 2: (i) introduction of a pilot program of income-based up-front housing subsidies for low-income families and preparation of a feasibility study for a new government-sponsored housing assistance scheme; (ii) development of a comprehensive housing and mortgage market database; (iii) eventual transformation of the HAU into an independent housing agency; (iv) preparation and approval of a new system for the collection and timely dissemination of statistical data and information on the housing sector, which will ultimately lead to the establishment of a house price index; (v) review and amendment of the current prudential and regulatory framework governing housing finance and mortgage lending in line with international norms; and (vi) comprehensive review of the housing sector (demand and supply sides) to identify areas and initiatives to promote greater competition by introducing international best practices. A feasibility study will also look into the future roles and relevance of the two dominant state-owned real estate developers.

17. **Output 3: The establishment and operationalization of the mortgage refinancing company supported with long-term funding.** Under this output (solely addressed by the FIL), ADB will provide long-term funding to the proposed UMRC to make long-term local currency resources available to banks to fund residential mortgage and housing improvement loans.²⁰ The UMRC will facilitate the provision of mortgage loans at an interest rate close to market rates (with an average loan maturity of 10 years), and address the demand for housing improvement loans, which are currently unavailable in the market.²¹ The UMRC will address a fundamental market constraint that is preventing banks from expanding their housing finance portfolios, by better matching their assets and liabilities.²² The UMRC will provide loans to participating financial institutions (PFIs) that are secured by eligible mortgage loans, based on criteria that will assess product design, market-based pricing, underwriting practices, loan documentation, and performance. This will help to professionalize the overall housing finance industry and address the risks associated with broadening access to housing finance across new borrower segments.²³ Eligibility criteria will also target end-beneficiaries that are currently underserved by the banking sector. In the medium to long term, the UMRC will support more exponential sector growth by

²⁰ The Financial Analysis (accessible from the list of linked documents in the Appendix 2) contains the proposed eligibility criteria with respect to the participating financial institutions (PFIs) and subloans to be refinanced.

²¹ The UMRC expects to onlend proceeds from the ADB loan at a fixed rate of 13% to the PFIs, which is very competitive when compared to banks' other sources of funding. The PFIs will onlend these funds to end-borrowers at a maximum spread of 5% for mortgage loans and 4% for home improvement loans. Mortgage market rates currently stand at about 21%–23% per annum for an average tenor of 7 years.

²² Further information on the objectives and roles that the UMRC is expected to play in the financial markets can be found in the Overview of the Uzbekistan Mortgage Refinancing Company (accessible from the list of linked documents in Appendix 2).

²³ An MRC is a wholesale financial institution providing long-term finance to mortgage lenders. It raises funds with long tenors from various sources (such as the government and bilateral and multilateral development finance institutions) and by issuing bonds in the capital markets. With the proceeds, an MRC provides long-term loans to participating commercial banks and housing finance companies. It bridges the maturity mismatch that mortgage lenders face when trying to do long-term lending using their short-term deposits. The business model of an MRC, like the proposed UMRC, is low risk. The refinancing loans are fully matched by the bond issues so there is no asset–liability mismatch. Loans are over-collateralized (typically 110%–125%) by a mortgage loan portfolio pledged by the banks that must meet strict quality criteria, which reduces credit risk.

using new debt instruments such as corporate bonds, covered bonds, and/or mortgage-backed securities to mobilize long-term funds from institutional investors.²⁴

C. Value Added by ADB

18. **ADB's value addition and lessons learned.** The program will address underlying housing finance market constraints that have inhibited its growth and sustainability. It will build on the foundations established under the two prior ADB rural housing programs, which have helped build the capacity of the domestic housing construction industry and stimulated the development of an emerging mortgage lending industry, largely under government-sponsored programs.²⁵ Prior program support has served to gradually expand the number of banks providing residential mortgage loans; however, the programs' impact and scale were constrained by the limited available fiscal resources. Therefore, the program is a logical continuation of ADB's work to reform the mortgage sector (and an acknowledgement of the limitations of the prior subsidized approach to market development).²⁶ The program will also help establish an institutional framework and empirical benchmarks to improve access to housing for low- and middle-income households.²⁷

19. The program fits within broader ADB engagement to improve the government's fiscal and financial management capacity and strengthen the banking sector (particularly its supervision frameworks) under the Economic Management Improvement Program;²⁸ and to develop the domestic capital markets (under a forthcoming ADB intervention) to diversify the banking sector's funding sources, reduce financing costs, and improve its management of risk—paving the way toward broadening the banking sector's business development potential and facilitating enhanced market activity (including the UMRC's expected future issuance of advanced capital market instruments, such as covered bonds and mortgage-backed securities).²⁹ The combination of policy reforms and local currency support for banks (via the UMRC) under the program will introduce international good practices into the housing finance sector. Further, ADB currently provides hands-on support to operationalize the UMRC through a TA of \$500,000, financed on a grant basis by the Republic of Korea e-Asia and Knowledge Partnership Fund.³⁰

²⁴ The establishment of a wholesale mortgage finance provider of long-term funds raised on the capital market has occurred in various countries, both developed and developing, always with support from the government for the initial ramp-up phase.

²⁵ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranchise Financing Facility to the Republic of Uzbekistan for the Housing for Integrated Rural Development Investment Program*. Manila; and ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Results-Based Loan and Technical Assistance Grant to the Republic of Uzbekistan for the Affordable Rural Housing Program*. Manila.

²⁶ The design of the program incorporates the two main recommendations from the performance evaluation report prepared by ADB's Independent Evaluation Department: (i) promote a competitive mortgage finance sector, and (ii) develop a unified database system of beneficiaries and applicants to assess beneficiary selection. Independent Evaluation Department. 2018. *Performance Evaluation Report: Housing for Integrated Rural Development Investment Program—Tranches 1, 2, and 3 in Uzbekistan*. Manila: ADB.

²⁷ The Affordable Rural Housing Program is currently under implementation. As of 31 July 2019, \$165 million of the program amount of \$500 million had been disbursed.

²⁸ ADB. 2018. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach, Policy-Based Loan for Subprogram 1, and Technical Assistance Grant to the Republic of Uzbekistan for the Economic Management Improvement Program*. Manila.

²⁹ In response to a specific request from the Government of Uzbekistan received in January 2019 to assist with the preparation of a strategy for financial market reforms, ADB has started the processing of a sector diagnostic analysis, which is expected to lay the groundwork for the preparation of a financial market development program in 2020–2021.

³⁰ ADB. 2019. *Technical Assistance to the Republic of Uzbekistan for Operationalization of the Uzbekistan Mortgage Refinancing Company*. Manila.

20. **Development partners' coordination.** The HAU (to be established under the program) will build the government's capacity to streamline housing finance policies and programs and prioritize development partners' support in line with a consolidated development agenda. ADB has been the lead partner in supporting a holistic approach to development of the sector to date (prior ADB support identified in footnote 25). Additional development partners' support has been concentrated on (i) expanding the supply of housing and its associated infrastructure (i.e., the Islamic Development Bank's contribution of \$300 million under the State Affordable Rural Housing Program); (ii) strengthening regulations and building codes for, and improving access to, cost- and energy-saving technology for lower-income housing (i.e., the United Nations Development Programme); and (iii) upgrading the real property registration and cadaster system (i.e., the World Bank). Further, ADB has coordinated with the International Monetary Fund (IMF) and addresses some of its recommendations in the program design.^{31, 32} These include recommendations to prioritize reforms that address market distortions and promote private sector development. The program will carry out this agenda through rationalizing fiscal expenditures and improving governance and business incentives in the housing sector to unlock market growth. The IMF's advisory support to the government is primarily focused on tax reforms and improvement of macroeconomic data collection, analysis, and dissemination systems.

D. Development Financing Needs and Investment and Financing Plan

21. The overall annual financing need for the housing sector is estimated to amount to about \$2.2 billion.³³ Given that about 44,000 housing units are projected to be built annually from 2019–2023 (under the various government housing programs at an assumed average housing unit cost of SUM140 million to SUM200 million), the cost to the government per year is estimated to be from SUM4,488 billion (\$476 million equivalent) to SUM6,600 billion (\$700 million equivalent) depending on the mix of housing unit prices.³⁴ The estimated shortfall between the government budget allocations and the overall housing sector financing needs therefore amounts to \$1.5 billion–\$1.8 billion per year. The program will mobilize private sector financing to reduce the sector's reliance on fiscal expenditures to address this shortfall, and introduce the structural reforms required to rationalize subsidy programs and related expenditures.

22. The government has requested a concessional loan of \$50 million from ADB's ordinary capital resources to help finance the PBL component of the program. The PBL will have a 25-year term, including a grace period of 5 years; an interest rate of 2.0% per year during the grace period and thereafter; and such other terms and conditions set forth in the draft loan agreement for the PBL. The government has also requested a regular loan of \$150 million from ADB's ordinary capital resources to help finance the FIL component of the program. The FIL will have a 20-year term, including a grace period of 5 years; an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year; and such other terms and conditions set forth in the draft loan and project agreements. Based on the straight-line method, the average maturity is 12.75 years, and there is no maturity premium payable to ADB. The PBL will be disbursed over a period of 3 years in two tranches of equal amounts against achievement of policy actions under tranches

³¹ Development Coordination (accessible from the list of linked documents in Appendix 2).

³² IMF. 2019. Republic of Uzbekistan: Staff Report for the 2019 Article IV Consultation. *IMF Country Report*. No. 19/129. Washington, DC.

³³ Assuming an average housing unit price of SUM140 million (\$14,859 equivalent as of 11 October 2019), based on the average cost under the current government housing programs, and annual demand of 145,000 housing units until 2040 (footnote 2).

³⁴ This is based on an exchange rate of SUM1.00 to \$0.00010612 (as of 11 October 2019).

1 and 2 of the PBL outlined in the government's development policy letter (Appendix 3) and detailed in the policy matrix (Appendix 4). The financing plan of the program is in Table 1.

23. The PBL loan size is based on the country's financing needs, the development impact of the policy reform package, and development spending arising from the key reforms, totaling \$1,697 million in 2019. In accommodating the need for development spending, the government envisions covering the state budget deficit, expected at 1.1% of GDP (\$517 million equivalent) in 2019, through external borrowing (78% of deficit) and the issuance of domestic securities.^{35 36}

24. The investment component supported by a FIL is estimated to cost \$162 million. The FIL of \$150 million is provided to fund the proposed UMRC.³⁷ The UMRC will be established (output 3) as a joint-stock company with a paid-in capital eventually expected to reach SUM100 billion.³⁸ The company will start its operations with an initial capital of SUM25 billion (about \$3 million, as reflected in the summary financing plan) to be contributed in full by the government.³⁹ As a policy condition under tranche 2, the government will invite commercial banks to invest the remaining SUM75 billion in the UMRC. The FIL will be lent to Uzbekistan in United States dollars. The government will bear the foreign currency risk and relend—through a subsidiary loan agreement—these funds in local currency to the UMRC for onlending to PFIs.⁴⁰ The government will charge a margin to cover the cost of funds plus a premium to offset possible foreign currency losses, while the UMRC will charge a small margin to cover its operational costs and earn a risk-adjusted return.⁴¹ The sector assessment and the business plan for the UMRC indicate that the proposed ADB loan amount is reasonable and required to support the operationalization of the company in its initial startup phase of 3 years.⁴²

Table 1: Summary Financing Plan

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Ordinary capital resources (program) (concessional loan)	50.0	23.5
Ordinary capital resources (project) (regular loan)	150.0	70.7
Government of Uzbekistan (project) ^a	3.0	1.5
Commercial banks (project) (loan)	9.0	4.3
Total	212.0	100.0

^a The Government of Uzbekistan, through its Ministry of Finance, will contribute the initial capital of the Uzbekistan Mortgage Refinancing Company, which amounts to about \$3 million, to cover salaries, overhead, and start-up costs. Source: Asian Development Bank estimates.

³⁵ Government of Uzbekistan, MOF. 2019. *Citizens' Budget: The State Budget for 2019*. Tashkent.

³⁶ This is based on an exchange rate of SUM1.00 to \$0.00010621 (as of 24 September 2019).

³⁷ ADB prepared a detailed business plan for the proposed UMRC with accompanying financial projections and sensitivity analysis (under TA support). The business plan benefited from the results and feedback that ADB received through a comprehensive survey conducted among the commercial banks in Uzbekistan.

³⁸ While the UMRC will be established prior to the program approval, it will not, however, be operational at the time of the ADB's Board of Directors' approval.

³⁹ This is based on an exchange rate of SUM1.00 to \$0.00010621 (as of 24 September 2019).

⁴⁰ Information on the UMRC's business strategy, its projected financial and operational performance, governance practices, credit and risk management policies, eligibility criteria for PFIs and subborrowers, and relending rates are in the Project Administration Manual (accessible from the list of linked documents in Appendix 2).

⁴¹ The UMRC will charge a spread above its funding costs to cover operational expenses. Initially, the UMRC will add up to 100 basis points to cover these expenses and, once refinance volumes increase to sustainable levels, this spread may be reduced over time once UMRC's operations expand and mature.

⁴² See Linked Documents for the Sector Assessment and Overview of the UMRC for more information (accessible from the list of linked documents in Appendix 2).

E. Implementation Arrangements

25. Disbursement of tranche 1 of the PBL is expected to be made shortly after loan effectiveness, following completion of all tranche 1 policy actions. The PBL closing date is 31 July 2021.

26. The FIL of \$150 million will be disbursed concurrently with the achievement of the UMRC's business growth targets (i.e., based on identified eligible PFIs and their submission of qualified subloans). The UMRC will submit withdrawal requests to ADB based on a maximum 6-month projected disbursement schedule, as submitted by PFIs.⁴³ The FIL closing date is 31 July 2023, in line with the implementation period of the program (Table 2).

27. Of the \$150 million FIL to the UMRC, which will be disbursed through the MOF, the UMRC will have the option to classify up to \$20 million as subordinated debt (i.e., qualified as tier 2 capital). This allocation will strengthen the balance sheet of the UMRC, stimulate confidence in its credit standing as a strong corporate entity and an eventual bond issuer, and enhance the sustainability of the mortgage refinancing model.

28. The loan proceeds will be withdrawn in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time). The implementation arrangements are summarized in Table 2 and described in detail in the project administration manual (PAM).⁴⁴

Table 2: Implementation Arrangements

Aspects	Arrangements
Implementation period	December 2019–January 2023
Estimated completion date	31 January 2023
PBL closing date	31 July 2021
FIL closing date	31 July 2023
Management	
(i) Oversight body	The government will establish, within 3 months of the loan effectiveness, a program steering committee chaired by the MOF and comprising the MOEI, CBU, CMDA, and SSC. ADB will be an observer.
(ii) Executing agency	MOF
(iii) Key implementing agencies	MOF, MOEI, CBU, and CMDA for the PBL component; UMRC for the investment component (supported by the FIL).
(iv) Implementation unit	Not applicable
Retroactive financing	Retroactive financing will be permitted to finance expenditures incurred under eligible qualified mortgages signed prior to loan effectiveness, but no earlier than 12 months before the signing of the FIL agreement, up to a maximum of 20% of the FIL amount.
Disbursement	The loan proceeds will be disbursed following ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed upon between the government and ADB. The \$50 million PBL will be disbursed in two tranches of \$25 million each.

ADB = Asian Development Bank, CBU = Central Bank of Uzbekistan, CMDA = Capital Market Development Agency, FIL = financial intermediation loan, MOEI = Ministry of Economy and Industry, MOF = Ministry of Finance, PBL = policy-based loan, SSC = State Statistics Committee, UMRC = Uzbekistan Mortgage Refinancing Company.

Source: ADB.

⁴³ Training on ADB's disbursement policy and procedures will be provided prior to the first withdrawal, as required.

⁴⁴ Project Administration Manual (accessible from the list of linked documents in Appendix 2).

III. ATTACHED TECHNICAL ASSISTANCE

29. The TA will (i) support the implementation of the policy actions under tranche 2 of the PBL; (ii) help strengthen the UMRC's capacity in mortgage loan underwriting and monitoring (by working closely with the operational and credit units of the company); and (iii) support a gender sensitivity analysis of the government's housing finance programs and the UMRC's activities, and assist in the creation of a specialized sex-disaggregated database.⁴⁵ The TA will finance the mobilization of an advisor to the UMRC to provide hands-on support to credit officer(s) and refinance business officer(s) of the company. The advisor will guide, coach, and train officers on all business processes (e.g., handling requests for a refinance loan from a bank, undertaking the due diligence process of the prospective bank, processing the approval and disbursement of funding, and monitoring the PFIs and the quality and sufficiency of the refinanced subloans). The advisor will also work with the company to implement a comprehensive public awareness campaign to stimulate demand for the new housing finance products that the UMRC will help bring to the market in partnership with the banking sector. The MOF will be the executing agency for the TA, which will be implemented from January 2020 to December 2021.⁴⁶ The TA is estimated to cost \$850,000, of which \$800,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-6). The government will provide counterpart support in the form of counterpart staff remuneration, office accommodation and supplies, logistical support, and other in-kind contributions.

IV. DUE DILIGENCE

A. Economic and Financial Viability

30. The benefits of the program considerably outweigh the costs. The program will facilitate the phasing out of a costly and inefficient government-subsidized approach to mortgage market development. By intermediating access to long-term local currency-denominated funding, the UMRC will stimulate a transition to market-based finance solutions for commercially viable segments of the mortgage market and help expand the banking sector's mortgage lending capacity to address growing needs.⁴⁷ Reforms under the program will rationalize the current housing subsidy policies and programs to progressively reduce market distortions by introducing needs-based income-linked subsidies, rather than the current interest-linked subsidies. These will have direct economic benefits by (i) reducing the fiscal burden, estimated at 79% of the cost per housing unit, and redirecting savings to other priority areas or reducing the budget deficit; (ii) establishing reliable empirical data and detailed analysis to refine targeting and the effectiveness of housing subsidy programs; and (iii) improving affordability and facilitating the introduction of new lending instruments tailored to broader income segments (e.g., home improvement loans, which are currently not available in the market despite strong demand, estimated at 25% of the UMRC's refinancing business), and thereby broadening access to housing finance.

⁴⁵ The transaction TA will build on the outputs of (i) knowledge and support TA of \$560,000 for the Mortgage Market Development Program, which produced the business plan for the UMRC and the road map for regulatory changes required to ensure market uptake (Technical Assistance Special Fund [TASF 6 and TASF-other sources]); and (ii) TA of \$500,000 to be financed on a grant basis by the Republic of Korea e-Asia and Knowledge Partnership Fund, to support the operationalization of the UMRC.

⁴⁶ Attached Technical Assistance Report (accessible from the list of linked documents in Appendix 2).

⁴⁷ About 40,000 mortgage loans were provided in 2018, of which 75% by number and 72% by volume fell under the various government housing programs; this compares poorly with the estimated annual demand of 145,000 housing units.

31. The financial viability of the FIL is based on a thorough analysis of market data, a sound understanding of the local context drawn from inputs across all key stakeholders, the proposed business strategy and model, and lessons from similar companies operating in other countries. The UMRC will require an initial paid-in capital of SUM25 billion, which the government will provide to commence operations. Capital is expected to double to SUM50 billion within 12 months once the most active commercial banks in mortgage lending invest in the company. A further increase in capital to SUM100 billion has likewise been projected in line with the expected business growth and development of the company. The final shareholding structure is expected to be 25% government (through the MOF) and 75% commercial banks.

32. The UMRC will operate as a wholesale lending institution dealing with relatively few but large financial transactions. Operations will initially be funded through credit lines (starting with ADB's \$150 million loan) and subsequently through corporate bond issuances—sequentially with the growth and progress of the capital markets and as the size of the underlying mortgage loan portfolio grows. Based on the UMRC's business plan, the company is projected to remain profitable with an average annual growth in profit before tax of 28% during the period of 2020–2024 (i.e. its first 5 years of operation). As reflected in the UMRC's return on assets ratio, which is expected to average 1.0% during its first 5 years, the company's profit margins will remain small to maintain competitive lending costs. The UMRC will use its resources efficiently by allocating its shareholders' capital contributions to offset operating expenses and maintain a solid return on equity ratio of 14% on average during its first 5 years, reflecting fast anticipated growth in volume of refinancing because of strong demand. Based on the business strategy and conservative estimates (identified in the company business plan, see Supplementary Linked Document 12), the UMRC will begin refinance activities starting with a market share of 15% in the first year of operations and increasing to 22% over 5 years.⁴⁸ In the base-case scenario, the UMRC is forecast to earn an after-tax profit of SUM7.4 billion in the first year of operations, i.e. 2020, rising to SUM13.2 billion in 2024.⁴⁹

B. Sustainability

33. Regulations will be introduced under the program to enhance the supervision and ensure the sustainability of the UMRC's operations by facilitating the company's raising of long-term funds (i.e., by allowing institutional investors such as pension funds and insurance companies in Uzbekistan to invest in highly rated and liquid debt securities, including those issued by wholesale lenders), and to align regulations for bond market issuances with international standards.⁵⁰ Further, the HAU will steer the government's housing subsidy policy framework and programs to enable a coordinated and sustainable approach. The HAU will lead the consolidation and validation of housing sector data, establish a database of beneficiaries, and monitor the effectiveness of ongoing government housing programs. Under the second tranche of the PBL, the HAU is expected to become an independent housing agency with a mandate to develop, coordinate, and manage all housing subsidy programs in Uzbekistan. It will facilitate a fundamental change in the premise of government subsidy programs toward transparent up-front subsidies to low-income households and will help reduce the fiscal burden and re-prioritize public expenditures. To smoothen the transition to market lending rates, the ADB program will support

⁴⁸ MRCs typically refinance no more than 25% of total outstanding mortgage loans because of banks' preference for cheaper deposit-based funding, which would suggest about SUM435 billion (\$46 million equivalent, as of 11 October 2019) on the current commercial mortgage outstanding debt.

⁴⁹ Financial Analysis and Economic Analysis (accessible from the list of linked documents in Appendix 2).

⁵⁰ The UMRC will support capital market development as it begins to issue corporate bonds and more sophisticated products over time, by providing a safe investment channel for institutional investors.

the introduction of an income-linked up-front subsidy program to address the affordability stress caused by high interest rates and will support access to commercially priced mortgage products.

C. Governance

34. The UMRC will be regulated by the CBU and will follow its capital requirements and prudential regulations. The Capital Market Development Agency will regulate the issuance of securities issued by the UMRC. The UMRC may follow different regulatory requirements than those applicable to banks because of its specialized business functions. ADB will conduct integrity due diligence as soon as the UMRC has been incorporated.

35. The UMRC will have a seven-member supervisory board, of which two directors will be independent. All directors of the supervisory board will have to be knowledgeable in the areas of banking, mortgage finance, and/or housing. The company will be staffed with a professional team of 10–12. Noncore functions such as marketing, research, and human resources may be outsourced.

36. ADB will review and approve the financial and integrity due diligence of the first three commercial banks to be included in the program as PFIs to ascertain the UMRC's ability to manage the PFI selection process. ADB will also review the first three loans from the UMRC to PFIs. Thereafter, ADB will decide whether the PFI review and selection process can be delegated to the UMRC pursuant to the provisions of the Operations Manual section on financial intermediation loans based on (i) ADB's overall assessment of the UMRC's performance, (ii) the UMRC's PFI appraisal and selection standards, (iii) its loan portfolio quality, (iv) its management strength, (v) the quality of its annual audited project financial statements submitted to ADB, and (vi) its capacity to monitor the potential PFIs' environmental and social safeguard screening procedures.⁵¹ The UMRC will have the ultimate responsibility to verifying and assuring the eligibility of the subborrowers and their mortgage loans funded by the FIL.

37. Based on preliminary due diligence, the overall pre-mitigation financial management risk of the program is expected to be *high*, primarily because the UMRC will have substantial start-up risks as a new entity. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the MOF, and will be discussed with the UMRC Board, management team and staff, once established, and each PFI, once selected. The specific policy requirements and supplementary measures are described in paragraph 67 of the PAM.⁵²

D. Poverty, Social, and Gender

38. The program will serve to lower borrowing costs and incentivize PFIs to lend to underserved market segments, further enabling market growth and improving access to housing for lower- and middle-income households. Lending covenants for the project (FIL) will include eligibility criteria for PFIs and their onlending operations to expand access to commercial mortgage finance.⁵³ The SDP program will tackle key market constraints, which make borrowing prohibitively expensive and facilitate the introduction of lending products adjusted to different borrower risk profiles. Broader access to housing finance will contribute to improving the living

⁵¹ ADB. 2003. Financial Intermediation Loans. *Operations Manual*. OM D6. Manila. ADB will continue to carry out its integrity due diligence of any new PFI.

⁵² ADB. 2003. *Enhancing the Asian Development Bank's Role in Combating Money Laundering and the Financing of Terrorism*. Manila.

⁵³ For instance, it is expected that the UMRC will not refinance mortgage loans of more than SUM323 million and will cap the maximum monthly household income of eligible borrowers to SUM10 million.

standards of lower-earning market segments and strengthen their resilience to external shocks through asset building (reducing their financial burdens in retirement). In addition, the policy reforms introduced with the support of the program will have more targeted pro-poor housing assistance initiatives that benefit the low- and informal income-earning population.

39. Based on the independent evaluation of ADB's first rural housing program (footnote 25), 22% of the 22,284 beneficiaries of the said program were women.⁵⁴ At least 30% of the UMRC's funded loan portfolio must be provided to eligible women borrowers, per ADB's requirement.⁵⁵ Therefore, the program will foster increased home ownership among women through the ADB FIL and the TA. The program is classified as having *some gender elements* under ADB's guidelines. The loan and project agreements include covenants on labor standards and safety.

E. Safeguards

40. Given the nature of the intervention, all three safeguard categories (environment, involuntary resettlement, and indigenous peoples) are classified C under the PBL and FI-C under the FIL.⁵⁶ The program is expected to have minimal or no adverse environmental impacts and is unlikely to entail impacts on involuntary resettlement and indigenous peoples. The UMRC's funding of the PFIs will not finance real estate development or mass housing construction but will be used to refinance loans provided to individuals to purchase new housing units or to acquire and/or renovate existing homes. The UMRC will not provide any mortgage loans; it will instead refinance mortgage loan portfolios of its PFIs. Consequently, the UMRC will set up an environmental and social management system (ESMS) as part of the PAM. The UMRC ESMS will require it to ensure that PFIs have a screening process as part of their ESMSs—acceptable to ADB—in place or will establish one prior to any disbursements. ADB's prohibited investment activities list will apply.⁵⁷

F. Summary of Risk Assessment and Risk Management Plan

41. Table 3 summarizes major risks outside the control of the program and related mitigation measures.⁵⁸ Overall, risks are deemed high but manageable through mitigating measures. Benefits and impacts are expected to outweigh the costs of mitigation.

Table 3: Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
The UMRC will be exposed to downturns in the banking sector, so the default of one or two banks could cause its insolvency.	The UMRC will develop detailed eligibility criteria and credit limits for its participating financial institutions to ensure that only strong and financially sound banks will have access to its refinancing facility. The UMRC will closely monitor the performance of participating financial institutions.
Limited initial capacity of the UMRC to execute its mandate, given that it will be a newly formed entity.	ADB is providing technical assistance support for the establishment and operation of the UMRC. The UMRC's operationalization with satisfactory technical and risk management capacity is a condition precedent for disbursement of the financial intermediation loan.
Overall program: Trained staff are not retained, affecting program implementation and the capacity built	ADB will maintain consistent engagement with the government and UMRC to ensure that adequate capacity is maintained to operate the UMRC and achieve its business and development objectives. The

⁵⁴ Independent Evaluation Department. 2018. *Performance Evaluation Report: Housing for Integrated Rural Development Investment Program—Tranches 1, 2, and 3 in Uzbekistan*. Manila (para. 5).

⁵⁵ To be defined as households headed by women and those co-signed by husband and wife on both mortgage and ownership.

⁵⁶ In compliance with ADB's Safeguard Policy Statement (2009).

⁵⁷ ADB's Safeguard Policy Statement (Appendix 5).

⁵⁸ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Risks	Mitigation Measures
up in the UMRC and the Housing Assistance Unit.	attached technical assistance will play an important role in providing the necessary capacity to ensure adequate technical skills are available.

ADB = Asian Development Bank, UMRC = Uzbekistan Mortgage Refinancing Company.

Source: ADB.

V. ASSURANCES AND CONDITIONS

42. The government has assured ADB that implementation of the program shall conform to all applicable ADB requirements, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, financial management, and disbursement as described in detail in the project administration manual and loan and project agreements.

43. The government has agreed with ADB on certain covenants for the program, which are set forth in the loan and project agreements.

44. The government will not make any withdrawals under the FIL until (i) the UMRC has been established and the MOF has provided start-up capital; (ii) the UMRC has appointed key management staff; (iii) the UMRC has performed all requisite due diligence (including financial and integrity); (iv) the UMRC has adopted key operational policies, corporate governance and internal controls; (v) the CBU has commenced regulation and supervision of the UMRC; and (vi) the UMRC has established an ESMS.

VI. RECOMMENDATION

45. I am satisfied that the proposed loans would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the policy-based loan of \$50,000,000 to the Republic of Uzbekistan for the Mortgage Market Sector Development Program, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 2% per year during the grace period and thereafter; for a term of 25 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft policy-based loan agreement presented to the Board; and
- (ii) the loan of \$150,000,000 to the Republic of Uzbekistan for the Mortgage Market Sector Development Program, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 20 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and project agreements presented to the Board.

Takehiko Nakao
President

5 November 2019

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	<p>the HAU (2018 baseline: Not established)</p> <p>2d. A specialized sex-disaggregated database covering all government subsidy programs as well as UMRC's refinancing program established (2018 baseline: Not established)</p>	2d. Order of the Ministry of Finance	Commercial banks do not invest in UMRC's equity because the expected returns are too low, corporate governance standards are insufficient, or minority shareholder protection is inadequate
3. The establishment and operationalization of the mortgage refinancing company supported with long-term funding (under the financial intermediation loan)	<p>By 2019:</p> <p>3a. UMRC shareholder subscription agreement signed for the initial capital of at least SUM25 billion (2018 baseline: Not signed)</p> <p>3b. Environmental and social management framework adopted (2018 baseline: Not adopted)</p> <p>3c. Procedures and policies for lending operations, financial management, treasury operations, risk management, and transparent pricing adopted by the UMRC (2018 baseline: Not adopted)</p> <p>3d. Corporate governance framework acceptable to ADB and internal controls adopted (2018 baseline: Not adopted)</p> <p>By 2023:</p> <p>3e. Master refinance agreement, which sets out the terms and conditions for accessing the UMRC's refinancing facilities, signed by the UMRC and at least three participating financial institutions (2018 baseline: Not signed)</p> <p>3f. At least 30% of the ADB-funded loan portfolio provided to women (2018 baseline:0)</p> <p>3g. At least 5,000 subloans refinanced by the UMRC through ADB's financial</p>	<p>3a. Shareholder agreement</p> <p>3b–d. Minutes of UMRC board meeting minutes</p> <p>3e. Master loan agreement with individual participating financial institutions</p> <p>3f–g. UMRC board meeting minutes</p>	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	intermediation loan (2018 baseline: 0)		
Key Activities with Milestones 3. The establishment and operationalization of the mortgage refinancing company supported with long-term funding 3.1. Prepare the UMRC's organizational chart (by October 2019). 3.2. Hire senior management (e.g., chief executive and financial officers) and key employees (e.g., internal auditor and risk manager) (by November 2019). 3.3. Draft master loan agreement governing the lending operations of the UMRC with participating financial institutions (by December 2019). 3.4. Prepare and obtain UMRC board approval for its internal and operational policies (by December 2019). 3.5. Provide up to \$150 million for qualified UMRC subloans by ADB (2019: \$0 million; 2020: \$45 million; 2021: \$50 million; 2022: \$55 million).			
Project Management Activities Not applicable			
Inputs Asian Development Bank: \$150 million (regular ordinary capital resources loan) Asian Development Bank: \$50 million (concessional ordinary capital resources loan) Government (equity): \$3 million Banks (equity): \$9 million			
Assumptions for Partner Financing None			

ADB = Asian Development Bank, HAU = Housing Assistance Unit, SSC = State Statistics Committee, UMRC = Uzbekistan Mortgage Refinancing Company.

^a Government of Uzbekistan. 2017. *2017–2021 National Development Strategy*. Tashkent.

^b www.stat.uz/en

Source: ADB.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=51348-001-3>

1. Program Loan Agreement
2. Financial Intermediation Loan Agreement
3. Project Agreement
4. Sector Assessment (Summary): Finance (Housing Finance)
5. Project Administration Manual
6. Financial Analysis
7. Economic Analysis
8. Summary Poverty Reduction and Social Strategy
9. Risk Assessment and Risk Management Plan
10. Attached Technical Assistance Report

Supplementary Document

11. International Monetary Fund Assessment Letter
12. Overview of the Proposed Uzbekistan Mortgage Refinancing Company
13. List of Ineligible Items
14. Development Coordination
15. Country Economic Indicators

DEVELOPMENT POLICY LETTER

O'ZBEKISTON RESPUBLIKASI
VAZIRLAR MAHKAMASI



CABINET OF MINISTERS
REPUBLIC OF UZBEKISTAN

« 25 » October 2019 y.

№ 02/104-24

100008, Toshkent shahri, Hukumat uyi
Government House, Tashkent, 100008

To: The President of the Asian Development Bank
Mr. Takehiko Nakao

DEVELOPMENT POLICY LETTER

Dear President Nakao,

1. The Government of Uzbekistan and the Asian Development Bank (ADB) are cooperating closely and effectively in implementing social and economic reforms in Uzbekistan.

We would like to thank the ADB for its strong and continued support to Uzbekistan's reform initiatives.

Since 2017, Uzbekistan has been pursuing a new course of economic development. Not only economic reforms are being carried out but also reforms covering the political, social, humanitarian and other aspects of our life.

Achieving an integrated development and the further diversification of the Uzbek economy are set as key objectives of these reforms. Since 2017, Uzbekistan has undertaken critical reforms, including the liberalization of the foreign exchange regime, correcting the tariff structure for utilities, organizational restructuring of the energy sector and modernization of the tax system, all of which contributed to a sustained GDP growth of 5.1% in 2018 and 5.8% in the first half of 2019.

2. Within the framework of the foreign exchange market liberalization, the Government completely abolished restrictions on currency conversion for current account transaction, including the requirement for mandatory sale of foreign currency earned from export operations.

3. The purpose of the new tax system is to reduce the tax burden, as well as to eliminate imbalances in the level of tax burden between business entities, introduction of a simplified and stable tax regime and thereby increasing competitiveness of our economy and creating the most favorable conditions for entrepreneurs and investors.

As it is well known, a reduction in tax rates or abolition of certain taxes can lead to a reduction in state budget revenues. This can be counter-balanced by improving the tax administration, thus ensuring fiscal sustainability, which is our main goal.

4. Wide-scale ongoing reforms on restructuring state owned enterprises are aimed at increasing their efficiency, including through the reduction of the role of the state in the economy, attracting foreign investment and expanding the participation of the private sector.

5. As one of the main steps towards improving the collection and robustness of economic data and ensuring the its openness and transparency, Uzbekistan has subscribed to IMF's Enhanced General Data Dissemination System (EGDDS). In accordance with it, in May 2018, the National Summary Data Page with key economic, financial and social statistics has been published.

Ongoing work includes efforts to improve the balance of payment statistics, financial statement and financial stability indicators, compiling an international investment position for Uzbekistan, as well as publishing a consumer price index based on an updated methodology consistent with the methodology of IMF.

6. The need to develop the housing sector of the country necessitates the adoption of additional measures to improve the mechanisms of mortgage lending and increase the availability of mortgage loans for all categories of the population, based on market principles.

On 13 May 2019, the Decree of the President of Uzbekistan No. 5715 "On Additional Measures for Development and Expansion of the Mortgage Market" was adopted along with a 3-year reform roadmap which aims to address the further development and improvement of accessibility of mortgage lending based on market principles.

The Mortgage Market Sector Development Program (MMSDP), proposed by ADB, supports the government's plans and facilitates the reforms of the housing finance sector by establishing a comprehensive institutional and financial support framework.

In particular, over the medium- to long-term it is intended to (i) build on the reforms already carried out in the housing sector; and (ii) consolidate and sustain gains made in improving the economic management process in Uzbekistan.

ADB's support will be utilized to implement key reforms in the following areas:

(a) Policy, regulatory, and legal framework for the mortgage finance industry

Improving the housing policy and subsidy framework is important to ensure fiscal sustainability, effective pro-poor targeting and strengthening the environment for expanding market-based mortgage finance.

These reforms will cover: (i) modifications to the existing government housing finance programs to remove distortions by introducing a gradual step-up of the interest rates; (ii) introduction of small loans for home repairs and improvements as a new mortgage lending product.

The government also plans to eliminate the tax exemptions for existing and new housing subsidy programs starting next year.

(b) Housing strategy and subsidy framework

In line with the Presidential Decree, the MOF has already established a housing assistance unit (HAU) to coordinate all existing housing policies and subsidy programs. The HAU will take stock of the existing housing policies, subsidy programs and policy framework; help re-define the eligibility criteria for beneficiaries and agree on a road map that sets out priorities for the required legal and policy reforms.

Ultimately, it is expected that the HAU will become a single point of contact for all housing policies and subsidy schemes.

New housing finance solutions and instruments, such as up-front and one-time subsidies for the population, who are in need of better housing conditions will also be explored by the HAU.

(c) Uzbekistan Mortgage Refinancing Company (UMRC)

The program will initiate the establishment of the Uzbekistan Mortgage Refinancing Company (UMRC) which is a new type of financial institution in Uzbekistan to be used as a vehicle for making long-term local currency resources available to banks for providing mortgage loans. In the medium- to long-term, the mortgage finance sector will be expanded by accessing the domestic capital markets through the issuance by UMRC of new debt instruments such as corporate bonds and covered bonds to mobilize long-term funds from institutional investors.

UMRC will help to improve solvency assessment standards and procedures of mortgage loans issuance. The reform will also introduce new regulations on mortgage lending to induce sound lending practices by banks.

7. We believe that the proposed intervention, which is designed as a sector development program, will facilitate the effective development of the housing finance sector. The combination of dedicated policy actions with a project loan will stimulate the implementation of necessary reforms attract financing required to develop the sector.

This is, however, a challenging path since many of the proposed reforms will require acquiring new skills by the concerned agencies and officials. ADB's capacity development support will be essential for ensuring the effective implementation of reforms and maintaining their dynamics. The government from its side, is keen to reform the housing finance sector. We also confirm to implement the program as agreed.

8. We would like to thank ADB for working closely with the government in developing this program and would like to reiterate our full support for it. We hope to continue our fruitful collaboration with ADB.

Yours sincerely,



Deputy Prime Minister,

Minister of Finance of the Republic of Uzbekistan

POLICY MATRIX
UZBEKISTAN MORTGAGE MARKET SECTOR DEVELOPMENT PROGRAM (Uzbekistan MMSDP)

Tranche 1 (by 1 August 2019)	Tranche 2 (by 1 January 2021)
Output Area 1: Housing Policy/Subsidies	
<p>1. The Government of Uzbekistan (GOU) adopts the roadmap to develop the market for mortgage lending in Uzbekistan in 2019 – 2021.</p> <p>(Document required: Roadmap attached to the Decree of the President of Uzbekistan)</p>	
<p>2. The Ministry of Finance (MOF) together with the Ministry of Economy and Industry (MOEI), the State Statistics Committee (SSC) and the Ministry of Construction (MOC):</p> <p>(a) completes an analytical report that evaluates the effectiveness of the government housing finance programs; and</p> <p>(b) submits a proposal to the Cabinet of Ministers on the consolidation and unification of government housing finance programs with consideration to improve the affordability and access, as well as targeting of socially vulnerable groups.</p> <p>(Document required: Analytical Report by the MOF and Proposal submitted to the Cabinet of Ministers)</p>	<p>1. The GOU:</p> <p>(a) completes a consolidation of the government housing finance programs; and</p> <p>(b) on a pilot basis, implements a program of progressive, upfront government subsidies to housing unit buyers.</p> <p>(Document required: Cabinet of Minister's Resolution)</p>
<p>3. The GOU makes the following changes to the terms of loans made under the government housing finance programs effective 1 January 2020:</p> <p>(a) reduce to a maximum of 1 year the grace period for (i) new loans from the government to participating banks, and (ii) new mortgage loans from participating banks to housing unit owners; and</p>	<p>2. MOF jointly with the MOEI and the State Antimonopoly Committee submits to the Cabinet of Ministers an analytical report on possible strategic options to improve the efficiency of Qishloq Qurilish Invest (QQI) and Shahar Qurilish Invest (SQI); and submits proposals to promote competition in the housing developer industry.</p>

Tranche 1 (by 1 August 2019)	Tranche 2 (by 1 January 2021)
<p>(b) gradually step-up the interest rate on existing and new mortgage loans during the first 5 years to make it equal to the Central Bank of Uzbekistan (CBU) refinancing rate from year 6 onwards; and</p> <p>(c) require the use of the annuity payment scheme to ensure a fixed stream of repayments on mortgage loans.</p> <p>(Document required: Decree of the President of the Republic of Uzbekistan)</p>	<p>(Document required: Analytical Report including proposals to promote competition submitted to the Cabinet of Ministers)</p>
<p>4. The GOU adopts a resolution to introduce the following changes to the existing government housing finance programs:</p> <p>(a) increase the number of participating banks;</p> <p>(b) provide loans to finance repairs and reconstruction of housing units; and</p> <p>(c) include household income and housing unit price levels as selection criteria for individuals applying for the purchase of housing units.</p> <p>(Document required: Decree of the President of the Republic of Uzbekistan)</p>	<p>3. The government adopts a resolution with qualification requirements, developed by MOC, MOF and MOEI by October 2020, which allows companies to participate as contractors or subcontractors in government housing finance programs.</p> <p>(Document required: Resolution of the Cabinet of Ministers)</p>
<p>5. The GOU eliminates from 1 January 2020 the value added tax benefits provided under the government housing finance programs.</p> <p>(Document required: Decree of the President of the Republic of Uzbekistan)</p>	

Tranche 1 (by 1 August 2019)	Tranche 2 (by 1 January 2021)
<p>6. The GOU commissions an assessment of the impact on the economy and the state budget of:</p> <ul style="list-style-type: none"> (a) abolishment of tax benefits other than the value added tax to companies involved in housing construction (including Qishloq Qurilish Invest, UzShahar Qurilish Invest, Qishloq Qurilish Loyiha, Uzsanoateksport JSC, Toshkent Qishloq Qurilish Servis); (b) abolishment of all property tax exemptions for owners of housing units; (c) limiting annual income tax exemptions on mortgage loans to UZS 15 million for housing units costing less than UZS 300 million; (d) providing down payment subsidies and/or interest rate subsidies to some housing unit owners. <p>(Document required: Decree of the President of the Republic of Uzbekistan)</p>	<p>4. The GOU implements the recommendations of the assessment study by abolishing additional tax benefits and tax exemptions to companies involved in housing construction, and owners of housing units.</p> <p>(Document required: GOU Resolution on the abolishment of the tax exemptions)</p>
<p>7. The State Statistics Committee (SSC) develops a comprehensive information database on the housing market in accordance with international practices, and makes it available on its website.</p> <p>(Document required: Order of the SSC)</p>	<p>5. SSC (i) approves the new system for the collection and dissemination of timely data and information on household incomes and the housing sector; (ii) collects and disseminates available data on household income and income distribution by relevant sub-categories; current housing conditions, new construction, housing transactions, and other aspects of the living standards of population; and (iii) collects data on house prices for new and existing houses and start developing a house price index in accordance with international best practices.</p>

Tranche 1 (by 1 August 2019)	Tranche 2 (by 1 January 2021)
	(Documents required: (i) SSC order approving the new system; (ii) Status report from SSC on actions taken in actions 5(ii) and (iii))
Output Area 2: Establishment of the Housing Assistance Unit (HAU)	
<p>8. The MOF establishes a Housing Assistance Unit (HAU)^a within the MOF and appoints at least 8 full-time staff.</p> <p>(Documents required: Decree of the President of the Republic of Uzbekistan and Order of the MOF)</p>	<p>6. The GOU decides to transfer functions of HAU to a line ministry/agency or transform HAU into an independent housing agency to develop, coordinate and manage housing policy and programs in Uzbekistan.</p> <p>(Document required: Decision of the GOU with time-bound action plan)</p>
<p>9. The GOU issues an order directing one or more government ministries or departments to:</p> <ul style="list-style-type: none"> (a) develop by 1 December 2020, a database of mortgage market statistics containing consolidated information on borrowers, the number, type and amount of mortgage loans, the value of mortgaged property, the cost of loans, data on non-payment of loan debt; and (b) develop by 1 January 2021, a web portal publishing information about the cost, number and locations of construction of individual residential and apartment buildings. <p>(Document required: Decree of the President of the Republic of Uzbekistan)</p>	<p>7. The MOF/HAU:</p> <ul style="list-style-type: none"> (a) operationalizes the unified mortgage market database and makes it accessible to relevant government agencies, mortgage lenders, insurers, investors and other stakeholders;^b and (b) launches the web portal to: (i) announce all government housing finance programs and housing sites; (ii) receive and process applications to receive housing finance; and (iii) provide information on those banks that participate in the Government housing finance programs. <p>(Documents required: For (a) Letter from HAU confirming the operationalization of the database and for (b) screenshot of the website with functioning pages for all activities)</p>
Output Area 3: Creation of the Uzbekistan Mortgage Refinance Company (UMRC)	
<p>10. The GOU establishes the Uzbekistan Mortgage Refinancing Company (UMRC) as a joint-stock company (JSC), which will allow banks and other legal entities to become shareholders.</p>	<p>8. Shareholding structure of UMRC will be expanded to include public and private banks.</p>

Tranche 1 (by 1 August 2019)	Tranche 2 (by 1 January 2021)
(Documents Required: (i) Decree of the President of the Republic of Uzbekistan; (ii) Resolution of the Cabinet of Ministers; and (iii) copy of UMRC's Charter; and (iv) UMRC's certificate of registration)	(Document required: Copy of the list of shareholders of UMRC from the Central Depository)
	<p>9. The GOU jointly with CBU submits to the Parliament a legislative package to make amendments to the following laws and by-laws:</p> <ul style="list-style-type: none"> (a) the law on mortgages, the law on bankruptcy, the civil code, the law on securities market, the law on joint stock companies and other relevant laws that, in the event of an insolvency of a financial institution that has pledged mortgage loans to a mortgage refinancing company, the mortgage refinancing company will have priority over other creditors of the financial institution with respect to such mortgage; and (b) the Law of the Republic of Uzbekistan "On Mortgage"; (ii) the Civil Code; (iii) the Law of the Republic of Uzbekistan "On Register of Pledges"; (iv) the Law of the Republic of Uzbekistan "On Insolvency"; (v) the Regulation on the Procedure for Registration of Rights to Immovable Property and other relevant laws and by-laws.^c <p>(Document required: Submission of the proposed package of amendments to the above-mentioned laws and by-laws by the Cabinet of Ministers to the Parliament)</p>
<p>11. The CBU:</p> <ul style="list-style-type: none"> (a) submits a legislative package to the Parliament that establishes supervision and regulation of organizations specializing in mortgage refinancing activities; and 	<p>10. The CBU commences regulation of the activities of mortgage refinancing organizations, including establishment of prudential norms and other mandatory standards (including requirements for the level of capital adequacy, liquidity)</p>

Tranche 1 (by 1 August 2019)	Tranche 2 (by 1 January 2021)
<p>(b) prepares normative acts regulating the activities of mortgage refinancing organizations, such as establishing prudential norms and other mandatory standards (like requirements for the level of capital adequacy, liquidity, etc.) which will be completed by 1 December 2019.</p> <p>(Documents required: For (a) submission of the proposed legislative package by the CBU to the Parliament; and for (b) CBU Order with clear timeline)</p>	<p>(Documents required: Regulatory document of the CBU on regulating activities of mortgage refinancing organizations registered with the Ministry of Justice)</p>
<p>12. The CBU initiates the update of the framework on mortgage lending to define and facilitate sound mortgage lending practices^d, which must be completed by 31 December 2019.</p> <p>(Document required: CBU Order on updating of the framework with clear timeline)</p>	<p>11. The CBU approves the updated framework on mortgage lending to define and enforce safe and sound mortgage lending practices.</p> <p>(Documents required: Regulatory document of the CBU registered with the Ministry of Justice)</p>
<p>13. The State Committee on Land, Geodesy and Cadastre jointly with CBU approves an action plan to link the Registry for Pledged Financial Assets with the State Registry of Property Rights to facilitate the registration and search of the rights to mortgage portfolios and is accessible by all relevant stakeholders.^e</p> <p>14.</p> <p>(Document required: Joint Action Plan approved by the CBU and the State Committee on Land, Geodesy and Cadastre, and (ii) CBU order on enforcement within CBU)</p>	<p>12. The Registry for pledged financial assets maintained by the CBU is linked to the State registry of property rights and is accessible by all relevant stakeholders.</p> <p>(Document required: Joint letter from the CBU and the State Committee on Land, Geodesy and Cadastre confirming the linkage of the Registry for pledged financial assets with the State registry of property rights)</p>
	<p>13. MOF jointly with the Capital Markets Development Agency (CMDA) amends regulations governing the procedures by which institutional investors (pension funds, insurance companies and others) invest in debt securities, including those issued by mortgage refinancing organizations, for the purpose of facilitating increased investments in such debt securities.</p> <p>(Documents required: Revised normative documents of the MOF regulating investment policies of institutional investors)</p>

Tranche 1 (by 1 August 2019)	Tranche 2 (by 1 January 2021)
	<p>14. The Capital Market Development Agency (CMDA):</p> <ul style="list-style-type: none"> (a) amends regulation on issuance of securities to introduce shelf-registrations for the issuance of bonds; and (b) submits to the Cabinet of Ministers a legislative package to amend the procedures on issuing securities by joint stock companies, including abolishing restrictions that limit the issuance of bonds to the amount of the issuer's equity capital. <p>(Documents required: For (a) Approved amendment to regulations registered by the Ministry of Justice and for (b) legislative package submitted by CMDA to the Cabinet of Ministers on abolishment of restrictions related to bonds)</p>

CBU= Central Bank of Uzbekistan, CMDA= Capital Market Development Agency, GOU= Government of Uzbekistan, HAU= Housing Assistance Unit, MOEI= Ministry of Economy and Industry, MOF= Ministry of Finance, SSC= State Statistics Committee, UMRC= Uzbekistan Mortgage Refinancing Company.

- ^a To be called Department on coordination of government affordable housing programs and development of financial market instruments of the Ministry of Finance.
- ^b The database will be designed to include consolidated information on the number, type and size of all residential mortgage loans, borrower characteristics (income levels, household size, age, gender, location, etc.), loan-to-value ratios, loan default data, market values of mortgaged properties, etc.
- ^c The amendments would achieve the following objectives: (i) ensure a single "zakladnaya" instrument can create a mortgage in itself over a pool of mortgages (rather than only certify the rights created under a single mortgage agreement); (ii) allow the transfer of a pool of mortgage loans and rights by the bank to UMRC in a single zakladnaya instrument without the approval of debtors, and which will have priority on enforcement against other creditors in the event of bankruptcy of the bank; (iii) allow updates to the pool of mortgages attached to a zakladnaya instrument without requiring amendments or re-registration of the zakladnaya instrument or issuance of a new instrument (iv) eliminate notarization requirements in relation to the above-mentioned reforms, and streamline and minimize registration requirements at the Land Registry and Central Bank Register of Pledges.
- ^d This includes the following: (i) verification of property rights and title; (ii) loan-to-value ratio; (iii) debt servicing to income ratio; (iv) verification of a borrower's income; (v) assessment of the repayment ability of the borrower; (vi) credit checks; etc.
- ^e This could be done either by: (i) expanding the regulations so that the moveable collateral registry held by CBU which currently only encompasses vehicles and shares will also include financial claims; or (ii) developing a new registry specifically for financial collaterals, also to be managed by CBU. In both cases, a linkage with the land registry – currently administered by the cadastre – should be established.