



HSP

HSP/WUF/2/7



UN-HABITAT



Distr.: General
23 July 2004

English only

Second session

Barcelona, 13–17 September 2004

Item 5 (b) of the provisional agenda*

Thematic dialogues: Urban resources

Wednesday 15 September, 3 – 6 p.m.

Dialogue on urban resources

Abstract

The number of urban poor across the globe will double to 2 billion by 2030, dwarfing the Millennium Development Goal of improving the conditions of 100 million slum-dwellers by 2020. This prospect calls for all-round mobilization of available development partners and resources in favour of slum upgrading. The present paper takes a sustainable view of slum upgrading, setting improvements in shelter and infrastructure in the broader context of economic and social development. After a review of development partners, their approaches and their specific limitations, it focuses on sources of finance for housing and infrastructure. Apart from inadequate international financing, domestic sources of capital (including the private, non-governmental organization and informal sectors) are the most important and also the most promising despite the specific challenges that each of them faces. More effective mobilization of available resources in favour of slum upgrading calls for a number of reforms. Statutory and regulatory frameworks need adjusting and established institutions should do more to support and mainstream innovations pioneered by non-governmental organizations and the informal sector. Official development assistance (ODA) should leverage domestic efforts through well targeted financial and technical assistance. The paper ends with a few suggestions for discussion at the second session of the World Urban Forum.

* HSP/WUF/2/1.

K0471978 160802

For reasons of economy, this document is printed in a limited number. Delegates are kindly requested to bring their copies to meetings and not to request additional copies.

Contents

Discussion points	2
Dialogue on urban resources	2
I. Urban poverty, slums and upgrading	2
A. Urban poverty and slums	2
B. Defining slum upgrading	3
C. Development partners and their approaches to slum upgrading	3
II. Finance for housing and urban infrastructure: current status	4
A. International sources	4
B. Sources of domestic capital and access problems	5
III. Mobilizing resources	7
A. Domestic capital: overcoming the bottlenecks	7
B. Contribution and role of the international community	9
C. Organizing the dialogue at the second World Urban Forum	11

Discussion points

- ÿ Slums are a product of urban poverty and of institutional and political shortcomings;
- ÿ Even if increased, the contribution of international financing (including ODA) towards the needs of slum-dwellers can only be marginal;
- ÿ Upgrading slums requires a broad policy and legislative reform, community mobilization and institutional capacity-building;
- ÿ The various domestic sources of capital have a major role to play, must work together and must promote innovation;
- ÿ ODA should aim at leveraging domestic sources through well targeted financial and technical assistance.

Dialogue on urban resources

I. Urban poverty, slums and upgrading

A. Urban poverty and slums

1. Poverty in developing countries is increasingly urban and located in informal settlements. Today some 900 million people live precariously in slum areas. Living and working conditions in informal settlements are characterized by an absence of adequate housing and sanitation, of clean drinking water, education, health care, roads, electricity, and gainful forms of employment. The moral situation is marked by the deterioration of the social fabric, trust, basic human rights, and urban citizenship. Future growth in the world population will be concentrated in the urban centres of the south and the bulk of it in slum areas. World poverty will predominantly expand in these urban settlements. The number of urban poor is projected to double to 2 billion by the year 2030.

2. Although they still feature the world's largest rural population (70 per cent on average), countries in sub-Saharan Africa are urbanizing at an alarming rate. Capital and secondary cities are doubling in population every 15–20 years. But accelerated urbanization does not go hand-in-hand with strong economic growth, a major cause of urban poverty in Africa, and to a lesser extent in Asia. This is in sharp contrast with much of Europe and North America in the past century, when rapid urban growth occurred at a time of massive industrialization and associated economic expansion. In transition countries, urban poverty is characterized by rapid growth of substandard housing, gentrification of neighbourhoods, and the withdrawal of capital from investment in the existing housing stock.

3. Whereas urban poverty is certainly one factor behind the expansion of slums, these are also a product of a number of shortcomings: failed policies, bad governance, inappropriate legal and regulatory frameworks, dysfunctional land markets, unresponsive financial systems, and, ultimately, a lack of political will. The latter is not confined to Governments of the developing world. The international community has been slow to recognize the realities of urban poverty and to channel resources accordingly.

B. Defining slum upgrading

4. The narrow definition of slum upgrading refers to improvements in shelter and basic infrastructure. In a broader sense, upgrading also includes enhancements in the economic and social processes that can bring about such physical improvements.

5. The term “slum upgrading” gained significance in 2000 when United Nations Member States unanimously adopted the Millennium Declaration, pledging to promote cities without slums and “to improve the lives of 100 million slum-dwellers by the year 2020.” The United Nations task force on target 11 – established to monitor the Millennium Development Goal target of “cities without slums” – measures improvement of slum-dwellers against four benchmarks: security of tenure, access to safe drinking water, adequate housing, and affordable urban basic infrastructure. International development cooperation agencies, non-governmental organizations and public-sector programmes complement this list with factors such as income, employment and gainful productive activity, including access to credit, markets, and entrepreneurial skills.

6. In practical terms, the process of upgrading slums requires a broader policy and legislative reform, community mobilization and institutional capacity-building that can improve employment opportunities for slum-dwellers, increase their participation in planning processes, strengthen the capacity of local authorities and integrate slums into the wider urban economy and polity.

7. Significantly, many United Nations Member States recognize that improving the lives of slum-dwellers – and, in a broader sense, the cities in which they are located – can only be part of a wider strategy to tackle urban poverty. Slum upgrading deals with the existing population. Sound national and regional economic policies matter. It is spurious to assume that, in a democracy, the Government can reverse or even stop the flow of migrants from rural to urban areas. Even in apartheid South Africa, urbanization continued, only partially abated by pass laws. People have the right to move even if urban poverty flouts their initial expectations. But Governments can mitigate the pace of urbanization and mandate municipal authorities to plan for and manage the growth of cities.

8. At the national level, such mitigation includes spatial macro-economic planning to steer the growth of secondary and tertiary cities, in an effort to diversify opportunities for poor rural populations looking to move to capital cities. Mitigation also entails promoting peace and security as well as sound economic opportunities in rural areas, such as agricultural development, small-scale industries, and mining, which many people leave prematurely to escape social unrest and poverty.

C. Development partners and their approaches to slum upgrading

9. Various stakeholders such as national Governments, municipal authorities, communities and their organizations, private industry, professional associations and non-governmental organizations are involved in slum upgrading. Their respective approaches differ across countries and even from city to city. The main general trends are outlined below:

(a) National slum upgrading programmes, such as those in Kenya and Mexico, are large-scale initiatives that rely on policy and legislative reform as well as demonstration pilot projects. They include efforts to guarantee the rights of slum-dwellers and their organizations, including the outlawing of violent and forced evictions, to promote local self-governance and to enact legislation that will enable local authorities to involve community-based organizations, non-governmental organizations and business firms in the delivery of basic services. National programmes also include pilot projects in selected cities for practical demonstrations of policy reforms and also to introduce new municipal management practices and encourage public and private investment;

(b) Where slums and informal settlements host the majority of the urban population, city planning cannot be split from slum upgrading. Urban planning and upgrading are one and the same.

Those officials and civil servants aware of this fact recognize the importance of bringing communities and their organizations directly into the planning process, and of including informal settlements in service delivery schemes. In some cases, municipal authorities tender service delivery contracts to community-based organizations and supporting non-governmental organizations, recognizing that services are more likely to reach the urban poor through these channels. Where the formal business sector is in charge of water, sanitation and roads, municipal authorities look to cross-subsidize revenues to make these services more affordable to poor households;

(c) The non-governmental organization sector, typically, approaches slum upgrading in one of two ways. Either it provides services directly to slum-dwellers, or it supports strategies that empower them to participate in, and negotiate, the delivery of services. Those organizations that deliver services do so in almost all sectors including health, education, housing, water, sanitation, business training and electric power. In these functions, non-governmental organizations are supported, primarily, by bilateral development cooperation agencies and private foundations; they often operate at arm's length from local authorities and other such organizations, and provide services selectively and for specific periods of time. Those non-governmental organizations that adopt an empowerment strategy put slum-dwellers in a position to set up their own groups, define priorities, plan, advocate, and participate directly in all efforts (their own and others') to improve their basic living and working conditions. Empowerment strategies – working with rather than for the urban poor – are sustainable and highly cost-effective, but relatively few non-governmental organizations endorse them and their impact is limited given the magnitude of the problem;

(d) Many slum-dwelling, low-income households regroup to address their needs independently from national Governments, municipal authorities and non-governmental organizations. This is a big challenge given the many disparities that can keep slum-dwellers apart: religion, wealth, ethnic background, association, sex, age and livelihood. Slum-dwellers are most effective when they come together to address specific issues such as schools, roads and sewerage systems. Comprehensive community-based upgrading can happen but is quite unusual. Community groups can also take the form of organized crime, especially where the rule of law is weak and where police and provincial authorities are spread thin or corrupt. It is important to note that the vast majority of the urban poor living in slums and informal settlements are not organized in community action groups. Most of these households, however, are affiliated with some form of social organization, be it a place of worship or of informal employment;

(e) Private investment in slums and informal settlements varies significantly. At one end of the spectrum, individual households invest scarce resources in basic shelter and essential services. At the other end, commercial property developers invest in development schemes, often on the peripheries of slums. Property developers operate either as independent investors or on contract for public sector programmes. In between the two extremes are individual investors who provide basic shelter with basic services for rent. Some of them are of modest means, reside in the slums and operate the structures as a primary source of livelihood. Others are wealthy individuals or syndicates living outside the slums and who rent out the structures as viable commercial enterprises. Both resident and absentee landlords may or may not hold title to the land on which they erect structures, but more often than not they own structures on land that belongs to the government, business firms or individuals.

II. Finance for housing and urban infrastructure: current status

10. In developing countries, total investment in housing and related infrastructure tends to range between 3 and 8 per cent of gross national product (GNP), depending largely on the income level of the country concerned. On aggregate, these investments amount to around \$300 billion. This will not enable developing countries to reduce the growth of urban slums as mandated by the Millennium Development Goals.

A. International sources

11. Multilateral and bilateral assistance for housing and urban infrastructure comes short of 5 billion dollars annually, and less than 20 per cent of this amount (or roughly 1 billion dollars) is for slum upgrading. Not surprisingly, the beneficiaries of such meagre assistance do not include housing and

urban infrastructure in the poverty reduction strategy programmes which they submit to multilateral financial institutions. Whereas business sector investment in infrastructure increased rapidly during the 1990s and totalled more than \$750 billion over the 1990–2001 period, only 5 per cent of this has gone to water and sanitation, of which only a small proportion has been directed to slums and informal settlements.

12. Such low investment in housing and urban infrastructure stands in stark contrast to the amounts required to address the current needs of slum-dwellers. As agreed by United Nations Member States in 2000, target 11 under the Millennium Declaration calls for the improvement of the lives of 100 million slum-dwellers by the year 2020. The cost of achieving this goal is estimated at between \$70 billion and \$100 billion. As for improving the lives of the planet's prospective 1.5 billion slum-dwellers – the number of urban poor anticipated by the year 2020 – the cost is estimated at \$1,000 billion.

13. Increasing total ODA is a prerequisite for achieving target 11, as is a commitment to channelling a significant proportion to the urban sector. That said, even in the best of circumstances, additional – i.e., non-ODA – sources of funding will be required. A doubling of ODA from \$5 billion to \$10 billion, for example, would contribute only 10 per cent towards the cost of meeting target 11, which even then would only slightly mitigate the needs of slum-dwellers around the globe. Clearly, the contribution of international financing (ODA and other public and private sources) towards the needs of slum-dwellers can only be marginal.

B. Sources of domestic capital and access problems

14. Domestic capital is a potentially important, but as yet under-supported and under-used, source of finance for slum upgrading. Developing countries, typically, feature six different sources of domestic capital: commercial banking, housing finance institutions, municipal development banks, micro-finance, non-governmental organization revolving loan initiatives (community development financial intermediaries), and slum-dwellers' accumulated savings associations. As the following review shows, each source mobilizes capital and savings for slum upgrading, in its own way, and faces specific challenges.

1. Commercial loans

15. Commercial lenders in both developed and developing countries offer perhaps the largest potential source of domestic capital for urban upgrading. But most banks are reluctant to lend to low-income households or to municipal authorities for a number of reasons: perceived risk of loan default, poor credit history, absence of collateral and high transaction costs. Commercial lenders in developing countries may also face serious liquidity problems, especially where high interest rates deter non-corporate borrowing and deposits outstrip loans. Retail banks in particular see slum-dwellers as a huge untapped market – a very mixed group representing more than 60 per cent of the urban population. Some banks are responding to this situation with loans for small, medium and micro-businesses, and by purchases of bonds issued by municipal authorities for urban infrastructure. Risk-sharing third-party guarantees support this type of lending. Intermediary institutions that can absorb transaction costs have also featured prominently, especially in small and micro-business lending.

2. Housing finance institutions

16. Housing finance institutions face problems similar to those of conventional commercial lenders but, like banks, they are also an important potential source of capital for slum upgrading. Many housing finance institutions were established to meet the growing housing needs of historically under-served populations in newly independent countries. Other such institutions supplement commercial lenders and provide home ownership and improvement loans to low and middle-income households. The more successful housing finance institutions focus on upper and middle-income households. High interest rates and legal fees have pushed borrowing costs out of the reach of lower-income groups. Loan requirements are another barrier for slum-dwellers, most of whom lack title deeds or other evidence of property ownership as well as verifiable employment records. Like banks before them, some housing finance institutions offer home improvement loans with relaxed credit requirements, supported by third-party guarantees and intermediary institutions (micro-finance and non-governmental organizations). To some observers and industry professionals, such innovation is not to be overlooked, but housing finance institutions should rather focus on middle-income mortgage lending – the rationale being that, in the

absence of acceptable terms and conditions, middle-income households will be too happy to resort to loan products intended for the least affluent, a phenomenon known as “downward raiding.”

3. Municipal development banks

17. Generally speaking, these banks are to urban infrastructure what housing finance institutions are to housing. They help strengthen the capacity of city governments with loans, access to domestic capital markets and financial facilities for urban infrastructure. Municipal bond issuance enables city authorities to attract domestic capital either from pension funds, local banks, municipal development banks or individuals. A form of longer-term borrowing, municipal bonds can finance investments in water, sanitation, roads, other types of urban infrastructure and services, whether bulk city-wide or basic services in slums and informal settlements. The success of municipal development banks rests on their ability to strengthen the capacity of city authorities to use loans and bonds effectively. In practice this means that infrastructure projects must generate enough revenue to repay loans and bonds. For safety's sake, such cost recovery must be diversified – rather than borne entirely by slum-dwellers – and supplemented by public subsidies as well as cross-subsidies from wealthier urban populations. Finally, although municipal development banks vary in their ability to strengthen municipal finance, most are significantly under-capitalized.

4. Micro-finance institutions

18. Micro-finance institutions are major potential providers of slum-upgrading credit to low-income households. The “mini-banks”, as they are sometimes called, collect deposits and make small loans. Their small scale and physical location in or near informal settlements makes them more accessible to low-income households. Micro-finance institutions have traditionally made micro-business loans for amounts as small as \$50. Conventional loan requirements such as collateral and employment history are often relaxed. Prospective borrowers can demonstrate their ability to repay through deposits, references, past-borrowing history and anticipated income flows. Most micro-finance institutions start with very small loans and follow up with larger ones only after borrowers demonstrate their ability to repay. Such institutions have evolved over time and are increasingly diversifying product ranges to include home improvement and small-scale services. These developments are encouraging and offer real financial potential for slum upgrading. But the shift from micro-enterprise to housing entails higher administrative costs associated with such factors as longer periods of repayment, pressure to lend only to persons with proper evidence of land title, and higher default risk. The shift from micro-enterprise to basic urban services entails moving from loans to individuals to loans to groups, with implications for accountability and repayment. A more over-arching limitation of micro-finance institutions is that they are too few and far between to match the credit needs of slum-dwellers.

5. Community development financial intermediaries

19. Community development financial intermediaries are non-governmental organizations (rather than commercial entities). They operate revolving loan funds and act as intermediaries, lending on to low-income households the funds which they receive from public and commercial sources. Like non-governmental organizations, community development financial intermediaries receive grants from Governments, private foundations, charitable organizations and from the banks that provide them with credit (some receive public funding only). In turn, they lend the funds to low-income households and the rate of interest is slightly above their own grant-subsidized cost of funds from commercial banks. The “spread” – the difference between the two rates – pays for the transaction costs associated with educating borrowers and making many small loans. Loan repayments fund new loans. Domestic banks find community development financial intermediaries attractive because they can reach out to lower-income borrowers and absorb risk and transaction costs. The lending practices of these organizations have little to do with conventional banking and include very relaxed terms. Those community development financial intermediaries referred to as “locally managed funds” combine finance with empowerment and are managed by low-income borrowers and their organizations.

6. Accumulated savings organizations and cooperatives

20. Accumulated savings organizations and cooperatives represent yet another source of capital for slum upgrading. Contrary to other sources, they lend on savings accumulated by slum-dwellers, rather than funds from banks, Governments or private foundations. Depositors are eligible for small loans. Loan capacity growth is exponential as borrowers repay loans and new depositors contribute savings. Slum-dwellers, typically, borrow to deal with emergencies, start a micro-enterprise, or improve their shelter and services. The more advanced savings cooperatives also lend for land acquisition, settlement upgrading and community-based mortgage initiatives. A major feature of organizations such as these is that they are managed by slum-dwellers. Direct participation in a scheme involving their own precious savings enhances confidence and trust among slum-dwellers and lays the foundation for collective action to improve their own living and working conditions.

21. In addition, daily saving systems represent a form of accumulated savings organization in which members contribute or repay on a daily basis. Those in very precarious conditions find this easier than setting aside larger sums every month. Yet these prove to be very powerful social organizations. They regroup into associations which, in turn, link up with others to form federations of slum-dwellers with members numbering hundreds of thousands. Slum-dweller federations provide both a source of capital for slum upgrading and a vehicle for social mobilization in favour of the rights of the urban poor.

III. Mobilizing resources

A. Domestic capital: overcoming the bottlenecks

22. The wide range of sources described above is evidence of the potential of domestic capital for slum upgrading. If adequately harnessed, funding from banks, housing finance institutions, municipal development banks, micro-finance institutions, community development financial intermediaries and accumulated savings associations and cooperatives is formidable. Overall, domestic capital can supplement ODA and direct foreign investment to improve the conditions of people living and working in informal settlements. The problem is that mobilization of domestic capital for slum upgrading runs into many bottlenecks. In order to tackle these, institutions must meet three main challenges, as described in the following paragraphs.

23. The first such challenge is to move down-market: If significant amounts of domestic capital are to support slum upgrading, commercial banks must find ways of lending to the lower end of the market – moving down-market. Banks can meet the challenge of commercially viable lending to people with very limited incomes provided they make efforts:

(a) To challenge the widely held, false perception that poor people cannot save or borrow and raise awareness of the success and achievements of micro-finance institutions, community development finance intermediaries and accumulated savings organizations and cooperatives;

(b) To develop loan products that depart from conventional lending requirements and are more attuned to the realities of low-income borrowers which include non-title collateral or non-collateral requirements, productive capacity rather than employment records, demonstrated borrowing capacity rather than strict credit history, and so on;

(c) To lower the risk (perceived and real) attached to such unconventional loans through third-party guarantees (see chapter II, section B, subsections 1 and 2, above);

(d) To spread out the transaction costs of making high-volume, low-value loans, for example large numbers of small loans, such that these loans are borne by the primary lender, an intermediary and the borrower;

(e) To recognize micro-finance institutions, community development financial intermediaries and accumulated savings organizations and cooperatives as viable intermediaries between commercial lenders and slum-dwellers;

(f) To share in the costs of first-time borrower education with intermediaries through grant funding, a practice that should become a condition for commercial banks onward-lending;

(g) To persuade Governments that they have a role to play, such as providing commercial lenders with incentives (the so-called “pull and push” approach) to lend down-market, including tax breaks, and making bank expansion or access to secondary markets conditional upon proof of lending to low-income populations.

24. The second challenge is to scale up slum-dwellers’ initiatives, non-governmental organizations, and micro-finance institutions: Over the past 30 years accumulated savings organizations and cooperatives, supporting non-governmental organizations and micro-finance institutions have arguably produced the greatest innovations in savings and lending for slum-dwellers. Their facilities are accessible to low-income households and, in many instances, they have not only financed micro-enterprise, shelter, land and basic services but also empowered slum-dwellers and their organizations. But these initiatives have been too few and too small to have had significant impact. They are also largely under-funded and dependent on the support of a few select benefactors. Few Governments, local authorities and commercial banking institutions have embraced their innovations and taken them into the mainstream. A central challenge for mobilizing domestic capital, then, is to mainstream the instruments developed by alternative lending institutions. These are a few relevant practical suggestions:

(a) Diversify the funding base of support non-governmental organizations through savings and lending instruments for low-income clients, ensuring that they have the capacity to manage increased funds;

(b) Leverage municipal bonds and associated public sector investments in urban infrastructure through improved service delivery and cost-recovery, the practicalities of which local authorities, accumulated savings associations and cooperatives, micro-finance institutions and support non-governmental organizations should explore together;

(c) Promote collaboration between commercial lenders (banks, housing finance institutions and municipal banks) and those financial institutions working with low-income populations as discussed above, through specifically designed opportunities for the joint financing of slum-upgrading projects and the joint development of loan products;

(d) Encourage banks and public authorities to work more directly with intermediaries, such as opening lines of credit for the revolving loan funds of micro-finance institutions and community development financial intermediaries, and the locally managed funds of non-governmental organizations, in order to increase the size of their respective savings and loans portfolios;

(e) Promote the expansion of micro-finance institution lending from micro-credits to home improvement loans, assessing performance as well as changes in rates of default and in credit conditions;

(f) Promote collaboration among micro-finance institutions and accumulated savings associations and cooperatives through experimental joint initiatives that demonstrate areas of compatibility;

(g) Increase the absolute numbers of intermediary financial institutions and savings associations through appropriate regulatory and legislative reforms as well as awareness campaigns among policy-makers.

25. Finally, the third challenge is to strengthening cooperation between financial service providers and development partners: For banks to move down-market and for financial intermediaries and savings associations to scale up their innovations will take more than the efforts suggested above. It also requires a closer working relationship between financial service providers (at all levels) and conventional development partners, namely, Governments, slum-dwellers, non-governmental organizations, local authorities and the business sector. For the time being, these institutions remain far apart in many respects. Financial institutions work primarily with individuals, whereas development partners work

with groups. Where the former provide a service to a client for a fee, the latter offer a mixture of public and private goods to groups for a fee subsidized out of public expenditure. Financial institutions develop business plans that seek to define their role as creditors. Development partners put forward projects that define roles and responsibilities among partners through a consultative process. Creditors abide by rules of safety and soundness, whereas development partners adhere to principles of participation and political consensus. This admittedly stereotypical dichotomy is most pronounced at the high end of the market, but is far less sharp where the scale is smaller and where informal settlements are concerned. One reason for this is that non-governmental organizations, community development financial intermediaries and micro-finance professionals are involved in both finance and development. The slum-dwelling member of a daily savings association is debtor and creditor, a loan recipient and an active development partner. Since finance and development easily blend together at slum level and greater cooperation is in order among the institutions behind them, then efforts to build institutional arrangements at the high end would do well to draw upon the factors of cooperation found in slums. Practical suggestions include:

- (a) Launch joint slum-upgrading projects that bring together representatives of slum dweller savings associations, micro-finance institutions, cooperatives and support non-governmental organizations;
- (b) Over time, expand participation in such projects to include representatives of government (central and local), housing finance institutions, municipal development banks and commercial lenders, retaining the focus of the specific project, but developing loan products for application elsewhere;
- (c) Through a series of such projects, launch a public relations campaign requesting banks to design loan products for slum-dwellers as part of a given project, with the winner receiving an award at a highly publicized event, possibly in the settlement where the project is located;
- (d) Appoint senior executives of banks, housing finance institutions and municipal banks to the advisory boards of national slum-upgrading programmes, beginning with executives serving on the boards of those micro-finance institutions that already have a degree of exposure to upgrading; and
- (e) Establish a national advisory council for the promotion of community lending that regroups professionals from the banking industry, micro-finance institutions, non-governmental organizations, savings associations, the ministry of finance, central bank and relevant government departments, for example, public works, housing, land, water, labour, and local government.

B. Contribution and role of the international community

26. The rationale behind the present paper is that better cooperation between financial institutions and development partners can mobilize domestic capital to improve shelter, land, services and the productive capacities of the urban poor. If we accept this premise, then what is the role of the international community? United Nations Member States can and should honour their pledges to reach the target of “cities without slums” by increasing ODA to levels more commensurate with the resources needed. Just as important, Governments need to consider how such aid can leverage domestic capital. They could achieve this through financial and technical assistance, as suggested below.

1. Financial assistance

27. Grant support, equity investments and loan guarantees are some of the forms of financial assistance that can, preferably in combination, mobilize domestic capital in favour of slum upgrading. As mentioned above, non-governmental organizations are primary candidates for grant support, particularly those that support the income-generating activities of slum-dwellers and those acting as financial intermediaries within the community, between banks and urban poor organizations. Private foundations, faith-based philanthropies and bilateral development agencies support non-governmental organizations with grants. More is required but, if it is to be effective, such assistance must be targeted, transparent and creatively designed, for example, with a view to increasing the capacity of non-governmental and urban poor organizations to manage funds.

28. Equity investment is extremely useful as it strengthens the capital of micro-finance institutions and helps them build loan portfolios over time. This is particularly true for micro-finance institutions that seek to diversify their lending portfolios beyond small-business to include home improvement and tenant buy-out schemes. The International Finance Corporation (IFC) has invested in the capital of several hundred such institutions around the world, often acting as a catalyst for equity investment from domestic and international private banks.

29. Loan guarantees, like equity investments, can leverage additional capital for slum upgrading. They reassure lending institutions that the guarantor will meet the obligations of the borrower in case the latter fails to repay. Such an assurance can motivate lending institutions to grant more loans than perceived or actual risk would otherwise authorize. Accordingly, banks can use guarantees to make loans for shelter improvement, small-business development (including infrastructures) and other aspects of slum upgrading. Banks can also use guarantees to make loans to micro-finance institutions or community development financial intermediaries, which can, in turn, lend on to cooperatives or community groups. Alternatively, guarantors can underwrite bonds issued by cities and local authorities to finance infrastructure. Providers often guarantee a percentage of a loan portfolio in order to share risks with the lending institution and encourage it over time to make similar loans without the assurance of a guarantee.

30. The Development Credit Authority (DCA) of the United States Agency for International Development (USAID) issues 50 per cent local currency loan guarantees through its country missions to local banks in support of a wide range of development activities. A consortium of bilateral agencies known as the Private Infrastructure Development Group, acting through the GuarantCo Facility, also issues local currency guarantees to local banks for loans to private sector infrastructure development. Homeless International and its Indian national affiliate, Society for the Promotion of Area Resource Centres Samudaya Nirman Sahayak, provide guarantees that are tailored to bank lending to community-based initiatives as part of the Community-led Infrastructure Finance Facility (CLIFF);

2. Technical assistance

31. As is often the case with development initiatives, finance is only part of the challenge. Institutions at the receiving end of grants, equity investments and loan guarantees must have the capacity to manage funds, account for them and use them for the purposes of equitable economic and social development. Technical assistance directed to this end can take the form of capacity-building, finance packaging, and policy or regulatory reform.

32. Capacity-building is necessary for all institutions involved in mobilizing domestic capital for slum upgrading. Most non-governmental organizations are small partly because they need to be flexible and responsive. Technical assistance directed at these organizations, particularly those working with urban poor groups, can help them to acquire financial management skills and to restructure, balancing their needs to retain flexibility and to handle greater amounts of funding. Cities and local authorities also need technical assistance, particularly for fund management, revenue collection, tendering contracts to private firms, and partnerships with urban poor and non-governmental organizations. The high turnover of professional staff both in such organizations and in local government requires technical assistance that is both continuous and systematic. Banks, housing finance institutions and micro-finance institutions, particularly in the developing world, are rapidly re-tooling and adjusting to new financial markets. This is particularly true for retail banking, where few banks are set up for mortgage lending, let alone working with intermediary non-governmental organizations, urban poor savings associations and loan guarantees. Here too, building capacity is crucial. Bilateral development agencies – either directly or through trust funds anchored in multilateral agencies – can play a pivotal role in providing technical assistance in this regard.

33. Financial packaging is another crucial form of technical assistance. A great number of government programmes and slum-upgrading projects have never moved beyond the design and planning phase. Community mobilization is strong, as is the involvement of local authorities and private developers, but the funds are just not there. These programmes would benefit greatly if technical assistance enabled them to design and test financial mechanisms that could attract investment into upgrading projects. In this respect, multilateral development institutions can play a crucial brokering

role, bringing together both development and financial partners, and field-testing financial mechanisms that mobilize domestic capital for slum upgrading.

34. Technical assistance can also be directed at policy and regulatory reform. Mobilizing domestic capital is conditional on functional domestic capital markets, foreclosure laws, legally recognized land tenure, as well as legislation that enable cities to collect revenues, issue bonds, work with urban poor organizations, and tender contracts to private service delivery providers. Naturally, the enabling environment that facilitates capital flows for the purposes of improving the lives of slum-dwellers varies across countries. Many countries need some degree of policy and regulatory reform, however, and many of those carrying out such reforms would benefit from technical assistance. Again, bilateral development cooperation agencies are playing an important role in this regard, as are their multilateral counterparts and international financial institutions. Technical assistance facilities include the private-public partnerships for the urban environment, the Private-Public Infrastructure Advisory Facility, the Urban Management Programme and the Technical Assistance Facility.

C. Organizing the dialogue at the second World Urban Forum

35. The dialogue on urban resources to be held at the World Urban Forum on Wednesday, 15 September 2004, will attempt to capture and advance the issues raised in this background paper in a three-hour session. The dialogue will include two sets of panel presentations each followed by a sustained period of open discussion. The first panel and discussion will focus on financial institutions and draw upon the experiences of representatives of international agencies, commercial banks, housing finance institutions, and micro-finance institutions in mobilizing domestic capital for slum upgrading. Emphasis will be placed on issues of risk mitigation, retail banking, intermediaries, and innovations in low-income mortgage and urban infrastructure finance.

36. The second part of the dialogue will learn from the experiences of representatives of national governments, municipalities, urban poor organizations and non-governmental organizations about their efforts to upgrade slums. Discussion will focus on the challenges that they face in financing urban upgrading initiatives and the role of domestic financial institutions. The dialogue will conclude with a synthesis of shared experiences and debate, including an inventory of innovations and recommendations for future areas of action.
