

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

E C U A D O R

HOUSING SECTOR SUPPORT PROGRAM II

**Operation No. 1416/OC-EC
Approved on July 31, 2002**

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

ECUADOR

HOUSING SECTOR SUPPORT PROGRAM II

(EC-0207)

LOAN PROPOSAL

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ABBREVIATIONS

BEV	Ecuadorian Housing Bank
CTH	Mortgage titling company
DPM	MIDUVI provincial office
EA	Environmental assessment
IBRD	International Bank for Reconstruction and Development
IDB	Inter-American Development Bank
IFF	Intermediate Financing Facility
IFI	Intermediate financial institution
MIDB	Comprehensive neighborhood improvement
MIDUVI	Ministry of Housing and Urban Development
NGO	Non-governmental organization
OC	Ordinary capital
PCU	Program coordinating unit
PMA	Environmental management plan
PTI	Poverty-targeted investment
SELBEN	Ecuadorian social program beneficiary identification system
SIV	Housing incentives system
UBN	Unmet basic need
USAID	United States Agency for International Development



ECUADOR

IDB LOANS

APPROVED AS OF MAY 31, 2002

	<i>US\$Thousand</i>	<i>Percent</i>
TOTAL APPROVED	3,671,270	
<i>DISBURSED</i>	3,431,925	93.5%
<i>UNDISBURSED BALANCE</i>	239,345	6.5%
<i>CANCELLATIONS</i>	503,158	13.7%
<i>PRINCIPAL COLLECTED</i>	1,466,931	40.0%
APPROVED BY FUND		
<i>ORDINARY CAPITAL</i>	2,651,338	72.2%
<i>FUND FOR SPECIAL OPERATIONS</i>	932,325	25.4%
<i>OTHER FUNDS</i>	87,607	2.4%
OUTSTANDING DEBT BALANCE	1,964,994	
<i>ORDINARY CAPITAL</i>	1,349,377	68.7%
<i>FUND FOR SPECIAL OPERATIONS</i>	607,361	30.9%
<i>OTHER FUNDS</i>	8,255	0.4%
APPROVED BY SECTOR		
<i>AGRICULTURE AND FISHERY</i>	1,059,837	28.9%
<i>INDUSTRY, TOURISM, SCIENCE TECHNOLOGY</i>	435,826	11.9%
<i>ENERGY</i>	314,568	8.6%
<i>TRANSPORTATION AND COMMUNICATIONS</i>	309,747	8.4%
<i>EDUCATION</i>	208,422	5.7%
<i>HEALTH AND SANITATION</i>	362,353	9.9%
<i>ENVIRONMENT</i>	45,980	1.3%
<i>URBAN DEVELOPMENT</i>	208,592	5.7%
<i>SOCIAL INVESTMENT AND MICROENTERPRISE</i>	295,702	8.1%
<i>REFORM PUBLIC SECTOR MODERNIZATION</i>	400,388	10.9%
<i>EXPORT FINANCING</i>	0	0.0%
<i>PREINVESTMENT AND OTHER</i>	29,854	0.8%

** Net of cancellations with monetary adjustments and export financing loan collections*



ECUADOR

STATUS OF LOANS IN EXECUTION AS OF MAY 31, 2002

(Amounts in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROJECTS	AMOUNT APPROVED	AMOUNT DISBURSED	% DISBURSED
Before 1996	5	219,453	212,463	96.81%
1996 - 1997	8	253,600	191,781	75.62%
1998 - 1999	3	104,500	53,463	51.16%
2000 - 2001	9	251,520	132,939	52.85%
TOTAL	25	\$829,073	\$590,645	71.24%

* Net of Cancellations . Excluding export financing loans.



Ecuador

Tentative Lending Program

2002

Project Number	Project Name	IDB US\$ Millions	Status
EC0200	Environmental Sanitation of Quito Metropolitan District	40.0	
EC0207	Housing Sector Support Program II	30.0	
EC0201	Sustainable Develop. Northern Amazon Region	10.0	
Total - A : 3 Projects		80.0	
EC0210	Institutional Strengthening of the Ministerio de Obras Publicas	2.0	
EC0101	Strengthening of the Seguro Social Campesino	5.0	
Total - B : 2 Projects		7.0	
TOTAL 2002 : 5 Projects		87.0	

2003

Project Number	Project Name	IDB US\$ Millions	Status
EC0132	National Road Rehabilitation Program I	35.0	
EC0199	Citizenship Security National Townships	10.0	
EC0193	Coastal Resource Management Program II	13.0	
EC0139	Municipal Development II (PDM II)	40.0	
EC0205	Innovation and Technological Development Program	20.0	
EC0211	Rural Transport Infrastructure Program II	20.0	
EC0185	Porte Medio Urban Transport	15.0	
Total - A : 7 Projects		153.0	
TOTAL - 2003 : 7 Projects		153.0	

Total Private Sector 2002 - 2003 0.0

Total Regular Program 2002 - 2003 240.0

* Private Sector Project

HOUSING SECTOR SUPPORT PROGRAM II

(EC-0207)

EXECUTIVE SUMMARY

Borrower and guarantor:	Republic of Ecuador		
Executing agency:	Ministry of Housing and Urban Development (MIDUVI)		
Amount and source:		Phase I	Phase II
	IDB: OC-IFF ¹	US\$25 million	US\$35 million
	Local:	US\$15 million	US\$15 million
	Total:	US\$40 million	US\$50 million
Financial terms and conditions:	Amortization period:	25 years	
	Grace period:	4 years	
	Disbursement period:	42 months	
	Interest rate:	variable	
	Inspection and supervision:	1%	
	Credit fee:	0.75% on undisbursed amounts	
	Currency:	U.S. dollars under the Single Currency Facility	
Objectives:	<p>The proposed program aims to deepen and consolidate the transformation of Ecuador's housing sector, to afford broader access to housing for low-income groups. With the primary goal of enhancing the quality of life of this population segment, the program's specific objectives are as follows: (i) to consolidate the housing incentives system (SIV), eliciting greater participation in this area by the private financial and construction sectors; (ii) to improve housing conditions for populations living in deprived urban areas; and (iii) to promote local government participation in the housing sector.</p>		
Multiphase modality:	<p>The program described in this document is a multiphase operation, consisting of an initial phase of US\$40 million and a second one of US\$50 million. The operation is the continuation of a process to transform Ecuador's housing sector that began with the Bank-</p>		

¹ Subject to definitive allocation of IFF resources.

funded housing sector support program (loans 1002/SF-EC and 1078/OC-EC). This program helped institutionalize the system of direct demand subsidies known as the housing incentives system (SIV). As well as proving to be a successful targeting mechanism that helps low-income families gain access to housing, the SIV is also transforming government intervention in the sector and promoting private-sector participation.

A multiphase modality is proposed for this operation, because of the need to continue with the long-term transformation process, bringing all housing sector activities and programs under a coherent policy. The first phase of the program will aim to consolidate the SIV, which includes making progress institutionally; and an additional subsidy modality will be introduced through a comprehensive neighborhood improvement program to extend the benefits to the poorest population groups neglected in the first program. Phase II, which is expected to start in 2006, will expand this program nationwide and press ahead with institutional strengthening in the sector. Although this document sets out the general strategy of both phases, it only describes and defines activities corresponding to the first one.

Description: In order to achieve the desired results, the program will fund the following components:

I. Consolidation of the direct demand subsidy system (US\$32.4 million)

(a) Subcomponent: Direct demand subsidies for new housing (US\$21.6 million). This subcomponent will finance the provision of approximately 12,000 vouchers for the purchase of new housing, worth US\$1,800 each and benefiting 54,000 people. SIV principles are based on providing incentives for the purchase of housing in the market by families whose income levels prevent them from doing so without a subsidy. When their own incomes and savings are augmented by a subsidy they may become eligible for a loan, which would make their latent demand for housing effective. To give continuity and stability to the system, the conditions and criteria for obtaining the voucher used in the first program will be maintained in this operation. The subsidies target households with monthly incomes of up to US\$360. The maximum value of the housing to be subsidized is US\$8,000, so with the subsidy and a 10% contribution to the total value of the home, the buyer would need a loan of up to US\$5,400. Judging by experience gained in the previous operation, the average home generated under SIV parameters costs

US\$4,500. With the subsidy and the buyer's own savings, this means the average loan required is US\$2,250, which is accessible to families with an average income of US\$200 per month.

(b) Subcomponent: Direct subsidies for home improvement (US\$10.8 million). This subcomponent will fund the provision of approximately 14,000 vouchers worth US\$750 each, benefiting 64,000 people. In this activity, funds will be used to improve housing located in consolidated neighborhoods owned by families with incomes below the poverty line of US\$240. The subsidy will give priority to financing household connections to basic utilities, construction or extension of bathrooms and kitchens, and the construction, repair or expansion of roofs. The maximum value of the housing to be improved may not exceed US\$4,000, excluding the value of the land plot.

II. Comprehensive neighborhood improvement (US\$4.45 million).

This component will implement a program for comprehensive improvement of run-down settlements, by financing activities to promote the physical and social integration of informal areas into the formal city, making improvements to urban infrastructure, supply of social services and regularization of property ownership among the beneficiary population.

In this initial phase, the program will benefit 3,600 families, or over 16,000 individuals, located in six municipios of over 20,000 inhabitants, chosen from a group of 13 pre-selected municipios using the criteria shown in table II-1. The average investment required per family is approximately US\$2,100,² a figure obtained by analyzing unit market costs and a sample of municipal works budgets. Of this amount, 50% will be funded by the program, and the other 50% will be paid for with complementary funding provided by contributions from the MIDUVI Marginal Urban Housing Program, topped up with municipal contributions.

² This calculation results from an evaluation of investment budgets in several municipalities and a pilot experience implemented in the municipio of Cayambé.

III. Institutional strengthening, technical training and studies (US\$1.34 million).

This component will finance consulting services and studies to provide technical support in a number of areas (institutional, credit and municipal strengthening), and to sectoral agents. It will include the following activities: (i) expansion and deepening of the information system; (ii) design and implementation of the programmed saving system; and (iii) support for municipios in making land available for social housing, simplification of procedures and greater flexibility in urbanization regulations; and support for processes relating to legalization of urbanizations, property titling and registration.

The component also includes funding for program management and monitoring (US\$1.55 million). This will provide funds for staff hiring, equipment and operating expenses in the program coordinating unit (PCU).

Benefits:

The main benefit of this program stems from consolidation of the transformation and modernization of the country's housing sector, a process that began with the first operation with clear benefits. It will also encourage municipios to target their investments in a coordinated and participatory fashion through a comprehensive neighborhood improvement (MIDB) strategy.

This new operation is expected to benefit about 136,000 mainly low-income people, who will be able to afford a new home, improve the one they currently occupy, or enhance the deficient and unhealthy surroundings in which they live.

The benefits of consolidating the direct demand subsidy system embrace a number of fields. The subsidy provides incentives to deepen the supply of mortgage loans and microcredit, and for the private sector to generate a supply of low-income housing. This will increase the quantity of resources entering the construction sector, with concomitant benefits such as job creation and additional fiscal revenue at both local and national level.

The MIDB component ensures access for families currently living in deprived conditions, to household services such as water supply, sanitation, drainage, parks and squares, along with social services, day-care centers and community halls, among other things. The greatest benefit of this activity stems from its status as a targeted and coordinated public investment that aims to reduce social inequalities and help prevent and minimize the risks associated with poverty.

Environmental and social review:

Favorable impacts. The housing sector support program generated, and will continue to generate mainly positive impacts. Evaluation of the previous program has shown that the environmental and social impacts, both expected and observed in reality, are entirely positive.

Unfavorable impacts such as temporary disruptions in terms of traffic, noise and particulate emissions were, and will continue to be limited during housing construction works. These impacts can be mitigated by enforcing current standards, which lay down the precautions to be taken by builders during the construction process.

Social inclusion. The first operation mostly benefited women, who accounted for 45% of all voucher applicants. The main reason for this is that, as families headed by a single adult, whether a man or woman, are particularly vulnerable, they gain special recognition (additional points) in the household classification process; and most single-parent families are headed by women. The same criterion will continue to be used in the present operation.

The conditions established for access to the program are not expected to restrict participation by indigenous and Afro-Ecuadorian groups in any way; on the contrary, the MIDB component targets low-income families in deprived urban areas where a large part of this population segment lives. The program preferentially preselected municipios with a concentration of indigenous and Afro-Ecuadorian populations, including one municipio representing each of these ethnic groups.

In addition, the program offers good opportunities for civil-society participation, particularly in the home improvement program, which has led to the creation of 300 technical entities (paragraph 3.7). These consist of NGOs, professionals and small firms that organize and provide technical support for voucher beneficiaries. The MIDB component will also encourage civil-society action by requiring active participation from NGOs in the technical assistance and social organization areas. The participatory process envisaged will also involve beneficiaries in the social auditing of the program's civil works. During preparation of the operation, a number of consultations were held on this aspect, and the results have been incorporated in the design of its activities.

Risks:

Sustainability of the voucher system. Sustainability depends on the following: (i) *the future financing of the subsidy system*, which needs to be assumed as a government responsibility to ensure its long-term survival. For this purpose, the Government of Ecuador is taking on greater counterpart responsibilities in this program. It has also been agreed that Bank funding for the voucher component will be phased down over time, such that by the end of phase I, the

government will be providing sustainable financing from its own funds for at least 7,000 vouchers per year; and (ii) *the flow of long-term finance sustaining the mortgage market*. Small banks and other lending institutions, such as mutual societies and cooperatives, which have traditionally dominated mortgage lending to low-income sectors, need access to funds on terms compatible with those they grant in their loans. The program will conduct a study to identify and develop alternatives for increasing participation by the mortgage titling company (CTH) and second-tier banks in rediscounting mortgages for low-income sectors.

Municipal participation. Both the continuity of the voucher system and the new MIDB component will depend heavily on the institutional capacity of municipal governments to participate in the design and execution of individual projects. The program's reliance on municipal participation is a risk that will be mitigated by the municipios perceived need to participate, and by the possibilities they have to make a variety of contributions in terms of idle assets (land plots), streamlining procedures and regulations, coordinating and concentrating activities on the program's target settlements. To facilitate their participation, the program includes municipal support actions especially in the training area.

Coordination of agents participating in the MIDB. This is a risk that arises in comprehensive programs where the diversity of the participants and tasks involved becomes a worry. Nonetheless, the program starts by training participants and creating coordination mechanisms, the main agents being the MIDUVI provincial offices (DPMs) and the coordinator delegated by the participating municipality.

Special contractual clauses:

Implementation of the program's operating regulations (see paragraph 3.19).

Poverty-targeting and social sector classification:

This operation qualifies as a social equity-enhancing project, as described in the indicative targets mandated in the Bank's Eighth Replenishment (document AB-1704). The operation also qualifies as a poverty-targeted project (PTI) under the "headcount" criterion, since over 50% of direct beneficiaries have incomes below the Bank's poverty line (see paragraphs 4.9 and 4.10). The borrower will not be using the 10 percentage points in additional financing (see paragraph 2.21).

Exceptions to Bank policy:

None.

Procurement: International bidding will be used for procurement of goods and services in amounts over US\$250,000, and for civil works contracts in excess of US\$1.5 million.

I. REFERENCE FRAMEWORK

A. Introduction

- 1.1 The program described in this document is a multiphase operation, consisting of an initial phase of US\$40 million and a second one of US\$50 million. The operation is seen as the continuation of a transformation process in Ecuador's housing sector, initiated with the Bank-funded operation "Housing sector support program (loans 1002/SF-EC and 1078/OC-EC)". This program institutionalized the system of direct demand subsidies known as the Housing Incentives System (SIV), which, apart from proving to be a successful targeting mechanism giving low-income families access to housing, is transforming government intervention in the sector and promoting private-sector participation.
- 1.2 The multiphase modality is proposed for this operation given the need to continue with the long-term transformation process, incorporating all housing sector activities and programs into a coherent policy. The first phase of the program will aim to consolidate the SIV, including progress made on institutional issues; an additional subsidy modality will be introduced through a comprehensive neighborhood improvement program (MIDB), in order to extend benefits to low-income groups not covered in the first program. In phase II, which is expected to start in 2006, the latter program will be expanded nationwide, and institutional strengthening of the sector will be continued. This document sets out the general strategy of the two phases but only describes and defines activities corresponding to the first phase.

B. Macroeconomic context

- 1.3 The Ecuadorian economy has been showing clear signs of recovery over the last two years, in sharp contrast to the crisis period of the late 1990s. The new policy framework currently in place, which is centered on dollarization and backed by improved fiscal accounts, has made it possible to stabilize the economy and restore confidence among economic agents. Trust in the financial system is gradually recovering, private sight deposits doubled last year and credit has begun to expand again. The credit revival has been particularly noticeable in the consumer durable and housing sectors. This is the macroeconomic setting in which the housing sector support program has unfolded, and which is also the reference framework for the new operation now being proposed.

C. Evolution of housing policy and the country's strategy in the sector

- 1.4 For several decades in the past Ecuador's housing problems were assumed by the State, which, through its central organizations, supplied low-cost housing directly as developer, builder and financial agent, acting through the Ecuadorian Housing Bank (BEV). This involved subsidized credit and direct housing construction.

- 1.5 The Bank-funded urban development program was implemented in 1987, to provide housing plots with services installed and to build homes. This was executed with a loan from the International Bank for Reconstruction and Development (IBRD). The evaluation of these programs showed that they failed to benefit low-income population segments,¹ while generating solutions with high administrative costs, variable quality, very little private participation, politicized beneficiary selection, and low rates of loan recovery which put the BEV in a precarious situation. The conclusions were that direct State intervention in the financing and construction of housing was neither efficient nor sustainable, and benefited families with higher-than-desired income levels.
- 1.6 As a result of this housing policy, the government began to redefine its role, seeking a new conception for the function of public institutions and the development of market mechanisms. For this purpose, between 1992 and 1997, the Urban Development and Housing Office of the United States Agency for International Development (USAID) provided major technical assistance to MIDUVI and BEV, in creating the Mortgage Titling Company (CTH), formulating a new housing policy and bringing the system of direct demand subsidies to fruition.
- 1.7 In 1996, the BEV halted its lending operations, and in 1998 the Junta Bancaria decided to transform it into a second-tier bank to rediscount the mortgage portfolio of private financial institutions.
- 1.8 Starting in 1998, and based on developments up to that point, the housing sector support program was initiated (loans 1002/SF-EC and 1078/OC-EC). This was when sectoral policy made the transformation and modernization of the housing sector its fundamental objective, and incorporated an innovative and highly decentralizing vision aimed at: (i) promoting private-sector intervention in both financing and construction; (ii) improving families' access to housing by promoting saving and providing direct demand subsidies through a voucher; and (iii) achieving more equitable and transparent use of public resources.

D. The country's housing and urbanization deficit

- 1.9 Ecuadorian cities are expanding rapidly as a result of urban migration; the urban growth rate in the 1990s was 3.67% per year. Of the estimated population of 12 million in 2001, 7.3 million (i.e. 61%) live in cities.²
- 1.10 Housing conditions in Ecuador vary widely from city to city. In general, there is visible growth of housing lacking in basic services; and there is a shortage of urban

¹ Ex-post evaluation of loan 805/SF-EC and World Bank, 1992.

² Source: National Institute of Statistics and Censuses (INEC), Administrative Policy Division, 2001.

land plots with infrastructure services suitable for low-income housing in the formal sector. The result is that a large part of housing production takes place informally; between 1990 and 2000, 441,000 informal homes were constructed.³

- 1.11 The population's living standards depend on the quality of housing and availability of public utilities. The situation is reflected in an index measuring the "basic residential services deficit",⁴ which stands at 70.1% nationwide, 74.9% on the coast, 63.9% in the mountain zone (sierra) and 88.2% in Amazonia.
- 1.12 It is also important to consider the unmet basic needs index,⁵ which, according to a 1999 household survey affected 52.8% of the total population of the country, 75.8% of rural inhabitants and 37.1% of those living in urban areas. About 50% of the country's urban population is living with deficient services and in conditions of poverty. This segment includes the country's lowest-income families, who are unable to purchase housing on the formal market.
- 1.13 The magnitude of the quantitative deficit (850,000 homes), and the incidence of the qualitative deficit (350,000 units) demonstrate the need to maintain efforts to promote new housing production, and mainly to act in a broader and comprehensive way to improve existing habitat conditions for low-income populations.
- 1.14 **Annual demand for urban housing in Ecuador**, arising from growth in the number of households, is estimated at 54,000 units. At the present time supply in the formal sector is generating 23,000 new homes per year, of which 10,000 receive support from public-sector programs, including the SIV voucher. These figures mean that 31,000 families solve their housing needs in the informal sector every year. Housing produced in the formal sector is mainly aimed at households in the higher income quintiles (4 and 5), but the voucher makes it possible for families located in the upper second and third quintiles to access the formal market.

E. Factors affecting the development of housing market

1. Formal-sector housing production in Ecuador

- 1.15 In the 1990s the private sector aimed all of its production at high-income groups, producing homes for families with incomes above US\$1,200 per month. In contrast,

³ Quito land market, published by IMDMQ-1996. Year 2000 update.

⁴ Defined as the percentage of homes which: (i) are not connected to main water supply; or (ii) do not have a system for discharging waste water connected to the public sewerage network; or (iii) do not have electric power supply.

⁵ Source: Integrated Social Indicators System of Ecuador (SIISE) - Version 2.0, 2000.

production of housing for middle- and low-income segments was virtually non-existent. Starting in 2000, the private sector began to participate in low-income housing construction with prices between US\$4,500 and US\$8,000, and built areas of between 40 and 70m², depending on location in the various cities and different regions of the country. This development occurred for two main reasons: (i) the country's economic crisis restricted spending capacity generally, and the prioritization of spending by high-income segments hurt the construction sector and forced it to explore other markets; and (ii) the introduction of a new government housing policy involving a direct subsidy encouraged the search for markets among middle- and low-income sectors that had been shunned until then.

- 1.16 Nonetheless, land values and housing costs have been rising in the wake of dollarization, so now it is difficult to produce the same home for the same price, especially in cities such as Quito, where land available for urbanization is scarce. Accordingly, continuation of the SIV, together with the program proposed here, should produce the same type of housing but in greater concentrations in small and intermediate cities, while in the large cities smaller area homes should start to appear with fewer finishings to be completed over time. To offset these effects, the changes that have generated this supply need to be intensified, such as municipios giving greater flexibility to urbanization rules and building standards, together with provision of urban land suitable for building low-cost housing—a decisive factor in the rise in costs.

2. Home purchase capacity

Table I-1
Urban family income and home purchase capacity

	Average monthly income	Maximum monthly payment	Maximum loan	Saving (five-months' wages)	Purchase capacity
Quintile 1	104	25	774	520	1,294
Quintile 2	184	44	1,369	920	2,289
Quintile 3	281	70	2,587	1,405	3,992
Quintile 4	439	114	5,787	2,195	7,982
Quintile 5	922	258	14,327	4,610	18,937
Average	386	97	4, 893	1,930	6,823

- 1.17 Real demand for housing is determined by families' payment capacity and the value of housing available on the market. Table I-1 illustrates home purchase capacity by income quintile. A family's home purchase potential depends on the supply of housing available on the market, which today offers units ranging upwards from US\$4,500 in the smaller cities and from US\$8,000 in the larger ones. In other words, homes are available costing between 1 and 1.7 times the average annual

wage, which is a highly satisfactory indicator of accessibility compared with the Latin American average of 3.9.⁶ Nonetheless, despite progress made in the production of low-cost housing, purchase capacity only affords unsubsidized access to housing for families mostly located in the fourth and upper half of the third quintiles.

3. Financial sector participation in housing

1.18 During the oil boom period, banks played a major role in home financing for middle- and high-income groups. In later years, high inflation and interest rate ceilings sharply reduced the availability of long-term funds. As a result, the mortgage portfolio which in 1980 amounted to 24% of total lending, by 1990 represented less than 8%. In the first half of the 1990s, banks began to see a recovery in mortgage lending, which by 1996 had climbed back to 17% of the total. Alongside this, bank lending to the construction sector grew from US\$174 million in 1992 to about US\$500 million in 1996. This period saw two important trends in relation to this portfolio: (i) loans were financed basically with short-term deposits;⁷ and (ii) fewer operations were carried out, and larger scale projects were funded.⁸

1.19 This dynamic was interrupted by the spell of economic instability the country went through in the late 1990s, which hit bottom in 1999-2000 with the freezing of bank deposits, crisis in the financial system and collapse of the sucre. The banks were hardest hit by the crisis, suffering drastic cuts in their total assets and lending portfolio, such that by September 2001 these stood at under 50% of their 1998 level. During the same period, deposits shrank by 33%, and those with

Table I-2
System
(US\$million)

	Dec-98	Dec-99	Dec-00	Sep-01
Banks				
Total assets	8,984	2,630	2,912	4,155
Portfolio	4,286	1,075	1,218	2,005
Mutuals				
Total assets	107.1	57.8	64.7	101.2
Portfolio	44.3	20.0	25.6	58.3
Cooperatives				
Total assets	133.8	75.9	79.8	164.0
Portfolio	94.5	39.2	53.3	117.2

⁶ This measure of accessibility (downmarket penetration indicator) is calculated as the ratio between the minimum value of the housing offered on the market (US\$4,500 and US\$8,000) and average family income per year (US\$4,632).

⁷ In 1996, only 9.8% of bank deposits had maturities longer than 180 days.

⁸ In 1992, 48,049 loans were extended to the construction sector, whereas in 1996 the figure was just 24,108.

maturities longer than 360 days plummeted from US\$269 million to US\$73 million.

1.20 In contrast, following an initial adverse impact, the mutual and cooperative group saw a sharp recovery in their lending activity, such that by late 2001 these intermediaries had larger portfolios than in 1998. Available data suggests this recovery was based on larger volumes of lending to the construction sector, which grew by 87% in the case of mutual institutions and 124% among cooperatives between 1999 and 2000. The upturn in these lending operations coincided with relaunch of the SIV and award of the first housing subsidy vouchers.

1.21 The larger market share of mutuals and cooperatives targeted small-scale operations, often supported by SIV vouchers. Suppliers of microcredit have also been leading players in the funding area, catering specially to the needs of families with even lower incomes. The technical

Table I-3
Construction sector lending

	Mutuals		Cooperatives		Banks	
	1999	2000	1999	2000	1999	2000
Construction portfolio (million)	6.4	11.8	15.0	33.6	207.9	53.5
No. Operations	N/A	N/A	16,263	25,655	10,099	5,607
% of Total Portfolio	32.0	54.6	20.3	29.4	3.7	1.6

support that can be given to such entities in the future will be important in consolidating and building on progress made in terms of housing credit.

1.22 The crisis in the financial system undermined public trust and thus worsened the availability of long-term resources, which is one of the constraints on the development of housing credit. It will be necessary to continue with efforts to expand BEV and CTH mortgage rediscount operations, and to provide technical support aimed at giving greater flexibility to marketing the mortgage portfolio, in order to channel long-term funds into housing finance.

F. The municipio as housing sector regulator and promoter

1.23 Current legislation gives municipalities mandatory and exclusive jurisdiction on physical and urban planning in their “canton”, for which reason urbanization rules and regulations are decided by the municipalities. The production of an adequate and sufficient supply of housing is subject to incentives and obstacles in these regulations and their respective procedures, which affect the development of the sector in a number of ways including the following: (i) barriers implied by long and complex paperwork and procedures required for the approval of urbanization and building permits, compounded by the complexity of procedures for transferring ownership of real estate, shortcomings in land cadastral records, and incomplete titling of land ownership; (ii) the municipal regulatory framework frequently imposes excessively high and inflexible standards of urbanization, housing, services

and infrastructure, which unnecessarily raises the cost of producing urbanized land and makes the production of low-cost housing more difficult; and (iii) municipios do not participate in the sector as key players, promoters of new housing, but generally remain in a regulatory role.

- 1.24 In recent years several steps have been taken to improve the situation described above. During execution of the first housing sector support program, MIDUVI made the regulatory environment more flexible. In particular, regulations were formulated and applied for the development of low-income housing programs in the progressive urbanization and housing modality, whose main objective is to enable housing developers and builders to implement housing programs by stages. Some 20 of the country's municipalities, mostly in large and intermediate cities, have made a commitment to follow these guidelines. Nonetheless, their effective application and results require technical support and monitoring.
- 1.25 In terms of promoting housing sector development, there are several ways the municipio can act. One way, which is starting to be implemented in several of the country's municipios, is to make available urban land that is suitable for low-income housing development. Pressure on land prices, resulting from the adjustment in prices and demand generated by the subsidy system itself, has made land more costly and reduced possibilities for low-income housing production. To address this problem, the municipalities of Guayaquil, Cuenca and Quito are developing a number of modalities, including the following: public intervention, involving joint ventures with the private sector, to provide public or private land plots with basic infrastructure services and installations; private-sector development of low-cost housing or the sale of urbanized land plots for acquisition by low-income families. In such cases, the municipio acts like a private company responsible for developing specific projects, mainly contributing land plots that are generally owned by it. The program will support these interventions, making it a requirement for participation in the comprehensive neighborhood improvement component (MIDB), that the municipios undertake to support and participate in initiatives to remove barriers preventing efficient development of the sector, and become promoters of low-income housing production in their respective jurisdictions.

G. Results obtained with the housing sector support program (loans 1002/SF-EC and 1078/OC-EC)

- 1.26 Following approval in December 1997, execution of the program began in late 1999 after adjustments were made to its operating parameters. With Bank financing of US\$62 million and counterpart funding of US\$6.6 million, the program financed the start of housing sector reform with the following activities: (i) creation of the system of direct demand subsidies (SIV); (ii) deepening of the supply of credit and housing production by the private sector; and (iii) reforms to the municipal

regulatory framework. The program has now completed disbursement of 100% of the loan proceeds.

1.27 In addition to meeting its established objectives and targets, the program also brought about major transformations: (i) the State went from being executor of housing policy to facilitator in the process of new housing production and home improvement; (ii) the private sector became the policy executor; (iii) a transparent system of direct subsidies was set up and institutionalized; and (iv) MIDUVI gradually adopted and incorporated SIV processes into its other programs. The main results that can be identified are as follows:

a. **Institutional modernization of the sector.** This is one of the program's main contributions; there are four key points:

- (i) The SIV awards and manages vouchers in an organized and fully institutionalized way through rules, procedures, information systems and trained staff. This has generated an efficient and transparent system for evaluating applicants and awarding the subsidy, with: (i) pre-established publicly known eligibility criteria; (ii) award of vouchers on the basis of points gained in a systematic process; and (iii) results and information made available to the public. In addition, the program has established a regular ex-post monitoring and oversight mechanism to verify correct use and application of the subsidies awarded.⁹
- (ii) Gradual adoption by MIDUVI of the main SIV guidelines for the following programs: campesino housing, improvement of marginal urban housing, housing program for solidarity bond beneficiaries, and housing program for teachers in single-teacher rural schools.
- (iii) The creation of 19 auxiliary institutions to support the financial institutions and their promoters, and the formation of 300 technical entities¹⁰ consisting of non-governmental organizations (NGOs) and professionals whose function is to provide technical support to families applying for a home improvement voucher.

⁹ Oversight on a sample of about 10% of works completed shows that 0.5% have been misused—in other words, one voucher for every 200 assigned and executed. In the 124 cases identified, return of the housing voucher has been demanded.

¹⁰ Source: MIDUVI 2002.

- (iv) Participation by 30 of the country's municipios in the different program interventions, such as bylaws, legalization, simplification of procedures and joint interventions in historic centers.

- b. **Organization and empowerment of demand.** Registration of 110,000 families in the system with saving accounts open; 48,000 are currently beneficiaries of the subsidy and they represent effective demand for housing. The voucher incentive succeeded in turning the housing needs of families with incomes as low as US\$200 into effective demand, thereby demonstrating the effect of the policies implemented and the use of the direct demand subsidies (see table I-5). This made it possible to satisfy part of the demand from population segments in the third income quintile, and in the upper half of the second.

Table I-5
Impact of subsidy on home purchase capacity

Quintile	Average monthly income	Purchase capacity	Capacity with subsidy
1	104	1,294	3,094
2	184	2,289	4,089
3	281	3,992	5,792
4	439	7,982	N/A
5	922	18,937	N/A
Average	386	6,823	3,094

- c. **Promotion of private supply of low-income housing.** Registration of 126 housing projects in the SIV and 65,000 homes either built or in the process of construction. Emerging supply of housing in the US\$8,000 to US\$20,000 range, and lending for middle-income groups, which despite being able to gain access to housing without a subsidy, have been unable to find suitable supply on the market. The introduction of the voucher as a mechanism to expand housing demand led to progressive development housing modalities, the introduction of new technologies and participation by non-profit NGOs, such as foundations and institutions specializing in the financing, production and commercialization of low-income housing. This made it possible to produce housing at lower cost than the market average (US\$2,500), and thus give access to families in the second income quintile (see table I-1).

- d. **Deepening of supply of financing.** Savings accounts worth US\$28 million held by program applicants, and the incorporation of 32 private financial institutions managing US\$100 million in credit. This is one of the aspects that requires greater deepening, however, and involvement from other players (see paragraph 1.22). The BEV increased the volume of disbursements from US\$900,000 to US\$12.9 million between December 2000 and 2001, and signed contracts with intermediate financial institutions (IFIs) for the equivalent of US\$43 million.

- e. **National coverage.** Participation in the program by 21 provinces, of which Guayas absorbs 32% of total subsidies granted, Pichincha 21% and Manabi 14%. Provinces with high poverty indices such as Bolívar, Chimborazo, Carchi

and Loja, also participated, between them accounting for approximately 20% of subsidies awarded.

- 1.28 These results have meant significant progress in Ecuador's housing sector. Nonetheless, the magnitude of the problem, together with the extent of poverty and the rate of urban growth, requires the reforms started to be deepened and persevered with.

H. Lessons learned and challenges for the future

- 1.29 Program development has been evaluated on a yearly basis, through external monitoring and annual execution reviews. In addition, an external and independent evaluation has been made at the end of the process.¹¹ These processes have made it possible to learn lessons and identify the challenges to be faced. The annual program review meeting held in March 2000 analyzed problems affecting its progress, which the Bank and the SIV used to agree modifications to the program's original design parameters. Adjustments focused on moving from a system of graded vouchers applicable to homes of different values, to a system that limited and unified the maximum value of the housing and set a flat subsidy rate.
- 1.30 Since this adjustment, the program has been executed without problem, fulfilling the targets established in the original design. This experience, among other things, has confirmed the need to: (i) simplify and unify conditions, categories and amounts of the subsidy system to ensure feasible and controllable execution; (ii) encourage the supply of housing for low-income sectors, working closely with constructors and making them an integral part of the process; (iii) reconcile time frames and requirements in terms of demand, supply and financing, generating a smooth and efficient process; and (iv) set a ceiling on the value of housing to be subsidized, thereby allowing better verification and encouraging beneficiary self-targeting.
- 1.31 There is a need to expand the range of alternatives and allow lower-income population groups access to a better quality of life. These families are between the middle of the second income quintile and the middle of the first, and they occupy or own a land plot in run-down state. The instrument used to achieve this would be comprehensive neighborhood improvement.
- 1.32 The production of economic housing in a stable and sustained fashion also needs to be maintained. This requires persevering with the institutional transformation of the sector, creating a long-run stable environment, together with SIV consolidation and

¹¹ Housing Sector Support Program, Impact Evaluation, Phillip Rourk, December 2001. Evaluation and monitoring reports, 1998 to 2001, Urbana Consultores Cía. Ltda.

sustainability in order to encourage and keep active private-sector participation in the financing and production of social housing.

- 1.33 In keeping with the decentralization process, it will also be necessary to strengthen the participation of the country's municipalities, which are key players in the provision of urban land and in the promotion of social housing and improving the quality of life in deprived urban areas.

I. Program strategy

- 1.34 In an initial phase, the program will finance activities to consolidate the direct subsidy system (SIV) and continue with the sector's institutional transformation. By the end of this phase, the **government is expected to be providing sustainable financing from its own funds for at least 7,000 vouchers a year**. The transition will take place through a gradual phase-out of the Bank funding. The proceeds of the loan will be used to finance 80% of the vouchers in year one, 60% in year two, and 40% in year three. It will also prepare and initiate an MIDB component and will provide institutional strengthening for selected municipios to enable them to fulfill their functions as required in the new subprogram. In the second phase, the program's MIDB component will be extended nationwide, and funding will be provided to extend institutional strengthening activities to the new participating municipios.
- 1.35 One of the objectives of the new program is to give lower-income families access to its benefits. This will be achieved through a new instrument with different characteristics than the individual subsidy currently paid by SIV. The existing instrument benefits a family directly and individually by helping it to: (i) gain access to the market to purchase a new home; this requires sufficient and stable incomes to enable the family to obtain a loan; or (ii) improve the deficient conditions of the housing it already legally owns. While these two options benefit families with some economic capacity, the new MIDB instrument is of a collective nature and will benefit a community of families living in illegal areas in conditions of precarious habitability, with income levels predominantly below the poverty line. These families will be benefited through legalization of ownership, installation of infrastructure facilitating the provision of residential and social services, and improvement of environmental conditions in the surrounding area.
- 1.36 The MIDB entails an initial training period for participating institutions and potential beneficiary communities alike. In addition, during this period it will be necessary to prepare projects and generate instruments and mechanisms for participation and coordination between entities at the national, local and civil-society level. These will need to participate simultaneously in generating activities and subprograms of a physical and social nature.

1.37 Table I-5 illustrates the strategy and the time distribution of the program's main activities.

**Table I-5.
Program strategy**

Phase I			Phase II		
Year I	Year II	Year III	Year IV	Year V	Year VI
1. Direct demand subsidy component (SIV)					
9,500 vouchers	9,500 vouchers	7,000 vouchers	Single housing subsidy system operating. Government expected to be financing at least 7,000 vouchers per year.		
2. Comprehensive neighborhood improvement component					
Identification of participating municipios. Training of participants and formulation of projects	Stage I a) Development of initial program in six of the country's municipios; execution of 20 projects b) Systematization of the experience and definition of national program c) Municipal teams trained and 20 projects prepared for phase II		Stage II Expansion of program nationwide with development of projects at the national level for municipios with over 20,000 inhabitants		
3. Institutional strengthening component					
Institutional development, training of main participants and identification, selection and preparation of projects				Institutional consolidation of MIDB component	

1.38 The Bank is expected to use the multiphase loan modality in this long-term process, which requires graduated interventions to create consensus and capacities at the national and municipal level. The US\$25 million loan proposed in this document will support the first phase and last for three years. The initial phase will focus on consolidating the housing incentives system and on implementing the MIDB component. A new loan for US\$35 million to support the second phase of the expansion of the MIDB component, lasting a further three years, would be processed once 75% of the proceeds of the first loan have been disbursed, and the targets agreed as triggers have been met. These elements are expected to have the characteristics shown in table I-6.

Table I-6
Phase II trigger elements

1. Policy and institutional
<ul style="list-style-type: none">• The government phases in financing of the program vouchers as follows: 20% in year one, 40% in year two, and 60% in year three• The government has programmed and budgeted funding for 7,000 vouchers in 2006• The SIV is entirely managed by the MIDUVI Undersecretariat for Housing• MIDUVI housing programs operating in a system with unified criteria and procedures and under a single informatics system
2. Results of the comprehensive neighborhood improvement program
<ul style="list-style-type: none">• 3,600 families benefited by the MIDB voucher• 50% of the neighborhoods targeted have household connections to utilities (water, sanitation, and power) and having a working day care center and community space• 80% of program beneficiaries below poverty line• 15 municipal teams trained (5 from phase I and 10 from phase II)• 6 municipios selected, 10 projects completed, and 10 projects with works under execution• Municipal progress in eliminating barriers to the generation of economic housing evaluated (soil management, streamlining of procedures, more flexible regulations, incentives for gradual development), and action plan for second phase• 20 interventions with projects prepared for execution in phase II• Operating regulations adapted• 75% of funds in this component disbursed

II. THE PROGRAM

A. Objectives

- 2.1 The proposed program aims to deepen and consolidate the transformation of Ecuador's housing sector, in order to provide broader access to housing for low-income groups. Its main aim is to help improve the quality of life of this population segment, and it has the following specific objectives: (i) to consolidate the housing incentives system (SIV) and elicit greater participation by the private financial and construction sectors; (ii) to improve housing conditions among populations settled in deprived urban areas; and (iii) to promote local government participation in the housing sector.

B. Description of the program

- 2.2 To achieve the desired results, the program will finance the following components:

1. Consolidation of the direct demand subsidy system (US\$32.4 million)

- 2.3 In order to consolidate the SIV and generate continuity and credibility in the system, approximately 26,000 vouchers will be funded, of which 12,000 will be for purchase of new housing, and 14,000 for home improvements, benefiting approximately 120,000 people. Bank funding for this component will be phased down over time, such that during program execution the government will assume responsibility for financing the direct demand subsidies system.

a. Subcomponent: Direct demand subsidies for new housing (US\$21.6 million)

- 2.4 Funding will be provided to award approximately 12,000 vouchers worth US\$1,800 each, to help low-income families purchase a new home. SIV principles are based on providing incentives for families to purchase housing on the market, where income levels prevent them from doing so without the aid of a subsidy. With the subsidy, together with their own income and savings, they may become eligible for a loan and thus make their latent demand for housing effective. In order to give continuity and stability to the system, the conditions and criteria used in the first program to gain access to the voucher will be maintained in this operation. Subsidies will target households with incomes of less than US\$360 per month. The maximum value of housing to be subsidized is US\$8,000, such that with the subsidy and a 10% contribution to the total value of the home, the buyer would need a loan of up to US\$5,400. Experience of the previous operation shows that the average home produced under SIV parameters costs US\$4,500. This means that with the contribution made by the subsidy and the family's own savings, the

average loan required is US\$2,250, which makes the system accessible to families with an average monthly income of US\$200.

- 2.5 Funding will be provided for a study to design a programmed saving system to encourage a stronger and more direct relation between the financial entity and the saver (the future loan applicant).
- 2.6 As much as 70% of total funds will be channeled to families with incomes below the country's poverty line of US\$240,¹² thereby targeting most resources on the lowest-income families. Effective targeting will be guaranteed by using a beneficiary selection and weighting system using the following criteria: (i) socioeconomic aspects based on income, family composition and number of dependents; and (ii) economic condition based on demonstration of saving capacity and the possibility of obtaining a loan with the private sector. Starting in the second year of program execution, Ecuador's Social Program Beneficiary Identification System (SELBEN) will be used as a requirement for measuring the socioeconomic conditions of applicants.

b. Subcomponent: Direct subsidies for home improvement (US\$10.8 million)

- 2.7 There will be financing for approximately 14,000 vouchers worth US\$750 each. The resources in this activity will be wholly used to improve homes located in consolidated neighborhoods owned by families with incomes below the poverty line of US\$240 per month. The subsidy will give preference to financing domestic connections to residential services, construction or expansion of bathrooms and kitchens, and construction, repair or extension of roofs.
- 2.8 The minimum improvement will use the total subsidy plus a family contribution of US\$100. The maximum value of the housing to be improved may not exceed US\$4,000 excluding the value of the land. In addition to socioeconomic aspects, evaluation of the improvement will take account of the condition of the housing to be improved.
- 2.9 Although admission to the program is through financial institutions, support from technical entities is fundamental in helping potential program beneficiaries gain access. These consist of NGOs and professionals who are paid to assist the applicant in collecting and verifying the necessary information, and in the design of the intervention and its budget. These entities will guarantee the product, making it possible to monitor all interventions carried out using improvement vouchers, despite their diversity and dispersion.

¹² Poverty line for 2002 defined by the SIISE.

2. Comprehensive neighborhood improvement component (US\$4.46 million)

2.10 This component will implement a program of comprehensive improvements in run-down settlements, by funding activities to promote the physical and social integration of informal areas into formal city spaces, improving urban infrastructure, supply of social services and legalization of properties occupied by the beneficiary population.

2.11 In this initial phase, the program will benefit 3,600 families, i.e. over 16,000 individuals, located in six municipios of 20,000 inhabitants each, chosen from a group of 13 municipios preselected using the criteria shown in table II-1. The average investment required of each family is approximately US\$2,100,¹³ based on an analysis of unit market costs and a sample of municipal works budgets. Half of this amount will be covered using program funds, and the remaining 50% through complementary resources provided from the MIDUVI marginal urban housing program, topped up by municipal contributions. The preselected municipios (see paragraph 3.13) are: **(i) Coastal region:** Guayaquil, Machala, Manta, Eloy Alfaro, Portoviejo, Quevedo and Esmeraldas; **(ii) Sierra region:** Quito, Santo Domingo, Ambato and Riobamba; and **(iii) Eastern region:** Lago Agrio and Puyo.

Table II-1	
Municipio preselection criteria	
1.	Municipal capital with population greater than 20,000 according to latest census.
2.	Classification and weighting matrix according to following criteria:
2.1	Larger population, 10% weighting.
2.2	Larger population with UBN, 70% weighting
2.3	Housing management (bylaws, vouchers, legalization program), 20% weighting.
3.	Regional representation.
4.	Representation of Afro-Ecuadorian and indigenous population.

2.12 Settlement selection criteria are shown in table II-2. Program funds will cover the costs of the minimum comprehensive intervention required, as specified below:

¹³ This calculation results from an evaluation of investment budgets in various municipalities and a pilot experience conducted in the municipio of Cayambé.

Table II-2
Settlement selection criteria

• Location in municipios that satisfy program requirements
• Technically feasible, with residential service provision certified by the municipios or the respective firms
• Willingness of local competent bodies to assume responsibility for the operation and corresponding maintenance
• Location in areas without environmental risk and in residential or compatible zones, in accordance with municipal urbanization regulations
• Location on publicly owned land plots or sites obtained through legally accepted private transaction
• Settlements with over five years' proven existence
• Settlements with a minimum of 50 land plots
• 80% of land plots must be occupied and lived on
• 75% of households in the settlement to have at least one UBN
• 80% of families with incomes below the poverty line
• Communities with some degree of social organization

a. Integrated urbanization (US\$3.6 million)

- 2.13 This component will finance comprehensive interventions to be undertaken in each of the settlements chosen to participate in the program. The range of interventions can include: **(i) basic infrastructure:** funding will be provided for basic infrastructure works to supply residential services such as potable water supply, sanitation, rainwater drainage; construction, expansion and rehabilitation of distribution systems/networks and household connections; local road works and connections to the city; public spaces, parks and squares; environmental protection works and actions such as tree planting, control of erosion, stabilization of soils and natural protection of canals; **(ii) legalization of ownership:** this will include legalization of property deeds and support in procedures for global titling; management of occupied land; municipal procedures for approval and resolution of land subdivision prior to individual legalization, titling and registration. Urban legalization of housing units, including the drafting of plans and the municipal paperwork needed for their approval; and **(iii) social and community development:** this includes community organization, mobilization and strengthening for identifying and designing projects; training to monitor their execution; training in the use and maintenance of infrastructure produced by the program; environmental care and protection; garbage collection; social monitoring of projects during the stages of formulation, execution of works and subsequent maintenance.

b. Management of MIDB program (US\$860,000)

- 2.14 This activity will include funding for actions to support promotion, project preparation and training for the various program participants, in the coordinating unit, as well as in MIDUVI provincial offices (DPMs) and the technical teams of participating municipios, and to provide support in those municipios where necessary (NGOs, technical entities), as follows: **(i) technical and operational training for participants:** an annual training course for participants will be designed and delivered, starting with professionals from the PCU and the DPMs, who will be the future trainers and disseminators of accumulated experience. Training will also be given to technical teams in the municipios chosen to participate in the initial stages of the program; **(ii) project formulation:** where necessary, the program will finance consulting services for the technical-economic formulation of projects resulting from proposals identified by the municipios; **(iii) preparation of projects for phase II of the program:** 20 interventions will be prepared with their respective communities and projects to be executed in the first year of phase II of the program.

3. Institutional strengthening, technical training and studies (US\$1.34 million)

a. Institutional aspects

- 2.15 These include: **(i) SIV information system.** Funding will be provided for an expansion and deepening of the information system in the following aspects: (a) creation of a national information network to integrate the various MIDUVI housing programs; (b) integration of data and procedures at the national level with each DPM; (c) provision of information tools to the various participants from the private financial and construction sector; and (d) systematization of MIDB operating mechanisms; **(ii) optimization of processes.** Consulting services will be hired to define the adjustments to be made, where necessary, to procedures for voucher payment and execution of guarantees; and **(iii) DPM strengthening.** In order to raise DPM capacity to respond to the new program demands, these will be strengthened through courses, equipment and technical support.

b. Credit aspects

- 2.16 Training and technical support will be provided for IFIs and auxiliary institutions, in order to identify and develop technologies enabling them to play a larger role in financing low-income population groups. These activities include the following **(i) strengthening and technical training for microlending institutions.** There will be funding for technical assistance to identify and implement a suitable lending technology. This will mainly involve training loan officers and helping institutions set up credit departments specializing in this market. Funding will also be provided for a study to define a sustainable microlending operating scheme; **(ii) design and**

implementation of the programmed saving system. Consulting services to design the system will be financed, along with the necessary procedures and the corresponding legal and institutional framework. This will make it possible to start putting the system into operation, which will have the benefits of creating a saving culture among potential subsidy beneficiaries and providing lending institutions with knowledge of possible demand, which should facilitate the granting of a mortgage loan; and **(iii) support for the mortgage rediscount process.** Technical assistance will be provided to standardize loans and mechanisms allowing for greater rediscount activity. Among other positive effects, standardizing the portfolio origin will make operations to market the mortgage portfolio more flexible, which in turn should help channel a portion of the long-term resources available in the market into funding for social housing.

c. Municipal strengthening for the production of social housing

- 2.17 Continued and expanded support will be given to municipios in deepening their knowledge of housing and urban infrastructure problems, to enable them to play a more active role in the sector, promote associations with the private sector to generate urban land, and in training for fulfilling the functions required by the new MIDB component. **(i) support for processes to generate land for social housing.** In order to promote strategic alliances between municipalities and the private sector to generate a supply of urban land for social housing programs, and establish land management models that can be replicated in other municipios, consulting services will be financed to support municipios that are working on this aspect or which agree to conduct demonstration experiences. Apart from encouraging the supply of land at a cost that makes social housing development viable, these land management models will allow more organized and structured urban developments with adequate levels of service provision. Public intervention will be limited to participation in the supply of urbanized land, leaving the construction of homes to the private sector. **(ii) simplification of procedures and flexibility in urban standards.** Municipios will receive technical assistance in order to deepen reforms to the regulatory framework initiated in the previous program, aimed at reducing and adapting urban and infrastructure standards, as well as deregulating and simplifying paperwork and procedures. **(iii) support for processes to legalize urbanizations and for the titling and registration of land ownership.** Municipalities will receive technical assistance in urban legalization and land ownership processes, based on experiences gained in the previous program.

d. Strengthening of other participants

- 2.18 Funding will continue to be provided for the training of technical entities to enable them to maintain technical support for families applying for home improvement vouchers. Support will be expanded to cover new activities such as: technical support for families who own a piece of land and apply for a voucher to build a new

home; and support in preparing projects for communities that will participate in the MIDB component.

4. Program management and monitoring (US\$1.55 million)

- 2.19 **Management and support for execution.** This includes funding to cover staff hirings, equipment and operating expenses of the program coordinating unit (PCU), which will continue installing the SIV in MIDUVI until the system is fully institutionalized by the end of the first phase of this operation. In addition, during this first phase, technical staff will be contracted to carry out activities to implement and develop the MIDB component in the two phases of the program. The PCU will also coordinate and supervise the local and international consulting services needed to implement activities in the institutional strengthening and training component.
- 2.20 **External audit, operational monitoring and evaluation.** The program will finance activities to support execution, specifically in: (i) **external audit**; (ii) **operational monitoring**; following the pattern established in the first program, every six months external monitoring of program operations will be carried out in component 1 and in the integrated urbanization activity of component 2; and (iii) **monitoring and evaluation**: starting with the second annual program review, the PCU will publish the results of monitoring the program's partial impacts, including improvement of the physical, social and environmental conditions of families living in settlements subject to intervention in the MIDB component.

C. Cost and financing

- 2.21 The total cost of the program, excluding contributions by beneficiaries and municipios participating in the MIDB component, has been estimated at US\$40 million, of which the Bank is expected to lend US\$25 million from its ordinary capital. Central government is expected to contribute US\$15 million. Program costs will be distributed as shown in table II-3.

Table II-3
Housing sector support program II (EC-0207)
(US\$ thousand equivalent)

Investment categories	TOTAL			% Total
	IDB	Local	Total	
Administration	1,190	360	1,550	3.9
1.1 Management and monitoring	1,190	360	1,550	3.9
Direct costs	23,560	14,640	38,200	95.5
2.1 New housing subsidy	14,074	7,526	21,600	54.0
2.2 Improvement subsidy	6,480	4,320	10,800	27.0
2.3 Comprehensive neighborhood improvement	3,006	1,454	4,460	11.1
2.4 Institutional strengthening	0	1,340	1,340	3.4
SUBTOTAL			39,750	99.4
Financial costs	250	-	250	0.6
3.1 Credit supervision	250	-	250	0.6
GRAND TOTAL	25,000	15,000	40,000	100.0
% by source	62.5	37.5	100	

D. Conditions of Bank funding

2.22 Financing amounting to US\$25 million will be provided from the Bank's ordinary capital (OC), with interest rate support from the Intermediate Financing Facility (IFF) subject to allocation of resources from the fund. Table II-4 sets out the terms and conditions of the loan.

Table II-4.
Terms and conditions of loan

Source of funding:	Ordinary capital (Intermediate Financing Facility)
Amount:	US\$25 million
Terms:	
Amortization:	25 years
Grace:	4 years
Disbursements:	42 months
Interest rate:	Variable
Inspection and supervision:	1%
Credit fee:	0.75% on undisbursed amounts
Currency:	United States dollars from the single currency facility

III. INSTITUTIONAL FRAMEWORK AND PROGRAM EXECUTION

A. Institutional framework

1. Borrower and executing agency

- 3.1 The Republic of Ecuador will be the borrower and the Ministry of Housing and Urban Development (MIDUVI) the executing agency. The latter will channel all program activities through its various line organizations, mainly DPMs. For the coordination of activities and program management, MIDUVI will be supported by a coordinating unit; this is expected to operate in a similar way to the PCU that coordinated actions in the first program.

2. Participating entities and their main functions

- 3.2 Supported by the PCU, and in agreement with the Bank, MIDUVI will establish the basic parameters of the program, adapting them as necessary to ensure consistency and coherence in execution. The unit's main functions will involve: (i) financial administration and oversight; (ii) program information and promotion; (iii) classification and selection of voucher beneficiaries and MIDB projects submitted by the municipios; (iv) qualification of IFIs to participate in the program and auxiliary institutions to support applications; (v) registration and on-site training of house builders and technical entities; and (vi) registration of housing projects suitable for SIV voucher support.
- 3.3 The IFIs, which consist of commercial banks, mutual institutions or saving and loan cooperatives, have the following functions: (i) they take in savings from potential beneficiaries through the savings accounts required for subsidy application; (ii) they receive information from applicant families in the informatics system installed by MIDUVI; and (iii) they grant mortgage loans which, together with savings and the subsidy received, put the beneficiary in a position to purchase the home in question. To participate, IFIs needs to satisfy the requirements established by the program and sign an agreement with MIDUVI. The BEV and CTH, both second-tier organizations, will provide long-term funding through mortgage rediscount and securitization.
- 3.4 Municipios will facilitate execution of the component to consolidate the demand subsidy system by making the requirements of low-cost urbanizations more flexible; they will also simplify procedures for obtaining permits and will make other changes to improve the functioning of the land market. In execution of the MIDB component, municipios will act as co-executors, and through municipal technical teams they will: (i) select settlements eligible for funding, in accordance with criteria established in the operating regulations; (ii) manage funds earmarked for studies, and investment and social projects; (iii) maintain a bank account in the

name of the program; (iv) keep the respective accounts; and (v) prepare technical and financial reports on projects carried out and those under execution. Precedent to disbursement of funding in the MIDB component, an execution agreement between MIDUVI and the municipio in question will be presented.

- 3.5 Firms providing residential services will participate in designing the infrastructure works to be undertaken in the MIDB component, and will sign agreements with the municipality for the provision of the corresponding services and subsequent maintenance of the civil works installed.
- 3.6 Private developers and/or builders will build the homes, and construction firms will execute the infrastructure works in the MIDB component.
- 3.7 Technical entities, consisting of NGOs, other civil associations and individual consultants, will provide paid technical assistance to beneficiaries on questions of housing. They will support the organization of potential SIV users and, in some cases, serve as subcontractors and/or constructors. They will also support municipios in community organization and in identifying and prioritizing needs with the neighborhood community, for the formulation of projects in the MIDB component.

B. Project administration and coordination

- 3.8 Within MIDUVI, responsibility for program execution will be in the hands of the Undersecretariat for Housing, supported by the PCU and other Ministry operating units. In order to ensure actions are effectively coordinated, the existing professional team is expected to continue running the PCU. Changes and/or additions to PCU staff will require the Bank’s non-objection. At the national level, the necessary operating activities will be executed by the Ministry’s 21 provincial offices (DPMs). The SIV has a suitable execution structure, together with tested procedures that will be maintained during execution of this program. Municipios will also act as co-executors of the MIDB component.

C. Execution of components

1. Consolidation of the system of direct demand subsidies: project cycle

- 3.9 In order to give stability to the SIV and maintain the self-targeting process used during the first program, the existing eligibility criteria and conditions will be maintained

**Table III-1
Program parameters
(US\$)**

	New housing	Home improvement
Maximum monthly family income	360	240
Maximum value of housing	8,000	4,000
Value of voucher	1,800	750
Minimum saving	10% of housing	100

(see table III-1). Similarly, the mechanism for selecting subsidy beneficiaries used in the previous program will also be kept on. Applications received will be evaluated using a points system, in order to screen applicants and establish an order of priority for allocating subsidies in each contest (operational cut-off). Starting in the second year of program execution, Ecuador's Social Program Beneficiary Identification System (SELBEN) will be used to measure the socioeconomic conditions of applicants. Table III-2 shows the main aspects of the project cycle in force at the present time.

Table III-2
Key aspects of project cycles

New housing	Home improvement
<ol style="list-style-type: none"> 1. Opening of account 2. Identification of home 3. Application 4. Invitations to apply 5. Request for and presentation of requirements 6. Processing of applications 7. Publication of results 8. Issue and award of voucher 	<ol style="list-style-type: none"> 1. Opening of account 2. Contact with technical entity 3. Application 4. Invitations to apply 5. Request for and presentation of requirements 6. Processing of applications 7. Publication of results 8. Issue and award of voucher
<p>1-2-3. Initial requirement and application for the subsidy. Interested families need to open a savings account in an IFI, which will provide information on the subsidy system. The interested party will furnish the IFI with the information and documentation needed to apply for a housing voucher. In the case of new home purchase, the interested party identifies a home offered by a private developer and signs an agreement to purchase as a pre-requisite for application. In the case of home improvement, the application is supported by a technical entity, which works with the family to decide on the type of improvement to be made. By the end of this operation, the programmed saving system will be implemented.</p>	
<p>4. Invitations to apply. MIDUVI will issue annual invitations to apply for housing subsidies. These public invitations will establish annual cut-off dates, together with the number of subsidies to be allocated in each one, and the dates and deadlines established for the entire process.</p>	
<p>5. Receipt of applications. Applicants will present the information required to be considered eligible for the subsidy. During this stage, the entities receiving applications (IFIs) will simply verify that the necessary information is complete. The main requirements for application are as follows: (i) certification of the saving account; (ii) socioeconomic information on the applicant, including proof or sworn statement of income; and (iii) certification that the applicant does not own any real estate. Applications are received continuously between the operational cut-off dates established during the year. The Beneficiary Selection Informatics System, which is installed in the participating IFIs, will process the information and issue a certificate of application indicating the points obtained.</p>	
<p>6. Processing of applications. On the dates established for each operational cut off, the IFIs send information electronically to MIDUVI, where information from the whole country is validated, and the beneficiaries list is drawn up on the basis of points scored in the application.</p>	
<p>7. Publication of beneficiaries list. The list of beneficiaries is published in national and local newspapers and also sent to the IFIs, technical entities and DPMs for diffusion. The points scored can be checked against the corresponding application certificate. If, when the information is consolidated, several beneficiaries have the same score and the number of vouchers is insufficient, a weighting process will be applied using criteria defined in the operating regulations.</p>	
<p>8. Issue and award of subsidy certificates. One month after publication of the definitive beneficiaries list, the MIDUVI Financial Office issues the corresponding certificates and sends them to the 21 DPMs. These in turn will deliver them to the beneficiaries through the procedure established in the operating regulations, which, among other things, requires verification that contracts have been signed for construction or purchase of the home for which the subsidy will be used.</p>	
<p>Activation of the voucher (certificate). On collecting their voucher, beneficiaries endorse it in favor of the promoter, constructor or technical entity, which in turn present it for payment at the DPM, after posting bank guarantees or duly registered deeds of sale.</p>	

3.10 The detailed project cycle and expected timetable for each call for applications, together with the general subsidy allocation mechanism, are contained in the project's technical files.

2. Comprehensive neighborhood improvement: project cycle

3.11 Execution of the MIDB component will involve the same PCU, supported by DPMs, and the municipal technical teams responsible for coordination of the municipal offices participating in the program. The municipalities supported by the appointed technical teams and with additional support from specially trained technical entities, if necessary, will: (i) preselect settlements eligible for financing in accordance with criteria established in the operating regulations; (ii) receive bids and award civil works and services in accordance with parameters established in the program; (iii) administer funds for contracting studies, investment and social projects, and technical support consulting services; and (iv) maintain a bank account in the name of the program, keep the respective accounts and prepare technical and financial reports.

3.12 Social monitoring teams will participate in the provision and administration of the social services contained in the program. These entities or NGOs will be chosen on criteria defined in the program's operating regulations. The project cycle for this component will include the steps shown in table III-3.

Table III-3
MIDB cycle

0. Selection of municipios satisfying the criteria.
1. Dissemination in selected municipios →agreement
2. Selection of neighborhoods →socioeconomic study →confirmation
3. MIDUVI-PCU pre-investment plan
4. Formulation of projects
5. Evaluation of projects
6. Contracting for social monitoring
7. Civil works bidding process
8. Contracting-execution-oversight
9. Reception of civil works
10. Monitoring of maintenance

3.13 **Selection and training.** Given that this phase of the MIDB component will be carried out in an initial stage with limited participation and resources, it has preselected 13 municipios from the original list of participants (see table III-4), using the points methodology based on criteria set out in table II-1.

Table III-4
Classification of pre-selected municipios

Region	Municipios (cantón)	Canton capital	Population of canton capital	Result	National ranking	With option for first phase
Coast	Guayaquil	Guayaquil	1,952,029	37.40	1	Top priority
Sierra	Quito	Quito	1,399,814	36.60	2	Top priority
Sierra	Sto. Domingo	Sto. Domingo	200,421	35.50	3	Top priority
Coast	Machala	Machala	198,123	34.70	4	Top priority
Coast	Manta	Manta	183,166	34.10	5	Top priority
Coast	Eloy Alfaro	Durán	167,784	32.80	6	Top priority
Coast	Portoviejo	Portoviejo	170,326	32.40	7	Top priority
Sierra	Ambato	Ambato	154,369	31.50	8	Top priority
Coast	Quevedo	Quevedo	119,436	30.80	9	Top priority
Sierra	Riobamba	Riobamba	124,478	28.10	13	Indigenous population
Coast	Esmeraldas	Esmeraldas	95,630	26.00	15	African population
East	Lago Agrio	Nueva Loja	34,505	19.80	22	Regional rep.
East	Puyo	Puyo	24,355	3.40	43	Regional rep.

3.14 Of these initially identified municipios, the PCU will choose the first six that submit the respective participation application. This should include: (i) definition of settlements pre-selected by the municipality, which must satisfy the requirements established in table II-2; and (ii) the Municipal Participation Agreement, the content of which is set out in the operating regulations and includes a commitment by municipios to simplify procedures and rules for generating social housing. The criteria for ranking and weighting the settlements presented are as follows: (i) *Level of poverty*: indicator composed of the percentage of households headed by a single person, and the level of family income; (ii) *Cost-efficiency*: cost per family of solving sanitation and drainage deficits in the settlements, and lower number of families subject to involuntary resettlement; and (iii) *Strategic dimension*: complementarity with other projects, community participation and mobilization, and physical clustering of settlements.

3.15 In order to achieve participation by most municipios, the PCU will begin a task of information and preliminary training to support them technically in fulfilling program requirements. Once the municipios are defined, the municipal teams appointed will receive initial training provided by the program, with support from local or international consultants with specific experience in this area. This training will be aimed at members of the PCU, the DPMs, technical teams from the selected municipios and the identified technical entities. The training will subsequently be provided annually, such that each municipio entering the program will receive training for its teams. This will be provided on a yearly basis by trained staff from the PCU and DPMs.

- 3.16 **Community work and preinvestment expenses.** Participant municipios, along with their technical teams, will start promoting the program with neighborhood communities identified for support in preparing their participatory neighborhood improvement plan, which includes the involuntary resettlement plan. The content of the plan is defined in the operating regulations, along with the priority works to be carried out. Subsequently, the municipios will prepare the agreed projects and, where necessary, contract preinvestment studies using either program funds or the municipal contribution, which will be included in the municipal commitments. This stage should involve public or private firms providing residential services, to ensure they participate in the project's technical decisions and undertake to supply the respective service and subsequently maintain it.
- 3.17 **Execution.** Once projects have been technically evaluated and approved in the selected neighborhoods, and the comprehensive neighborhood improvement project is fully funded (neighborhood improvement voucher plus local resources), the municipios, supported by the PCU, will invite bidding for urbanization works contracts in accordance with program standards. Civil works contracting will establish conditions to be met to ensure program disbursements. Alongside the contracting of infrastructure works and buildings, the PCU, together with the municipality and community representatives, will contract project social monitoring services; and, in cases where actions for the individual legalization of land plots need to be initiated, completed or concluded, the municipality will ensure that the necessary measures are taken.
- 3.18 **Operation and maintenance.** The project will conclude with reception of the civil works by the competent offices or firms, together with training needed to make the community an active participant in maintaining and ensuring good use of the works or installations in question. In cases where the services provided are to be operated by the community itself, the municipios, supported by the PCU, will provide community training. They will also verify delivery of the operation and initially oversee the maintenance process.

3. Operating regulations

- 3.19 The program will be governed by operating regulations consisting of two parts: one dealing with the direct demand subsidy system, and the other with the MIDB. The main items in the first part are: (i) the program's operating mechanism and criteria for eligibility and/or classification of its different participants; (ii) the PCU and DPM organization and operating procedures handbook; (iii) the beneficiary eligibility system; (iv) regulation of vouchers, criteria for eligibility and classification of participating financial and auxiliary institutions; and (v) type and scope of intervention by technical entities, housing developers and builders. The key elements of the MIDB component operating regulations are as follows: (i) program eligibility criteria—socioeconomic, technical, legal, urban and environmental; (ii) description of activities and eligible projects; (iii) project

financing conditions; (iv) program operating mechanisms; and (v) oversight and monitoring systems. **Putting the operating regulations into effect is a condition precedent to disbursement of program funds.** The project team has reviewed the draft operating regulations, and the final version will be delivered at the time of signing the loan contract.

4. Institutional strengthening and technical assistance components

- 3.20 The implementation of components not directly related to individual or collective vouchers will be carried out directly by MIDUVI, acting through the PCU. The latter will be responsible for hiring the consulting services needed to ensure adequate monitoring of these components. MIDUVI will prepare selection criteria and draw up the terms of reference agreed with the Bank, as needed to initiate procedures for contracting firms or individuals.

D. Flow of funds and financial management

- 3.21 The financial resources, both from the loan and counterpart funding, will be transferred to the program as required by the execution timetable. The program's flow of funds will operate as follows: MIDUVI, acting through its financial office, will keep two bank accounts for the program—one for the loan proceeds and the other for the counterpart funding. The operational management of the bank accounts will be governed by a financial management handbook agreed with the Bank, forming part of the operating regulations.

E. Procurement of goods and services

- 3.22 Goods and services procurement and contracting for construction services will be conducted in accordance with the procedures stipulated in Annex B of the loan contract. International competitive bidding will be mandatory for procurements in amounts exceeding US\$250,000, in the case of goods and services, and US\$1.5 million for construction works. The country's experience with similar projects in the past indicates that bidding processes above these amounts attract international participation. Procurements for smaller amounts will be conducted in accordance with local legislation, which requires at least three quotes for amounts below US\$100,000, and competitive bidding for higher amounts.¹⁴ These rules are compatible with Bank procedures (see Annex III-1 of the contract).

- 3.23 Contracting for consulting services will be subject to Bank procedures, as set out in Annex C of the loan agreement.

¹⁴ The Bank and Ecuador have agreed special procedures for local competitive bidding.

F. Execution period and disbursement timetable

3.24 The program will be executed over a three-year period. Table III-5 gives a tentative timetable for disbursement of the loan proceeds and local counterpart funding in accordance with program execution.

	YEAR 1	YEAR 2	YEAR 3	TOTAL	%
IDB	10,761.7	9,100.5	5,137.8	25,000.0	62.5
Local counterpart	2,825.7	5,739.2	6,435.1	15,000.0	37.5
TOTAL	13,587.4	14,839.7	11,573.0	40,000.0	100.0
% per year	34.0	37.1	28.9	100.0	

3.25 The borrower will present evidence to the Bank's satisfaction that it has earmarked counterpart funding for the first year of the operation, and the mechanism for transferring funds to the executor has been agreed.

G. Recognition of expenditures and revolving fund

3.26 Before approval of the operation, the borrower will announce an invitation to apply for vouchers, resulting in a financial commitment of program resources. The project team has reviewed and approved the preliminary operating regulations to be used in this invitation, so disbursements related to it could be recognized as retroactive and/or counterpart funding.

3.27 Given the type of activities to be undertaken and the expected pace of execution, it is recommended that a revolving fund be established with an advance of funds of up to 5% of the total funding, i.e. US\$1.25 million.

H. Monitoring of program execution and evaluation

3.28 Monitoring and evaluation processes will identify problems and recommend changes needed in program execution and/or targets. The Bank's country office in Ecuador will monitor the general progress of the program. To support this process, the program has funds for contracting a consulting firm, to be hired by MIDUVI subject to the Bank's non-objection, during the first six months of execution. The monitoring and evaluation methodology will be based on program indicators or landmarks defined in the logical framework (Annex I); and the corresponding information will be compiled in accordance with responsibilities and modalities to be agreed with the Bank. The consultant's report, prepared for the first annual meeting, will indicate the measurements necessary to establish the baseline indicators, as set forth in the logical framework. The baseline data will be used as

the benchmark for the annual meetings to be held throughout the program execution period. In principle, monitoring and evaluation will be carried out according to the following program:

- 3.29 **Start-up meeting.** No later than three months after the loan agreement is signed, the borrower, assisted by the Bank, will hold a seminar-workshop to implement the MIDB component. This event will be attended by the MIDUVI staff who will be responsible for executing program activities, including personnel from the PCU, the DPMs and municipios participating at that time.
- 3.30 **Reports and annual meetings.** The executor will present six-monthly reports detailing progress in executing each of the components, and compliance with each of the annual targets set out in the table of program landmarks on which the annual work plans will be based. Annual meetings are expected to be held within two months following presentation of the second six-monthly report each year. Meetings with the Bank will be attended by the MIDUVI Under-secretaries, together with executive and technical staff from the PCU, directors of regional units, and delegates from participating municipios and other program participants. Annual reviews will involve the following at least: (i) review of program execution during the previous year, including activities carried out and disbursements made; (ii) IFI participation in the program; (iii) comparison of specific program achievements with the detailed targets contained in the tables of landmarks and targets; (iv) evaluation of execution mechanisms; (v) agreement in the action plans for execution of program activities in the following year, including any corrective action, possible changes in the regulations, resource allocation by investment category, and any new execution targets resulting from the review; and (vi) review of progress on the trigger elements agreed for second phase start-up.
- 3.31 **Evaluation of trigger elements.** Once 75% of the loan proceeds have been disbursed, the Government of Ecuador and the Bank will evaluate the results achieved by the program, in terms of the monitoring indicators agreed on as trigger elements (table I-6). This will constitute a basis for processing funding for the second phase of the operation.
- 3.32 **Ex-post evaluation.** An ex-post evaluation will be performed 12 months after the end of the second phase of the program. Annual monitoring will be carried out during the first phase, and a baseline will be defined for this purpose. These measurements, together with the six-monthly reports and evaluation of trigger elements, will provide a complete evaluation at the end of the first phase of the program.
- 3.33 **External audit and operational monitoring.** During the execution period, the executor will present annual financial statements for the program, duly audited by a firm of independent auditors accepted by the Bank. The firm in question will be contracted for a three-year period, subject to a rescission clause in the event of

inadequate performance. In addition, depending on the characteristics of program execution, the concurrent operational audit mechanism will be adopted to ensure adequate technical monitoring.

IV. VIABILITY AND RISKS

A. Institutional and financial viability

- 4.1 The positive experience of the previous program has led to significant institutional change, as the use of the direct demand subsidy has made it possible to execute a viable housing policy, while resources from other MIDUVI programs are being rechanneled for administration under SIV guidelines. This structural change is not only financial — it will also consolidate legal, regulatory and organizational changes, which apart from facilitating execution of this program will also support the continuity and consolidation of housing policy in a solid and stable fashion.
- 4.2 In addition, the operating experience gained from the first program will make it possible to establish the institutional capacity of MIDUVI and the PCU, which will be the main executors of this program. These bodies will fulfill the same functions in executing the component on sustainability of the direct demand subsidy system. Apart from the executors mentioned above, implementation of the MIDB component will involve collaboration with municipios in the role of program co-executors. To achieve correct execution by them in the initial part of this first phase, one of the criteria for selecting participant municipios will be their management capacity and their degree of compliance and support for initiatives and commitments established by the SIV for execution of the first program. Not only does this guarantee timely and efficient participation by them, but it also gives them an incentive to expand their participation in the low-income housing sector.
- 4.3 The sustainability of the voucher scheme mainly depends on future funding of the subsidy system, which needs to be assumed as a government responsibility in order to ensure its long-term survival. For this purpose, the Government of Ecuador is putting up a larger counterpart contribution for this program, and it has been agreed that Bank funding for the voucher component will decrease over time, such that by the end of phase I the government will be financing an estimated minimum of 7,000 vouchers per year out of its own funds, in sustainable fashion. The system will also need a larger flow of long-term funds to sustain the mortgage market; the program will develop alternatives to make it possible to expand participation by the CTH and second-tier banks in rediscounting mortgages for low-income sectors.
- 4.4 To make their participation in the program official, municipios will sign an undertaking to appoint a technical team. This will be led by a coordinator responsible for coordinating team members, external participants and the various secretariats or municipal bodies involved in program execution. It is important to note that the counterpart requirement from municipios does not impose an additional burden on them. The program works with the municipal budget cycle

and encourages municipios to prioritize, integrate and target their investment resources.¹⁵ The program also introduces municipal participation with a training course for staff and officials assigned to participate in the program, thereby guaranteeing a minimum level of preparation to ensure correct execution.

B. Technical and economic viability

- 4.5 The SIV sustainability component does not involve significant technical aspects, since it is a program that does not undertake civil works directly. Housing construction and improvement is in the hands of registered professionals who submit projects for approval and obtain the necessary licenses and permits from local authorities, in compliance with current standards and codes. In the MIDB component, the works to be carried out have to comply with current regulations, both locally and nationally. The designs submitted by municipal teams will be produced by specialized consultants using program funds, and will be reviewed by PCU technical specialists.
- 4.6 The economic viability of the type of interventions expected in the MIDB component stems mainly from cost-efficiency aspects and an appreciation in property values in the sectors concerned. Average costs of the minimum intervention per family are obtained by analyzing unit market costs and a sample of municipal works budgets. In order to achieve greater efficiency in the projects, one of the selection parameters is their cost-efficiency factor, measured as the ratio between project costs and the number of families benefited.
- 4.7 As regards property values, this type of comprehensive intervention raises values not only in the settlements subject to intervention, which according to other experience in the region¹⁶ may rise by as much as 90%, but also in the surrounding areas, possibly by about 20%. Similarly, the works, stability and security generated by urban and property legislation, will provide an incentive to invest in existing housing, thereby raising values still further and increasing family wealth.
- 4.8 Two requirements are imposed to ensure project sustainability: (i) when the project is submitted to MIDUVI, it should include an analysis of beneficiary families' capacity to pay the minimum charges associated with the improved land plot, such as land tax, and public utility charges. On this point, it is worth noting that the families already pay some of these expenses, mainly relating to water supply and garbage collection; and (ii) participation by potential service providers in the

¹⁵ The current budgets of four of the preselected municipios have been studied.

¹⁶ Urban Improvement Program of Rio de Janeiro "Favela Bairro" — Second Stage (BR-0250); and Neighborhood Improvement Program in Argentina (AR-0163).

different stages of project development, in order to ensure their subsequent commitment and compliance.

C. Social and environmental viability

1. Targeting

- 4.9 To be eligible for the housing improvement subprograms, family income should not exceed US\$240 per month; in the new home program, monthly family income can rise to US\$360. Nonetheless, the maximum value of the housing to be obtained (US\$8,000), and better classification arising from higher charges and lower incomes, has made it possible to target over 50% of funding on beneficiaries living below the country's poverty line (US\$240 per month).
- 4.10 In the MIDB component, according to established eligibility criteria, participating settlements should have 80% of resident families with incomes below the poverty line, thereby making it a program of high social impact. The pattern in the first program, where 53%¹⁷ was targeted on families with incomes below the Bank's poverty line of US\$120 per month, shows that the operation qualifies as a poverty-targeted investment (PTI) on the headcount criterion.

2. Social inclusion

- 4.11 There are no formal obstacles in Ecuador, either in legislation or in institutional policies, preventing female heads of household or indigenous or Afro-Ecuadorian families from receiving a direct subsidy, or from saving or taking out a loan in a financial institution, or holding ownership title over a property.
- 4.12 In addition, the program recognizes that families headed by a single adult, whether a man or woman, are specially vulnerable, so they are awarded special recognition (additional points) in the household classification process. In the first operation, this incentive mostly benefited women, who account for most single parent households. As many as 45% of voucher applicants were women, 63% living with a partner, 28% as heads of family, while 8% were either divorced or widows.¹⁸
- 4.13 Conditions for admission to the program are not expected to contain any restriction on participation by indigenous and Afro-Ecuadorian groups; on the contrary, the MIDB component is intended for low-income populations living in deprived urban areas. The program preferentially preselected municipios with a concentration of

¹⁷ "Análisis de Focalización del Programa" (Analysis of program targeting), Ministry of Housing and Urban Development, Quito, Ecuador, October 2001.

¹⁸ Housing Finance in Ecuador "Lessons from a government program geared to supply private financing for low-income housing". Frontier Finance International. December 2001.

indigenous and Afro-Ecuadorian populations, including one municipio representing each of these ethnic groups (see table III-4).

- 4.14 In addition, the program provides good opportunities for civil-society participation, particularly in the housing improvement program. This has encouraged the creation of 300 technical entities consisting of NGOs, professionals and small firms, which organize and provide technical support for voucher beneficiaries. They also provide support in the MIDB component, which calls for active participation by NGOs in the technical assistance and social organization areas. Similarly, the participatory process envisaged makes it possible to involve the beneficiaries in the social audit of program works. During preparation of the operation, a number of consultations were held on this aspect, the results of which have been built into the design of the activities.

3. Environmental viability

- 4.15 The program's profile II was presented and approved by the Committee on Environment and Social Impact (CESI) on 5 April 2002. The committee's recommendations were incorporated by the project team in the process of designing the operation. As explained in this document, the program has two main components with different characteristics: firstly, there is the *component to consolidate the direct demand subsidy system*, which absorbs 81% of program funds. This does not entail undertaking works directly but provides a subsidy for beneficiaries to choose a home on the market or to undertake minor improvements in a home they already own and occupy. The second is the *MIDB component* which absorbs 11% of total program funding. This will finance minor infrastructure and community building works in an initial program of limited coverage, as preparation for a national program to be developed in the second phase of the program starting in 2006. As part of program preparation, an environmental assessment (EA) was conducted separately for the two components; greater emphasis was given to the second, since it is the new element incorporated into this operation. An environmental management plan (PMA) is also included, which defines the monitoring baseline, and actions needed to mitigate expected negative impacts and make the most of the positive ones.

a. Component to consolidate the direct demand subsidy system

- 4.16 The housing sector support program has generated and will continue to generate mainly positive impacts. Evaluation of the previous program has shown that the environmental and social impacts anticipated and observed in reality are positive, and the negative impacts that were expected generally did not occur. Unfavorable impacts from house building activities were and will be limited. These involve temporary disruptions in terms of traffic, noise and particulate emissions, and can be mitigated by applying current standards which indicate the precautions the builder should take during the construction process. The program's institutional and

socioeconomic impacts were also evaluated; these were positive and are described in detail in paragraphs 1.26 to 1.28.

b. MIDB component

- 4.17 Given its mitigating nature, this new component will have only a positive impact on beneficiaries, by enhancing the quality of life in the settlements they occupy, in aspects including sanitation and public health. Program funds will also be used specifically to finance environmental protection works, such as the creation and restoration of green areas, control of erosion and stabilization of soils. Similarly, its status as an initial program with limited funding and municipal participation, makes it possible to confine its action to settlements located outside areas of risk. Accordingly, the operation is not expected to generate negative environmental impacts. Like any intervention in the environment, however, it will cause alterations in the physical, biological, institutional and environmental domains. Possible impacts and measures to prevent or to mitigate them are shown in table IV-1.
- 4.18 To guarantee the program's environmental and social feasibility, resources have been set aside for the actions described in the PMA, which are grouped together as follows (see table II-3): (i) involuntary resettlement (US\$700,000), included in item 2.3; (ii) dissemination and training plan in items 2.3 and 2.4; and (iii) monitoring and oversight in item 1.1.

**Table IV- 1
Impacts and mitigation measures**

Impacts	Preventive and mitigation measures
a) Gradual but major changes in the urban management culture among participating municipalities and communities. There may be resistance from parties involved, because of the innovative and participatory nature of the program. This may occur in municipalities that are used to executing works unilaterally without participation by beneficiaries; and among existing community organizations which have previously operated under different parameters, often in pursuit of interests other than those of the community itself.	As part of the training programs, the PCU and DPM will give support to municipal teams in working with a participatory methodology, and to communities in developing and transforming neighborhood organization as necessary.
b) Risk of social exclusion when the works to be carried out require families to be resettled.	One of the requirements for program access is that the settlement should not require resettlement for more than 7% of total families benefited. The program requirement that the participatory neighborhood improvement plan should include a resettlement plan that applies the guidelines established in the preliminary resettlement plan (see annex in RE3/SC3 file) which is designed under OP-710 policy guidelines.
c) The family shopping basket may be affected by new payment obligations arising from the program (taxes and domestic services).	The participatory neighborhood improvement plan mentions the need to train communities in the rational use of water and electric power, and the incidence of this on family budgets. In addition, it is also intended to work with service-providing entities to establish plans for the transition between a situation of non-payment to one of regular payment.
d) Risk of accidents in the works construction phase.	MIDUVI will review current regulations on this aspect and present the regulatory framework to be adopted or included in municipal rules.

D. Benefits

- 4.19 The program's main benefit is to allow consolidation of the transformation and modernization of Ecuador's housing sector, a process that began with the first operation and has produced clear benefits. Another fundamental benefit is that by encouraging municipios to make their investments in a targeted, coordinated and participatory fashion through a strategy such as MIDB, they will adopt and regularly work in this more efficient way, once the benefits of this practice are perceived.
- 4.20 The operation is expected to benefit around 136,000 mainly low-income inhabitants, who will be able to gain access to a home, improve the conditions of

- the housing they currently occupy, or improve the run-down and unhealthy surroundings they live in.
- 4.21 The benefits from component 1 embrace a number of fields. The subsidy mechanism encourages a deeper supply of mortgage and microcredit, together with private-sector supply of low-cost housing. This in turn increases the quantity of funds entering the construction sector, producing concomitant benefits such as job creation, and fiscal revenue at the national and local level.
- 4.22 The MIDB component ensures access for families currently living without residential services such as water supply, sewerage, drainage, squares and parks, social services, day-care centers and community halls, among other things. The greatest benefit of this activity arises from its nature as a targeted and coordinated public investment that aims to reduce social inequalities and help prevent and minimize the risks associated with poverty. In similar experiences in other countries of the region, the benefits obtained have included lower crime rates and a heightened sense of safety, greater investment in housing and the emergence of commercial establishments in the improved neighborhoods. Actions to enhance the quality of life and physical surroundings of these settlements translate into higher property values, not only in the settlements themselves but also in the surrounding areas (see paragraph 4.7).
- 4.23 The institutional strengthening, technical training and studies component will make it possible to expand and deepen the SIV, achieve more efficient procedures for payment of vouchers and execution of financial guarantees, strengthen municipal capacity in the housing sector, simplify its procedures and make its urbanization standards more flexible. The studies to be carried out in this component will be used to identify the processes to be improved during phase II of the program.

E. Risks

- 4.24 **Sustainability of the voucher system.** Sustainability depends on the following: (i) *the future financing of the subsidy system*, for which the government must take responsibility in order to ensure its long-term survival. For this purpose, the Government of Ecuador is providing a larger counterpart for this program. It has also been agreed that Bank funding for the voucher component will decrease through time, such that by the end of phase I, the government will be providing sustainable financing for an estimated minimum of 7,000 vouchers out of its own funds; and (ii) *the flow of long-term funds that sustain the mortgage market*. Small banks and other lending organizations, such as mutual and cooperative societies, which have traditionally dominated mortgage lending to low-income sectors, now need access to funds on terms compatible with those on which they themselves lend. The program will conduct a study to identify and develop alternatives to make it possible to expand participation by the CTH and second-tier banks in mortgage rediscount operations for low-income sectors.

- 4.25 **Municipal participation.** Both the continuity of the voucher system and the new MIDB component will depend heavily on the institutional capacity of municipal governments to participate in the design and execution of individual projects. The program's reliance on municipal participation is a risk that will be mitigated by their perceived need to participate and their potential to contribute in various ways: e.g. idle assets (land plots), streamlining of procedures and regulations, and coordination and concentration of activities in the program's target settlements. To facilitate participation by municipios, the program will include actions to support them especially in the training area.
- 4.26 **Coordination of MIDB participants.** This is a risk that arises in comprehensive programs where the diversity of participants and tasks becomes a problem. Nonetheless, the program starts by training participants and creating coordination mechanisms, the main agents being the DPMs and the coordinator delegated by each participating municipality.

LOGICAL FRAMEWORK

	INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>AIM To help improve the quality of life of low-income groups by increasing their access to housing and improving urban habitability conditions.</p>	<p>Five years after end of each program phase: <i>Phase I indicator:</i> 1) Housing policy and subsidy system consolidated and 100% of annual housing deficit absorbed <i>Baseline:</i> annual deficit of 31,000 units in 2001 <i>Phase II indicator:</i> 2) Improved provision of basic housing services; 60.1% decrease in basic housing services deficit <i>Baseline:</i> 70.1% deficit in 2001</p>	<p>INEC housing service Ex-post evaluation.</p>	
<p>OBJECTIVE Transformation of Ecuador's housing sector consolidated, allowing access to housing and better housing conditions for the country's low-income population.</p>	<p>One year after execution of each program phase: 1. Policy and system for generating stable low-income housing <i>Indicators:</i> a) Number of sectoral stakeholders (financial institutions, NGOs, construction companies) is maintained. <i>Baseline:</i> entities participating in the SIV as of Dec. 2001 <i>Expected outcome:</i> number of entities equal to or greater than baseline b) Flow of SIV resources stable and permanent. <i>Baseline:</i> average number of vouchers granted in last 3 years (1999-2001); <i>Expected outcome:</i> beginning in 2006, a minimum average of 7,000 vouchers programmed and financed with budgetary resources c) Number of loans and rediscount operations for housing sector increases <i>Baseline:</i> amount of loans and rediscount operations for housing in December 2001. <i>Expected outcome:</i> amount of loans and rediscount operations for housing increased annually by 5%.</p>	<p>SIV Report, Dec. 2001 External Consultant's Report, SIV, Dec. 2005/2008 SIV Report, Dec. 2001 Budget Act for central government, 2006 et. seq. 2001 Reports, Office of the Bank Examiner 2005/2008 Reports, Office of the Bank Examiner</p>	<p>There is political, economic, and financial stability.</p>

¹ Access to credit indicator: ratio between minimum annual income required by financial institutions and average annual family income.

² Access to housing indicator: ratio between the minimum market value of the housing provided and average annual family income.

	INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
	<p>2. Housing access conditions are improved or maintained <i>Indicators:</i> a) Financial institutions grant credit to families with incomes below US\$300. Indicator: Down Market Penetration.¹ <i>Baseline:</i> Indicator: Down Market Penetration as of Dec.2001. <i>Expected outcome:</i> Down Market Penetration Indicator maintained.</p> <p>b) Market offers housing at prices below US\$4,500 in small cities and US\$8,000 in large ones. <i>Indicator:</i> Down Market Penetration.² <i>Baseline:</i> Down Market Penetration Indicator was 1 to 1.7 as of Dec.2001 <i>Expected outcome:</i> Down Market Penetration Indicator maintained at 2001 level</p> <p>c) Number of low-cost housing units provided by construction companies. <i>Baseline:</i> average number of low-cost housing units available on the market in the past three years: 18,000 <i>Expected outcome:</i> minimum number of low-cost housing units provided by construction companies: 18,000</p> <p>d) Access to credit for informal and self-employed workers increased. <i>Baseline:</i> From 1999 to 2001, 41% of SIV beneficiaries who worked in the informal sector or were self-employed had access to credit for housing (indicator proxy) <i>Expected outcome:</i> percentage of those beneficiaries with access to credit is maintained or increased.</p> <p>e) Share of microlending in the sector expanded <i>Baseline:</i> Findings of baseline survey for 2002 (coverage of 5 institutions, number and amount of operations) <i>Expected outcome:</i> increase in number and amount of operations by 25% over baseline figures</p>	<p>SIV Report, Dec. 2001</p> <p>External Consultant's Report, SIV, 2005/2008</p> <p>SIV Report, Dec. 2001 External Consultant's Report, SIV, 2005/2008</p> <p>Low-cost housing registry, SIV, MIDUVI, Dec. 2001 Low-cost housing registry, SIV, MIDUVI, Dec. 2005</p> <p>Study on Housing Finance in Ecuador, Dec. 2001 Special survey, 2005, using Housing Finance Study methodology</p> <p>Survey of Microcredit Institutions, 2002 Survey of Microcredit Institutions, 2005</p>	

	INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
	<p>3. Deficient conditions in marginal settlements improved <i>Indicators for Phases I and II:</i> a) Target settlements have better road access, uninterrupted household utilities (water, sewerage, and power), a space for child care and community space in operation. <i>Baseline:</i> to be determined based on the profiles of the beneficiary settlements and families, which must be submitted by the municipios to gain access to the program. <i>Expected outcome: Phase I</i> At least 50% of beneficiary families have greater road access and service delivery, and child care and community spaces (total beneficiary families: 3,600) <i>Expected outcome: Phase II</i> At least 80% of beneficiary families have greater road access and service delivery, and child care and community spaces (total beneficiary families: 20,000)</p>	<p>Profiles to be submitted by the beneficiaries External Consultant's Reports, SIV, 2003-2005 Profiles to be submitted by the beneficiaries External Consultant's Reports, SIV, 2005-2008</p>	
<p>COMPONENTS 1. Housing incentives system (SIV) consolidated, institutionalized and fully operational, as a mechanism giving access to low-cost housing.</p>	<p>By end of program in 2005: a) MIDUVI housing programs integrated and systematized under SIV guidelines and instruments. Year 3. b) Voucher payment mechanism for low-cost housing operating in permanent, stable and streamlined fashion in MIDUVI Undersecretariat for Housing. Year 3. c) 12,000 vouchers of US\$1,800 each for new homes nationwide. Years 1-3. d) 14,000 vouchers of US\$750 each for home improvement nationwide. Years 1-3.</p>	<p>Evaluation report and legal provisions, MIDUVI Semiannual Reports, SIV Semiannual Reports, SIV Financial records, SIV Semiannual Reports, SIV Financial records, SIV</p>	<p>The government can afford to finance the voucher system on a permanent basis. Macroeconomic stability is maintained and the financial position of the intermediary financial institutions is consolidated.</p>
<p>2. Neighborhood improvement program consolidated with processes institutionalized and systematized to begin operations nationwide.</p>	<p>a) Initial neighborhood improvement project executed in six municipios; 15 interventions selected with at least 3,600 beneficiary families; systematization of lessons learned. Years 1-3. b) 20 projects prepared for execution in the second phase of the program. Year 3. c) Document prepared containing elements corresponding to phase 2 of the project, including operations handbook adapted for presentation to the Bank for its approval and financing. Year 3.</p>	<p>- Inspections to verify system operation. - Supervisory visits and periodic evaluations. - Inspection of the system in operation. - Document approved by the Bank.</p>	<p>Program participants working in co-ordinated fashion.</p>

	INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>3. Improvement of aspects relevant to the sector; program participants strengthened and trained.</p> <p>Institutional aspects SIV established in the Undersecretariat for Housing, operating in deconcentrated fashion. Provincial offices strengthened to operate the SIV and the new neighborhood improvement program.</p> <p>Credit aspects Institutions trained to supply microcredit for home purchase and improvement.</p> <p>Municipal strengthening for the production of housing Strategic alliances formalized between municipios and private sector for development of low-cost housing programs. Municipal procedures and paperwork for low-cost housing simplified and adopted.</p>	<ul style="list-style-type: none"> a) MIDUVI marginal urban housing program incorporated into SIV. b) SIV transferred to relevant MIDUVI offices, trained and equipped to operate appropriately. Year 1-3. c) Provincial offices strengthened with periodic training on issues relating to SIV, neighborhood improvement program, equipment, communications media, and others. Years 1-3. d) 200 technical entities accredited and trained; house builders trained on-site, registered and accredited. Years 1-3. e) 25 IFIs and 25 lending intermediaries (cooperatives, mutuals, auxiliary institutions, NGOs) trained to encourage them to grant microcredit for low-cost housing. f) 30,000 savers in the system for more than one year. g) Six of the country's municipios participating actively in low-cost housing and neighborhood improvement programs. h) Number of low-cost housing projects carried out in the respective municipio beginning in 2003 and more flexibility in urban development regulations i) At least five strategic alliances formalized (e.g. habilitation of land, basic access, procedures, etc.). Years 1-3. 	<p>Semiannual reports of external evaluator</p> <p>MIDUVI legal provisions and SIV semiannual evaluation report</p> <p>SIV semiannual evaluation reports; reports on training provided</p> <p>MIDUVI official records</p> <p>Reporting by participating savings institutions</p> <p>Semiannual reports of external program evaluator</p> <p>Evaluation report and copy of legal provisions issued by municipios</p> <p>Copies of agreements entered into by municipios</p>	<p>Private sector continues to participate actively, both in lending and in the construction of low-cost housing.</p>

TENTATIVE PROCUREMENT PLAN

MAIN PROCUREMENT	FINANCING	METHOD	PRE-QUALIFICATION	DATE
1. Demand subsidies, aggregate amount up to US\$32.3 million The program will not directly finance civil works.	N/A	N/A	N/A	N/A
2. Comprehensive neighborhood improvement, aggregate amount US\$4.5 million a. Consulting services Feasibility study and design, US\$200,000 b. Improvement works 2 projects totaling US\$ 450,000 3 projects totaling US\$ 675,000 6 projects totaling US\$1,350,000 8 projects totaling US\$1,800,000	IDB 100% IDB 80% IDB 80% IDB 55% IDB 55%	ICB LCB LCB LCB LCB	Yes No No No No	I/2003 I/2003 II/2003 I/2004 II/2004
3. Main consulting services, aggregate amount US\$484,000 a. Develop training modules, US\$120,000 b. Didactic material, US\$80,000 c. Study of access to financing, US\$50,000 d. Microcredit study, US\$72,000 e. Technical assistance for micro lending IFIs, US\$162,000	IDB 100% IDB 100% IDB 100% IDB IDB	LCB LCB LCB LCB LCB	Yes Yes Yes Yes Yes	I/2003 II/2003 II/2003 I/2004 I/2004

- ICB = International competitive bidding
 LCB = Local competitive bidding
 CP = Comparison of prices
 Date = Refers to the semester in which the invitation to bid for the procurement is made
 N/A = Not applicable

PROPOSED RESOLUTION

ECUADOR. PARTIAL PAYMENT OF INTEREST ON LOAN /OC-EC
TO THE REPUBLIC OF ECUADOR

(Housing Sector Program 11)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, as administrator of the Intermediate Financing Facility Account (the "Account"), to enter into such contract or contracts as may be necessary with the Republic of Ecuador, as Borrower, and to adopt other pertinent measures to use the resources of the Account to pay a part of the interest due by the Borrower on outstanding balances of the loan authorized by Resolution DE- /02, in accordance with the provisions set forth in Document FN-263-2, as amended, approved by the Board of Executive Directors on December 21, **1983**.