

Innovative financial mechanisms in housing and infrastructure finance and slum upgrading

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The Informal Economy

- The informal economy (IE), that is the unregulated economy, continues to grow in the developing world
- IE accounts of 0.5-0.75 of non-agricultural employment in developing countries
- IE deprives governments of the tax base
- IE keeps a large share of the population outside the sphere of law and order
- IE has been argued to be the sole way for entrepreneurial activities to develop
- IE represents an important source of wealth

Social consequences from Informal Economy

- Repressing the IE without offering alternatives can result in excessive degradation for poor people
- People within the IE lack access to financial institutions and financial housing products tailored to their ability to pay back
- 72% in slums in Sub-Saharan Africa; 42% in Asia; 32% in Latin America

Housing microfinance

- A range of informal financial institutions are applying good microfinance practice to housing finance following a grass-roots approach
- Progressive building
- Construction assistance related to the loan
- Land acquisition and new housing construction are still dominated by subsidies
- Housing microfinance has the potential to connect the low/moderate-income majority with formal sources of capital

Challenges for expanding housing microfinance

The housing microfinance industry faces some challenges:

- Limited access to medium- and long term capital
- Access to housing credit for low-income population

Limited access to medium- and long term capital

- Strategies for financing land acquisition, infrastructure provision, new house construction remain inadequately developed in relation to need
- The revolving potential of funds in housing microfinance programs is limited
- Programs with a solid track record in microfinance, such as SEWA Bank and Grameen Bank, can leverage large public and private institutional loans and grants

Examples on Capital Enhancement Initiatives (1a)

The Grameen Foundation (GF)

- The Grameen Foundation (GF), a US-based non profit organization.
- Growth Guarantees is a guarantee program dedicated to poverty microfinance institutions (MFIs)
- Developed in 2005 in cooperation with Citibank, the innovative structure of the Growth Guarantees enables MFIs around the world to raise funds by accessing local commercial financing
- Donors, individuals or institutions provide a guarantee to Citibank
- The donors do not give up their money, but enable their assets to be put to valuable use as guarantees
- Citibank in turn issues letters of credit to local banks to support financing for MFIs selected by GF

Examples on Capital Enhancement Initiatives (1b)

Cont. Grameen Foundation

- An important feature of this program is its multiplier effect
- The structure of the GF Growth Guarantees innovatively enables MFIs to borrow in their own local currency thereby minimizing foreign exchange risk
- If local commercial banks not are showing interest in supplying capital to MFIs, then GF works directly with MFIs and try to educate the banks to supply loans to the MFIs
- There is no financial loss
- However, due to the country context some programs have had to close, for example in Marocco and some countries in the Sub-Saharan Africa

Examples on Capital Enhancement Initiatives (2a)

CLIFF

- The Community-Led Infrastructure Finance Facility (CLIFF) is currently being implemented by local partner organisations in India, Kenya and the Philippines
- In India, CLIFF is being implemented by four organisations, which work in alliance. They have between them mobilised over £5.2 million in finance and municipal guarantees from four separate banks, and with just over £1 million in guarantees from Homeless International, USAID and themselves
- A bank loan for a new sanitation project is being discussed, for which Homeless International and Guarantco are working together to provide the guarantee required

Examples on Capital Enhancement Initiatives (2b)

Cont. CLIFF

- The increase in the demand for bank guarantees over the last three years in India comes as a result of an increase in both the number and size of projects that the Indian Alliance undertakes, despite a generally declining guarantee-to-loan ratio
- The Kenyan and Philippines Alliance has a much smaller portfolio of CLIFF-supported projects, compared to the Indian Alliance.
- This mainly because the political and economic environment is very different from India
- Communities and the NGOs with whom CLIFF work are making significant investments in urban development and being most effective when they follow the informal processes
- Scaling up requires an engagement with the formal sector institutions.

Examples on Capital Enhancement Initiatives (3)

Swedish Cooperative Centre (SCC)

- SCC is promoting a model that tries to build on the cooperative advantages
- They address the difficult issue of how to best support poor people's own effort to solve their housing needs
- The particularity of the model is that it addresses the needs of people that do not have anything to improve - because they do not have anything of their own
- The model combines organised, self-administered cooperatives who are the authentic owners of the organising process
- This social property model implies that the cooperative is a legal entity owner of the entire housing stock and the entity that negotiates credits and later on assumes the amortization of the credits
- SCC has good experience of this model from several Latin American countries and is eager to implement it in other parts of the world

Targeting issues (1)

- Effective identification of the target population is crucial for the success of housing microfinance programs
- A good knowledge of the local market is a strong comparative advantage for financial institutions
- Informal structures should be considered.
- Better understanding of the appropriate relationship between subsidies and financial services
- Insecure land tenure:
In most developing countries, poor families do not possess formal proof of land ownership. While formal land titles are not necessary in housing microfinance, land security is essential

Targeting issues (2)

- Households are more likely to invest in their homes when they know they will not be evicted. This security is also important for financial institutions' risk management
- According to Nobel Prize winner Douglass North, institutions are created to reduce uncertainty in human exchange

Institutions are formal rules, informal norms and the enforcement characteristics of both

Informal norms provide an essential legitimacy to formal rules

Therefore, North argues, societies that adopt formal rules of other societies will generally not perform as well as the country where the formal and informal rules coexist

Conclusions

- The challenge seems to be whether banks are interested and able to scale up their engagement with local partners to the extent that lending for community-led – or at least 'community-focused' slum redevelopment becomes mainstream business
- There is a need to look at this as a research & development exercise based on potential future business and lessons learnt
- Context - there must be a genuine willingness to solve the growing problem with informal settlements. This is a question of global survival