Homeless International

PAUCITY AND CAPACITY WITHIN CITY FINANCING

An exploration of the use of capital funds to catalyse the transformation of cities characterised by failing internal relationships between authorities and the poor into cities that create development on the basis of equitable and capable partnerships

An interim paper prepared by Ruth McLeod
as part of the
Bridging the Finance Gap in Housing and Infrastructure Research Project, May 2002

EXECUTIVE SUMMARY

The paper provides an analysis of the different forms of finance required by organisations of the urban poor in order that they may take a legitimate and effective role in designing and implementing urban regeneration initiatives in partnership with city authorities. Within this analysis a framework for asset formation related to capacity building is suggested. A range of local community funding, including the provision of guarantees, is analysed and a tentative typology of funds intended for community use is presented based on the forms of financing available and the manner in which they can be used effectively by organisations of the poor. A particular emphasis is placed on the need for investment strategies that enable the building of effective demand by organisations of the urban poor with the processes developed by the network of SDI used as an exemplar.

The paper is also the story of an exploration that has taken place within a partnership between practitioners who have worked together for the last fourteen years and who have increasingly realised the need to communicate the understanding and priorities that have emerged from that partnership to others.

1. INTRODUCTION

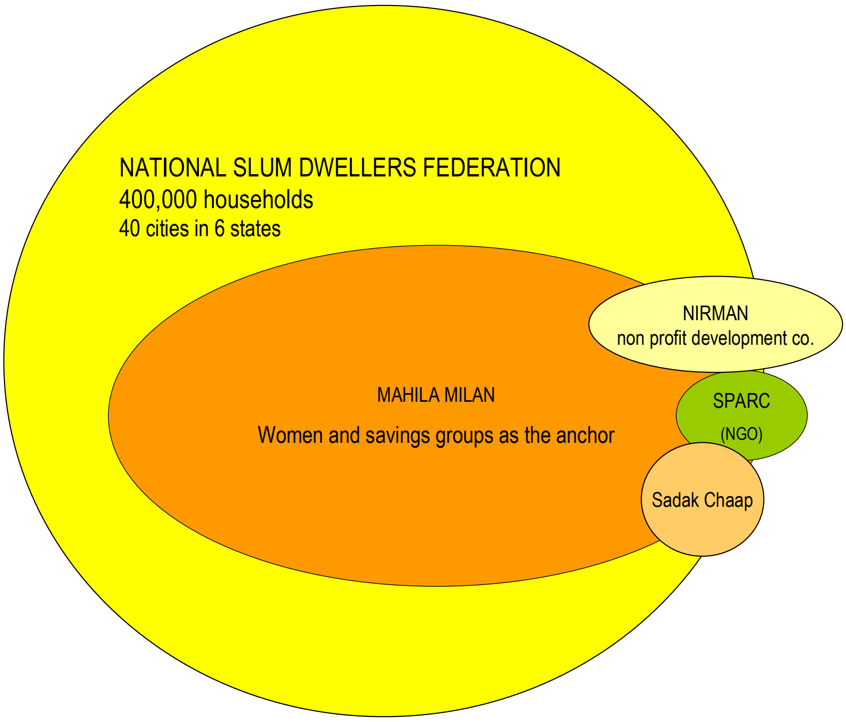
The starting point for this paper is a recognition that within most cities there are few effective mechanisms which allow city authorities to engage with the poor in a manner that facilitates building on the massive resources that the poor have at their disposal[1]. There is a paucity of capacity to build relationships in a way that gives credence to the poor as dynamic subjects within a change and development process that can benefit the city as a whole. Given that mechanisms dependent on human agency are by definition dependent on the relationships within which citizens live on a daily basis, this gap in connection requires a focus on the formation and nurturance of on-going relationships, of connection, of communication. Short term, spasmodic interventions simply don't work. This is as true in addressing questions of urban finance as it is in addressing challenges of social welfare in general. When resources are scarce the lack of relationships that enable recognition and leverage of the assets that people do possess, including their capability as subjects of change, becomes more than inconvenient – it becomes actively dysfunctional. Frustration, anger and resentment dominate interactions between city authorities and vast numbers of urban residents to the cost of everyone. So how can an investment in the creation of long term constructive relationships be developed? What are the basic ingredients? What are the processes that create dynamic and pro-active engagement? And how does that most basic of elements, financial capital, fit into all of this?

The Homeless International DFID Bridging the Finance Gap in Housing and Infrastructure project, funded by the Knowledge and Research programme of DFID, has been exploring these questions for the last two and a half years, with a range of NGOs and Homeless People's Federations (HI's partner agencies) and a host of other interested parties including municipalities, funders, bankers, and officials working within regulatory bodies. The research has looked at the regulatory frameworks that govern poor people's access to capital. It has investigated examples of recognised good practice where organisations of the urban poor have seized the initiative and created precedents for new forms of settlement development. It has also examined the manner in which organisations of the urban poor take risks in order to enter into constructive relationships with city authorities and the formal financial sector. As a result of the exploration that has taken place we have been able to clarify some key principles that guide the practice that we have found to be most successful over the last fourteen years.

Before describing these principles in more detail it may be helpful to explain the reasons why, and the manner in which, Homeless International has entered into the realm of research.

The organisation was formed in order to co-ordinate activities in the UK during the International Year of Shelter for the Homeless in 1987. During that year the IYSH Trust, as the organisation was then known, raised funds in order to support "shelter" projects within the UK and in Africa, Asia, Latin America and the Caribbean. By the end of the year it had become obvious that a niche for a specialist development agency had been discovered. The demand from indigenous organisations in developing countries for support that would enable them to tackle land, housing and infrastructure issues associated with poverty far exceeded the supply of assistance that was available from Northern NGOs. This was particularly so in urban areas as few donors were willing to become involved in the political complexities of land allocation, service provision and finance in large cities. Homeless International was established as a permanent organisation in 1989 with the ambitious aim of trying to address the demand that had been identified.

[1] De Soto 2001 suggests that the value of real estate held, but not legally owned, by the poor in the developing world, is at least $9.3 trillion.



From its earliest days the organisation was involved with an alliance of organisations based in Mumbai in India. The Alliance is made up of the Society for the Promotion of Area Resource Centres (SPARC), the National Slum Dwellers Federation (NSDF) and Mahila Milan (MM).

SPARC is a small NGO which works in 40 cities in six states and one union territory in India, to provide professional support to the National Slum Dwellers Federation and Mahila Milan.

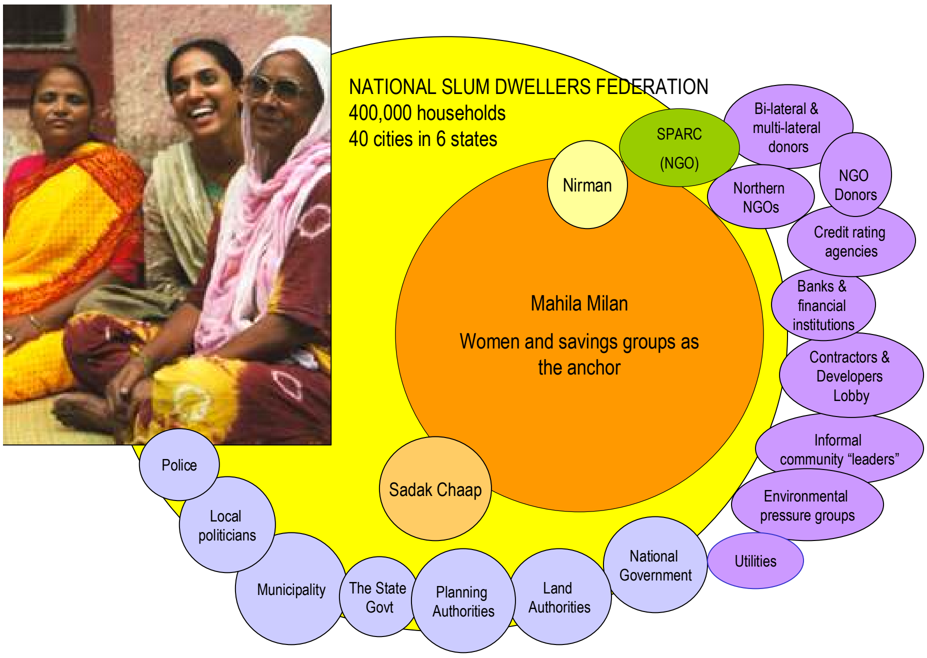
The National Slum Dwellers Federation (NSDF) is a national organisation of leaders of informal settlements in cities established in 1974. NSDF began working collaboratively with SPARC in 1986. The organisation initially concentrated on lobbying for changes in housing policy. However when it entered into partnership with SPARC it changed its focus to emphasise proactive demonstration of the ways in which communities could become effective managers of urban development processes. Over the last sixteen years NSDF has successfully helped local Federations of Slum Dwellers to form effective partnerships with Municipalities.

Mahila Milan (MM) meaning "women together " - is composed of collectives of women from the slums where NSDF has membership. They build skills for community leadership among women as a collective and initiate and manage community savings and loan systems.

The three organisations have helped street children to form their own federation known **as Sadak Chaap** (the stamp of the street) and have also recently formed a not-for-profit development and marketing company called **SPARC Samudaya Nirman Sahayak** (usually referred to as Nirman)

The Alliance has a well-developed process of building capacity at community level, investing in pilot demonstration projects and then using these demonstrations to work in partnership with the state, usually at city-level, to change policy and scale up solutions. Their process is commonly referred to as "the Federation Process". The process has relationship building as its core. The relationships that are formed both internally and externally are complex, dynamic and sometimes volatile. As a consequence negotiations is valued as an important skill, particularly as the clear preference is to progress on the basis of consensus rather than dominance by one group or another.

The range of relationships that have to be negotiated on an ongoing basis at the local level are illustrated schematically in the diagram below.



The Alliance and its local relationships

As the work of the Indian alliance developed, and Homeless International continued to provide support, discussions between the two organisations increasingly focused on the limitations of conventional NGO grant funding. If the federation process achieved its mobilisation objectives many thousand of people in India would need access to finance for land development– a scale of demand that no European NGO could match. It was also clear that the demand was not just in India. The success of community exchange programmes which had been an early initiative supported as a result of the partnership between the two organisations meant that the Federation process was not just spreading in India but in a growing number of countries in Asia and Southern Africa. By 1996 additional sister federations had been formed in South Africa, Zimbabwe, Namibia, the Philippines, Cambodia and Thailand. There were nascent federations in Sri Lanka and Nepal and contacts with a range of slum dwellers in other countries. Shack/Slum Dwellers International was formed during that year, linking a network of people living in urban informal settlements from across Asian and Southern Africa.

In recognising the significant demand that was likely to result from the spread of the Federation process, our first response was to explore the use of guarantees. Could small amounts of funding be used to secure larger amounts through guaranteeing loans from the commercial banking sector? This seemed worth trying and Homeless International established a Guarantee Fund using interest free deposits from the UK housing movement. However, our early optimism was short-lived as it became clear that while guarantees could eventually release loan finance from banks the investment of time, money and energy to obtain this result was huge. Even when guarantee agreements were eventually signed there were significant delays between agreement and the receipt of funds and if any progress was to be made we found that bridge financing was essential. Banks wouldn't take a construction project initiated by slum dwellers seriously until it had been started and was well underway. By 1998 we were clear that guarantees were not enough and that other forms of investment funding specifically geared to the needs of organisations of the urban poor were necessary if the potential of the federation process was to be fully realised. The problem was that within our own discussions we were clear but we couldn't communicate that clarity to others who were more sceptical about the need and the solution. We realised that we would have to sharpen our arguments, deepen our analysis and develop the knowledge, language and skills to communicate with a whole range of actors with whom we had had very little previous contact. The result was a decision to develop a collaborative research project which has since become known as the Bridging the Finance Gap in Housing and Infrastructure Project.

The aim of the research was summarised as "to create the necessary knowledge base for analysis, management and mitigation of risks undertaken by the urban poor when they enter into partnerships with the state and financial sectors in order to develop new options for slum rehabilitation and resettlement".

2. OUR STARTING ASSUMPTIONS

The assumptions with which we began the research were based on the learning and principles that had emerged from the Federation process. In simple terms, and perhaps more clearly articulated than they were at the beginning of the research process they are:

- The Federation process seeks to change the way in which urban development is conducted rather than simply to demand entitlements and services within a given regulatory and delivery framework.

- The Federation process "is based on a commitment to methods of organisation, mobilisation, teaching and learning that build on what the poor themselves know and understand. The central principle of this approach is that no one knows more about how to survive poverty than the poor themselves"[2].

- The federation process is built around a basic acknowledgement that women must be at the centre of the process if it is to be effective and sustainable.

- The participation of large numbers of people is required if investment in capacity building within organisations of the urban poor is to have any significant impact on their effective demand of for urban resources and services. This is most effectively facilitated when networks are created with the ability to share experiences, learning and knowledge.

- The development of capacity by organisations and networks of the urban poor within the federation process is dependent on the building of relationships that facilitate the collective creation and use of common resources.

- Relationship building between organisations of the urban poor and with other institutions having a major stake in urban development is contingent on an ongoing and widespread process of dialogue and exchange.

- Financial and knowledge resources comprise the most strategic assets in building a collective resource base.

---

[2] Appadurai 2001

3. DEVELOPING A CONCEPTUAL FRAMEWORK

Our theoretical framework was distinctly hazy. How could we conceptualise what was happening in our work? How could we measure its progress? What terminology would make sense to the diverse range of people with whom we wanted to carry out this exploration? We started by looking closely at the conceptual framework provided by sustainable livelihoods theory. It is a theory that has been adopted by our main funders the UK Governments Department for International Development (DFID). It seemed sensible, if we were going to try and deepen a dialogue with them around urban finance, to understand the framework that they were using to assess progress made in tackling poverty. As we began the process we found ourselves struggling with the relationship between two fairly nebulous concepts – assets and capacity. In doing so we found ourselves struggling with the relationship between two fairly nebulous concepts – assets and capacity.

The concept of Capacity Building is used ubiquitously by development theorists and practitioners. However, precision in definition, and even more so in measurement, has proved elusive. When significant investment is made in creating capacity through complex process methodologies this lack of precision can prove particularly problematic in assessing impact and hence in justifying the level and form of investment that funders and "communities" make. We needed to clarify the way in which the concept of capacity could be used to understand the relationship of assets, investment, and intermediation between formal and informal financial sectors specifically in the context of initiatives undertaken by organisations of the urban poor. In order to do that we tried to link the concept of capacity to that of assets, through an exploration of our understanding of the way in which the theory of sustainable livelihoods might be applied to the federation process.

The theory of sustainable assets has been copiously documented elsewhere and I will not attempt to replicate it here. However it should be noted that limitations within the original sustainable livelihoods model have been identified by a range of writers within the urban context. As our work progressed we identified two in particular.

- The unit of analysis within "conventional" sustainable livelihoods theory has been that of the household. We have chosen instead to focus on a higher level of "organisations of the urban poor" because the kind of interventions and solutions that we are interested in are not achievable by individual households or indeed communities – they require broad based collective action. In choosing organisations of the urban poor as our unit of analysis we are aware that, in fact, we are dealing with a wider concept of alliance, a conceptual hybrid which brings together the organisational structures, systems, and cultures of federations of the urban poor, which have frequently been categorised as people's movements[3], and NGOs which provide a huge range of diversity within themselves. To simplify discussion we have chosen to focus on capacity within the Federations themselves and to treat the capacity of the NGOs which support the Federation process as a form of capacity that the Federations are able to access and, to varying degrees, influence and control.

- While the original typology of assets within sustainable livelihoods theory (financial, physical, natural/environmental, social and human) constitute a significant step forward from a method of asset analysis based solely on income or consumption, we have found it useful to consider two further assets. These are knowledge capital and political/institutional capital[4].

[3] Batliwala has identified the complex conceptual confusions and overlaps which this term in itself has encompassed.

[4] See McLeod 2000

Knowledge Capital -The institutional knowledge created by the poor – a form of intellectual capital that has a significant role to play in the negotiation of partnerships and in the formation of collaborative arrangements with the state and with formal financial institutions. The production and collation of information by the poor, about the informal settlements where they live provides a basic example. This information has a tangible value for local authorities planning urban development. A more complex example is provided by the capacity of the urban poor to share learning and experience locally, nationally and internationally through exchanges and dialogue, a capacity that has been enhanced by the use of new information technologies that allow almost immediate sharing of information. It is this asset base that constitutes the anchor for the development of the institutional (political) capital discussed below.

Institutional (Political) Capital - the organisational forms, relationships and processes specifically developed by the poor to increase their capacity to escape from poverty. This concept incorporates relationships that facilitate access to, and influence on, the structures, processes and procedures that constitute the external policy and regulatory environment in which organisations of the urban poor operate. In effect this form of asset constitutes the political base of the urban poor's organisational influence.

The extensive groundwork carried out by the Indian Alliance in building institutional capacity among the poor and in developing relationships that have brought together diverse stakeholders at local, city, national and international levels exemplifies the creation of institutional (political) capital.

4. HOW DOES ASSET FORMATION RELATE TO CAPACITY?

In exploring how asset formation relates to capacity development for organisations of the urban poor, we looked at the way in which development has been conceptualised within writings on housing and more general development. The most concise definition of development we found was "the capacity to choose" which in turn is closely associated with the concept of freedom[5]. John Turners seminal work "Freedom to Build" brought to the attention of international policy makers the folly of seeking to "deliver" housing to people who were already, through their own efforts and with their own resources, developing more shelter than all the world's governments and formal developers[6]. In the absence of any constructive engagement by the state people "chose" to self-build. Turner's plea was to remove the aggressive constraints that limited people's freedom to build – in particular to do away with unrealistic and unaffordable building standards legislation and the systematic denial of secure land tenure to the poor.

Turner's work highlighted the urgency of removing regulatory impediments that constrained poor people's capacity to build their own homes. His insights emerged from the survival dynamics of pioneer settlers on the outskirts of some of Latin America" largest urban centres. However, by the end of the 90's the increasing commercial demand for land within large cities in the developing world was creating a crisis of major proportions for urban planners and managers as well as for the urban poor. With inner city land at a premium and high densities precluding the kind of peri-urban development that Turner had described so well, it became clear that in many of the World's mega cities the only feasible solution was upwards – high rise residential development. This form of construction is not conducive to self-help, household-based initiative. Simply turning a blind eye to the "illegal" development that poor households invested in could not be conceived of as a long-term solution. Planned high density developments had to be incorporated into policy, necessitating a reconsideration not only of land allocation practices but also of access to the financial capital that would be required for such developments.

During the eighties international interest in urban development had begun to focus on housing finance and the lack of access that the urban poor had to formal financial markets. However by the mid '90s it was widely acknowledged that the financial institutions that had been set up to meet this need had largely been subverted towards serving the requirements of middle-income groups. In the meantime, micro-finance, characterised by short term retail lending, at relatively high interest rates, to individuals and small groups, became a popular trend within development practice. In recent years there has been recognition that up to 40% of the loan portfolios of Micro-finance Institutions (MFIs) in Asia, Africa and Latin America is being "diverted" for use in housing development and improvement, an area prioritised for investment by women who constitute the majority of MFI borrowers. However these diverted funds seem largely to be used for home improvements and extensions rather than for slum upgrading and resettlement. While there is a growing interest in the development of lending products designed for housing there remains a paucity of provision for medium and long term borrowing for larger scale urban projects.

As MFIs have multiplied the issue of institutional regulation and credit rating has inevitably arisen. Conventional credit rating applied to individual, group, project and institutional borrowing, has severe limitations for individuals, households and organisations dependent on informal earnings. MFIs have developed modified systems to accommodate the irregular and uncertified earnings associated with income generation in the informal sector but there has been only limited development of specialist credit rating processes for Non Governmental

[5] See Amartya Sen (1999)

[6] De Soto 2001 estimates that the value of real estate held, but not legally owned, by the poor in the developing world, is at least $9.3 trillion.

Organisations (NGOs) and Community based organisations (CBOs) working in the area of housing and infrastructure development. Credit rating applied by agencies such as the Housing Development Finance Corporation (HDFC) and the Housing and Urban Development Corporation (HUDCO) in India incorporates elements of MFI credit assessment together with more conventional assessments drawn from standard mortgage lending methods used by Banks. However, these approaches continue to focus on the analysis and assessment of organisational balance sheets, property assets and historical credit management performance - requirements that exclude agencies with minimal physical assets and no demonstrable track record in managing credit from commercial institutions. They have yet to adequately consider alternative asset forms such as the knowledge and institutional/political capital which has emerged as such critical security factors in the case studies undertaken in this research.

5. THE FEDERATION PROCESS AND SOME ISSUES OF MEASUREMENT

If development is fundamentally about enhancing the ability of people to make meaningful choices about their lives then it seems likely that the most significant indicators of progress will relate to the manner in which decisions regarding choice are made. Who defines what options exist as choice? Who can influence the way in which choices are made with respect to accessing land, finance, infrastructure, and information? Which institutions make which choices on whose behalf? And how do the answers to these questions change as the Federation process designed and developed by the Indian Alliance and its affiliates within SDI grows and adapts?
Some insights into these questions have emerged as a result of the research studies carried out with members of the SDI network in India, Cambodia, South Africa, Zimbabwe and, more recently in Kenya. Other organisations that were not members of SDI were also involved in India, Kenya and Bolivia. Their focus has historically been on the delivery of services aimed at improving shelter conditions but they do not use a methodology that incorporates systematic exchange, mutual support and collaborative learning within a network that shares a common development process across cities, countries and continents. The diversity between these two broad groups provided us with an opportunity to make some comparisons between processes based on the federation model and processes that are not. However first things first. Perhaps it makes sense to begin by explaining the way in which the federation process works.

The Federation process is built around a number of principles and practices, sometimes referred to as "rituals" that relate to asset formation within the federations and their membership. They are summarised below.

- The formation of **saving and credit groups** creates a basis for collecting money, people and information resulting in collective capital and basic organisational capacity. As savings groups mature and move into credit activities the ability of their leaders (mainly women) to manage collective money develops. At the same time, as savings groups become federated first locally, then nationally the options to leverage this capital and organisational capacity increase.

- **Enumerations and settlement mapping** carried out by the urban poor themselves enables the collection of settlement based information, particularly relating to housing, land and infrastructure, which is owned by the poor rather than by outsiders. When this information is shared and collaboratively checked and interpreted it provides the basis for collective knowledge, owned by organisations of the poor, which can be used strategically to negotiate with, and frequently to assist, local and external authorities.

- **Housing and toilet exhibitions and festivals** demonstrate the possible in a manner that enables fundamental choices to be made about allocation of collective assets – particularly land and infrastructure -provided through local or national state agencies. Exhibitions also create a space for policy makers, politicians and the urban poor to explore alternative options for investment and new options for planning and building standards.

- Learning and mutual support are nurtured through a process of **exchanges** – visits to each other's communities so that experiences can be shared. Increasingly such exchanges also include public officials and other professionals, encouraging their exposure to the way in which organisations of the urban poor perceive, analyse and respond to the issues that they prioritise within their local contexts. It is through exchanges that the relationships that form the infrastructure of political capital are frequently created.

- The implementation of **small pilot projects** which demonstrate how a community driven process can design and implement solutions that make sense to them, and which act as precedents for larger scale development. The implementation of such projects constitutes the research and development activity of the federations with respect to costing, construction techniques, negotiation with authorities over standards and approvals and also test the relationships that must be developed if larger scale work is to be taken on.

These elements of the federation process are not followed in any sacrosanct sequence. However as Appadurai [7] has argued:

> *"Daily savings – and its spread – are conceived as the key to local and global success of the federation model. In this connection it may be noted that Mahila Milan, the women's group within the Alliance, is almost entirely focused on organising small savings circles. For in putting savings at the core of the politics of the Alliance, its leaders are making the work of poor women fundamental to what can be achieved in every other area. It is a simple formula: without poor women joining together, there can be no savings; without savings there can be no federating; without federating there is no way for the poor themselves to enact change in the arrangements that disempower them".*

Our experience over the last fourteen years indicates that the challenge faced by the urban poor in developing safe and secure shelter can be summarised in seven main objectives:

- Accessing land and achieving secure tenure
- Accessing development finance
- Negotiating development standards that are appropriate and affordable.
- Designing, controlling and managing the construction process.
- Securing the commitment of the state to provide basic infrastructure –water, electricity, sewage access roads, and solid waste disposal.
- Providing for long term maintenance
- Helping others to learn from the experiences that take place through a process of collective knowledge development and sharing

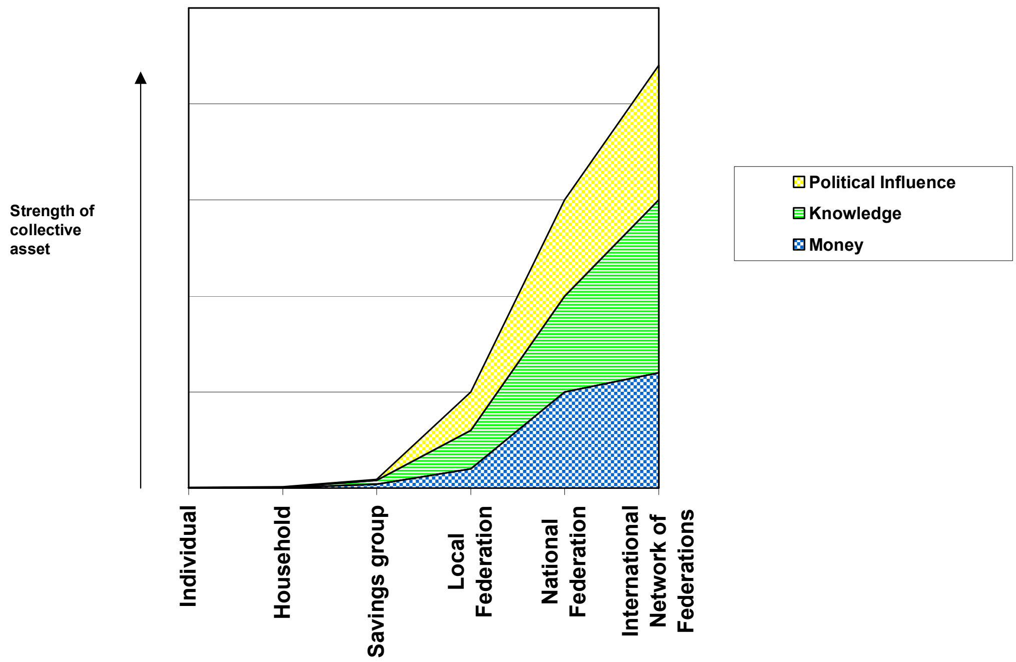
Looked at simplistically, determining whether or not organisations of the urban poor have developed the capacity to achieve these objectives is fairly straightforward. Either they have managed to create safe secure housing which is secure, habitable, maintainable and which supports their ability to make choices in other areas of their lives or not. The problem is that whether or not the objectives are reached can only be determined in the long term – twenty years would probably be a realistic time frame. To determine whether or not the actions that these organisations take in the short and medium term constitute effective progress along that development path[8] is quite another matter because it assumes that certain forms of organisational development, asset accumulation and policy influence are more appropriate than others. Who is to determine what makes sense? Who is to define what constitutes progress? Homeless International believes that it is within this sphere that its most important advocacy work should be carried out – to create a space where dialogue, debate and negotiations can take place, between organisations of the urban poor and the other key stake holders in urban development regarding the basic criteria and judgement of elements that constitute progressive investment and development in implementing the Habitat Agenda and the urban objective embedded within the Millennium Declaration of the United Nations.

---

[7] Op.cit

[8] Note the Habitat Agenda's commitment to "the progressive realisation of the right to housing!

In order to understand how effective the Federation principles are when operationalised it might be useful to consider what should happen to collective assets if the Federation process proves successful. A schematic version of success is given below.



A schema such as this may help to plot out a vague development path. However a critical problem arises with such an approach as soon as the search for quantifiable indicators begins. Some indicators appear simple. For example various measures of collectivised capital could be used – average savings per individual/household/savings group/federation are some of the most obvious. The level of recycling of capital through loans and additional economic value created as a result within a defined geographic settlement could in theory be calculated. External funds leveraged as a result of gearing savings would also provide a significant means of establishing the benefit or otherwise of collectivised savings. However in practice these theoretical constructs collapse because of the logistical mechanics and cost (in terms of energy and time as well as money) that such tracking requires.

Indicators of political/institutional capital prove equally if not more elusive. Formal registration of co-operatives created within federations, legitimisation of federation units through allocation of collective subsidies to those units, and ability to withstand forced evictions and change state land allocation policies could all be considered indicator options. The difficulty lies in determining under what circumstances it would be possible to claim that any of these result exclusively, or in the main, from the impact of the federation process as opposed to other factors such as World Bank conditionalities, national shifts in political control and so on.

Indicators of collective knowledge or intellectual capital prove equally problematic not least because it is difficult to locate where such knowledge resides, written or notated insights of the Federations being the exception rather than the rule. One option might be to track the content of the Federation voice by tracking the development of their musical lyrics. However in Asia song has not played the same mobilisation role as it has in Southern and Eastern Africa.

Another option might be to track innovative construction processes and the introduction and transfer of new building methods. In either case it is clear that any conclusions drawn would be indicative of only a single feature of a much more complex whole.

The conclusion that we have drawn is that measuring asset creation by organisations of the urban poor in the form of financial, institutional and intellectual capital is a near impossible task, at least within the confines of a theory that assumes objective, robust and independently verifiable indicators. However that does not mean that the development impact of the Federation Process cannot be measured. It rather implies that impact should be measured and assessed in a manner that reflects perceptions of capacity and development within the Federations themselves i.e. that the evaluative process needs to assimilate subjective judgement as a central feature and to focus on performance rather than impact indicators[9].

---

[9] This issue had been addressed in a recent paper on the role of UK based civil society organisations in development – see Muir 2002

6. FORMS OF FINANCE

To date the research has identified nine forms of capital that are required to support slum resettlement, rehabilitation and infrastructure provision in which the urban poor themselves take a leading role. Later on in this paper, these different forms of financial provision are summarised together with the impact that their use can have on creating additional access to local capital by organisations of the urban poor. Before that however we will take a slight detour into a discussion of asset formation in order to explore some of the basic ingredients that seem to be required if the urban poor are to be recognised as agents rather than victims or beneficiaries of change.

6.1 FINANCING IMMEDIATE SHORT TERM CREDIT REQUIREMENTS FOR INDIVIDUALS

Saving and credit groups provide an important basis for the accumulation and circulation of capital within local communities. Collective savings are used for emergency, consumption and business purposes. Within the federation model groups manage themselves and determine the interest rates at which they lend their own money to each other. However patterns of consistency develop over time as the groups learn through experience and share this learning with other groups with whom they network.

Impact on access to local finance:
Immediate access to capital enhances the individual's ability to cope with crises, to increase earning capacity and to provide for the needs of their families.

Saving and loan histories can provide a track record that enhances an individual's credit worthiness at community level.

Where savings are deposited with formal banking institutions a more formal track record potentially provides the basis for leveraged borrowing.

The collective savings of a group or groups can sometimes be used to secure additional external loan funds from banks and other formal financing agencies.

The skills that the leaders of saving and loan groups develop in money management build confidence for further negotiations around financial matters within a community and with external agencies.

Impact on local governance:
Women, in particular, develop confidence as a result of their membership and management of saving and loan groups. This results as much from the communication and sharing of information associated with group activities as it does from their access to credit. As this confidence develops it is applied in other areas of people's lives. Members of Mahila Milan in Pune for example, applied the confidence they had developed in their savings groups to taking on the challenge of learning how to design communal toilets, how to manage the construction and how to ensure the long term maintenance of the facilities. In building their capability to take on leadership responsibilities within the community they also entered into dialogue with local politicians and municipal officials – influencing decisions that were to have a significant impact at local and eventually at national level.

6.2 EXTERNAL GRANTS FOR FINANCING BASIC CAPACITY - THE ECONOMIC AND SOCIAL BASE

Grant funding has enabled the creation of strong community organisations anchored in women-led savings and loan groups. Representatives of established groups spread the word and help others to start through an exchange process that spans cities, countries and continents. In doing so they create a network of linked communities. Local groups develop the capacity to collate and use information about their own resources and enumerate, map and profile the settlements where they live. The information collated as a result is used to negotiate with city officials. As more groups become involved the process tends to speed up. However the Indian Alliance estimates that it takes about two years of basic mobilisation of this kind before a local federation emerges that shares common objectives and principles.

Impact on access to local finance:
As communities begin to negotiate with local authorities using the information they have compiled they increase their chances of accessing subsidies for land, infrastructure and other services. In some countries the databases created by local groups have helped local authorities to draw down state subsidies and/or external assistance that they would not otherwise have been able to obtain.

Impact on local governance:
It is far easier to initiate and participate in negotiations with others if you have resources to put on the table. Community based capital and community generated information constitute significant resources or assets which can transform discourse between city officials and the poor from a transaction between the "haves" and the "have-nots" into a negotiation in which both parties respect each other as active contributors to the development process.

6.3 GRANTS & REVOLVING LOAN FUNDS FOR FINANCING DEVELOPMENT OF SMALL SCALE PILOT AND DEMONSTRATION PROJECTS

With basic organisational capacity at community level, organisations of the urban poor are able to take on small scale investment projects in slum rehabilitation, resettlement and/or infrastructure provision – toilets, sanitation, water, solid waste management, access roads, drainage. These projects demonstrate how designs and ideas developed at community level can work in practice. They provide an opportunity to develop and test new skills, not least within the relationships that must be negotiated as a project is implemented. Perhaps most importantly they provide a chance for people to learn from their own collective initiative. In order to implement such projects organisations of the urban poor need access to the investment capital required for such schemes which is likely to range from US$0.2 to US$1 million

Impact on access to local finance:
Demonstration and precedent setting projects provide a chance to try out and refine budgeting and project costing skills. They also provide a background of experience from which to approach formal financial institutions for refinancing and the experience to develop scaled up approaches in collaboration with municipal/bi-lateral/multi-lateral agencies

Impact on local governance:
Pilot projects draw attention to the ideas and abilities of those who design and implement them. When a poor community designs and implements a solution that becomes visible and comprehensible to others, they begin to change the terms of engagement between different actors in city development. When other communities come to share celebrations of these initiatives they provide support, reflection and the chance for the learning that emerges from the pilot, both negative and positive, to be shared by others.

6.4 GRANTS FOR FINANCING LEARNING, KNOWLEDGE CREATION AND CAPACITY BUILDING

As communities and NGOs invest in demonstration projects and in scaling up, their learning is rapid and dramatic. Sharing the learning that takes place and the knowledge that is created is vital. However funding for documentation and exchanges that facilitate this sharing is scarce.

City level teams of Municipal authorities, slum dwellers, NGOs and private sector interests could use funding in this area to build on the basis of experience from other cities and receive ongoing support from people who have gone through the process before them.

Impact on access to local finance:
Successful initiatives within one municipality can act as important precedents for replication by other municipalities. Tried and tested procurement and contractual procedures can be re-used adding to the "comfort" factor required by public and private sector financial institutions. In effect community-municipal teams that have already successfully implemented community-led initiatives can provide affordable and appropriate technical assistance to cut the "research and development" phase of creating new approaches that build on the assets of the poor.

Impact on local governance:
When organisations of the urban poor are able to form relationships with officials and professionals on their own turf, dealing with their own priorities and interests, the power dynamics of the relationship are likely to be more equitable than those dependent on formal meetings held in office buildings, and dominated by a protocol that is often unfamiliar and alienating. As one resident of Victoria Falls put it – "we don't have to make an appointment weeks in advance to discuss our housing scheme with the Mayor or Town Clerk or Engineer. We can go and knock straight on the door and it opens".

When teams of representatives from communities travel with officials to visit other teams and to learn from the experiences of city-community partnerships in other cities, the quality of the relationship often dramatically improves at the same time as new options are explored and new sources of support are developed.

6.5 FINANCING RISK MANAGEMENT AND MITIGATION.

Work during the Bridging the Finance Gap project has shown clearly that communities and the NGOs with whom they work, are managing significant and substantial levels of risk in order to finance demonstration projects and to set the basis for scaling up. This is largely because public sector financing is severely constrained and because the most obvious alternative sources – banks and other formal financial institutions – have proved relentlessly reluctant to lend to the poor. Explanations o this reluctance have engaged a plethora of development theorists. Our own limited findings suggest the following options.

In some cases local financial markets are relatively underdeveloped and medium and long-term financing is not yet being offered at all by banks. Where the financial markets have developed further, existing demand from the commercial sector and from higher income consumers may absorb all the available financing. Crowding out of commercial loans also occurs in cases where Governments borrow extensively on the domestic market, typically by issuing Treasury Bills.

Banks may consider the margins to be made on lending for community based urban development to be uncompetitive, particularly where significant investment is required in developing new mechanisms and systems for credit delivery.

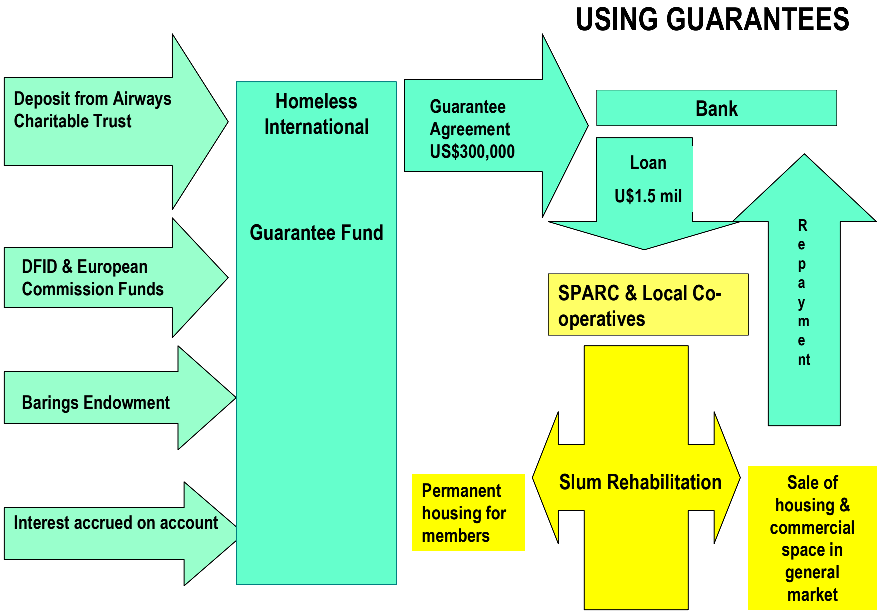
In many cases banks have never been asked to deliver this form of financing either to local government or NGOs and therefore have not considered the option or explored how viable such lending might be. NGOs may also not have developed the capacity to articulate such a request in a form that can be implemented by banks and local authorities and may need technical assistance to achieve this.

Banks, with few exceptions, are established to make profits, and their business models emerge from this fundamental purpose. As a result they have a strong aversion to risk. Their assessment of risk is based on judgements that revolve around the notion of asymmetric information – in layman's terms the chances that, as a potential lender, their knowledge of the likelihood of a borrower repaying a loan differs from that of the borrower. In our many discussions with bankers it was interesting that only one mentioned the concept of asymmetric information directly. Their conversations however were frequently punctuated with the term "comfort". The need for comfort, the search for an elusive comfort factor, and the acknowledgement that frequently the criteria for determining how comfortable a lending arrangement might be resided in the intuitive judgement of a credit manager with a "nose for the business". This confirmed out own intuition – if the banks don't understand the context of the borrower, in particular if they fail to grasp the form in which security is symbolised within the borrower's reality, and the nature of the borrower's asset base, they will entertain a polite conversation, and then either shut the door firmly behind you or string out negotiations for so long that the effort to obtain the loan becomes more costly than the value of the loan that is being sought.

In theory the provision of guarantees, particularly hard currency guarantees[10], should help to alleviate the nervousness that banks and other financial institutions display. In practice guarantees are difficult and expensive to negotiate. Even when negotiations are successful two year delays in delivery of contractually agreed financing, following the completion of guarantee agreements, are not unusual, leading to an enforced use of scarce bridge financing. This is often because banks will not lend if the full compliance with planning and building regulations[11] has not been certified by the authorities. In addition guarantees and other security requirements from formal lenders continue to be onerous. Homeless International has managed to achieve significant gearing in some cases, for example 25% guarantees with HUDCO and the Indian Bank, but other institutions have required 100% hard currency equivalent guarantees and HDFC in India insisted on 107% to ensure that interest on a wholesale loan would also be secured. This begs the question "why continue to negotiate guarantees?" The answer comes back to the need to create space for the development of new relationships that can potentially benefit the urban poor. Once a guarantee negotiation begins, an important new space is created – for learning and understanding how the processes of informal and formal credit allocation differ, for exposure to new terminologies, and for engagement in dialogue that sometimes leads to accommodation and compromise. However the guarantee path is not for the faint-hearted or impatient.

[10] Guarantee requirements on current projects supported by Homeless International range from US$50,000 to US$300,000

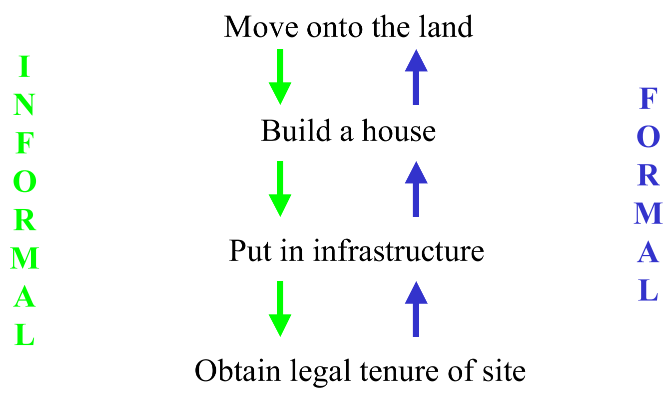
[11] This can be a long saga in itself due to the number and complexity of the regulations that usually apply and the inability or unwillingness of the authorities to "fit" community-driven design processes into their procedures.



The asset base of most support NGOs tends to be slim; hence the requirement for alternative forms of collateral when negotiating loans. Hence also the significance of the risk that is undertaken when bridge financing is provided to ensure that projects get off the ground while loans are being negotiated. Again this begs the question – "why start a project before loan financing has been agreed?" To answer that question a small digression into the process of informal land development is required.

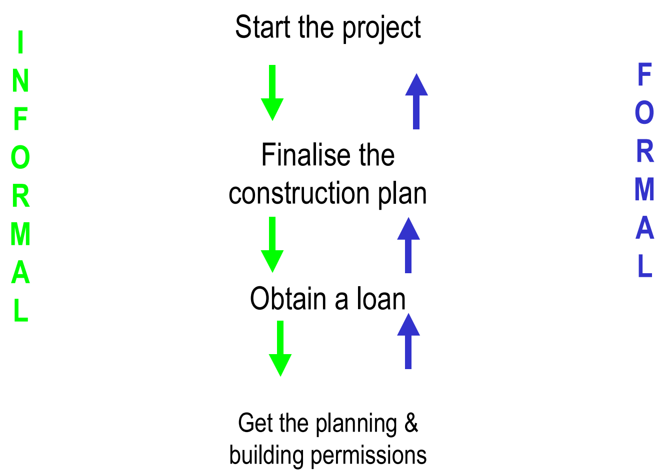
The investment strategies of the poor nearly always begin as survival strategies which reverse the logic of the formal planning and approval process that operates in developed economies. While the formal process begins with an assumption of a "legal" route, the informal process is often forced to assume that legality is non-achievable, at least in the short term. In terms of governance this means that the poor start as investors who are "outside" the comfort zone with few chances to access the resources of the state or the formal financial markets. In the past this "outside" status has effectively meant that the poor's struggle for survival becomes a war of attrition with formal authorities, consuming valuable resources that could arguably be used far more effectively.

How does the development process go?



Over the last two decades this war of attrition has increasingly been questioned and a rhetoric of "enablement" and "partnership" has become popular in the global policy debate. However the challenge has been to "walk the talk". All too often progressive, enlightened policies gather dust on office shelves because no real mechanisms are in place for delivering the solutions that are required and the partnership arrangements that are envisaged remain a fantasy. Survival rather than development strategy rules the day for both the poor and the state. In the meantime the financial sector minds its own business, carrying on regardless of the fact that, from the perspective of the poor, its own logic is as upside down as that of the state.

How are investment choices made?



For this situation to change, the risks undertaken by the poor when engaging with the state and with the formal financial sector need to be acknowledged. At the same time a far greater degree of understanding needs to be developed by both banking institutions and organisations of the urban poor as to what lies behind the differences in perception and judgement that are so apparent between them. Without better understanding, the chances for improved mediation between the formal and informal financial sectors seems remote.

One of the entry points to building understanding in this area is that of providing support for risk analysis, management and mitigation by organisations of the urban poor so that the dialogue and negotiations with banks can be accelerated.

Impact on access to local finance:
Guarantees and security deposits buy space within which negotiations with formal financial institutions can take place. These negotiations help organisations of the urban poor and banking institutions to become familiar with the processes and procedures that are used in each of their differing contexts. When such a negotiation works well a financing agreement is concluded releasing capital for investment on major projects. Success with one financial institution also usually adds to the credibility of organisations of the urban poor so that negotiations with other financial institutions become easier and less prolonged.

Impact on local governance:
Guarantees and articulated risk mitigation and management strategies enhance the capacity of the poor to negotiate with local authorities and their representatives. A guarantee sourced from an agency seen by the formal world to be reliable adds to the credibility of the potential borrower. For example when SPARC and NSDF sought to tender for contracts to deliver toilet blocks in informal settlements across Mumbai, they were able to win because a guarantee from the UTI Bank was accepted in lieu of a contractor's bond which they could not have afforded.

6.6 FINANCING PROMOTION AND THE CREATION OF NEW ALLIANCES WITH PUBLIC AND PRIVATE SECTOR AGENCIES

Urban slum rehabilitation, resettlement and infrastructure provision is of interest to many different stakeholders. Too often however the learning that is emerging from leading edge community driven processes is restricted to a network that is already part of the process. Funding is needed for promotional work with major local and international agencies to persuade them of the importance of the work that is going on and to enable them to find ways in which they can become part of supporting it.

Impact on access to local finance:
When community-led schemes prove successful they provide an empirical basis for the promotion of community-led approaches. Such advocacy, when successful can lead to significant policy change at city, state and national levels releasing financial resources, including subsidies that would otherwise not be available directly to the poor, e.g. replication of the Pune sanitation approach

Impact on local governance:
When the learning and insights that emerge from community driven processes are shared with policy makers, opportunities arise to change the way in which the urban development business is done. In the MUTPII railway slum resettlement project coordinated by the Indian Alliance, changes were eventually made in the World Bank procurement policies in order to accommodate communities taking on the role of contractors. MUTPII also included important conditionalities from the World Bank that required resettlement to be negotiated with communities rather than carried out against their will. Provision was made for compensation in recognition of the significant investment that families had made over many years in the homes that were to be

demolished. None of this would have been possible without a communication channel that enabled the voices and opinions of the slum dwellers to be heard. It would also not have been possible if the slum dwellers had not had the organisational capacity to make effective demands of the state and its funders.

6.7 GRANTS, LOANS, CONTRACT FEES AND SUBSIDIES FOR LARGE SCALE PILOT PROJECTS

Once an approach has been tried and tested it may be refined. It is then ready for scaling up. This is a stage when the financing gap becomes very apparent. Because initial attempts at scaling up are themselves considered pilots and demonstrations, the funding required is usually too large (and sometimes too complicated) to be covered by standard NGO project financing. The potential for leveraging the resources of the poor is significant at this level if the appropriate financing, procurement and community contracting processes and mechanisms can be established. However, with very few exceptions lack of access to capital is a prohibitive constraint. The capital amounts required are likely to be in excessive of US$1 million per project.

Impact on access to local finance:
Where bridging finance is available options to secure direct loans from commercial and public sector financial institutions can be taken advantage of. Such access is usually dependent on the capacity to provide guarantees. Municipal contracting can be negotiated but often requires capital deposits to cover performance bond requirements and necessitates access to start-up capital as contracts are normally funded on a reimbursement basis.

Impact on local governance:
Resources of the poor can be leveraged to create solutions that work for the poor as well as for the city as a whole. When pilot projects prove successful everybody wants to own them, including local politicians. This reverses the conventional role of the poor from that of supplicant to that of provider, in the process changing the way in which they perceive themselves and are perceived by others as citizens.

6.8 MORTGAGE REFINANCING

Refinancing is needed to release the bridge financing that is used to cover the capital costs in rehabilitation, resettlement and infrastructure projects, so that it can be re-used on other schemes. Most refinancing comes in the form of long term mortgage financing designed around individual retail lending. Refinancing from local financial institutions however requires that negotiators are well prepared and appropriate technical assistance in this area (that is sensitive to the processes of organisations of the urban poor) is hard to come by.

Impact on access to local finance:
Access to refinancing allows scarce capital funds to be recycled as working capital on new projects. It also widens potential participation in schemes, particularly where residential units are developed for sale, generating project income that in effect functions as an internal cross-subsidy within the project.

Impact On Local Governance:
Refinancing is imperative if solutions are to be scaled up significantly. Facilitating such access could benefit many thousands of citizens, the majority of whom have voting rights and many of whom constitute existing and potential voting blocks. Given the size of populations living in informal settlements in most of the developing world's urban centres, this has important implications for prioritisation within the agendas of local political institutions

7. WHERE CAN THE FORMS OF FINANCING NEEDED BE OBTAINED?

A recent conference on local development funds[12] revealed the huge diversity of institutions that exist which purport to offer poor communities the financing they need to overcome poverty. We have taken the opportunity afforded by that collation of documentation, and the presentations and discussions that took place, to examine the degree to which different institutions seem able to meet the demands reflected in the previous section. In doing so we have also drawn on the rich case studies that have been developed within our own research.

The first attempt at a typology of funds that seek to meet the needs experienced by the urban poor as they initiate and manage urban regeneration strategies is extremely tentative. There are literally hundreds of funds in existence and, as yet, there have been few attempts to create any systematic categorisation or classification of their forms, functions and aims. The task is made more difficult by the evolving nature of the funds, many of which are changing constantly in response to an external environment that is beyond their control. Some of the funds have fairly limited objectives, restricted to philanthropic service delivery to self-selected organisations and initiatives assumed to represent, in some manner, the poor. Others are consciously ambitious and strategic. CODI in Thailand for example, offers a growing range of financial services to organisations and networks of the urban poor and seeks consciously by doing so to build the basis for alternative participatory systems and structures of representation and governance at local and national levels. Given this diversity we would urge caution in extrapolating too much significance from the rather simplistic table that is given below. Its purpose is simply to demonstrate the possibility that a continuum of financial services are currently available, that some forms of funding are extremely rare restricting options for scaling up, and that there are options to develop a more strategic approach to the use of existing capital to support organisations of the urban poor as they go through their own development.

In looking at a range of local funds we have found it useful to ask a number of questions:

- What are the sources of capital and the conditions of provision?
- Who controls the allocation process?
- What is the cost of access?
- How/where does the capital circulate and where does it end up?
- Who takes the major risk?
- Whose institutional capacity, political clout and knowledge base is strengthened?
- What broader impact does the capital provision have on further access by the poor to local capital?
- What broader impact does the capital provision have on the capacity of organisations of the poor to take an active role in urban governance?

[12] Organised by David Satterthwaite of IIED

	Local saving & credit groups	**NNGO Grants**	**Local Development Funds**	**Challenge Funds**	**Local Bridge Funds**	**SDI International Bridge Funds**	**Guarantee Funds**	**CLIFF**	**Formal mortgage funds**
Source of funds	Daily savings within local savings groups	Charitable giving, statutory grants, trust & foundation grants.	Bi-lateral and multi-lateral grants and soft loans. Debt forgiveness allocations. Corporate giving. State allocations.	Bi-lateral grants	Northern NGOs, local savings groups contribution to pooled saving, local NGO reserves, state allocations	Northern NGOs,	Local NGO reserves, NNGOs, corporate depositors, bi-lateral and multi-laterals	Bi-lateral and Northern NGOs	Government allocations, Bi-lateral & multi-lateral grants and soft loans. Commercial deposits. Bond issues
Allocation	Controlled by leadership of savings groups	Controlled by funders	Controlled by funders	Controlled by reps. of key stakeholder groups	Controlled by communities & local NGOs	SDI Co-ordinators and Board	Funders	Controlled by reps. of key stakeholder groups	Controlled by Management and Share holders
Examples	Mahila Milan, savings groups in Federations belonging to SDI	All Northern NGOs providing grants for urban work, Trusts & Foundations	Social Investment Funds, KRC Trust Fund, Corporate Philanthropy Funds, CODI, Social Housing Foundation,	DFID Civil Society Challenge Funds, C3 Challenge Funds, Country & sectorally specific Challenge Funds	uTshani, CODI Gungano, Twahangana, Phnom Penh UPDF, NACHU, OPP, Payata UPDF	SDI Central Funds	HI Guarantee Fund, USAID Loan Guarantee Fund, Women's World Banking		HUDCO, HDFC, Commercial Banks, Building Societies
Individual credit	X			X					
Federation Building		X				X			
Small pilots		X	X	X	X	X			
Local learning & knowledge creation		X	X	X	X	X		X	
Promotion & new alliances		X				X		X	
Risk mitigation & management		X				X	X	X	
Up-scaling								X	
Refinancing									X

8. DESIGNING A FUND ON THE BASIS OF THE RESEARCH FINDINGS SO FAR

As a result of the findings that have emerged from the research so far, and as a result of the discussions that have taken place with a wide range of agencies concerning the findings, a new fund –-the Community Led Infrastructure Financing Facility (CLIFF) has been designed. DFID has agreed to provide US$10 million start-up financing and the facility is due to become operational by mid-2002[13]. Homeless International is the implementing agent and will work to establish the initial pilot facility in India with SPARC.

The CLIFF project has been designed to act as a catalyst in slum upgrading through the provision of strategic support for community initiated housing and infrastructure projects that have the potential for scaling up. The overall goal is to reduce urban poverty by increasing the access of poor urban communities to commercial and public sector finance for medium to large-scale infrastructure and housing initiatives.

The MIFF project will:

- Provide bridging loans, guarantees and technical assistance, both local and international, to initiate medium scale urban rehabilitation in cities in the developing world;
- Work in partnership with community based organisations/NGO's who have, or can be assisted to have, a track record in delivery of urban rehabilitation;
- Seek to attract commercial, local and public sector finance for further schemes thus accelerating or scaling up the response to the challenge of urban renewal.
- Establish local MIFF agencies that can operate on a sustainable basis in the future

The four main areas of activity envisaged in the delivery of the MIFF project are as follows:

Financing development of pilot and demonstration projects. With strong organisational capacity at community level, organisations of the urban poor will be able to take on investment projects in slum rehabilitation, re-settlement and/or infrastructure provision. These projects will demonstrate how the resources of the poor can be leveraged to create solutions that work for the poor as well as for the city as a whole.

Financing initial scaling up. Scaling up community-based projects is difficult. This is the stage when the financing gap becomes most apparent. The funding required is usually too large and sometimes too complicated to be covered by standard NGO project financing. State, municipal, regional bank and/or World Bank financing is generally required. The MIFF will provide bridging finance and technical assistance to enhance the potential for leveraging the resources of the poor through appropriate financing procurement and community contracting processes and mechanisms.

Financing risk management and mitigation: When attempting to scale up local projects communities take on substantial additional risk. Two or three year delays in delivery of contractually agreed financing, even when guarantees are available, are not unusual leading to use of scarce and expensive bridge financing. Security requirements from formal lenders continue to be onerous. As the asset bases of most NGO's tend to be slim, loans often require complex guarantee arrangements. The MIFF funds will be used to ensure that some of this risk is shared and not left completely on the shoulders of

[13] The project is being funded under the auspices of the Cities Alliance programme.

the poor. The fund will also assist in the development of risk management and mitigation strategies for local groups taking on significant risk commitments.

Financing learning, knowledge creation and partnership capacity building.
As communities and NGOs invest in demonstration projects and in scaling up, their learning is rapid and dramatic. Sharing this learning and the experience gained is vital. A key aspect of the MIFF project will be documentation and exchanges that facilitate this sharing experience. City level teams of municipal authorities, slum dwellers, NGO's and private sector interests will use funding in this area to build on the basis of experience from pilot schemes and experience from other cities receiving ongoing support from people who have gone through the process before them.

If the initial CLIFF pilot in India proves successful it is anticipated that the process will be replicated in a second country within three years.