



Concept Paper

Project Number: 51348-001
April 2019

Proposed Policy-Based Loan, Project Loan, and Technical Assistance Grant Republic of Uzbekistan: Mortgage Market Sector Development Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 18 March 2019)

Currency unit	–	SUM
SUM1.00	=	\$0.0001169
\$1.00	=	SUM8,553.33

ABBREVIATIONS

ADB	–	Asian Development Bank
m ²	–	square meter
PBL	–	policy-based loan
SDP	–	sector development program
TA	–	technical assistance
UMRC	–	Uzbekistan Mortgage Refinancing Company

NOTE

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

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 51348-001	
Project Name	Mortgage Market Sector Development Program	Department/Division	CWRD/CWPF
Country Borrower	Uzbekistan Government of Uzbekistan	Executing Agency	Ministry of Finance
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Finance	Housing finance		200.00
		Total	200.00
3. Strategic Agenda	Subcomponents	Climate Change Information¹	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
Regional integration (RCI)	Pillar 3: Money and finance		
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development Institutional systems and political economy Public financial governance	Some gender elements (SGE)	✓
Knowledge solutions (KNS)	Pilot-testing innovation and learning		
Partnerships (PAR)	Implementation Private Sector		
Private sector development (PSD)	Conducive policy and institutional environment Promotion of private sector investment		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Nation-wide	High
Household Targeting	Yes		
General Intervention on Poverty	No		
SDG Targeting	Yes		
SDG Goals	SDG1, SDG5, SDG10, SDG11		
6. Risk Categorization:	Complex		
7. Safeguard Categorization	Environment: FI-C Involuntary Resettlement: FI-C Indigenous Peoples: FI-C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		200.00	
Sovereign Project (Regular Loan): Ordinary capital resources		150.00	
Sovereign Stand-Alone Policy-Based Lending (Regular Loan): Ordinary capital resources		50.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		200.00	
Note: An attached technical assistance will be financed on a grant basis by the Technical Assistance Special Fund (TASF-OTHERS) in the amount of \$800,000.			
Currency of ADB Financing: USD			

¹ The project reduces greenhouse gas emissions. However, it does not fall under the eligibility criteria for climate mitigation finance as defined by the joint multilateral development bank methodology on tracking climate finance, which notes that not all activities that reduce greenhouse gases in the short term are eligible to be counted towards climate mitigation finance. Accordingly, greenfield fossil fuel projects are excluded, and climate mitigation finance is considered zero.

I. THE PROPOSAL

1. The proposed Mortgage Market Sector Development Program aims to establish a new institutional infrastructure and financing mechanism to promote market-based mortgage finance in Uzbekistan and expand residential mortgage product availability to broader segments of the population. These measures will allow to provide long-term funding to banks, promote competition, and remove inefficient and market-distorting elements in the housing finance environment. The program will also support the Government of Uzbekistan in reforming some of the parameters of the existing government housing subsidy programs, so as to ensure the efficient use of public resources, strengthen fiscal sustainability, and improve the housing policy and subsidy framework.

2. The country operations business plan, 2019–2021 of the Asian Development Bank (ADB) for Uzbekistan reflects the program.¹ As part of the program preparation, ADB initiated small-scale knowledge technical assistance (TA) to conduct a comprehensive sector analysis—identification of key constraints and necessary policy actions.² The proposed transaction TA attached to the program will help implement the program.

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. **ADB's response to a specific government request.** In view of ADB's support to the country's rural housing segment, the Government of Uzbekistan requested ADB to support the development of market-based housing finance by mobilizing commercial residential mortgage finance from the banks.³ Access to affordable and long-term mortgage finance is needed to meet the housing demand attributed to protracted population growth.⁴

4. **Strong government involvement in housing finance proven problematic.** While the government is seeking to tackle the key challenges on the supply side of the housing market, it needs to limit its allocation of budgetary resources to support multiple state-funded housing subsidy programs, given the growing pressure on the state budget and the enormous demand.⁵ The government acknowledges that the current allocation of state resources and the provision of subsidized funding are inefficient, uncoordinated, lack focus, and crowd out the private sector. It also recognizes the need to gradually replace or phase out the state programs and move to market-based mortgage finance in the banking industry.

¹ The project is included in ADB. 2018. *Country Operations Business Plan: Uzbekistan, 2019-2021*. Manila.

² ADB. 2017. *Technical Assistance to the Republic of Uzbekistan for the Mortgage Market Development Program*. Manila.

³ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranchise Financing Facility to the Republic of Uzbekistan for the Housing for Integrated Rural Development Investment Program*. Manila; and ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Results-Based Loan and Technical Assistance Grant to the Republic of Uzbekistan for the Affordable Rural Housing Program*. Manila.

⁴ The housing stock in Uzbekistan increased by nearly 180 million square meters (m²), or about 1.2 million new dwellings, since 1999. Housing construction averaged 8.9 million m² or 59,700 dwellings annually. Since the population of Uzbekistan is expected to increase by 6 million over the next 10 years (from the current 32 million), this will require an additional 100 million m² of housing per year, the equivalent of about 67,000 new dwellings annually. If the estimated current housing shortage of about 138 million m² is added to this, a total of 150,000 house units will need to be built per year, which would require to double the existing output, and focus on urban areas to counter the increasing urbanization. United Nations Economic Commission for Europe. 2015. *Country Profiles on Housing and Land Management: Uzbekistan*. Geneva (p. 33).

⁵ By ADB's last count, Uzbekistan has at least eight different government housing subsidy programs, targeting for instance the rural and urban population, young families, teachers, military personnel, or public sector employees.

5. **Low mortgage finance intermediation by banks.** The mortgage loan portfolio of Uzbek banks increased steadily during 2008–2016. In 2008, mortgage loans totaled SUM369 billion (6% of banks' total loan portfolio and 1% of gross domestic product). As of October 2018, the amount had grown to SUM12.8 trillion (equivalent to \$1.55 billion at the official exchange rate), but still only represented 8.2% of banks' total loan portfolio. These indicators are very modest compared with more mature markets—the percentage of mortgage loans to the total loan portfolio in banks in the United States and most European countries is about 50%. The ratio of mortgage loans to gross domestic product in selected countries of the Commonwealth of Independent States is about 4.3% (Russian Federation) and 12% (Georgia), while it is only 3.8% in Uzbekistan.⁶

6. **Limited internal capacity and no access to long-term funding.** Most commercial banks have limited experience and insufficient internal capacity to properly design, analyze, price, and service mortgage loans, and very limited access to long-term funding (beyond 1 year). This adds to the challenges for the banking industry, which struggles to provide commercially priced yet affordable mortgages. The capital market in the country is severely underdeveloped and illiquid: it has no bond market to mobilize long-tenor financing from institutional investors such as pension funds or insurance companies. New instruments such as long-term saving plans for households are also absent. Recent changes in the monetary policies of the Central Bank of Uzbekistan and a rise of the refinancing rate from 9% in 2016 to 14% in July 2017, and to 16% in September 2018 substantially increased the interest rate risk in the short term for banks and other market participants in earning a robust risk-adjusted return.⁷

7. **Need for a larger role by banks to meet market demand.** Since 2009, the government has pursued its strategy of supporting housing finance (both construction and mortgage lending) through a series of state housing programs delivered by public banks.⁸ As a result, out of 19,466 mortgage loans provided in 2016, 87% by number and 77% by volume fell under the various state housing programs. This had the effect that the mortgage loan portfolio of public banks increased on average by 45%. Coupled with the global financial and economic crisis, this resulted in a drop of private banks' share in the total mortgage loan portfolio from 24% in 2008 to 3% as of the end of 2016.

8. **Fragmented framework of housing policies and subsidy schemes.** Although the government recognizes the importance of housing finance for economic and social development, Uzbekistan does not have a comprehensive, unified housing policy and subsidies framework. The present housing policy structure is dominated by various worthwhile but isolated and overlapping government programs that lack coordination. These programs were not always consistently designed and are not cost-effective in their targeting, resulting in inefficient use of the limited fiscal resources.⁹

B. Policy Reform and ADB's Value Addition

9. The program aims to support a market-based mortgage finance industry, improve access to mortgage finance, and expand product availability to commercial banks and ultimately to all borrowers by (i) undertaking some of the most urgent housing policy, regulatory, and legal reforms; (ii) strengthening the institutional structure for an efficient housing policy and subsidy

⁶ Housing Finance Information Network. www.hofinet.org.

⁷ On 5 September 2017, the official exchange rate was devalued by 92%. As a result of the new monetary policy and liberalization of the foreign currency exchange regime, higher market interest rates are expected in the near future.

⁸ Public banks here are referred to as commercial banks with substantial government ownership and/or control.

⁹ According to ADB's calculations, the total subsidy costs to the government for the existing rural (150,000 houses) and proposed urban housing programs (50,000 houses) by 2040 amount to more than \$5.3 billion or \$26,400 per housing unit.

framework; and (iii) making long-term fixed-interest local currency funds available through a sustainable mechanism and at reduced costs.¹⁰ Given ADB's leading role in supporting the government's goal to develop the housing industry,¹¹ ADB is uniquely placed to advise the government on the program, which will build on the achievements of and lessons from the previous two ADB programs in support of rural housing (footnote 3). The design and monitoring framework (initial draft) is in Appendix 1.

10. **Consistency with ADB strategy and country strategy.** The program supports ADB's Strategy 2030, which aims to (i) overcome poverty and reduce inequalities, e.g., through quality job creation and support for small and medium-sized enterprises; and (ii) make cities more livable, e.g., by expanding inclusive financing sources for infrastructure. In addition, the ADB project encourages private sector development by mobilizing resources for development and supporting financial inclusion of the rural population in the mainstream economy.¹² The project is also consistent with ADB's draft country partnership strategy, 2019–2023 for Uzbekistan, which supports inclusive and sustainable economic growth through financial market development, access to finance, and domestic resource mobilization.

C. Impacts of the Reform

11. The overarching development objectives of the country are macroeconomic stability and sustainable high growth. The effect of the reforms will be improved living standards for the majority of the population. This will be achieved by broadening access to market-based mortgage finance. The outcome of the reforms—availability of affordable mortgage credit increased—will be achieved through the delivery of three outputs: (i) policy, regulatory, and legal framework for the mortgage finance industry strengthened; (ii) housing strategy and subsidy framework strengthened;¹³ and (iii) wholesale mortgage refinancing company established and operational.¹⁴

D. Development Financing Needs and Budget Support

12. To effectively support the sector reforms, ADB will provide a sector development program (SDP) that combines a policy-based loan (PBL) and a project loan.¹⁵ The PBL will support policy actions. The project loan will support the establishment and rollout of the proposed Uzbekistan Mortgage Refinancing Company (UMRC) by providing long-term funding to the company. The ADB program is estimated at \$200 million to be financed from ADB's regular ordinary capital resources. The PBL of \$50 million will be disbursed over a period of 3 years in two equal amount tranches against clearly defined policy actions. The project loan of \$150 million will be lent to the government in United States dollars, which in turn will provide a local currency credit line to UMRC

¹⁰ Overall, the supply side of the mortgage market infrastructure in Uzbekistan is stronger than in many countries of similar income level, and is conducive to the development of housing finance. Further due diligence will serve to ensure that the main supply-side elements are in place and functional to support the key priority areas for reform (supported under output 1) aimed at accelerating the development of housing finance.

¹¹ While ADB is the leading lender to the government in the housing industry through its two rural housing programs, other lenders are also active in this area, e.g., Islamic Development Bank (development of rural housing), World Bank (technical assistance to support the development of housing finance), and United Nations Development Programme (technical assistance to stimulate green housing techniques in the rural areas of Uzbekistan).

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

¹³ It was decided to house the proposed housing assistance unit in the Ministry of Finance given the ministry's capacity for it and past experience in coordinating the participation of other key agencies such as the central bank.

¹⁴ In response to a specific request from the Government of Uzbekistan received in January 2019 to help with the preparation of a strategy for financial market reforms, ADB is currently in discussion with the government to carry out a sector diagnostic analysis.

¹⁵ The investment component of the SDP will be provided through a project loan which satisfies the requirements of Financial Intermediation Loans under OMD6.

for onlending to qualified commercial banks.¹⁶ The government will absorb the foreign currency exchange risk. A preliminary sector assessment and the business plan for UMRC indicate that the amount is reasonable and required to support the operationalization of the company in its initial years. Outputs 1 and 2 will be covered under the PBL, while output 3 will be covered under the project loan.

13. The proposed SDP modality is justified because the housing finance sub-sector requires both an investment component and a policy reform component, which are interlinked. While the PBL will focus on reforming the country's existing housing subsidy and policy framework and strengthening the implementation and monitoring capacity of the government, these activities would not be sufficient for a true reform without involving the private sector and mobilizing long-term funds, first through the project loan from ADB and, once the Uzbek capital markets are sufficiently developed, from institutional investors by issuing bonds through UMRC. Therefore, the SDP will ensure that reforms to improve market intermediation are pursued continuously, government housing policy and programs are streamlined, a coherent government system to support low- and middle-income borrowers is developed, and much-needed long-term financing to banks to expand market-based mortgage products is provided through the establishment of UMRC.

E. Implementation Arrangements

14. The Ministry of Finance will be the executing agency for the program. The Central Bank of Uzbekistan, the State Committee on Statistics, the Center for Securities Market Control and Coordination, and the Ministry of Finance are proposed to be implementing agencies. The proceeds of the two loans will be drawn down in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

III. TECHNICAL ASSISTANCE

15. A transaction TA of \$0.800 million from ADB's Technical Assistance Special Fund (TASF-other sources) is proposed to be attached to the program to help implement the policy actions under the second tranche of the PBL, and support the establishment and operations of the proposed UMRC under the project loan.¹⁷ The transaction TA will also provide capacity-building support to rectify any deficiencies identified during the due diligence of participating financial institutions, and to build awareness on standards and requirements.¹⁸

¹⁶ The proposed project loan will be structured as a Financial Intermediation Loan.

¹⁷ The transaction TA will build on the outputs of two other TA interventions: (i) knowledge and support TA of \$560,000 for the Mortgage Market Development Program, which produced the business plan for UMRC, including a road map for its operationalization and an outline of the regulatory changes required to ensure market uptake, and is financed by ADB's Technical Assistance Special Fund (TASF 6 and TASF-other sources); and (ii) TA of \$500,000 to be financed on a grant basis by the Republic of Korea e-Asia and Knowledge Partnership Fund, which is currently being processed to support the operationalization of UMRC.

¹⁸ Further, the use of eligibility criteria and covenants by UMRC will help promote the standardization of market lending practices and documentation.

IV. DUE DILIGENCE REQUIRED

16. Due diligence to be carried out is summarized as follows:
- (i) For the program: (a) assessment of the overall economic viability and sustainability of the program; (b) development of policy actions to improve public finance management, eliminate excessive subsidies, and streamline the existing state housing finance programs; and (c) preparation of a sector analysis, including an impact assessment of the program.
 - (ii) For UMRC: (a) preparation of the financial, integrity, legal, and regulatory due diligence; (b) review of the proposed corporate governance standards for UMRC; and (c) development of an environmental and social safeguard monitoring framework.

V. PROCESSING PLAN

A. Risk Categorization

17. The risk category is *complex* because the aggregate loan amount exceeds \$50 million.

B. Resource Requirements

18. The program will be processed by ADB staff with expertise in the finance sector and public finance. Staff will dedicate an estimated total of 8 person-months to process the program. Additional resources will be provided under the proposed transaction TA to support the implementation of some of the second-tranche policy actions.

C. Processing Schedule

19. The table below lists the major milestones.

Proposed Processing Schedule	
Milestone	Expected Completion Date
Fact-finding mission	February 2019
Management Review Meeting	June 2019
Loan negotiations	July 2019
Board discussion	September 2019
Loan signing	October 2019
Loan effectiveness	November 2019

VI. KEY ISSUES

20. The main issues include (i) ensuring strong political commitment and government ownership for initiating key policy changes under the program, and (ii) establishing the proposed UMRC, as an independent and financially resilient entity with a strong governance framework. No major poverty, social, or gender issues are manifest at this early stage. The processing team will consider these aspects while designing the program. The processing team may ask for support from other departments once significant issues are identified.

DESIGN AND MONITORING FRAMEWORK
(Initial Draft)

Impact of the Program is Aligned with Improved living standards for the majority of the population (National Development Strategy 2016–2020) ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome Availability of affordable mortgage credit increased	By 2022: a. Share of total mortgage loan portfolio in overall loan portfolio of all banks increased to y% (2018 baseline: 8.2%) b. Lengthening of the average tenor of market-based mortgage loans to z years (2018 baseline: 7 years)	a.–b. Annual report of the Central Bank of Uzbekistan	Employment and income levels decrease in the country, and interest rates increase. The commitment of the government toward the reform momentum is not sustained because the immediate priorities change.
Outputs 1. The policy, regulatory, and legal framework for the mortgage finance industry is strengthened (to be covered under the policy-based loan)	By July 2021: 1. Policy and institutional measures adopted to minimize the constraints faced by commercial banks in expanding market-based mortgage lending (2018 baseline: not in place)	1. Presidential resolutions and decrees; MOF order; resolution of the Cabinet of Ministers	Commercial banks do not invest in UMRC's equity because the expected returns are too low, corporate governance standards are insufficient, or minority shareholder protection is inadequate.
2. Housing finance strategy and subsidy framework strengthened (to be covered under the policy-based loan)	By July 2019: 2a. Housing finance strategy adopted (2018 baseline: not in place) 2b. HAU established (2018 baseline: not established) 2c. Monitoring and information systems for housing policy results analysis upgraded and established under HAU (2018 baseline: not in place) 2d. Revised operational guidelines of housing subsidy programs approved (2018 baseline: not in place)	2a.–b. Order of MOF 2c. Joint HAU–State Statistics Committee reports (annual) 2d. MOF order	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<p>3. Wholesale mortgage refinancing company established and operational (to be covered under the project loan)</p>	<p>By July 2019:</p> <p>3a. UMRC incorporated (2018 baseline: not in place)</p> <p>3b. Shareholder subscription agreement signed for the total capital of \$[XX] million (2018 baseline: not in place)</p> <p>3c. Environmental and social safeguard monitoring framework adopted (2018 baseline: not in place)</p> <p>3d. Procedures and policies for lending operations, treasury operations, risk management, and transparent risk-based pricing adopted by UMRC (2018 baseline: not in place)</p> <p>Under transaction TA 51348-003:</p> <p>3e. Regulatory and supervisory framework for UMRC established (2018 baseline: not in place)</p> <p>3f. Management information system for UMRC established (2018 baseline: not in place)</p> <p>3g. Information and communication technology platform for UMRC established (2018 baseline: not in place)</p> <p>By July 2021:</p> <p>3h. UMRC provides long-term funding of \$XX million to the commercial banks for the financing of YY mortgages (2018 baseline: not in place)</p> <p>3i. UMRC provides refinance loans to at least three Participating Financial Institutions (2018 baseline: not in place)</p>	<p>3a. Incorporation certificate</p> <p>3b. Shareholder agreement</p> <p>3c.–d. Minutes of UMRC's board meeting</p> <p>3e. Amendments to the central bank's regulatory documents</p> <p>3f. Annual report of UMRC to ADB</p> <p>3g. Online website of UMRC</p> <p>3h. UMRC's board minutes</p> <p>3i. Master loan agreement signed by UMRC and each Participating Financial Institution management</p>	

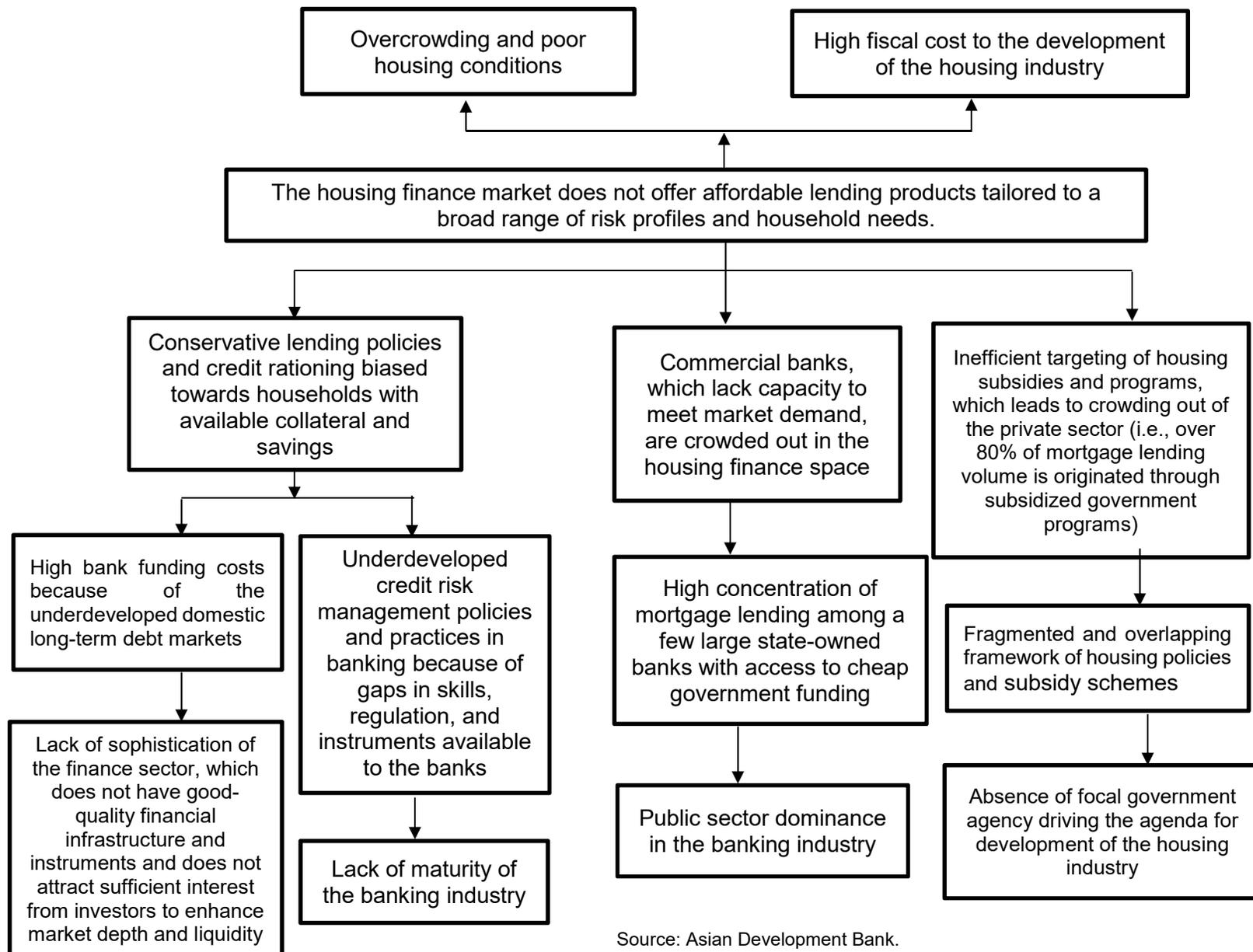
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	3j. Introduction by UMRC of three lending products tailored to commercial banks' needs (2018 baseline: not in place)	3j. Letter certified by UMRC's management and feedback from commercial banks incorporated in annual progress report by UMRC	
Inputs			
Asian Development Bank: \$200 million (regular ordinary capital resources loan)			
Government: \$5 million			
TA: \$0.800 million			
Assumptions for Partner Financing			
None			

HAU = Housing Assistance Unit, MOF = Ministry of Finance, UMRC = Uzbekistan Mortgage Refinancing Company.

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

Source: Asian Development Bank.

PROBLEM TREE



LIST OF LINKED DOCUMENTS

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

1. Initial Poverty and Social Analysis