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**Medium-term strategic and institutional  
plan for UN-Habitat for the period 2008–2013**

**United Nations Habitat and Human Settlements Foundation  
Question and Answer  
13 April 2007**

**Introduction**

The present document has been prepared by the secretariat at the request of the Committee of Permanent Representatives in order to facilitate consultations during the twenty-first session of the Governing Council. It is intended to enable delegates to gain a better understanding of the United Nations Habitat and Human Settlements Foundation (referred to herein as the "Foundation"). In preparation for the session, members of the Working Group of the Committee of Permanent Representatives of UN-Habitat have engaged in ongoing constructive dialogue with the secretariat on the Medium-term Strategic and Institutional Plan, including those aspects of the Plan pertaining to the Foundation. The selection of questions and corresponding answers in the present document reflects the content and spirit of that dialogue. Questions emerging from previous sessions of the Governing Council, the 2007 staff planning retreats of the secretariat, the Oslo donors conference, the post-Oslo joint consultations of the Committee of Permanent Representatives and various meetings of the regional groups have also been taken into account. The present document is organized into five parts beginning with the institutional setting of the Foundation and then moving on to recent progress, the regulatory framework, reimbursable seeding operations and next steps.

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## Part one: Institutional setting

### 1. What is the role of UN-Habitat?

1. The mandate of UN-Habitat is to promote affordable shelter and sustainable human settlements development. It is responsible for coordinating the implementation of the Habitat Agenda and assisting member States and Habitat partners to achieve agreed targets of the Millennium Development Goals. Of particular relevance is Goal 7, target 10, to “halve by 2015 the proportion of people without sustainable access to safe drinking water”, and target 11, “by 2020 to have achieved a significant improvement in the lives of at least 100 million slum dwellers”, which would be in line with the Cities Without Slums Initiative of UN-Habitat and the World Bank. The latter role was given further impetus in paragraph 56 (m) of the 2005 World Summit Outcome, which also recognized “the urgent need for the provision of increased resources for affordable housing and housing-related infrastructure, prioritizing slum prevention and slum upgrading” and encouraged “support for the United Nations Habitat and Human Settlements Foundation and its Slum Upgrading Facility.”

### 2. What are the comparative advantages of UN-Habitat?

2. A comparative advantage of UN-Habitat is its ability to understand, work with and convene a wide range of local actors. These include slum dwellers and their organizations, local authorities, private utilities, formal and informal domestic financial institutions, nongovernmental organizations, departments of central Governments, professional associations and academics, among others. As a result of its work with member States through communities, Governments and the private sector the organization is well placed to provide technical assistance. Such assistance comes in the form of advocacy, policy advice, institutional reform and strengthening, training in planning and management, piloting and field-testing of new approaches and direct execution of projects for shelter delivery and urban basic services. Once tested and validated, such innovative new approaches can be emulated and brought to scale by institutions that are larger and better resourced such as international financial institutions and bilateral donors.

3. A second, related, comparative advantage of UN-Habitat is that it is one of the few multilateral development agencies established to promote a spatial rather than a sectoral approach to development. Improving human settlements is a complex undertaking that requires the integration of very different but inter-connected issues. These include participatory planning, shelter delivery, land management, infrastructure provision, finance and employment. More broadly it involves inclusive urban management, decentralization of public administration, strengthened domestic capital markets, equitable macro-economic policy and pro-poor financial sector reforms. It is for this reason that UN-Habitat has gained competence in these diverse areas and is in the process of developing an enhanced normative and operational framework to make that competence available to member States in a more integrated, accessible manner. UN-Habitat applies a multi-pronged approach to address a multi-faceted agenda. To be effective, it offers member States a minimum package of interventions and coordinates the work of multiple agencies and local actors.

4. A third comparative advantage is the ability of the organization to draw upon its technical assistance and convening power at the country and local level to promote sustainable urbanization globally. The World Urban Forum, the State of the World Cities Report and the Global Report on Human Settlements elevate the issue of urbanization. So too does the active participation of the Executive Director of UN-Habitat in the United Nations Chief Executive Board, the Executive Committee of Humanitarian Agencies, the Commission for Social Determinants of Health, the 2005 Commission for Africa and the High-Level Committee on the Legal Empowerment of the Poor. UN-Habitat has been instrumental in the establishment of regional ministerial conferences on housing and urban development in Latin America, Africa and Asia and in the founding of United Cities and Local Government. It is also active in the Consultative Group for Assistance to the Poor, among other bodies.

### 3. What is the Foundation and what are its objectives?

5. The United Nations Habitat and Human Settlements Foundation (referred to herein as “the Foundation”) was established in 1974 by the General Assembly to assist member States mobilize resources for their shelter and infrastructure programs. In 1977, it was joined with the Department of Housing, Building and Planning of the Department of Social and Economic Affairs (DESA) to form the United Nations Centre for Human Settlements following the first Habitat Conference, held in Vancouver in 1976. The organization did not succeed in the 1980s and 1990s to capitalize the

Foundation, nor to set up appropriate institutional arrangements within the secretariat. As a result, it never fulfilled the objectives for which it was established. Member States did not benefit from the Foundation as a vehicle from which they could obtain technical assistance, seed capital, loan guarantees and equity investments that could be used to leverage investment for their shelter and infrastructure programs. The Foundation instead evolved into a repository for voluntary general purpose and earmarked contributions to UN-Habitat.

6. In the meantime urbanization increased rapidly and chaotically. At Habitat II (Istanbul, 1996) the world was awakened to the rude reality of increasing urbanization and growing urban poverty. The Habitat Agenda was endorsed, calling for among other things the strengthening of the Habitat secretariat to assist member States in coping with the urban crisis. This was to be revisited by the General Assembly at the special session held in New York in June 2001 (Instanbul+5). At that special session, the General Assembly requested the Secretary-General to provide it with options for upgrading the organization. Subsequently, in December 2001, the General Assembly in its resolution 56/206 upgraded the old Habitat Centre into a full-fledged programme, or UN-Habitat as it is today. The General Assembly also decided that the organization would be led by an elected Under-Secretary-General, under the oversight of a Governing Council that would be a subsidiary organ of the General Assembly itself albeit but would report through the United Nations Economic and Social Commission.

7. Since then, UN-Habitat has worked systematically to improve its effectiveness, including through revitalizing the Foundation in accordance with directives from the General Assembly, the Governing Council and Global Summits including the 2002 World Summit on Sustainable Development and the 2005 World Summit. The objective of the Foundation is to work with member States and Habitat partners to facilitate the mobilization of four types of resources: domestic capital from banks and private investors at the country level; savings by the urban poor through appropriate community level organizations; public investment from municipal and central governments; and investment from international financial institutions.

#### **4. Why is UN-Habitat concerning itself with financing?**

8. Housing and settlements infrastructure development cannot be delivered in a sustainable manner without considerable mobilization of domestic resources. From conception, it was clear that UN-Habitat could not fulfil its mandate without being successful in domestic resource mobilization. It follows that the interest of UN-Habitat in financing reflects the magnitude of urban poverty and the mandates from its governing bodies. In upgrading it to a programme, the General Assembly in its resolution 56/206 recognized the need for the international community to come to terms with the social, environmental, and economic implications of chaotic urbanization. The challenge of slums warranted a dedicated programme of the United Nations. As part of the transformation of the organization in 2001, the General Assembly called upon the new Programme to revitalize the Foundation; the Assembly understood that the ability of UN-Habitat to confront urban poverty would require it to move the Foundation from being a mere repository of voluntary contributions to becoming a robust instrument for assisting member States to mobilize investment in line with its original objectives. Since that time, the General Assembly has never ceased “to urge the Executive Director to increase her efforts in strengthening the Habitat and Human Settlements Foundation.”

9. In its efforts to respond to the General Assembly, in 2002 the secretariat commissioned studies with funding from SIDA and DFID aimed at assessing the status of financing for human settlements and determining how best to implement the General Assembly’s request to revitalize the Foundation.<sup>1</sup> The studies established that there was a huge gap between the requisite and available resources to improve the lives of at least 100 million slum dwellers (Millennium Development Goal 7, target 11). Total combined official development assistance, public expenditure and private investment made up less than 10 per cent of the estimated \$74 billion required to improve conditions in slums. The studies also found that slums were not stagnant. In fact, in the absence of formal financing in cities, private entrepreneurs and the urban poor were investing in slums and money was being made: the majority of slum dwellers are tenants and slum landlords were reaping considerable profits, which many consider to be excessive, from their poor tenants. Some savings associations, micro-finance institutions and financial intermediaries were at the forefront of efforts to mobilize resources for shelter but were going about it in an ad hoc and unsustainable manner. At the same time conventional financial institutions were not

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1 “The Global Shelter Facility: A Proposed International Guarantee Facility for Housing and Municipal Development,” March 2003; revised following the nineteenth session of the Governing Council under the title “Meeting the Challenge: Proposal for a Global Slum Upgrading Facility,” December 2006, PM Global Infrastructure, Inc.

active because of the complexity of social organization and very high transaction costs. There was a clear gap in social organization to enable the poor to access institutional credit and an intermediary such as UN-Habitat was needed to bridge it. The studies concluded that UN-Habitat should draw upon its expertise working in cities and slums to link traditional sources of finance (official development assistance, public expenditure and formal sector private investment) with innovative financing in informal settlements (savings associations, micro-finance institutions, etc.). The study recommended the establishment of a global shelter facility, offering loan guarantees and seed capital, and a global shelter assistance facility, offering technical assistance.

10. These recommendations were submitted by the secretariat to the Governing Council at its nineteenth session, in 2003. The Governing Council provided the secretariat with guidance on how to proceed in strengthening the Foundation in its resolution 19/11. Rather than recommend a fully fledged global shelter facility as recommended by the financial consultants, the Council urged the secretariat to provide technical assistance and seed capital to field-test design instruments, establish a track record, assess lessons learned, build up internal capacity and thereafter identify ways of scaling up. The Governing Council also called upon the secretariat to work with the World Bank Group, regional development banks and other international financial institutions to direct investment to informal settlements. The secretariat launched the Slum Upgrading Facility in response to resolution 19/11 and embarked on intensive consultations with international financial institutions, including the World Bank. The essential point of this first phase was to demonstrate how traditional and innovative sources of finance could be combined to mobilize investment for slum upgrading.

## **Part two: Strengthening the Foundation -- recent progress**

### **5. What are the key developments in the life of the Foundation over the past four years and how have international and regional development banks supported it?**

11. Since the nineteenth session of the Governing Council, in 2003, the secretariat has strengthened the Foundation in line with the recommendations of the General Assembly and the Governing Council. Following its revitalization, its upgrade to a programme and the appointment of a new Executive Director at the level of Under-Secretary-General, donor confidence has been restored and financial contributions to the Foundation have increased approximately seven-fold from \$16 million in 2000 to \$135 million in 2006. Four elements instrumental in this positive progress are the Slum Upgrading Facility, the Water and Sanitation Trust Fund, enhanced partnerships with international financial institutions and institutional arrangements designed to position the Foundation strategically within the UN-Habitat secretariat itself.

12. The secretariat launched the Foundation's Slum Upgrading Facility in 2004, with initial financial support from the Department for International Development of the United Kingdom (DFID) and the Swedish International Development Cooperation Agency (SIDA) and additional funding in 2006 from the Government of Norway, and engaged in extensive collaboration with other members of the Cities Alliance, which is co-chaired by the World Bank Group and UN-Habitat. Activities commenced in Ghana, the United Republic of Tanzania, Sri Lanka and Indonesia. With additional support other pilot countries of the subregions of West Africa, East Africa (notably Kenya and Uganda), South Asia and Southeast Asia are being covered. The Slum Upgrading Facility is a direct application of the recommendations of the Governing Council in its resolution 19/11 as it seeks to assist member States and Habitat partners to field-test design instruments for mobilizing resources for their shelter and infrastructure programs. The facility places emphasis on domestic capital, including investment for slum upgrading activities that can be sourced from mortgage finance institutions, pension funds, private securities investors, microfinance institutions, urban poor savings associations and community-development financial intermediaries. It offers financial actors and Governments a combination of technical assistance and seed capital (in the form of grants) for introducing business plans for slum upgrading projects that can attract diverse sources of domestic capital. Technical assistance is administered by UN-Habitat with the assistance of the Slum Upgrading Facility pilot team, an international service contractor with expertise in finance. In 2005 the Governing Council, in its resolution 20/18, took note of progress made by the secretariat of the Slum Upgrading Facility, as did the heads of State who issued the 2005 World Summit Outcome (paragraph 56 (m)).

13. Concurrently, and following adoption in 2002 of the Programme of Implementation of the World Summit on Sustainable Development, the Water and Sanitation Trust Fund was established to link the pre-investment activities of the secretariat to the investment portfolios of regional development banks and to thereby help cities mobilize resource for infrastructure improvements in slums – a key objective of the Foundation. In 2005, UN-Habitat entered into an agreement with the Asian

Development Bank to fast track \$500 million in lending by the Bank to six cities in China, India and Indonesia that had successfully participated in Water for Asian Cities Programme. A second agreement with the Asian Development Bank was signed this year to designate an additional \$1 billion for such lending. UN-Habitat has also signed an agreement with the African Development Bank to fast-track \$540 million in lending to six cities in Sub-Saharan Africa participating in the Water for African Cities Programme. In 2003 the agency also signed a memorandum of understanding with the Inter-American Development Bank for similar cooperation in Latin America and the Caribbean. These are by no means small achievements, and they demonstrate the vigour and zeal with which UN-Habitat is approaching the subject of securing follow-up investments for its pilot programs and normative work.

14. Starting in 2002, the secretariat re-established consultations with the World Bank Group pursuant to the recommendations of the General Assembly that called for engaging international financial institutions including the World Bank in partnerships to strengthen the Foundation (see General Assembly resolution 56/206). In their consultations in 2002, the then President of the World Bank (Mr. James Wolfensohn) and the Executive Director of UN-Habitat (Mrs. Anna Tibaijuka) agreed to strengthen their cooperation with members of the Cities Alliance and to explore additional areas of collaboration in the areas of finance, water and sanitation and research. Subsequently, the Executive Director held consultations with the head of the International Finance Corporation that resulted in deepening cooperation between the two organizations in the area of housing finance in West and East Africa. Since then, Mrs. Tibaijuka has held consultations with the Director of the World Bank's Water and Sanitation Programme as well as with the Bank's vice-presidents for infrastructure (now sustainable development), Asia and Africa and the country directors from those regions. Whereas in 2002 cooperation between UN-Habitat and the World Bank Group at the country level was non-existent the secretariat is now working with country directors in selected member States to situate its pre-investment activities within the Bank's Country Assistance Strategy. More recently, the Deputy Executive Director of UN-Habitat (Mrs. Inga Klevby) and the Vice-President for Sustainable Development of the World Bank (Mrs. Kathy Sierra) have agreed to co-chair annual consultations among senior managers of the two institutions to review progress and explore areas for future cooperation.

15. In 2004, the secretariat established the Human Settlements Financing Division as the fourth subprogramme (SP4) of UN-Habitat pursuant to its work programme for the biennium 2004–2005, approved by the Governing Council at its nineteenth session (see resolution 19/4). Reflecting the limited availability of resources, initially the composition of the new division included the Slum Upgrading Facility, a Programme Development Branch (for partnerships and special projects) and an Urban Finance Branch (for analysis and financial modeling). In February 2007, the secretariat relocated the Water and Sanitation Trust Fund to the division, thereby consolidating key elements of the Foundation within one subprogramme. While the substantive elements of the Foundation are situated institutionally within the new division (SP4), the Office of the Executive Director provides added support for the functions of political and inter-institutional relations, as well as monitoring and evaluation. The Programme Support Division administers the trust funds of the Foundation, which include the Slum Upgrading Facility and the Water and Sanitation Trust Fund, as well as other voluntary contributions (general purpose and earmarked). In line with General Assembly resolution 56/206 the Executive Director serves as the administrator and custodian of the Foundation, delegating authority for the day-to-day management of Foundation activities to the Deputy Executive Director.

## **6. What is the relationship between the Foundation and the Medium-term Strategic and Institutional Plan?**

16. The Medium-term Strategic and Institutional Plan provides new strategies and institutional arrangements for UN-Habitat to achieve greater impact in its efforts to improve the conditions of people living and working in poverty. The Foundation is embedded in the Plan and its strengthening is a pre-requisite for the Plan's successful implementation. The planned enhancements of the Foundation as presented in the Plan will enable the organization to harmonize its interventions with those of financial institutions (domestic and international) and leverage public and private investment and, in so doing, address the challenges of urban poverty on a large scale.

17. The Medium-term Strategic and Institutional Plan sets out a strategy for how the organization can sharpen its focus and work more effectively to coordinate its assistance to member States, improve coherence with international actors and have an impact on a large scale. Emphasis is placed on the development of an enhanced normative and operational framework (ENOF) for interventions at the country level in line with calls for United Nations reform and system-wide coherence. The framework

enables member States to draw upon a package of technical assistance from the organization that includes four elements of human settlements development (planning, land and housing, infrastructure and finance). It provides member States and United Nations country teams an opportunity to situate urban development and housing more prominently within poverty reduction strategies and United Nations assistance development frameworks.

18. Once operational, the enhanced normative and operational framework will serve not only as a mechanism for harmonizing diverse sources of public investment (municipal, national, bilateral and multilateral) but also as a pre-investment package for leveraging private savings and capital from different sources (international development banks and domestic financial institutions). The framework will build upon the pre-investment package for regional development banks established by the Water and Sanitation Trust Fund, bringing in elements of planning and land and housing, as well as of infrastructure and environmental management. It is also envisaged that the framework will accelerate ongoing efforts by World Bank country directors to integrate sustainable urbanization within the Bank's Country Assistance Strategy. Furthermore, the framework will enhance work under the Slum Upgrading Facility to prepare business plans for affordable housing and basic services, thereby attracting domestic private investment and savings.

### **Part three: Regulatory framework -- instruments of management and control**

#### **7. What are the financial regulations and rules of the Foundation? Why were they revised?**

19. The Financial Regulations and Rules of the United Nations and of the Foundation are adopted by the United Nations General Assembly. The Financial Regulations and Rules of the United Nations (100 series) and the Financial Rules of the Foundation (300 series) are formulated by the Secretary-General and issued as bulletins of the United Nations Secretariat and the Secretary-General (carrying the symbol prefix ST/SGB). The Regulations and Rules for the United Nations (100 series) govern the Foundation except to the extent that exceptions or additions are specifically authorized in the 300 series. Such exceptions are determined to be required by the Secretary-General for the Foundation pursuant to the Financial Regulations adopted by the General Assembly specifically for the Foundation. The Secretary-General may determine and authorize exceptions to the 100 series in view of the nature of the Foundation activities, the method of its funding, and the procedures of its budget.

20. The first 300 series financial rules for the Foundation (ST/SGB/UNHHSF/3(1978)) were issued in January 1978. They remained in force until 1 August 2006, when a new set of rules issued by the Secretary-General (ST/SGB/2006/8), known as the Special Annex for the United Nations Habitat and Human Settlements Foundation (series 300) to the Financial Regulations and Rules of the United Nations (series 100), entered into force. The new rules were made necessary by General Assembly resolution 57/537 of 20 December 2002, in which the Assembly decided that the Financial Regulations on the Foundation which applied exclusively to the Foundation should be presented in the Special Annex. In effect the new financial regulations and rules outlined in the Special Annex (ST/SGB/2006/8) provide financial authority and control to the full range of the Foundation's mandate.

#### **8. What are the draft Operational Procedures and Guidelines of the Foundation and why has the secretariat prepared them?**

21. Following the promulgation of the Special Annex, the old General Procedures and Guidelines governing the operations of the Foundation had to be revised and updated. Thus the draft Operational Procedures and Guidelines (hereinafter the draft Guidelines) build upon the General Procedures Governing the Operation of the Foundation which were adopted by United Nations Environment Programme Governing Council decisions 72 (IV) 1976 and decision 94(V) 1977. The draft Guidelines state clearly what is required in practical operational terms to enable the Foundation to play its catalytic role to assist communities and member States in mobilizing resources for affordable housing and infrastructure services. It should be recalled that the need for this instrument has been recognized from the first years of the Foundation's existence, at which time it was guided by the Governing Council of the United Nations Environment Programme.

22. The secretariat has prepared the Draft Guidelines to assist the Governing Council to fulfil its responsibility to guide the policy direction of the Foundation and to provide the Executive Director with tools for effective control and management. Without such policy guidance, the Executive Director would have to proceed on her/his own in delivering the mandate. Obviously this would be an undesirable situation. In order to discourage this state of affairs, Rule 305.3.5 of the Special Annex

envisages that the Governing Council of UN-Habitat will “provide policy guidance to the Executive Director for the establishment of Operational Procedures and Guidelines concerning the general principles, detailed systems and procedures of the Foundation, in order to guide the reimbursable seeding operations of the Foundation.” In light of this, the General Assembly at its 61st session, in its resolution 61/206) in December 2006, took note of the Special Annex and requested the Governing Council “to address in a comprehensive manner, any issues relating to the Foundation at its twenty-first session bearing in mind the need to effectively mobilize resources for the Foundation”.

**9. Why do we need new operating procedures and guidelines?**

23. The original financial regulations and rules of the Foundation (1977) made provision for lending and borrowing. The Special Annex provides, among other things, the necessary rules that were not included in the original rules and gives priority to “seeding operations.”

**10. Why should the Foundation take on lending and borrowing functions? Isn't this the role of international financial institutions? How would the Foundation work with international financial institutions?**

24. The General Assembly is aware that international financial institutions are not able to reach poor communities and municipalities with housing and infrastructure finance and has therefore mandated UN-Habitat to bridge this gap. Accordingly, the draft Guidelines envision that the Foundation will undertake small-scale, targeted lending (referred to as seed capital operations) that will augment and accelerate large-scale lending undertaken by international financial institutions.

25. Notwithstanding that the Foundation has the full mandate and authority under its financial rules and regulations to undertake a broad range of borrowing and lending operations, the draft Guidelines (in article 8.7), envisage the adoption of a cautious, phased approach to such activities by the secretariat. Borrowing functions of the Foundation would therefore be deferred until the secretariat develops a sufficient track record in small-scale, targeted lending that would warrant borrowing as a means of increasing the working capital of the Foundation. The long-term vision of the Foundation is to direct lending and borrowing functions to set precedents in uncharted territory where financial institutions, because of their nature, are either unable or unwilling to lend. The Foundation would in this way serve as an international financial intermediary, connecting the poor and otherwise excluded to institutional finance at the national and international levels. It would assist member States and Habitat partners to introduce financial instruments in slums and informal settlements, working with international financial institutions to mainstream large-scale lending and make it accessible to the poor.

26. It needs to be recognized that in the 34 years of its existence, effective cooperation between the Foundation and financial actors has been constrained by the absence of requisite financial rules and operational procedures. The promulgation of the Special Annex in 2006 is therefore one of the landmark achievements in strengthening UN-Habitat to deliver its mandate. The draft Guidelines provide the means by which international, regional and domestic financial institutions can work with UN-Habitat and in so doing direct investment to urban poor organizations and local authorities without incurring large transaction costs. For example, international financial institutions can undertake joint programming with UN-Habitat that involves working closely with local actors who have secured small-scale, targeted lending from the Foundation. International financial institutions can monitor the precedent set by these local actors and augment the seed capital provided by the Foundation with larger flows of investment. Partnering in this way, financial institutions will be well placed to assess and strengthen the targeted-lending operations of the Foundation and advise the secretariat on how best to implement the draft Guidelines.

27. The draft Guidelines therefore chart a cautious approach for the implementation of the lending and borrowing mandate of the Foundation, deliberately confining initial lending to modest seed capital on a pilot basis. The Governing Council will be able to guide the secretariat through continuous reviews drawing from experience. The risk for entering into new areas hastily is minimized if not eliminated through a pragmatic incremental approach clearly elaborated under article 8.7 of the draft Guidelines.



## Part Four: reimbursable seeding operations -- revolving loan fund account

### 11. What is the “revolving loan fund account” of the Foundation and how does it relate to the general and special purpose fund accounts?

28. The revolving loan fund account is the same as the Loan Fund referred to in the Special Annex. It is dedicated to the reimbursable seeding operations<sup>2</sup> of the secretariat and the provision of capital for revolving loan funds, particularly at the country level. The revolving loan fund account will be independent from the accounts of the Foundation that serve as a repository for other non-reimbursable voluntary contributions (general purpose and earmarked). The establishment of separate accounts of the Foundation will ensure that the secretariat will not use funds from one account to finance activities not stipulated for that account. This will maximize the efficiency of the Foundation, offer greater clarity about the purpose of the Foundation and ensure greater transparency regarding the use of donor funds.

### 12. What is a revolving fund in general?

29. A revolving loan fund is a source of money from which loans are made, normally to low-income people or groups, and, once repaid, lent out again. Such a fund is normally initially capitalized with grants that do not need to be repaid to the donor. In the case of the Foundation, loans would be made to community-based organizations or municipalities for undertaking low-income housing and infrastructure projects which fall within the scope of the Habitat Agenda and other related United Nations mandates.

### 13. Why do we need revolving funds?

30. The purpose of a revolving fund is to provide a source of financing that may not otherwise be available at the community or municipal level for undertaking low-income housing and infrastructure projects. It is often used to fill a “financing gap” or to play a catalytic role in (or in promoting) low-income housing and infrastructure projects. A gap occurs when a low-income project lacks sufficient funds to meet the equity requirements of banks or requires a lower interest rate to make the project affordable. The revolving fund itself is not a bank. Rather it facilitates access by community-based organizations and municipalities to more affordable financing. A revolving fund may also create incentives to leverage local financing for low-income housing and infrastructure projects.

31. A revolving fund also reduces the dependence of communities on donors and grants. Heretofore, UN-Habitat has given grants to local project implementing parties such as communities or municipalities or governments. It does not require parties implementing projects to repay such grants, including for physical infrastructure. Grant funding is free money and obviously beneficiaries welcome it, at least in the immediate term. However, in the sector of housing and community infrastructure, grants or free money do not create a sense of responsibility or ownership. Over time grant funding leads to neglect and poor maintenance of the assets that are built with it. Beneficiaries can also develop a dependency syndrome and expect donors to come back to their aid once the assets deteriorate. In contrast, the revolving fund requires beneficiaries to pay back the funds borrowed to develop their assets. This invariably creates an incentive and responsibility among beneficiaries to generate income to pay back their borrowing. Furthermore, revolving funds have a powerful multiplier effect: once the loans are repaid, the replenished revolving fund can lend money to other projects and hence address urban poverty on a large scale. Given the resource intensive nature of the housing and urban infrastructure sector, a revolving fund is the most effective way to implement the Habitat Agenda. The founders of the agency were aware of this reality and necessity, and the General Assembly therefore granted the Foundation the authority to lend and eventually to borrow to replenish its capital base in aid of the poor and low income groups at its own risk and without need for binding sovereign guarantees.

### 14. Exactly how does a revolving fund create a multiplier effect in promoting low-income housing and infrastructure development?

32. At the local level housing revolving loans are given normally on a 1–3 year term depending on the nature of the investment and the time needed to complete it. Once the first revolving loan is repaid, the funds can immediately be lent for a second project; and once the second project repays, it can be used for a third project, a fourth project and so on. Figure 1 shows the process of revolving and scale-

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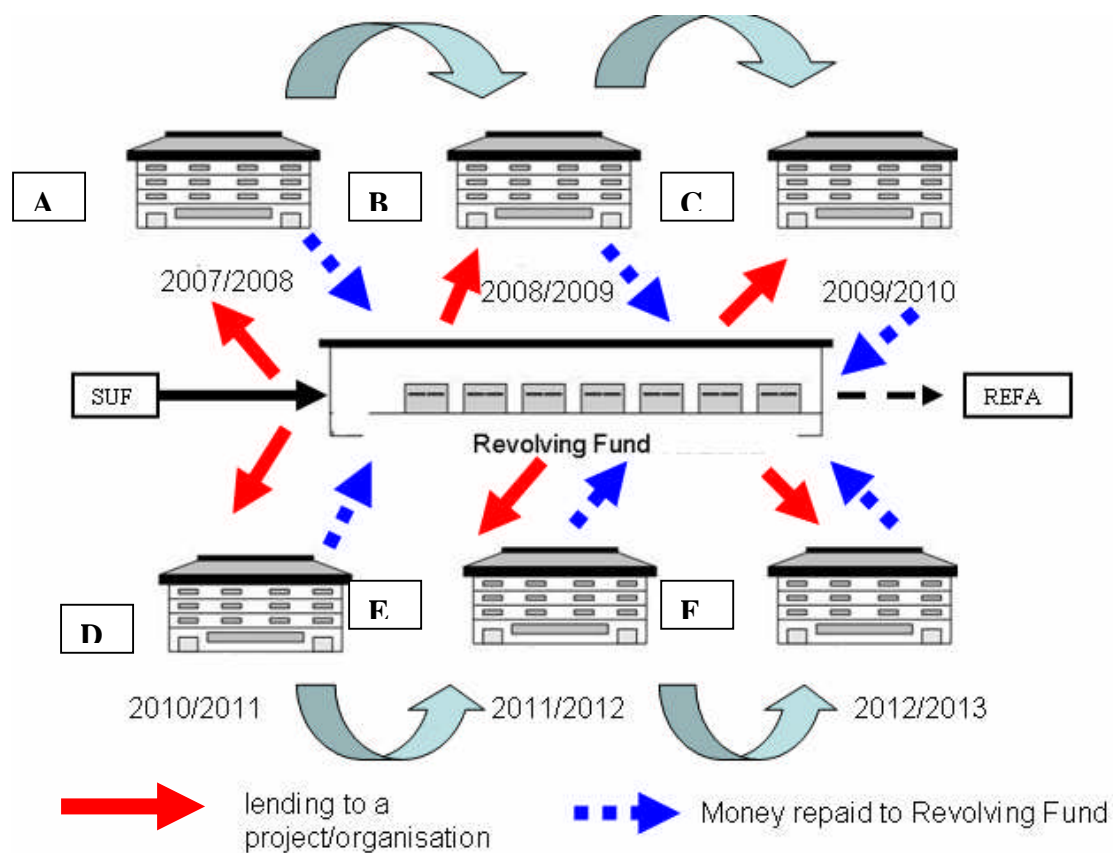
<sup>2</sup> The General Assembly first referred to "reimbursable seeding operations" in 1977 when it approved the original financial regulations for the Foundation. The term is also used in the Special Annex, in article 2, section F, on Foundation borrowing operations. The General Assembly reaffirmed this borrowing authority regulation.

up, using as an example a revolving fund proposed for some pilot women's cooperative housing projects.

The process is as follows:

1. The Slum Upgrading Facility Gender Unit at UN-Habitat enters into a partnership with a financial intermediary called a Women's Land Access Trust (WLAT) willing to assist poor women to organize themselves into housing cooperatives;
2. The Slum Upgrading Facility provides a loan to the WLAT, channelled through a local partner bank, to establish a revolving fund for its associated housing cooperatives;
3. The partner bank transfers the loan (interest-free or otherwise) to the financial intermediary WLAT to develop a housing project for its first housing cooperative (Housing Cooperative A);
4. Financial intermediary WLAT develops the housing project in consultation with member beneficiaries in Housing Cooperative A (development phase);
5. Upon completion, beneficiaries in Housing Cooperative A take mortgage loans from the partner bank to occupy their respective houses/apartments (mobilization of domestic resources);
6. Resources generated in stage 5 enable the financial intermediary WLAT to recover the principal of the loan from the beneficiaries of Housing Cooperative A and restart the process for the next housing cooperative (Housing Cooperative B). The process repeats itself *ad infinitum* if the revolving fund is a country-level activity or until the time the loan matures and is to be repaid to the global revolving fund account. In the example below, 6–10 years are contemplated, all other things being equal.

Figure 1. Revolving Fund and its Multiplier Effect



**15. What is the experience of revolving funds and what is UN-Habitat's role and advantage with them?**

33. Essentially, a revolving fund is a normal lending operation. It is the basis of all lending, especially in situations of poverty and low-level financial resources often requiring group action of some sort. Lending is defined for a specific purpose – such as mortgages or even small loan facilities for housing or upgrading. Money is lent for the specified purpose and repayments are made to the revolving fund either regularly or at a specified end date. Once returned, the money is lent again. This was the basis of “friendly societies” set up as forerunners of building societies and mortgage-type lending institutions. Over time financing mechanisms naturally became more complex but the principle remains the same.

34. Revolving funds can be set up and administered locally (in-country schemes), or globally – in which case a global fund is accessed by in-country operations. UN-Habitat is a global body mandated<sup>3</sup> to facilitate finance for local urban development, slum upgrading and pro-poor housing. The Special Annex sets out the requirements for UN-Habitat to undertake such a global facility. This will be undertaken in cooperation with the existing international financial architecture, extending its reach to more of the one billion slum dwellers than have ever been reached with formal financial arrangements.

35. UN-Habitat has a unique understanding of the financing requirements of the world's one billion slum dwellers, which it has acquired through its collective Habitat Partnership arrangements. Where already operating, Habitat Partners have considerable experience in the workings of local revolving funds in which community savings and loans schemes have demonstrated solid repayment performance based on local peer-level management. This is consistent with the experience of the Grameen Bank short-term micro-credit in Bangladesh and elsewhere, and others such as the IIED/Sigrid Rausing Trust International Urban Poor Fund with Slum Dwellers International. When a person of extremely modest means is helped with “micro-credit” they honour their debt by repaying their loan. Proportionally the urban poor have more to lose through any default. The community basis of repayment also ensures that initial difficulties are overcome at the community level. Bankers recognize this as good financial management and worthy of extended financial arrangements.

36. However, the methodologies for longer term finance for housing construction and upgrading are more complex and require more extensive technical assistance and support than is the case with most short-term micro-credit schemes, which tend to be short-term. Due to this complexity, there is a clear gap in pro-poor housing finance and UN-Habitat is therefore tasked by the General Assembly with building this experience directly with the Slum Upgrading Facility and the Water and Sanitation Trust Fund and indirectly with the various women's land access groups and trusts that it is assisting, specifically in several pilot countries in Africa, through cooperation between the Gender Unit and the Slum Upgrading Facility, as illustrated in figure 1 above.

**16. How could an experimental phase be introduced in the UN-Habitat 2008-2009 biennium that would allow the field-testing of reimbursable seeding operations?**

37. The Special Annex enables UN-Habitat to undertake reimbursable seeding operations that make “provision, on a reimbursable basis, to eligible public and private institutions, with special emphasis on developing countries and countries with economies in transition, of seed capital, loan guarantees, including housing loan insurance, and equity investments to support the mobilization and effective utilization of domestic financial resources for human settlements by local lending financial institutions, in particular housing finance and community-based savings and loan organizations and other institutions engaged in low-cost housing and slum upgrading programmes”. (See rule 301.3, subparagraph (l))

38. Operations for supporting the mobilization of domestic financial resources by local lending financial institutions are very similar to the methodologies already employed by the Slum Upgrading Facility and, through pre-investment finance, the methodologies employed by the Water and Sanitation Trust Fund, with the significant difference that, in line with the previous financial regulations and rules, they are all currently exclusively on a grant basis rather than a reimbursable basis. Presently, there is no mechanism for UN-Habitat to channel grants through banks and it is limited to giving them directly to partners, thus limiting the prospect for official local revolving funds arrangements like those illustrated in figure 1 above.

39. In order to field test reimbursable seeding operations, some experimental projects would need to be undertaken that would in turn test the provisions of the draft Guidelines (see HSP/GC/21/5/ADD.3).

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<sup>3</sup> UN-Habitat mandate is through General Assembly resolution 56/206 and the Foundation most recently by the heads of State in paragraph 56 (m) of the 2005 World Summit Outcome and the Special Annex.

40. An experimental phase, also called phase I under article 8.7 of the draft Guidelines, could be implemented and could run alongside the existing General Fund and Special Fund windows of the Foundation such that the Special Annex could apply as envisaged by the draft Guidelines. In this way the Governing Council would be in a position to observe first-hand how the provisions for reimbursable seeding operations perform. The extent to which such an experiment could be exercised would naturally depend on available funding and timing. Regular reporting of these experiments would allow an evaluation of progress to be made at the twenty-second session of the Governing Council and thereafter.

41. It should be noted that the draft Guidelines require and make provision for the establishment of a Foundation Advisory Board and a Loan Operations Review Committee. These bodies would work with others to bring together the leading authorities in financing operations that deal with human settlements and pro-poor housing in such a way that they and their institutions could all contribute to the process of identifying and facilitating the local operations defined above.

42. New specific voluntary contributions would be required in order to fund such an experimental phase. (Existing funds are currently allocated on the basis of existing programmes utilizing exclusively grant procedures.) The Slum Upgrading Facility and water and sanitation donors willing to earmark part of their existing grants to test revolving fund pilot projects would be approached, as appropriate. After evaluation at the end of its first period of operations within the biennium, the progress on the experimental phase would help inform the Governing Council on the stage at which they would feel comfortable in any upscaling of the processes envisaged for reimbursable seeding operations.

**17. Could an experimental phase for testing reimbursable seeding operations be established under specific trust fund arrangements for the purpose?**

43. This question is answered clearly in the draft Guidelines under article 8.7, which states: "Initially the foundation will provide financing for reimbursable seed capital operations solely from the capital it receives from such earmarked voluntary contributions and other sources". Earmarked contributions are another name for trust fund arrangements.

44. Thus, the experimental phase would be conducted using similar mechanisms to those employed for the Slum Upgrading Facility and the Water and Sanitation Trust Fund, but utilizing a separate and specific trust fund for reimbursable seeding operations under the revolving loan fund account window that has authority for such lending operations. This could be set up quite quickly and would have the advantage of clearly defining the purpose of funding allocated for use in the field-testing of reimbursable seeding operations. The Special Annex already permits such an operation. The relevant parts of the draft Guidelines would set out the principles under which the experiment would take place, including all governance, monitoring and evaluation arrangements required. The experimental nature of the pilots makes it possible for existing capacity to be utilized for these operations. The additional posts envisaged in the Medium-term Strategic and Institutional Plan would also supplement and strengthen existing capacities under the Slum Upgrading Facility and the Water and Sanitation Trust Fund. Relevant partnering arrangements would be employed for most of the work, together with specific coordinating personnel for the experimental phase.

**18. What would be the additional costs for UN-Habitat to run an experimental phase for reimbursable seeding operations in the forthcoming biennium?**

45. Initially it would be a marginal undertaking. Costs would be split between some modest additional operational costs and the capital costs for the reimbursable seeding operations. There would be some requirements for legal and accountancy opinions and drafting that could be obtained through consultancy and appropriate partnerships, including technical assistance from appropriate institutions through, for example direct staff support by donors. There would therefore be calls for inputs from our many different Habitat partners including the private sector, existing public and private institutions and various organs of the United Nations system. These additional but modest costs would need to be built into the experimental phase. The capital disbursements would be subject to the Regulations and Rules now in place, together with the relevant elements of the draft Guidelines as agreed for the experimental phase.

**19. What would an example of a pilot reimbursable seeding operation look like?**

46. It would be important to run the reimbursable seeding operations experiments on pilot projects that have already had ground work established for their physical and local institutional properties together with costings for their implementation and potential affordable cost recovery patterns. To this would be added an analysis of their respective business plans that would form the basis of potential local finance agreements. These steps would be the same as those involved in a typical grant under the

Slum Upgrading Facility or the Water and Sanitation Trust Fund. A pilot reimbursable seeding operation would be known as a “target project” and would be located in a country that has demonstrated its commitment to urban poverty reduction (through, e.g., national urban development strategies). An appropriate level of funding for such a project is estimated to be on the order of \$500,000 to \$2,000,000 per project, an amount commensurate with the Foundation's current grant allocations.

47. The target project would be introduced to a partner bank, a local financial institution already known to be suitable for a local lending operation. The blended capital requirement (the combination of land and public investment) for the target project would be analyzed for local elements and “introduced” elements, i.e., those elements that would be needed from an external source. When the extent of the introduced elements is known the project would be assessed in terms of a potential reimbursable seeding operation from the Foundation Trust Fund and a target project term proposal would be drafted, containing provisions relating to, among others, the repayment schedule, the repayment term (5–15 years) and conditions to be included in the loan agreement. Initially the terms will be concessional and, inasmuch as they will allow for the first time the possibility of recovering what would otherwise be pure grant assistance, will pose no real additional risk for UN-Habitat. Experimental loans could thus be given at zero interest plus administrative costs and in local currency where and as appropriate.

48. The target project term proposal would be analyzed by the Loan Operations Review Committee, which would function as the Foundation's “credit committee”, although the Committee itself would be at a very early stage of development. Further opinion would be sought from the relevant Foundation Advisory Board members and other partners as appropriate. When agreed by all relevant parties, a conditional fund term transfer agreement would be established with the local financial institution. Payments would then be honored between the parties, including all service charges and interest where appropriate/and or applicable.

49. Performance would be closely monitored. Independent verification and evaluation would be made within the terms of the agreement. On maturity the reimbursable seeding operation would be completed with the local partner, the borrower absolved and the capital returned to the Trust Fund for lending for another project.

50. The experiment would itself be evaluated periodically and regularly, as well as finally upon completion. However, the intermediate evaluations would be used to inform decision-making about the merits of the operation and the extent to which it should form a model for up-scaling operations. The experiment would be reported in sequence for evaluation and consideration by the Governing Council at its twenty-second and twenty-third sessions in 2009 and 2011.

## **Part five: Realizing the mandate of the Foundation - next steps**

### **20. Why is the secretariat suggesting a phased approach? Won't that slow the whole process down?**

51. The General Assembly and the Governing Council recognize progress made by the secretariat in strengthening the Foundation. Restoring donor confidence and increasing contributions seven-fold in five years, leveraging domestic capital through the Slum Upgrading Facility, fast-tracking investment by regional development banks through the Water and Sanitation Trust Fund, deepening partnerships with various bodies of the World Bank Group (the International Finance Corporation, the International Development Association and the vice-presidencies) and establishing institutional structures to support the work of the Foundation (HSFD-SP4) have provided key building blocks for the Foundation. Furthermore, the Secretary-General has promulgated in the Special Annex the new financial regulations and rules pertaining to the Foundation, the General Assembly has taken note of these rules and called upon the Governing Council to address at its twenty-first session all issues related to strengthening the Foundation and the secretariat has prepared the draft Guidelines.

52. That said, however, the secretariat recognizes that while much has been put into place, a great deal of work remains with regard to establishing a revolving fund account, introducing seed capital operations and designing systems for lending and eventually borrowing functions. The secretariat therefore recommends that it build upon its existing structures and capacities in a phased approach as envisaged in article 8.7 of the draft Guidelines, which is reproduced in box 1, below. In accordance with article 8.7:

- Phase 1 is but an experimental phase limited to implementation on a trial basis of the revolving fund account. It is proposed that it last for 4 years, although the Governing Council could choose to extend it;

- The secretariat cannot move to the second phase before it satisfies the Governing Council that the revolving fund account experiments have been successful;
- Borrowing operations are to be deferred to phase 2 and beyond and then undertaken under the watchful eye of the Secretary-General and the Governing Council.

**Box 1: The cautious phased approach as recommended by the Executive Director (article 8.7 of the draft Guidelines)**

8.7 The Foundation will take a cautious and conservative approach to borrowing. This approach will ensure compliance with the Foundation Financial Regulations particularly rules 302.1, 303.9, and 303.10. This approach is reflected in the following three phases:

- i) **Phase 1 (2007-2011). Lending from Voluntary Contributions:** Initially, the Foundation will provide financing for reimbursable seed capital operations SOLELY from the capital it receives from EARMARKED VOLUNTARY CONTRIBUTIONS and other such sources. ONLY after having achieved a DEMONSTRATED track record of successful lending from its voluntary contributions will the Foundation undertake borrowing activities. The Lending Operations Review Committee will provide recommendations on specific indicators and benchmarks that will be applied to evaluate the performance of the Foundation in reimbursable seeding operations.
- ii) **Phase 2 (2012-2016): Government and institutional borrowing:** Having achieved the phase I benchmarks, the Foundation may embark on borrowing operations, within limits set by the Secretary-General and upon recommendation by the Executive Director, from Governments, governmental agencies and intergovernmental organizations, subject to an evaluation report to be prepared by the Loan Operations Review Committee (discussed below) and submitted to the Governing Council at its twenty-third session and to the provisions of financial rules 303.9 and 303.10. The Lending Operations Review Committee will provide recommendations on specific indicators and benchmarks that will be applied to evaluate the performance and institutional capacity of the Foundation for phase 2 reimbursable seeding operations.
- iii) **Phase 3: Issuance of debt:** ONLY after having achieved the Phase 2 benchmarks and a DEMONSTRATED track record of successful borrowing and lending will the Foundation undertake to raise funds by issuing debt such as bonds and other debt instruments. The Secretary-General, in accordance with financial rules 309 and 310, and upon recommendation by the Executive Director, shall set the limit the Foundation will be authorized to issue its own debt instruments, either directly in its own or through eligible financial institutions in borrowing countries.

(All emphasis added)

53. The Executive Director is also recommending that, if it so wishes, before borrowing is embarked upon, the GC, under its 2006 rules of procedure (rule 22 and 69), could consider to delegate its responsibilities and authority, with respect to the Foundation, in part or in whole, to a subsidiary body of the Governing Council established by it specifically for this purpose. This would result in creation of an Executive Board to run the Foundation borrowing and lending activities and relieve the current heavy burden on the Executive Director (see article 4.4 of the draft guidelines).

**21. What are the risks associated with lending and how will UN-Habitat mitigate them?**

54. In principle, there are no risks associated with lending under the experimental four-year phase 1 because the alternative is to give pure grants with the disadvantages they entail as elaborated under part 2 above. Any recovery of funds is better than no recovery at all.

55. Beyond phase 2, the draft Guidelines provide for the mitigation of risks associated with the Foundation's lending and borrowing activities. Regarding loan loss, in the case of loans from voluntary contributions, risk may arise from default on loan repayment. This risk will be mitigated through the following measures:

- (a) Risk analysis will be undertaken by the Foundation to identify the prospect of success and the level of commitment of each beneficiary. The World Bank's Country Policy and Institutional Assessment (CPIA), where appropriate, will be used to assess risk and appraise proposals;

- (b) Where feasible, the Foundation will ensure that each project is guaranteed by a local institution;
- (c) The Foundation, through its technical assistance activities, will provide support in order to strengthen local partners and mitigate management risk;
- (d) In the case of direct loans made or participated in by the Foundation, the contract will establish the terms and conditions for the loan, including those relating to security for the loan and payment of principal, interest and other charges, maturities, and dates of payment in respect of the loan and associated fees and other charges. (Special Annex, rule 305.3.7);
- (e) Loans will be maintained and audited based on the standard procedures of other lending institutions and with due regard to United Nations audit procedures.

56. Regarding currency risk, payments of principal, interest and other charges to the Foundation by any borrower under a loan agreement will be made in United States dollars or in other currencies acceptable to the Foundation at the United Nations operational rate of exchange in effect on the date payment is made.

**22. How best can UN-Habitat in future mitigate risk associated with borrowing?**

57. The repayment of borrowed funds, including the principal amount and any interest or other charges, will be made only from the resources of the Foundation Loan Fund and its reserve; no lender will have any claim against UN-Habitat, the United Nations or any of their assets. Only the resources of the Foundation Loan Fund, as identified by the Executive Director, may be committed as security for the repayment of borrowings and charges thereon. This limitation of liability will be stipulated on all borrowing documents. Furthermore, the Foundation is likely to incur borrowing from development lenders willing to provide capital not so much to get it back or make a profit but to make it available to an institution that has the capacity to support innovative approaches and projects for pro-poor housing and urban infrastructure development and implementation of the Habitat Agenda in general.

58. The Foundation will only make loans on such terms as will allow it to obtain a reasonable spread between the cost of borrowing and lending. A loan fund reserve will be established as provided for in the Special Annex in order to secure the funds borrowed and lent by the Foundation. The loan fund reserve will underwrite all of the debt incurred by the Foundation.

59. The Lending Operations Review Committee will help to implement a system of supervision that will ensure the use of loans for the purposes for which they are granted and adherence by borrowers to the conditions stipulated in loans and guarantee agreements. The Under-Secretary-General for Management may authorize the writing-off of investment losses. A summary statement of investment losses incurred during a given financial period, if any, will be provided to the United Nations Board of Auditors within three months of the end of the financial period. Investment losses will be borne by the fund, trust fund, reserve or special account from which the principal amounts were obtained (Special Annex, rule 304.16).

**23. Does UN-Habitat have the systems and internal capacity to fulfil the mandate of the Foundation?**

60. Since its transformation in 2001 to a programme of the United Nations, UN-Habitat has endeavored to increase its capacity to fulfil the mandate of the Foundation through the establishment of the Slum Upgrading Facility, the Water and Sanitation Trust Fund and the Human Settlements Financing Division. The Programme will undertake further efforts to increase its capacity as envisioned in the Medium-term Strategic and Institutional Plan. This will be carried out through the recruitment of additional staff members in the Human Settlements Financing Division with expertise in finance (combining excellence in municipal, housing, investment and community finance). Further, the Executive Director will request international financial institutions and member States to consider seconding staff members to UN-Habitat or recruiting professionals to work with the organization on short-term contracts. Importantly, and as envisioned in the phased approach recommended by the Executive Director, the secretariat will also increase its capacity to control and monitor the reimbursable seeding operations by establishing an Advisory Board and a Loan Operations Review Committee comprising representatives from international financial institutions and other professionals. In doing so the Executive Director will seek to minimize overhead costs and attain a high standard of delivery through implementing partners and associates. The process by which UN-Habitat builds internal capacity will also strengthen partnerships with financial actors, globally and locally.

**24. How will the Foundation be capitalized and why should donors contribute to the revolving fund account and to defraying the costs for establishing and running it?**

61. As outlined in the draft Guidelines, UN-Habitat will call upon member States in a position to do so to make voluntary contributions to the Foundation. It will also approach private foundations and non-traditional donors. Funds secured from those sources will be used to initiate reimbursable seeding operations. Starting in 2011 and subject to the successful field-testing and assessment of its lending operations, UN-Habitat and the Governing Council will consider appropriate ways to introduce borrowing operations. This will be undertaken initially by borrowing from international organizations and Governments and, after 2015, possibly through the issuance of debt instruments. It will all depend on whether the experiments work and whether a project pipeline emerges that warrants higher capitalization of the Foundation.

62. The Foundation offers a unique opportunity for member States to reduce urban poverty. Member States in a position to invest in the Foundation will be part of an important exercise in innovation and partnership, helping to set precedents from which other institutions can learn and build upon. Contributions to the Foundation will help local actors create new instruments for affordable housing and urban infrastructure. Member State voluntary contributions will enable local partners to combine grants for technical assistance with reimbursable seeding operations. This will at once strengthen relations among development and finance partners at the country level, deepen capital markets and mainstream urban poor organizations within the domestic financial service sector. Further, the Foundation offers a high return on investment. Voluntary contributions channeled through the Foundation for grant-based technical assistance and reimbursable seeding operations will leverage private capital, public investment and community savings. They will also attract larger investments by international financial institutions -- finance partners that will work hand-in-hand with UN-Habitat, thereby learning about and building upon the work of the Foundation.

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