Armenia - Creation of a Sustainable Market for Housing Finance (Phases I&II)

Ex post evaluation report

OECD sector	2403000	
BMZ project ID	2005 65 275 (Phase I) 2007 66 717 (Phase II) 2005 70 135 (Complementary measure) 2005 340 (B+AT measure)	
Programme executing agency	Central Bank of Armenia	
Consultant	Frankfurt School of Finance & Management	
Year of ex post evaluation report	**2010 (2010 sample (Phase I), 2011 (Phase II))**	
	Programme appraisal (planned)	**Ex post evaluation report (actual)**
Start of implementation	3rd quarter 2006 (I) 1st quarter 2008 (II) 3rd quarter 2006 (CM, B+AT)	1st quarter 2007 (I) 1st quarter 2008 (II) 1st quarter 2007 (CM, B+AT)
Period of implementation	20 months (I) N.A. months (II) 26 months (CM, B+AT)	36 months (I) 24 months (II) 28 months (CM, B+AT)
Investment cost	N.A.	N.A.
Counterpart contribution	N.A.	N.A.
Financing, of which Financial Co-operation (FC) funds	EUR 6.0 million (I) EUR 6.0 million (II) EUR 1.5 million (CM, B+AT)	EUR 6.0 million (I) EUR 6.0 million (II) EUR 1.5 million (CM, B+AT)
Other involved institutions / donors	--	--
Performance rating	I: 2 II:2	
• Relevance	I: 2 II:2	
• Effectiveness	I: 1 II:1	
• Efficiency	I: 2 II:2	
• Overarching developmental impact	I: 1 II:1	
• Sustainability	I: 2 II:2	

Brief description, overall objective and programme objectives with indicators

The programme objective was to develop the long-term retail lending business of private finance institutions in the segment of home mortgages and housing modernisation finance. The overall objective was to contribute to improving the housing conditions of the population and to deepening and broadening the financial system (incentive for developing a local capital market) by reducing existing weaknesses in the finance institutions and improving the supply (maturity and availability) of housing finance. In compliance with the request of the Armenian Government, among the bilateral and multilateral actors KfW, as the agency in charge of German Financial Cooperation, was commissioned to take a lead role in the creation of a sustainable market for housing finance. The support in this market segment is intended to be long-term and, commencing with this programme, was designed to make a significant contribution to creating a solid housing finance market and, in the medium term, to creating donor-independent sources of funding as well.

Under the programme, a total of EUR 12 million was provided in two phases to selected partner finance institutions (PFIs) to fund their long-term lending. The funds were channelled to them through the German Armenian Fund (GAF), a competent project unit which has implemented diverse programmes aimed at providing accessible finance for MSMEs in Armenia. Staff of the GAF were prepared intensively for the tasks under a training measure (EUR 1.0 million), and staff of the credit institutions received training under the B+AT measure (EUR 0.5 million). In connection with the training measure, so-called minimum quality standards (MQS) for the lending business that must be met by each bank participating in the programme were developed in cooperation with the credit institutions and the consultant.

The achievement of the overall objective was measured by four indicators: (a) loan maturities of ten years in at least six banks by the end of 2007, (b) growth of the housing finance portfolio in Armenia by at least 40% p.a. in 2006 to 2008, (c) application of the MQS to at least 25% of the volume of all new housing loans by the end of 2008, and (d) creation of the initial foundations for the development of a secondary market (primarily laws) by 2008. The achievement of the programme objective was measured using the following seven indicators: evidence of a high quality of loan portfolios, (b) intensification of competition, (c) increase in the share of local currency in the lending business from 2% to at least 20% of the volume of new loans by the end of 2008, (d) attendance by at least 100 bank employees of the training courses developed under the complementary measure and continuation of the courses, (e) ability of the PNU at the end of the complementary measure to independently perform the tasks of the programme, (f) mobilisation of five additional donors to become involved in housing finance and (g) availability of a sufficient number of instructors required for a sustainable continuation of the courses and use of scholarships for bank employees by at least twelve finance institutions.

<u>Programme design / major deviations from the original programme planning and their main causes</u>

The FC loan was provided to the Central Bank as the borrower and recipient at IDA terms and conditions. The Republic of Armenia, represented by the Ministry of Finance and Economy, guarantees the repayment. The funds were channelled to the PFI through the GAF at market-driven interest rates. The interest differential funds were used to finance the operational expenditure of the PMU, to grant additional loans and to assume the exchange rate risks incurred by the Central Bank.

The PFIs were selected on the basis of their financial stability and the requirement that they must not have breached any of the Central Bank guidelines in the two years before joining. The stability of the PFIs and their conduct in relation to the mortgage loans and, in particular, the MQS, are being monitored, and loans that are more than 90 days overdue must be repaid by the relevant institution to the GAF after a period of notice. The GAF PMU also reserves the right to pay visits to sub-borrowers.

Initially founded for the purpose of establishing a securitisation market in the housing sector, the Project Management Unit of the Central Bank was converted into the National Mortgage Company (NMC). As a measure aimed at stimulating the economy, the NMC also offers funding for housing loans at interest rates that are slightly different to those of the FC programme.

Key results of the impact analysis and performance rating

Against this background, we have arrived at the following rating of the programme's developmental efficacy (details on performance assessment can be found in the technical information sheet "Criteria and rating system in ex post evaluation reports on German bilateral FC" (14 September 2006)):

Relevance: The objectives of the programme are in line with the development policy concepts of both the Armenian Government and the German Government. It must be regarded as part of the German development cooperation priority "sustainable economic development" which, in agreement with the development policy objectives of the Armenian Government, is aimed at improving the economic and social conditions for the Armenian private sector. The cooperation in the sector, including with other donors, is running smoothly. The focus of German Financial Cooperation lies primarily on creating and supporting a functioning financial system, an objective that is also in line with the Millennium Development Goals. The core problem in the sub-sector of financial system development consists primarily in the fact that the young Armenian financial system must be brought up to international standards, and a particular weakness is the lack of access to long-term financing instruments, especially for the purchase and renovation of homes.

The objectives of the programme (and of the related projects) continue to be of high relevance for the country's development. The assumed impact chain of this programme was structured as follows. The increase in the supply of funding for housing loans and the associated basic and advanced training measures were designed to contribute to broadening (expanding the product of home finance) and deepening (adding a new customer group, particularly in rural areas) the Armenian financial system and, in this way, to also durably supply hitherto undersupplied groups of the population (households with low to medium income) with target group-oriented home finance products. In addition, the introduction of minimum quality standards in lending business was intended to raise the professionalism of the sector and create a demonstration effect that was expected to permeate the entire financial sector. This impact chain is largely plausible. It is reasonable to conclude that access to finance has improved particularly for the medium income groups which previously did not have any access to housing finance. The programme appears to have been of less direct poverty relevance, as the focus was primarily on developing the home finance market and, in this context, medium income groups are certainly easier to reach at the outset than low income groups. The programme offers incentives to members of medium income groups, which mostly consist of skilled workers, to remain in the country if they are successful so that they can make important contributions to its economic development. In the long term, however, it is quite possible that as the mortgage market continues developing lower income groups will increasingly gain access to longer-term housing finance as well. In addition, the programme will also help to increase the incomes of less qualified workers by stimulating investment in home renovations. Furthermore, the creation of home ownership can contribute to stabilising the country politically and economically. We rate the relevance as good (sub-rating 2).

Effectiveness: The programme objective was to develop the long-term retail lending business of private finance institutions in the segment of home mortgages and housing modernisation finance. The indicators were well selected and formulated to measure the objective of improving the credit supply, and it is also plausible that a correlation between the improvement of the credit supply and the improvement of housing quality can not only be implicitly assumed but will actually have an effect. Overall, the results for almost all indicators of the programme objective except one (mobilisation of five additional donors in the area of home finance) and of the overall objective (see section "Overarching developmental impact") were achieved and in many cases were even clearly overachieved. A particularly positive aspect is the quality assurance system in place for the mortgage lending business; the expertise in the sector has been preserved not only within the banks but by occupying positions at the NMC with staff from the consulting firm. Although some of the indicators may have been too soft, the simultaneous achievement of most indicators demonstrates that the programme can be rated as having exceeded the expectations. We therefore rate the effectiveness of the programme as very good (sub-rating 1).

Efficiency: The GAF PMU is currently on-lending the loan to the finance institutions at an interest rate of 8.75% and charging a commission of 0.6% (from 2010: 0.5%) for the management costs, which covers the costs of the GAF. The Central Bank deposits the differential to the FC loan interest rate of 0.75% p.a. in a "revolving fund" which is available for re-lending under the programme, and it also carries the exchange rate risk. The refinancing interest rate is at the lower edge of the recently increased interest rates for deposits but can still be described as being in line with the market. The margin of 3.25% to 5.25% which the credit institutions are charging to cover loan losses and administrative costs also appears to be reasonable, particularly since the mortgage loans are very labour-intensive. Refinancing is provided for 8 years with the requirement that the bank must grant ten-year loans, which creates some pressure for a slight maturity transformation. The rate of sub-performing loans is very low at 0.83% (PAR>30= 0.25%). The programme has achieved the developmental objectives in an efficient manner; both allocation efficiency (market conditions, low number of non-performing loans) and production efficiency (cost recovery) are very good, the "prices" for the recipients result from the requirement to follow the market, but they could even be improved in future projects (and in the continued revolving use of the programme funds) through a further extension of maturities so as to also reach groups of the lower medium-income segment. To achieve this, however, the refinancing options would have to be adjusted accordingly and free-rider effects could not be ruled out. A drawback is the existence of two refinancing institutions. The granting of loans at different conditions could well be justified from the perspective of an economic stimulus programme during the financial crisis, but conditions should now be harmonised and the Armenian side is willing to do this. Overall, we rate the efficiency of the programme for the time being as good (sub-rating 2).

Overarching developmental impact: The overall objective of the programme was to reduce existing weaknesses in the finance institutions and to improve the supply (maturity and availability) of housing finance in order to contribute towards improving the housing conditions of the population and to deepening and broadening the financial system. Just as for the specific programme objective, all indicators of the overall objective (loan terms of ten years in at least six banks, growth of the mortgage loan portfolio by at least 40%, application of the MQS to 25% of mortgage loans and creation of legal bases for the secondary market) have been achieved, and indicator No. 2 (growth of the mortgage loan portfolio) has even been overachieved. The question of attributability is relevant here as well, although it is observable that indicators 3 (MQS) and 4 (laws), which are only qualitatively measurable, are unmistakably attributable to the programme. It is plausible that, considering the development of the interest rates and the lending volume, as well as the observable broad impacts produced by the training measures, the programme had a strong catalyst effect on the longer-term mortgage lending business and contributed to intensifying competition as a result of falling mortgage interest rates. The programme can also claim to have provided an incentive for prolonging loan maturities. The programme is unlikely to be the single cause of the observed growth rate of the mortgage market, but it is very likely to have had indirect positive impacts (particularly through the MQS and the basic and advanced training) even if these impacts cannot be quantified. The programme has made a developmentally meaningful contribution. Structures were created through the MQS, the training measures and the reliable refinancing possibilities that enabled professional loan appraisals and corresponding loan monitoring and, thus, also significantly improved the supply of longer-term loans. First and foremost, the maturities and the share of local currency loans increased significantly, competition among the credit institutions has intensified and the margin between debit and credit interest in the mortgage business has significantly improved. It is not possible to prove that a correlation exists between this development and the programme without conducting a time-consuming investigation, but it can be regarded as certain that the programme acted as a catalyst in this development, primarily with regard to the prolonging of loan terms and the increase in the share of local currency loans. We rate the overarching developmental impact as very good (sub-rating 1).

<u>Sustainability:</u> The progress of the programme thus far suggests that the created structures for the lending business, the loan appraisals and the quality standards will remain effective. The talks we have held indicate that the banks would continue the mortgage loans even without the funds of the GAF. The decisive problem affecting the continuation of the mortgage lending business, however, is that the market still does not provide adequate long-term funding options. So far no functioning private capital market has emerged out of the passage of the law on "covered mortgage bonds" und "asset backed securities". This is due to the impacts of the financial crisis, whose political fallout will also make it very difficult to build up a retail market for "asset backed securities" in the near future. Even if the programme executing agency has responded to this development by establishing the NMC and has demonstrated a pronounced sense of ownership, it has to be stated that donor-independent refinancing will not be available in a sufficient volume in the near future either. However, the GAF as part of the Central Bank is continuing to perform its function (and in Phase III of the programme). There are plans to harmonise the duplicate structures of the GAF and the NMC by standardising the lending guidelines and the refinancing under a single roof. Even if this were to occur under the umbrella of the NMC, the GAF would continue to maintain its remaining functions and it or KfW would continue to be able to influence the lending guidelines through a seat in the supervisory bodies of the GAF. One of the changes that could be envisaged would be a gradual prolongation of loan maturities. We rate the sustainability of the programme as good (sub-rating 2).

In the overall assessment, the somewhat vaguely defined objectives of the programme (programme objective and overall objective) can be divided into two outcomes/impacts that correlate with each other:

- Expansion of the lending business for retail customers (private finance institutions) and, thus, deepening and broadening of the financial system (development of donor-independent financing)
- Contribution to the improvement of the housing conditions through the improvement of the supply (maturities and availability) of housing finance

As the stated indicators generally describe these outcomes/impacts well (under the assumption that an improvement in the supply of credit also improves the housing conditions), and as the indicators have all been achieved, the programme can be rated a success. In our overall assessment, however, it is questionable whether the catalyst effect of the programme has exceeded all expectations, since other banks that have not participated in the programme are also successful (and have been successful before the programme) in the housing finance business.

With regard to the impact (particularly the macro-economic impact), only assumptions can be made, that is, it is plausible that the programme had a stimulating effect on the economy primarily through its impact on demand, and that it also contributes to political stability by bringing security to the living conditions of the beneficiaries. After weighing these aspects and the above described sub-ratings, which document outcomes that fully meet or even exceed the expectations, we rate the overall developmental efficacy of the programme as good (sub-rating 2).

General conclusions and recommendations

None.

Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being relevance, effectiveness, efficiency and overarching developmental impact. The ratings are also used to arrive at a final assessment of a project's overall developmental efficacy. The scale is as follows:

1	Very good result that clearly exceeds expectations
2	Good result, fully in line with expectations and without any significant shortcomings
3	Satisfactory result – project falls short of expectations but the positive results dominate
4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
6	The project has no impact or the situation has actually deteriorated

Ratings 1-3 denote a positive or successful assessment while ratings 4-6 denote a not positive or unsuccessful assessment

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability) The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The overall rating on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Ratings 1-3 of the overall rating denote a "successful" project while ratings 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally "successful" only if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are rated at least "satisfactory" (rating 3).