Homeless International

RESEARCH ON BRIDGING THE FINANCE GAP IN HOUSING AND INFRASTRUCTURE

AND

THE DEVELOPMENT OF CLIFF

A paper prepared by Ruth McLeod of Homeless International
as part of the
Bridging the Finance Gap in Housing and Infrastructure Research Project *June 2002*

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INTRODUCTION

The Homeless International (HI) Bridging the Finance Gap in Housing and Infrastructure project, funded by the Knowledge and Research programme of DFID, has been exploring options for capitalising the scaling up of urban settlement development solutions that work for poor people and for cities as a whole, in developing countries. This paper provides a summary of the research process so far and how it has been used to develop a new initiative the - Community Led Infrastructure Financing Facility (CLIFF)

A SUMMARY OF THE RESEARCH PROCESS SO FAR

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".

The research has looked at the regulatory frameworks that govern poor people's access to capital for slum upgrading, resettlement and infrastructure provision. 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[1].

It was recognised from the beginning that the research process could not be an academic exercise if it was to engage, and be of use to, organisations of the urban poor. We decided to root the research in ongoing initiatives and to focus our energies on finding ways to articulate the complexities of the situation on the ground so that others with less direct contact could understand it.

A preliminary feasibility stage was followed by Phase I during which research was carried out with a diverse range of HI partner organisations in India, Cambodia, Kenya, South Africa, Zimbabwe and Bolivia. Within each context the regulatory and policy frameworks governing the access that organisations of the urban poor had to development capital were explored. Detailed case studies were carried out on infrastructure and housing projects that had already been implemented or were in process. A workshop held at the end of Phase 1 in January 2000, brought the participating organisations together to discuss the initial work that had been carried out. The workshop concluded that the research needed a clearer focus on exploring how a capital fund could be established that would function as a "war chest" for organisations of the urban poor seeking to initiate scaleable urban upgrading, resettlement and infrastructure initiatives.

Phase 2 deepened the analysis of capital investments undertaken by organisations in India, South Africa and Kenya. We looked at entire portfolios of work rather than at single projects and at how choices were being made about what to include in the portfolios. The process led to a more detailed understanding of the breadth and depth of the risks that were being taken by organisations of the urban poor, and their support NGOs, as they sought to engage with the state and with formal financial institutions. It was clear that they were experiencing a serious lack of support in taking these risks. Different forms of financial assistance required to assist the urban poor in developing community-driven approaches, were identified[2] with a basic analysis of how this assistance helped and where it could be sourced. The gap in provision of risk management funding and in the provision of investment capital for scaling up successful pilot approaches was more clearly identified and discussions were held with a range of agencies including DFID and the World Bank

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[1] See McLeod 2000 Experiences of Linking Community-based Housing Finance to Formal Finance Mechanisms, www.theinclusivecity.org for a detailed analysis of these risks.

[2] See Appendix 1

concerning how this gap might be addressed. In December 2000 discussions began on the possibility of setting up an international finance facility specifically designed to deal with the issue.

In March 2001 the research progressed into Phase 3 which began to focus on the feasibility of using the new financing facility in different contexts. Additional research was carried out in Thailand and Jamaica to look at how existing local capital funds, in addition to those already studied, had been used within urban development processes that sought to benefit the poor. Work also began, in collaboration with DFID, on developing a proposal to establish the Community Led Infrastructure Financing Facility (CLIFF).

In December 2001 Cities Alliance approved a proposal from DFID to establish CLIFF with seed capital of US$10 million from DFID. It was agreed that CLIFF would be piloted in India with HI being the implementing agent working in close collaboration with SPARC and SNSS as local development partners. The project to develop the facility has been designed with a ten-year time frame and it is envisaged that local CLIFFs will be established in at least two countries. In the meantime the research project has been expanded again to explore if and how CLIFF might be applied in different contexts. A further study is to be carried out in Zimbabwe and new studies will take place in Namibia and the Philippines. A supplementary research project has been commissioned by DFID to explore the feasibility of using a CLIFF approach in Ghana, Nigeria, Uganda and Tanzania.

THE EVOLUTION OF A CONCEPTUAL FRAMEWORK

Initially the theoretical framework was distinctly hazy and we were not sure how best to conceptualise what seemed to be happening on the ground. We focussed on detailed description of the regulatory frameworks that governed the operation of local organisations, the practices of the financial sector and the planning and approval requirements for housing and infrastructure development. We analysed the cash flows, investments and returns of schemes that had been, and were being, implemented by the organisations participating in the research. We asked a hypothetical question – in this context how could a local organisation of the urban poor access financing from the international capital markets? Would the schemes in which they were investing be seen as viable investment options by mainstream bankers? Would the regulatory system allow and support the channelling of the investment funds that were needed? If barriers existed what would be needed to overcome them? What terminology would make sense to the diverse range of people with whom we wanted to carry out this exploration?

To anchor our exploration of investment we looked at the conceptual framework provided by sustainable livelihoods theory which is widely used by DFID[3]. In doing so we found ourselves struggling with the relationship between two fairly nebulous concepts – assets and capacity. We also found ourselves struggling with a terminology that was seen as overly abstract and theoretical by many of the people who were leading the projects and initiatives that were being researched. We looked at the concept of capacity building, which we found was used ubiquitously by development theorists and practitioners, but rarely with the precision we believed we needed. What we wanted to do was to clarify the relationships between capacity, asset formation, investment, and risk in order to understand how intermediation between formal and informal financial sectors could be enhanced to the benefit of the urban poor.

During Phase 2 we began to try and "map" the assets of organisations of the urban poor. The attempt was useful because it helped to clarify questions that were emerging from our reading of the theory of sustainable livelihoods. However we found the theory more useful when we modified its application in two important respects.

- The unit of analysis within "conventional" sustainable livelihoods theory has predominantly been that of the household. We chose instead to focus on a higher level of "organisations of the urban poor" because the kind of interventions and solutions that we were interested in are not achievable by individual households or indeed communities – they require broad based collective action.

- 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

[3] For further information and discussion on sustainable livelihoods theory refer to DFID's web site – www.dfid.gov.uk

it useful to consider two further assets. These are knowledge capital and political/institutional capital[4].

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.

One of the most important findings of the research has been that these two forms of capital or capacity constitute the most important strategic resources that organisations of the urban poor can develop. Indeed when they enter into the significant collective investments that entail high levels of risk, the capacity of organisations to mitigate and manage these risks seems to be largely based on their ability to systematise their own knowledge and use it to build relationships that provide legitimacy and credibility within poor communities, and within state and municipal bureaucracies. The challenge is to find ways to leverage these assets in a manner that releases financial capital. In other words can knowledge and institutional/political capital be made fungible?

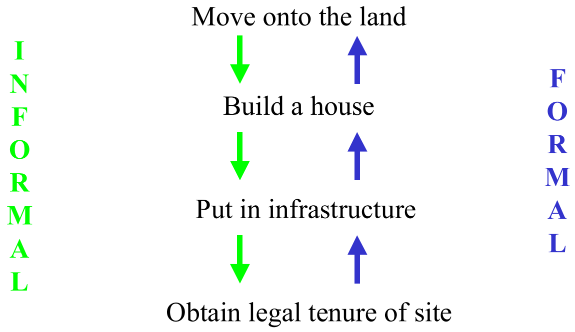
[4] See McLeod 2000 op.cit,

WHAT IS THE REAL PROBLEM?

Clearly there is serious inequity in the allocation of urban resources. This is reflected in the lack of access that the poor have individually and collectively to secure tenure, basic services and financial capital. An increasingly popular response to this lack of access is represented by the proposal that the property rights of the poor, in the form of ownership of land and dwellings should be formalised and codified within real estate legislative practices[5]. It is argued that this will release the leverage potential of investments that are otherwise treated as "dead capital". There are convincing critiques that undermine this argument (see Payne 2002 for example). However if formalising property rights with clear title is not the answer we are still left with the challenge of finding an approach that makes more sense. Our research findings suggest that this will require a review of the way in which urban investment in settlements is conceptualised.

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.

Informal and Formal Housing Development Processes

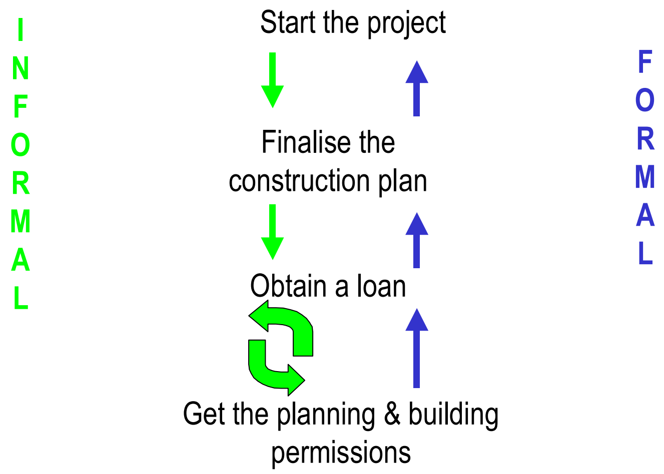


Over the last two decades this war of attrition has increasingly been questioned and a rhetoric of "enablement" and "partnership" has become popular in the global policy debate. However the challenge has been to "walk the talk". All too often progressive, enlightened policies gather dust on office shelves 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

[5] De Soto is probably the best known of the proponents of this approach.

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.

Informal and Formal Project Investment Processes



Work during the Bridging the Finance Gap project has shown clearly that communities and the NGOs with whom they work are making significant investments in urban development and being most effective in doing so when they follow the informal processes which they understand well. These investments require the management of significant and substantial levels of risk but are extremely valuable in the longer term because they provide the precedents that set the basis for scaling up. However scaling up precedents for city-wide application requires an engagement with the formal development process and the building of working relationships with formal sector institutions. This constantly proves financially problematic, largely because public sector financing is severely constrained but also because the most obvious alternative sources for financing– banks and other formal financial institutions – have proved relentlessly reluctant to lend to the poor and to adapt their systems to accommodate non-formal investment processes. Explanations of 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 driven 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 by local government or NGOs and therefore have not considered the options 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[6], should help to alleviate the nervousness that banks and other financial institutions display in lending to organisations of the poor. 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[7] 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

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

[7] 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.

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.

While guarantees can create space it is important to acknowledge that the basis on which they are usually negotiated relies on demonstrations of the achievable. These demonstrations themselves have to be financed and, at least in their early stages, invariably require bridge financing. For large scale investments that can provide a basis for scaling up, the lack of access to bridge financing is a serious impediment that cannot be overcome with the relatively slim resource base of NGO funders.

The real problem is that organisations of the urban poor have difficulty in demonstrating effective demand to the state and to formal financial institutions. As a result they cannot leverage the assets they do develop in a manner that releases the multiplicity of supply that has been built up in formal financial institutions. This is because the knowledge and institutional/political asset base that has been developed by some networks of the urban poor is either unorganised and relatively under developed, and/or because bureaucracies and banks do not recognise the real asset base of the poor as either legitimate or bankable. Supply and demand are, in effective, isolated from each other, and neither is effective. The consequence is that financial resources are trapped in institutions designed around a supply system that is inaccessible to those who need the resources most and the inequity that already exists is exacerbated rather than reduced.

ARE LOCAL CAPITAL FUNDS THE ANSWER?

A recent conference on local development funds[8] 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 provide the seven forms of external finance that have been identified in the research. More specifically we have tried to identify how effectively they provide bridge financing for large scale projects and assist in mitigating and managing the risks entailed in such investments.

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?

We have not provided the answers to these questions here but will be incorporating them into our research process as it develops further.

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[8] Organised by David Satterthwaite of IIED

If we are correct in our tentative categorisation, it is clear that the top end of the spectrum or continuum of financing– bridge financing for scaling up, and financing of risk mitigation and management needs urgent attention. The funds that do cater for these areas are few and far between and significantly under-resourced. We would argue that increasing effective supply in these areas could provide a basis for releasing some of the blocked funds available in agencies with the resources to deliver re-financing. However none of these three forms of financing are likely to be effective if the ground work in asset formation and capacity development within organisations of the urban poor has not previously been supported. A CLIFF approach will not work if an investment has not been previously made in basic mobilisation and in building up the knowledge and institutional/political asset base of the organisations of the urban poor that allows them to become drivers of the process.

	Local saving & credit groups	**NNGO Grants**	**Local Development Funds**	**Challenge Funds**	**Local Bridge Funds**	**SDI International Bridge Funds**	**Guarantee Funds**	**CLIFF (Proposed)**	**Formal credit agencies**
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					
Building CBO capacity and mutual support networks		X				X			
Small pilots		X	X	X	X	X			
Local learning & knowledge sharing		X	X	X	X	X		X	
Promotion & new alliances		X				X		X	
Risk mitigation & management		X				X	X	X	
Demonstrations of scaling up								X	
Refinancing									X

DESIGNING A FINANCE FACILITY 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 facility -–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[9]. Homeless International is the implementing agent and will work to establish the initial pilot 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. 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.

The CLIFF 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 CLIFF agencies that can operate as sustainable local institutions.

It is important to note that CLIFF will only be effective where organisations of the urban poor have developed the organisational capacity and asset base that enables them to operate collectively as investors. Where this does not exist other forms of financial assistance such as challenge funds will be necessary to support the development of such capacity.

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.

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

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 CLIFF funds will be used to ensure that some of this risk is shared and not left completely on the shoulders of 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 CLIFF 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.

APPENDIX 1

FORMS OF FINANCE

To date the research has identified eight forms of financing that are required to support slum resettlement, rehabilitation and infrastructure provision in which the urban poor themselves take a leading role. Seven of these represent financing that is sourced externally – i.e. not from the local community but from other local or international sources. 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, and their potential impact on local governance. The categorisation has emerged from research with federations of the urban poor in India, Zimbabwe, South Africa and Cambodia.

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 typified by the Indian alliance of SPARC, NSDF and Mahila Milan, 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 subsequently have a significant impact at local and eventually at national level[10].

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.

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.

[10] Further information on the sanitation programmes in Pune, Mumbai and Bangalore can be obtained from the SPARC website www.sparcindia.org

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, including municipal bureaucrats and local politicians. 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. This sharing can mobilise large numbers of people, helping to build the foundation for a critical mass of effective demand.

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 that public and private sector financial institutions seek when entering into relationships with the urban poor.[11]. In effect community-municipal teams that have already successfully implemented community-led initiatives can provide affordable and appropriate technical assistance to others avoiding the costs and efforts involved in reinventing the wheel and trying to do things on their own.

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*".

[11] The notion of "comfort" is discussed more fully in McLeod 2000 – op cit.

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.

5. FINANCING RISK MANAGEMENT AND MITIGATION.

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 space for dialogue and negotiations with banks can be created.

Impact on access to local finance:
Guarantees and security deposits buy space within which negotiations with formal financial institutions can take place. Another critical ingredient is the creation of institutional learning processes within banks and other financial institutions. It is frequently the case that guarantee negotiations become excessively prolonged because of high staff turnover within these institutions. Where no mechanisms exists to "capture" the insights and learning that individuals develop at an institutional level, staff relocation means that the negotiation process has to start all over again from the beginning. 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 and municipalities 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. 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 without swamping or co-opting the process. Funding is also needed to support exposure programmes for banking staff so that they can understand the investment processes of the poor and develop the internal mechanisms within their own institutions that are required if intermediation between informal and formal systems is to occur.

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. Exposure of Citibank and UTI Bank officials to the savings and credit systems of Mahila Milan in India strengthened their understanding and appreciation of the informal systems that Mahila Milan had developed and applied. This led to the release of money from the banks. However, in Citibank, because no investment was made in capturing the insights they had developed and transforming that knowledge into institutional knowledge, when staff turnover occurred, the process had to be repeated several times. In the meantime opportunities to scale up the provision of formal bank credit were stalled.

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[12] co-ordinated 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.

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. Initial attempts at scaling up are themselves considered pilots and demonstrations but the size of the projects means that , with very few exceptions, lack of access to capital is a prohibitive constraint. 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.

[12] For further information on MUTPII refer to the SPARC and Homeless International web sites.

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.

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 and/or other commercial components re 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