Homeless International

EXPERIENCES OF LINKING COMMUNITY-BASED HOUSING FINANCE TO FORMAL FINANCE MECHANISMS

Presentation by Ruth McLeod, Homeless international

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"The word 'risk' derives from the early Italian risicare, which means 'to dare'. In this sense risk is a choice rather than a fate. The actions that we dare to take, which depend on how free we are to make choices, are what the story of risk is all about. And that story helps to define what it means to be a human being".

Bernstein 1996.

"A problem is something you can do nothing about. We don't focus on what can go wrong. We know this is where we are and this is where we want to go. To get from point A to point B we have to go through all these things, and each one is a milestone, and when we cover one milestone we automatically move onto the next. It's a question of time, commitment and conviction – to make people see that this is the way to move ahead".

A. Jockin, President of the National Slum Dwellers Federation of India

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EXECUTIVE SUMMARY

The paper draws on Homeless International's twelve years of experience in developing methods for financing community-driven housing and infrastructure initiatives in Asia, Africa and Latin America. Findings from the ongoing Bridging the Finance Gap in Housing and Infrastructure research project are also incorporated.

Characteristics of community finance are identified and its significance in financing urban infrastructure and housing for the poor is reviewed. The performance of the formal financial sector in addressing urban poverty issues is considered in light of the relative lack of delivery by those institutions to date. The relative absence of effective linkage between community finance and formal financial systems is explored and the performance of micro-finance institutions in addressing urban infrastructure and housing needs is also analysed. The limitations that characterise micro-finance lending in this area are identified.

A major focus of the paper is a consideration of the resources that the poor bring to the negotiating table when their organisations enter into partnership arrangements with local authorities and formal financial institutions to implement community-driven urban development projects. It is noted that great attention has been given to the risks entailed for formal financial institutions in providing financial services to the poor. Little, if any, attention however has been given to the risks that the poor, and the NGOs who work with them, must manage and mitigate when they seek to engage in collaborative partnerships with the state and with banks.

The importance of developing an elusive "comfort" factor required by banks is identified, prior to a more detailed discussion on the nature of the risk-taking undertaken by the poor and the importance of developing the core asset base of their organisations if those risks are to be successfully managed and mitigated. Seven important categories of finance needed to support the urban poor in developing their capacity to become pro-active developers are considered, and the application of international guarantees to support lending from the formal financial sector is described. The importance of developing a capital and knowledge base at community level, linked through exchanges to the experience of other communities, is highlighted.

Finally the willingness and ability of banks to engage in creating and delivering needed financial services in the future is considered and the concept of a Municipal Infrastructure Financing Facility (MIFF) is described. MIFF has been developed to provide a means for key stakeholders to share some of the risks that the poor are shouldering so that the potential for scaling up community-driven solutions can be realised.

The appendix describes fifteen specific areas of risk that organisations of the urban poor and their NGO allies are facing as they seek to scale up the solutions they have developed.

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1. INTRODUCTION

This paper seeks to explore the learning in housing and infrastructure finance that has emerged from the experience of Homeless International and our partner agencies in Asia, Africa and Latin America over the last decade. It also draws on research that we have carried out over the last two years in a project called Bridging the Finance Gap in Housing and Infrastructure, which is financed by the UK Government's Department for International Development (DFID). Our research has been carried out in Bolivia, Cambodia, India, Kenya, South Africa and Zimbabwe.

The exploration of potential linkages between community finance systems and formal financial markets has been on the development agenda for many years. A major focus has been placed on the risks that the formal sector encounters in engaging with the poor. High transaction costs, little conventional collateral and small returns, have all emerged repeatedly as major constraints. To some extent these constraints have been overcome with the emergence of micro-finance during the '80's and '90's. MFI products are characterised by high interest rates that arguably compensate for the costs and risks of lending to the poor. However serious gaps in financial service delivery to the poor still remain, particularly in the areas of medium and long-term finance delivery to organisations of the poor rather than to individuals.

Homeless International's work has focused on an exploration of risks faced by the urban poor, rather than those faced by financial institutions. When organisations of the urban poor, and the NGOs that work with them, enter into relationships with the formal financial sector in order to access development finance, they face a formidable array of risks. They also face risks in entering into relationships with the state. Unfortunately this risk-taking has largely remained invisible and unacknowledged in development theory. The paper seeks to redress that omission.

1 WHAT IS COMMUNITY FINANCE?

At its most basic community finance is the finance that is created when individuals group together to create a capital base that they cannot generate as individuals. The prevalence of rotating savings and loan groups (ROSCOs) has been well documented - from the Merry-go-rounds of Kenya to the Sou-Sous of West Africa to the Partners and Boxes of the Caribbean. While ROSCOs take various forms they generally share a number of limitations when it comes to their use for housing and infrastructure development in urban areas. While ROSCOs lie behind many of the incremental improvements that families make in their individual shelter conditions, the capital formation that they represent is insufficient to fund planned, capital-intensive developments such as the installation of area infrastructure facilities (water, sewage, road and electrical services), slum rehabilitation and slum resettlement. Their capacity to leverage in additional capital from external sources has also proved limited.

2 HOW DOES COMMUNITY FINANCE RELATE TO INVESTMENT IN POVERTY-FOCUSED HOUSING AND SETTLEMENT DEVELOPMENT?

Despite the limitation noted above, "informal" finance, including the capital saved as a result of ROSCOs, has funded the vast majority of housing in the World's urban centres. It is the financing that lies behind the daily creation and maintenance of informal settlements – the slums, shanties, squatter camps and pavement dwellings that provide homes for between 50-70% of the population of urban centres in developing countries. And the value of the real estate that has been created as a result is impressive. Hernando de Soto estimates that *"…the total value of the real estate held but not legally owned by the poor of the Third World and former communist nations is at least $US9.3 trillion - wealth that also constitutes by far the largest source of potential capital for development. These assets not only far exceed the holdings of the government, the local stock exchanges and foreign direct investment; they are many times greater than all the aid from advanced nations and all the loans extended by the World Bank".* De Soto, (2000)

Since the first Habitat Conference in Vancouver in 1976, the creativity of the poor in financing and creating their own shelter survival strategies has become well recognised. However attempts to link this resourcefulness to the financial resources managed by the formal banking sector have proved relatively unsuccessful. Even Micro Finance Institutions (MFIs) have been largely ineffective in this area, particularly in urban areas. However a small number of NGOs have sought to create financing structures that provide an institutional alternative to banks and MFIs. They have established Revolving Loan Funds, sometimes known as Urban Poor Funds, extending loans to organisations and groups of the urban poor specifically for housing and infrastructure investment. While these agencies support basic savings and loan systems within settlements where they work they do not see themselves either as MFIs or as welfare service deliverers. They see their main role as being to assist organisations of the urban poor to strengthen their ability to negotiate with the state and the banking system in order to ensure that available local resources are more equitably distributed, and effectively used. The scale of the initiatives that have emerged from these new forms of alliance, between NGOs and organisations of the urban poor[1], and by at least one state initiated agency[2], is as yet relatively restricted, and their success in intermediation between the informal savings and loan mechanisms of the poor and the formal financial sector is new and tentative. However the path that they have begun to develop is deserving of serious attention because it represents the leading edge of developments aimed at leveraging the resources of the poor for planned infrastructure and housing development, particularly in high-density areas.

[1] The alliances that make up the membership of Shack/Slum Dwellers International (SDI) are particularly notable for their co-ordinated initiatives in this area. Members are located in India, the Philippines, Cambodia, Nepal, Thailand, South Africa, Zimbabwe, and Namibia with nascent groups in Kenya, Senegal, Colombia and the UK.

[2] The Urban Community Development Office, Bangkok. See UCDO, 2000.

3 HOW HAS THE FORMAL FINANCIAL SECTOR INVESTED IN HOUSING AND SETTLEMENT DEVELOPMENT IN A WAY THAT IS POVERTY-FOCUSED, AND WHY HAVE THEY DONE SO LITTLE?

While some banks have received substantial grants, and soft loans, from bi-lateral and multi-lateral sources and channelled these funds, in the form of wholesale loans, through to NGOs that have managed on-lending to household level, the banks concerned have tended to high levels of risk aversion[3] and the impact of this approach, especially within urban areas, has not yet been adequately assessed. Certainly, in the absence of earmarked grant and soft loan funding the banks have proved largely either unwilling or unable to deliver the forms and quantity of financing required for major slum rehabilitation, upgrading and resettlement. There are endless explanations concerning why so little has happened and one might justifiably ask why it is worth continuing to search for ways to create linkages between banks and poor people living in informal settlements when the available evidence seems to suggest an increasing gap between the two. Perhaps before we give up hope entirely, however it is worth considering why the gap between formal and informal financial practices remains so huge.

We believe that there are a number of reasons why finance institutions have proved unwilling or unable to invest in large- scale community-driven development. In some cases local financial markets are relatively undeveloped and medium and long term financing is not yet being offered at all by banks as in Cambodia4 for example. Where the financial markets have developed further, existing demand from the commercial sector and from higher income consumers may monopolise the interest of local banks. Kenya[5] and Zimbabwe[6] are good examples of this situation. Banks may consider the margins to be made on lending for urban development to be non-competitive, particularly where significant investment is required in developing new mechanisms and systems for credit delivery. This seems to be so in many countries where markets have only developed recently and where the market has not deepened. In many cases banks have never been asked to deliver this form of financing either to local government or to NGOs and have therefore 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 may need technical assistance in this area. In yet other cases banks have been ostensibly willing to enter into medium and long term lending to poor people but their internal systems have not been structured to deliver the necessary financial services. Headquarters may have agreed in principle but local offices prove unable to deliver in practice. Our early experience with HUDCO and HDFC in India was illustrative of this tendency. In yet other cases the security requirements of banks have proved prohibitive. The two guarantees we have backed with HDFC in India for example required 109% sterling guarantees as well as security from the implementing NGO[7].

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[3] Requirements for evidence of clear land title have excluded many potential beneficiaries despite the fact that they may have effective security of tenure through customary rights.
[4] See the Cambodian case study from Bridging the Finance Gap in Housing and Infrastructure – S. Boonyabancha, 2000.
[5] See the Kenyan Case Study from Bridging the Finance Gap in Housing and Infrastructure – M. Oriaro, 2000
[6] See the Zimbabwe Case Study from Bridging the Finance Gap in Housing and Infrastructure – T.Baumann 2000
[7] The sterling guarantee was expected to cover one year's interest charge as well as the full principal. HDFC argued that this was necessary because families living on tribal land to which they had inalienable rights possessed no documentary evidence of clear land title. Their property was therefore not considered mortgageable.

4 HOW HAVE MFIS BUILT ON COMMUNITY FINANCE SYSTEMS?

The rapid growth of micro-finance institutions (MFIs) during the 90's has provided a degree of intermediation between the organisational base of indigenous ROSCO systems and the institutional structures responsible for channelling funding aimed at poverty alleviation/eradication and allocated from national, regional and international sources. The growth of MFIs (effectively a parallel system to conventional banking) has led to a significant scaling up of accessible financial services for people who had previously been considered non-bankable. However the general trend has been for MFIs to focus on short-term (1-12 month) retail lending to individuals rather than medium and long-term wholesale lending to organisations of the urban poor. While the majority of MFI lending has been focused on support for small and medium enterprises (SMEs), there is increasing evidence that a considerable proportion of MFI loans are, in fact, being used for individual housing improvements and extensions within informal settlements[8]. However MFI products are not generally designed or structured to support larger scale community-driven infrastructure and housing initiatives.

5 WHAT IS THE NATURE OF THE GAP BETWEEN COMMUNITY FINANCE SYSTEMS AND FORMAL FINANCE INSTITUTIONS INCLUDING MFIS?

The gap between informal and formal financial systems that emerges when investment in infrastructure and housing is considered is complex. We have however identified a number of features, which characterise it.

5.1 THE COMFORT FACTOR

During our research, and in discussions with banks during guarantee negotiations, we have constantly come across references by them to their need for an undefined "comfort factor". Everyone involved is only too aware of the high incidence of bribery involved in local construction contracts. This is one of the factors that a community-driven process had been shown to eliminate[9]. However the comfort being sought by the banks is nothing so obvious or crude. It is a far less tangible, more intuitive sense that lending in a particular context "feels right". As our research has progressed we have begun to realise that the negotiations around guarantee arrangements in which we have been engaged were, in fact, about creating the space for this "comfort" factor to emerge. Homeless International has managed an international guarantee fund since 1994 and we have negotiated guarantee arrangements with banks and credit agencies in India and Bolivia. In each case the "comfort" factor has emerged as a recurrent theme. The guarantee negotiations have been anchored in rational discussions concerning collateral and security, but their substance has been more to do with bankers becoming familiar with, and confident about, community financial mechanisms. In our experience the "comfort" factor develops most effectively when financial institutions provide structured opportunities for their staff to be exposed to the ways in which communities manage their own money and implement projects on the ground. It is through this exposure that trust can be developed, providing the basis of the "comfort" factor required. The negotiation process has also led to a greater appreciation on our part of the very varied reasons that may lie behind bankers' requirements for

[8] Information from SEWA in 1996 and from a number of presentation delivered at the Micro-finance and Housing conference organised by the Inter American Development Bank in 2000.

guarantees. Their requirements often seem to have more to do with the way that they are assessed by central banks than their professional judgements concerning the likelihood of default on loan repayments[10].

5.2 RETAIL LENDING VERSUS WHOLSALE LENDING

Specialist housing finance institutions that have developed housing finance products for the poor have tended to concentrate on retail lending to individuals. These loans may be brokered through a local NGO that assumes community level loan management responsibility. However few agencies have offered wholesale or development loans of the type required for major infrastructure installation, green site development, in-situ high-density slum rehabilitation or for large-scale resettlement. A notable exception to this has been UCDO in Thailand; a state financed agency that has offered wholesale loans directly to community organisations for a range of development purposes. The lack of availability of development capital or investment finance for the poor represents a serious gap because it constrains collective action of the kind needed to tackle area redevelopment, and ensures that the poor remain dependent on expensive and scarce professional leadership either in the form of state agencies or in the form of commercial developers. The constraint on collective action, in turn, precludes investment in one of the most important assets that the poor can develop - that of institutional capital. The importance of institutional capital is explained in section 8.

5.3 SHORT TERM VERSUS MEDIUM AND LONG TERM LENDING

MFI lending for urban housing improvement has almost invariably been restricted to short term loans with relatively high interest rates. Specialist housing finance institutions have offered longer-term loans but these have largely been restricted to borrowers with clear land title and certifiable income – a condition that excludes the vast majority of the residents of urban informal settlements. Short term lending has severed limitations in high-density areas where options for incremental housing development may be severely limited.

5.4 CREDIT ASSESSMENT CRITERIA

Formal financial institutions have tended to apply conventional credit rating approaches to lending for low-income housing and infrastructure. In the case of lending to NGOs the emphasis has generally been on assessment of previous savings and loan management, the strength of the organisation's balance sheet and on the technical capacity of internal management systems. In addition requirements regarding clear land tenure on the part of end-borrowers are usual. Less emphasis has been placed on assessment of the NGOs capacity to strengthen the asset base of the poor and thus generate and increase social and institutional capital – a safety net that has both financial and mutual solidarity and pooled learning aspects.

5.5 ACCESSING SUBSIDIES

In some countries capital subsidies are available to support low-income housing and/or infrastructure provision in urban areas. South Africa is a current example. However the mechanisms associated with

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[9] See the Indian Alliance Case Study from the Bridging the Finance Gap in Housing and Infrastructure Research project – McLeod 2000 (a).
[10] It is also arguable that banks can use Central Bank requirements to "block" lending that they have no interest in.

subsidy delivery often preclude their access by organisations of the urban poor or the NGOs that support them. For example in South Africa the housing subsidy system was designed for delivery by developers and banks. Organisations of the urban poor were originally not eligible to act as brokers. As a result Peoples Dialogue on Land and Shelter and the South African Homeless Peoples Federation had to invest in a protracted negotiation with the state to have the Housing Subsidy legislation amended to include a special clause that recognised that the urban poor could act as their own developers. Where subsidies have since been delivered directly to the Federation, members have been able to demonstrate substantial cost savings and significant value-added compared to the to housing solutions delivered through conventional developers[11].

5.6 AN ISSUE OF VOLUME

Bi-lateral and multi-lateral agencies have been constrained in their choice of delivery agents for housing finance by their own internal requirements for high turnover of funds. This limits the number of projects that can be processed within a given time period and effectively excludes agencies that cannot absorb many millions of dollars of funding. Agencies eligible to receive soft-loans and grants for on-lending as housing and infrastructure loans are relatively restricted within each country, limiting competition and, in some cases, resulting in effective monopolies. Unfortunately, it is by no means clear that the agencies receiving bi-lateral and multi-lateral funds are those positioned to most effectively to deliver effectively to the poor.

6 AN EXPLORATION OF RISK

In developing our own thinking around options for housing and infrastructure finance we have found ourselves drawn into a consideration of risk. As our discussions have developed we have made a number of important assumptions about the nature of risk. We believe that risk is about what can go wrong, how badly it can go wrong, and what may happen as a result. Risk analysis involves judgement about the likelihood or probability that something will go wrong and how severe the consequences will be. Perhaps most importantly risk is about choice and the ability to choose. It is, as Bernstein[12] has pointed out "*a set of opportunities open to choice*".

The urban poor face a multitude of risks on a daily basis ranging from the risk of inadequate food, right through to the risk of forced eviction and the destruction of the shelter that they manage to create. For some, short-term risk management dominates their daily lives. For others a longer-term perspective is possible as is the potential to develop strategies to manage risk that can be combined with investments aimed at escaping poverty altogether. This longer term potential arises most often when the urban poor are organised, and have an institutional base, and associated allies, that provide a means to engage in pro-active negotiations with the state and with financial institutions[13].

[11] See the South African case study in Bridging the Finance Gap in Housing and Infrastructure – Baumann 1999
[12] Bernstein (1998)
[13] McLeod and Satterthwaite (1999)

It is important to note that the relationship between security and risk is dialectic. By this we mean, *"Security at one level allows risks to be taken at a higher order, in good faith*"[14]. So the starting point for risk analysis has to be the security that an organisation is already perceived to possess.

We have made three further assumptions that have been well articulated by Beck [15] He argues that …

> *"Risks only exist in terms of the…. knowledge about them. They can be changed, magnified, dramatised or minimised within knowledge, and to that extent they are particularly open to social definition and construction. Furthermore some people are more affected by the distribution and growth of risks and there are winners and losers in risk definitions. Power and access to and control of knowledge thus becomes paramount in a risk society".*

In other words:

- Risk is socially defined and constructed.
- People from different contexts define risk differently.
- People's access to, and control of knowledge, affects whether or not their definition of risk is accepted by others.

Our research so far, has led to the identification of fifteen areas of risk that alliances of the urban poor and NGOs must manage and mitigate when they seek to create safe and secure shelter in partnership with the state, and with financing from the formal financial sector. The main risk areas we have identified are[16]:

- Construction Risk
- Bribery and Corruption Risk
- Credit Risk
- Economic Risk
- Financial Risk
- Foreign Exchange Rate Risk
- HIV/AIDS Risk
- Interest Rate Risk
- Loss of Learning Risk
- Market Risk
- Natural Hazards Risk
- Organisational Risk
- Participation and Equity Risk
- Political Risk
- Savings Risk

[14] I am grateful to Xavier Briggs of Harvard for this insight which emerged from email correspondence.
[15] Quoted in Lupton, (1999)

7 THE ASSET BASE OF THE POOR

We have not just looked at risks. We have also looked at the resource base that the poor have developed and that enables them to take risks. We have identified and explored a complex asset base[17], developed by the urban poor and their NGO partners, that has allowed new and important partnerships with the financial sector and the state to be created. Our thinking around this asset base has emerged from sustainable livelihood theory which, in simple terms, provides a means of identifying the asset base of the poor rather than focusing on their needs. This assumption, that the poor do have resources which constitute assets, paves the way for exploring how these assets can be most effectively used, invested and leveraged. In addition it allows examination of the ways in which the asset base of the poor can be protected against stresses and shocks that may result from internal and external events, in short the ways in which risks associated with investment can be managed and mitigated[18]. The assets that are generally recognised within sustainable livelihood theory include:

HUMAN CAPITAL – skills, information, knowledge, ability to labour, health.

SOCIAL CAPITAL -social resources (networks, membership of groups, relationships of trust, access to wider institutions).

PHYSICAL CAPITAL – housing, basic infrastructure – (transport, shelter, water, energy and communications) and the means and equipment of production.

FINANCIAL CAPITAL – financial resources available (savings, supplies of credit, regular remittances or pensions)

ENVIRONMENTAL CAPITAL -natural resources (land, water, wildlife, bio-diversity, environmental resources).

We have added a sixth asset:

INSTITUTIONAL CAPITAL - organisational forms and relationships specifically developed to increase the capacity of the urban poor to escape from poverty.

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[16] Details of the characteristics of each of these risk areas are provided in Appendix 1, together with identification of the location of the risk and options that have been developed in different contexts for risk management and mitigation. It should be noted that risk within this analysis has been identified at the organisational rather than household or individual level.

[17] Asset mapping has helped us in this exploration. Asset mapping is a tool being developed by Homeless International as a means of identifying the range of resources that organisations of the urban poor have created as they organise around slum rehabilitation and resettlement initiatives. The process, which is very fluid, emerged from work in India with SPARC and the National Slum Dwellers Federation. In effect the method plots perceived resources and threats (risks) by building up a map based on clusters relating to financial, human, institutional, social, environmental, and physical assets, political and market factors, and specific investment areas such as land development and construction. The result is a single sheet summary that is used for discussion and brainstorming.

The asset mapping process helped Homeless International to articulate how the formation and development of social and human capital within informal settlements provides a strategic basis for negotiated partnerships between organisations of the urban poor, and both the state and the formal financial sector. Entering into such partnerships can entail significant risks for the poor at the same time as enhancing their capacity to influence policy in their favour. The mapping exercise helped in exploring options for risk management and mitigation within this context. Homeless International found the process particularly useful in developing arguments in favour of alternative forms of credit assessment by financial institutions considering lending for community driven infrastructure and housing initiatives.

[18] DFID has adopted the livelihood approach as a key theoretical tool in understanding poverty. However the agency has omitted the final component of Chambers and Conway's definition, namely the statement "*and which contributes net benefits to other livelihoods at the local and global levels and in the long and short term*". See DFID (1999), Moser (1998), Carney et al (1999), Sanderson (2000).

These asset bases are critical in determining the equity that the poor bring to the negotiation table when they enter into relationships with the state and financial institutions. The asset base of the poor provides options for leverage and investment within the complexity of political and market forces that the urban environment presents. However when this asset base remains invisible, unrecognised and unarticulated the power of the poor to determine how risk is defined, constructed and controlled is minimised[19]. It is in articulating and demonstrating the knowledge that has emerged with the creation of their asset base that the poor become pro-active subjects of development rather than objects of the plans and aspirations of others.

Different agencies have adapted sustainable livelihood theory to suit their own purposes but the starting point, and unit of analysis, seems usually to have been the household[20]. It is our opinion that this approach has serious limitations and we have therefore focused on exploring the asset base that has been created at institutional or organisations level by organisations of the urban poor and those who work in alliance with them[21].

8 FORMS OF DEVELOPMENT FINANCE

In seeking to identify financial arrangements that can build strategically on the asset base of the poor and enable the development of safe and secure shelter in its broadest sense we have identified seven categories of finance:

- Financing the Economic and Social Base
- Financing Development of Pilot and Demonstration Projects
- Financing Scaling-Up
- Financing Risk Management and Mitigation
- Refinancing
- Financing Learning, Knowledge Creation and Capacity Building
- Financing Promotion and Creation of New Alliances

[19] For example conventional bank lending, based on asset securities, assumes that collateral should be restricted to legally registered property and certifiable earnings. This conception of capital assets immediately excludes the vast majority of those living in informal settlements and dependent on livelihoods generated within the informal economy. Alternative asset bases that may offer far greater security in the long term are not understood or recognised as effective indicators or predictors of "safe" lending.
[20] See for example DFID (1999)
[21] This institutional base is frequently formed around common tenure. For example in the case of the National Slum Dwellers Federation of India, families living along the railway tracks on land controlled by the Railway Authority have formed the Railway Slum Dwellers Federation, those living on Airports Authority land have formed the Railway Slum Dwellers Federation.

The possible forms of finance that can be used in each of these categories vary. Some of the forms we have suggested have not, as yet, been tried by the agencies we work with. Considerable potential does however exist, if collaborative relationships can be formed and developed to take this exploration forward.

8.1 FINANCING THE CREATION AND EXPANSION OF THE ECONOMIC AND SOCIAL BASE

In India, South Africa, Zimbabwe, Cambodia and Namibia for example, grant funding has enabled the creation of strong community organisations anchored in women-led savings and loan groups. These federations of the urban poor develop the capacity to collate and use information about their own resources and to map and profile the settlements where they live. The basic building process usually takes around two years.

Forms of finance: Grants and direct loans.

Potential sources: Community Pooled Savings, Northern NGOs, Foundations, Bi-lateral Funders, Multi-lateral funders, Corporate Philanthropists, State Micro-finance support agencies.

8.2 FINANCING DEVELOPMENT OF PILOT AND DEMONSTRATION PROJECTS

With strong organisational capacity at community level, organisations of the urban poor are able to take on investment projects in slum rehabilitation, resettlement and/or infrastructure provision – toilets, sanitation, water, solid waste management, access roads, drainage. These projects demonstrate to the state and to potential financiers 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[22].

Forms of finance: Grants, direct loans, bridging loans, guarantees.

Potential Sources: Community Pooled Savings, Northern NGOs. Foundations, Bilateral Funders, Multilateral Funders, State Finance Institutions, Commercial Banks, State and Municipal Authorities.

8.3 FINANCING SCALING UP

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. The funding required is usually too large (and sometimes too complicated) to be covered by standard NGO project financing. Direct loan funds, bridge financing and guarantees are all likely to be necessary. The provision of investment from the regional development banks is particularly important for city and state level scaling up programmes. 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.

Forms of finance: Direct loans, Syndicated Loans[23], Bridging loans, Guarantees, Municipal Bonds, and Project Bonds

[22] The Citibank loan, backed by a sterling guarantee from Homeless International, for the development of the Rajiv-Indira Suryodaya slum rehabilitation scheme in Dharavi is an example of collaborative financing of a demonstration project linked to a major shift in policy at state level. See McLeod, 2000 (b).

[23] Loans provided by a syndicate or group of lenders who create a special lending vehicle for the purpose.

Potential sources: State Finance Institutions, Commercial Banks, State and Municipal Authorities Bilateral Funders, Multilateral Funders, Regional Development Banks.

8.4 FINANCING RISK MANAGEMENT AND MITIGATION

Our research has shown clearly that organisations of the urban poor 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. Two-year delays in delivery of contractually agreed financing are not unusual leading to an enforced use of bridge financing. Security requirements from formal lenders continue to be onerous. As the asset base of most support NGOs tends to be slim loans often require complex guarantee arrangements. Funds are needed to ensure that some of this risk taking is shared and not left completely on the shoulders of the poor. Funds are also needed so that groups taking on significant risk commitments are assisted in the development of risk management and mitigation strategies that are viable given local conditions.

Forms of finance: Deposits, Guarantees, and Bridging Loans.

Potential sources: Community Pooled Savings, Northern NGOs, Foundations, Corporate Philanthropists, Government, Bilateral Funders, and Multilateral Funders.

8.5 REFINANCING

Refinancing is needed to release the equity finance that is used to cover the capital costs in rehabilitation, resettlement and infrastructure projects, so that it can be re-used on other schemes. Refinancing from local financial institutions requires that negotiators are well prepared and assistance in this area is currently hard to come by.

Forms of finance: Mortgage Loans.

Potential sources: Building Societies, Mutual and Pension Funds, Government Financial Institutions, Commercial Banks

8.6 FINANCING LEARNING, KNOWLEDGE CREATION AND CAPACITY BUILDING

As communities and NGOs invest in demonstration projects and in scaling up, their learning can be 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.

Form of Finance: Grant

Potential sources: Community Pooled Savings, Northern NGOs, Foundations, Bi-lateral Funders, Multi-lateral funders, Corporate Philanthropists.

8.7 FINANCING PROMOTION AND THE CREATION OF NEW ALLIANCES

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 support it.

Form of finance: Grant

Potential sources: Northern NGOs, Foundations, Bi-lateral Funders, Multi-lateral funders, Corporate Philanthropists.

9 HHOW THE GUARANTEES WORK

The Homeless International Guarantee Fund was established in 1994 and has been used to provide security so that organisations of the urban poor can negotiate more equitably with banks for the financial services they need. The Fund has had some support from the Department for International Development (DFID) and from the European Union. However the majority of the funds have come from non-governmental sources, particularly from deposits provided by UK Housing Associations. As yet there have been no calls on the fund as a result of loan repayment failure.

The way in which the Citibank guarantee has been developed for the Rajiv Indira Suryodaya project demonstrates the basics of using a guarantee to release local funding and, where possible to leverage the security provided. The way in which it works is shown diagrammatically in Figure 1.

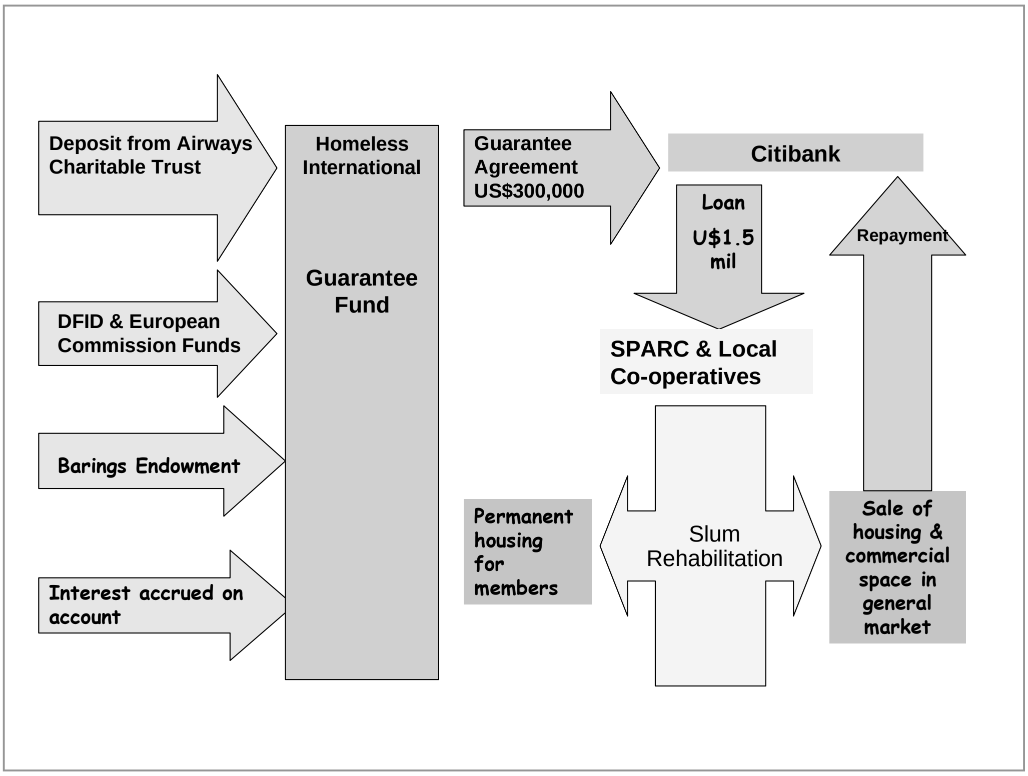

Figure 1 – How the Guarantee for the Rajiv Indira Suryodaya Project works

One of the lessons that we have learnt in using the Fund is that negotiating guarantees takes time. If projects were dependent on guarantees to start, they would never begin. The development of the comfort factor simply takes too long and, ironically, it is the demonstration effect of a project that actually gets off the ground so that there is something that bankers can go and look at, that frequently speeds the process up. "Seeing is believing", quite literally. However someone has to pay for the demonstration and the creation of precedents so that the possible becomes visible. Considerable bridge financing is needed, particularly as schemes become larger and more complex. At the moment the guarantees and the bridge financing are being provided to communities through NGO financing routes while the large scale housing finance provided by donors is going to the banks. A more equitable allocation of resources is required if the poor are to be expected to commit their own hard-won resources to the developments that are hoped for.

We have been looking at ways to support organisations of the urban poor to work in partnership with local authorities to create shelter and sanitation solutions that work for the poor and for cities as a whole. Our research has shown that community driven initiatives can result in solutions that have potential for scaling up when two conditions are met:

COMMUNITY PREPARATION

A process of preparation within informal settlements that enables residents to build the information, knowledge and capital base required for an organised response to external opportunity (e.g. options to enter into partnership with municipalities)

COMMUNITY NETWORKING

A systematic process of linkage and networking between settlements that enables exchange of learning, experience and technical support so that initiatives are not isolated but mutually supportive and reinforcing[24].

These conditions enhance the capacity of those living within informal settlements to manage and mitigate the risks involved in major upgrading and resettlement work. As risk management and mitigation is enhanced the potential for forming collaborative relationships with municipalities and for mobilising investment from the commercial banking sector increases. However for this potential to be realised the Banks and the Municipalities must understand the asset building process in which the poor are engaged and have the mechanisms that allow them to respond to it. This requires an investment in learning and systematisation within municipalities and the banking sector as well as within organisations of the urban poor. It also requires the creation of a new financial lexicon that allows the various stakeholders in the urban development process to communicate effectively.

The problem has been that the level of financing required for a high-rise slum rehabilitation scheme or a sanitation programme across informal settlements within a city requires financing at levels way beyond the delivery capacity of conventional NGO grant funding. We need access to larger amounts of capital. Perhaps this means that we will have to create specialist financial institutions as the British created the Building Society movement over a hundred years ago. The establishment of Urban Poor Funds is certainly a step in this direction[25]. However, hopefully, it will also be possible to persuade existing financial institutions to open their minds as well as their doors, and develop financial products and mechanisms with organisations of the urban poor and their supporters so that some of the necessary financing can be sourced from local financial markets through local banks. For this to happen the risks entailed in creating intermediation and the scaling up of community-driven housing and infrastructure investment will have to be shared. Leaving all the risk management and mitigation to the poor, as if they are beggars, is simply not viable.

10 BACK TO BASICS – CAN THE BANKS DELIVER EVEN IF THEY WANT TO?

Our work over the last six years suggests that it is too early to give up on banks yet. In both Bolivia[26] and India[27] guarantee arrangements have been successfully negotiated and wholesale financing has been released for on-lending to borrowers for the construction of housing. New guarantees are currently under negotiation with Citibank and with UTI in India to release development finance for slum rehabilitation[28] and sanitation. The arrangement with UTI will facilitate the National Slum Dwellers Federation (NSDF) and SPARC entering into a contractual agreement with the Mumbai Municipality to deliver over 340 community toilet blocks in 20 wards in Mumbai. Without a guarantee arrangement the NSDF and SPARC would be unable to submit bids for the work despite the fact that the toilets will be constructed and maintained by communities where the NSDF has an active membership. The requirements that potential contractors provide a 5% performance bond and 10% start-up capital mean that the Indian Alliance would have had to find US$1.3 million to facilitate communities becoming their own developers.

In the case of Citibank a guarantee arrangement has been reached in principle for financing of the Rajiv Indira Suryodaya project, the first community –led development to be initiated under the State of Maharashtra's innovative Slum Rehabilitation Act. The guarantee effectively top-slices the risk by covering the first 20%. However the development of this guarantee has been somewhat tortuous. Fifteen senior Citibank staff members, including the General Manager and the Credit Manager, worked with the Indian Alliance to initially develop the financing arrangements. However within eighteen months all fifteen had either left Citibank or been transferred to other locations as a result of acquisition and

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[24] For further information on community exchange learning see ACHR, 1999 and Homeless International, 1999
[25] Urban Poor Funds have been established in Cambodia, S.Africa, Zimbabwe and Namibia. In India SPARC has established a bridge financing fund. Revolving loan funds for home improvements have been capitalised in Kenya and Bolivia.
[26] With Fondo de la Communidad in Cochabamba. The five-year loan has been extended to Prohabitat as part of the capitalisation of a revolving loan fund for home improvements to reduce the incidence of chagas disease. For further information on Bolivia see the Bolivian Case Study from Bridging the Finance Gap in Infrastructure and Housing – R. Rojas
[27] Guarantees have been agreed with the Housing and Urban Development Corporation (HUDCO) and with HDFC for ten-year housing loans extended through women's savings and loan groups by YCO in Andhra Pradesh. A guarantee has also been agreed with the Small Industries Development Bank of India (SIDBI) to secure loans for investment in building material production enterprises.
[28] For more information on the arrangements see the Alliance Case Study in India, Bridging the Finance Gap in Housing and Infrastructure, R. McLeod, 2000 (a). For information on how the Slum Rehabilitation Act works see Slum Rehabilitation Authority, 1997.

merger activity. As a result the initial learning that was developed was lost and the process has had to be started again from scratch with new staff who had had no exposure or experience of the approaches being used[29].

In other countries the effective demand for larger scale financing of work initiated by organisations of the urban poor and the NGOs working with them is growing rapidly. While some urban poor funds already exist, their capacity is extremely limited and the potential for scaling up precedents that have been developed and shown to work is now severely constrained by lack of capital. The financing required, by the NSDF/SPARC alliance in India, in order to implement planned projects over the August 2000 to December 2001 period amounted to over US$26 million in August 2000 and has already increased substantially. Your own imagination can tell you the implications of that demand when the needs of other countries are considered.

11 MOVING FORWARD

There are intrinsic risks associated with bridging the gap between the formal and informal financial sectors and in scaling up investments in urban infrastructure and housing investment. Understanding the nature of these risks, who is taking them and at what cost is critical if their management and mitigation is to be addressed. At the moment it appears that the major risks are being taken by organisations of the urban poor and the NGOs who support them. This situation is neither equitable nor viable given the challenge that urban poverty poses. In attempting to address the need for a more effective approach to risk management and mitigation Homeless International, together with DFID and the World Bank are designing a Municipal Infrastructure Financing Facility (MIFF). The facility is intended to provide a range of financial and technical assistance to organisations of the urban poor and their partner NGOs.

PURPOSE	FORM
Financing development of pilot and demonstration Projects	Technical assistance grants, guarantees, direct loans
Financing scaling up	Technical assistance grants, guarantees, bridging loans
Financing risk management and mitigation.	Technical assistance grants, guarantees, bridging loans
Financing learning, knowledge creation and capacity building	Knowledge grants
Financing promotion and the creation of new alliances	Knowledge grants

Table 1 – The purpose and forms of support that MIFF plans to deliver

However the planned MIFF is small. An initial grant of US$10 million is envisaged. This will provide important options for organisations that are assisted but, as should be clear, the demand for such help

[29] This failure to capture individual learning by an institution is characteristic in agencies for whom working with the poor is a new experience that may initially be seen as philanthropic rather than as part of mainstream business.

will grow incrementally over the next five years and far more capital will be needed. Donors will have a choice. Put all their available capital through the formal financial institutions and hope that it will trickle down, or keep some aside and channel it through alternative mechanisms so that organisations of the urban poor can become active developers in partnership with financiers and local authorities. I leave you to consider the relative benefits.

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APPENDIX 1 - RISKS

THE RISKS INVOLVED, WHO'S TAKING THEM, AND OPTIONS FOR MANAGING AND MITIGATING THEIR EFFECTS

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
CONSTRUCTION				
Site safety	Building conditions unsafe.	CBOs, NGOs, Contractors.	Injury and death of site workers.	Incorporate safety standards into project contracts together with community monitoring.
Management	Poor management.		Delays, cost escalations, poor quality construction, theft, waste of materials.	• Investment in on-the-job training and mentoring. This can be particularly effective when objectives for skill transfer to community managers are built into contracts with professional contractors, engineers and architects and exchanges incorporated between community managers from different projects. The building process may take longer initially but the end result is increased management capacity and knowledge at community level, not just a building. • Incorporate community monitoring of building quality into project implementation. • Incorporate requirements for hiring of local labour and sub-contractors into agreements with main contractors.
CORRUPTION AND BRIBERY				
Pay offs for permissions	State and Local Authority planning and regulatory systems based on pay-offs rather than transparent decision making	CBOs, NGOs, Local Authorities	Benefits intended for the poor end up in the pockets of bureaucrats and officials.	• When CBOs and NGOs are strong they can publicly refuse to pay bribes and insist on accountable decision-making. This may involve initial delays in project approval processing but has considerable long-term benefits. • Documenting all project approval submissions, delays in decision-making, and requests for bribery can make existing processes visible and subject to accountability by the officials concerned.
Abuse of leadership	Leaders within the organisation use their positions to create their own systems of patronage and/or defraud the organisation.	CBOs, NGOs	The leadership loses credibility and their behaviour may be reflected as legitimate within the wider organisational culture. As a result less powerful members lose out and the organisation becomes subject to criminal charges and loss of support from donors and other stakeholders.	• Develop systems of leadership accountability and transparency, which are understood and monitored by the membership. • Establish clear and simple financial and performance assessment processes. • Create an internal audit function where there are high levels of decentralisation.

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
CREDIT				
Non-lending banks	Banks and other Financial Institutions unwilling or unable to lend at rates, and with terms and conditions, that meet the requirements of community driven initiatives.	Banks & other formal financial institutions	• Financial services remain fragmented and the financial market makes no structured investment in urban development. • Loans that are extended go to the better off.	Review the credit assessment criteria of financial institutions to assess the validity of the asset bases they use to determine the security of lending and to create alternative processes.
Lack of a comfort factor	Financial Institutions perceive the risks of lending to be too high for a loan to be agreed. Often this is based on the absence of an intangible “comfort” factor – the institution may feel uneasy about lending because of a total lack of understanding about how community-driven development processes work.	CBOs & NGOs	CBOs/NGOs continue to operate within a parallel system of investment with no effective gearing or leverage of their asset base. Their potential impact is consequently severely constrained.	• Encourage mutual exploration of credit management by financial institutions and NGOs/CBOs by offering initial loan guarantees. • Consciously plan to create a new “comfort” factor based on knowledge and understanding rather than formulae and fear.
Limitations of MFI approaches	MFIs draw in the savings of the poor but continue to focus on short term lending to individuals and create no alliances with agencies able to add necessary value in the delivery of urban services, slum upgrading and resettlement.	CBOs	Continued use of MFI loans on household level investments in infrastructure and shelter. These investments remain vulnerable to external factors because development does not take place at a wider settlement level.	• Explore options for new institutional bases/channels/partnerships for urban development investment – Municipal development funds, Urban poor funds, Bond issues. • Explore options for strategic alliances between MFIs and agencies with the technical capacity to work in partnership with the urban poor on infrastructure and shelter initiatives.
The big boys take all	Despite the investments made by the poor, Multi-lateral/bi-lateral funders and regional investment banks continue to lend to risk averse brokers with no capacity to deliver within informal urban settlements. The process is driven by volume of financial processing rather than effective impact at settlement level.	CBOs, NGOs, Statutory development assistance agencies	Massive amount of money spent with no commensurate or effective impact on urban poverty.	Review options for brokerage arrangements and examine basis of risk analysis. Explore new forms of asset-based assessment.
Fear of borrowing	If borrowing is excluded the result is severe constraints on gearing of resources managed by the urban poor and the potential to scale up successful interventions to City and State level.	CBOs, NGOs and local authorities.	Failure to build on political opportunities as they arise. Interventions remain at pilot project level. No scaling up.	Share information on available loan financing and work collaboratively to negotiate for loan agreements that can channel funds as near as possible to the point of effective demand and utility.

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
Default on repayments	CBOs and NGOs take on loans and default on repayments because of poor management or unviable loan terms and conditions	CBOs & NGOs	Loss of institutional credibility and capacity. In extreme cases there is complete institutional collapse.	• Incorporate a research and development phase into initial loans recognising that learning emerges from mistakes. • Create space for CBOs and NGOs to develop skills in money management, which do not undermine the areas where their existing practices add significant value. • Be prepared to renegotiate borrowing agreements when things go wrong.
Single or diverse loan products	Loans are restricted to a single or narrow range of products that cannot accommodate the diverse requirements of poor borrowers. Geographical cost and design variations are not incorporated into loan design and borrowers are forced to present their requirements in a manner that may not reflect their actual needs.	CBOs & NGOs	Loan misuse with a consequent loss of trust between lenders and borrowers.	Let the borrower design the product. Incorporate this into the loan negotiation process and monitor take up over time.

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
ECONOMIC				
Impact of macro-economic policies.	Macro-economic policies may result in changes in donor priorities leading to cuts or sudden increases in funding	CBOs, NGOs	• Anticipated funds may fail to materialise. • A sudden influx of funds may overload the capacity of an organisation to manage, leading to reduced work quality.	• Establish clear core values and development priorities. • Say no to funds that undermine this base or require investment in activities out of line with agreed development priorities.
Fixed or variable budgeting.	Inflation may lead to unanticipated increases in the price of local labour and building materials. Increases in interest rates may lead to unanticipated increases in the cost of finance.	CBOs, NGOs	Projects run into cash flow difficulties and associated loan repayments may escalate.	Negotiate for variation clauses in all contracts and include variation budget lines in budget projections.
Subsidies	State subsidies may be available (sometimes in theory rather than in practice) but are difficult to access.	CBOs, NGOs	• Accessing subsidies requires advocacy and lobbying. If these activities are not costed into projects deficits may result. • Where state subsidies are, in themselves, not sustainable substantial investments may be made in advocacy and design of internal processing systems that have no long term function and that may "skew" organisational systems away from longer-term requirements. • Subsidies may result in an "entitlement" culture that undermines the development of longer-term sustainable approaches. • Some people may be excluded from subsidies (for instance because of lack of secure land tenure) and their interests may be sacrificed in favour of those who are eligible.	• Assess the medium and long-term sustainability of subsidies taking into account the current trend to devolution of responsibility for housing and infrastructure investments to local authorities. • If subsidies are likely to prove unsustainable avoid building core systems around accessing them. • If subsidies have the potential for long-term sustainability invest strategically in obtaining direct access and establishing the necessary mechanisms to facilitate this with state agencies. • Where conditions attached to subsidies exclude the poorest lobby for inclusive approaches and invest in precedent setting projects that demonstrate how effectively these subsidies could be used by organisations of the urban poor. • Where subsidies are sustainable but not delivered in practice, invest in data collection to demonstrate scale of use, misuse and/or wastage of state resources.
Tax	Entering into formal engagement with the state may facilitate mechanisms for taxation of people who have previously existed outside the direct taxation systems.		The taxation costs of becoming a registered citizen may be greater than the benefits that result leading to increased rather than decreased poverty.	• When organisation of the urban poor form a critical mass with the means to negotiate partnerships with the state the risks associated with formal citizenship are reduced. • Developing information and knowledge of tax implications of planned initiatives should be incorporated into project planning.
Removal of earnings base	Resettlement can entail removal of people from the economic base that they rely on to generate income.		Established sources of income are lost or increased household expenditure on transport has to be absorbed.	• Prioritise in situ developments • Where relocation is necessary assess impact of new location on economic activities of participants.

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
FINANCIAL				
Investment judgement	• Judgements regarding investments in specific projects may be based on intuitive understanding and assessment by individuals that are difficult for others to understand. • Judgements and decision-making may be left in the hands of a single individual or a small group with no involvement of others for whom the decisions could have serious consequences.	CBOs, NGOs	• Organisations may make unwise or unviable investment decisions. • Individual or groups with tacit responsibility for decision making may leave the organisation resulting in a serious loss of decision-making capacity. • Sensible judgements arrived at intuitively may be rejected because they cannot be translated into a form that lenders can understand. • Options for managing and mitigating risks associated with planned investments may not be fully explored.	• Investment in viability assessment tools that a broad range of people within the organisation can understand so that they can participate in decision-making. These tools will, in most cases need to be highly customised requiring a personnel capacity that may need to be developed and will certainly need to be supported. • The development of joint viability assessment tools by CBOs. NGOs and financial institutions so that mutual learning occurs and a common lexicon of financial analysis and judgement is developed.
Cover costs or cover deficits	The real costs entailed in developing and implementing community driven initiatives are not accurately assessed. Inputs that add significant value are not covered in budgets and a false picture results of the real investment necessary to obtain the end benefits.	NGOs, Donors	A form of development “myth” is created which becomes part of the expectations of donors and financiers. Important investments remain invisible and real options for replication and scaling up are reduced.	• Evaluation of projects that have been undertaken already can provide a more accurate assessment of the real costs involved in developing and implementing new processes and initiatives. If this practice is institutionalised it provides the basis for a longer-term assessment of the “research and development” costs associated with earlier projects and the cost benefits that result from this investment in later replication and/or scaling up. • Once the real investment costs are identified a clearer dialogue can take place regarding how early investment and risk taking can be shared more equitably among stakeholders.
Pre-financing	Many initiatives driven by CBOs and NGOs are developed to prove through demonstration that community-driven processes can result in viable solutions. However this precedent-setting activity invariably requires pre-financing, often in a context of scarce available resources, over-stretching the financial capacity of the CBOs and NGOs involved	CBOs, NGOs	Lack of adequate and affordable capital creates delays and consequent cash flow problems and cost over-runs. Resources are sometimes diverted from other projects that the NGO, CBO has undertaken to implement with disruptions to those projects resulting in potential disputes with funders of those projects.	• Negotiate with donors to provide bridge-financing funds. Bridging funds can provide an important buffer that protects other project funding. • The introduction of project based accounting systems also helps to separate different inflows and out flows and provides a basis for ring fencing projects that may be considered particularly high risk. • Within this context it is also important for organisations to track the risk exposure of their project portfolio as a whole rather than simply focusing on the financial dynamics on a project-by-project basis.

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
Cash-in-time or reimbursement	Agencies "contracting" CBOs and NGOs to implement projects take a long time to reimburse up-front expenditure.	CBOs, NGOs	Reimbursement agreements fail to cover the real financial costs involved and the result is a project deficit which has to be covered by the NGO or CBO	If interest charges are accrued to the use of bridge financing they can provide a means of identifying the true financing costs of reimbursement delays. It is important in this context that the interest rates applied are reflective of market rates or of the rates that will be applied if re-financing is involved.
Pre-qualification requirements	Local authority procurement policies frequently require up-front performance bonds.	CBOs, NGOs	The onerous bond requirements effectively exclude participation by agencies that are ideally located to link the resource base of the poor to the investment priorities of the state. However their lack of capital precludes their taking on this role and the potential gains of community-city level partnerships are lost.	Procurement policies have frequently designed to provide transparency in bidding procedures and security against potential financial failure on the part of contractors. In the case of community contracts this method of ensuring transparency and security fails to recognise alternative methods for reaching the same ends. It is also arguable that community contracts, by definition, provide an added value based on historical investment in the development of community processes and capacity which is not recognised in conventional asset-based assessment systems.
Default or hedge	Inability to repay loans and maintain necessary cash flow due to non-viability of schemes or the impact of unforeseen circumstances.	CBOs, NGOs	If one project fails financially it may bring the whole institution down with it. Default on loan repayments can also become an embedded part of organisational culture.	• Awareness of the longer-term impact of loan repayment default needs to be incorporated into the preparation work carried out prior to loan extension. If projects are not designed as flag ships for others to follow but are seen as stand alone initiatives with limited number of beneficiaries, the moral pressure and social sanctions on beneficiaries to repay is likely to be low. • Formal hedging is only just emerging within many developing countries and is rarely available for periods exceeding 12 months. The costs (somewhere around 5%) can also be onerous. However there are ways of building up internal hedging funds in the form of deposits and reserves. These should be explored in more detail.
Offering loan security	In the urgency to secure needed capital security can be provided against loans, which severely restricts options for potential borrowing in the medium and longer term.	NGOs	Long-term advantage may be sacrificed for the sake of short-term gain. If an organisation's assets are held under lien to a single project their capacity to replicate and scale up the approach, if it proves successful is likely to be extremely limited.	• Create separate institutional arrangements for high-risk projects (known as special vehicles) • Negotiate with donors and lenders to take a long-term perspective that incorporates the creation of security systems that support incremental rather than simply immediate gain.
Use of bridge funds	Bridge funds are used to fund all deficits rather than being applied strategically.	NGOs	Investments are made in projects that are not viable or that have no potential for replication and scaling up.	• Establish criteria against which all projects should be assessed in terms of relative contributions to organisational goals. • Prioritise projects on the basis of short, medium and long-term returns for the organisation. • Ensure adequate viability assessment of all projects identifying key risk areas and anticipated returns (including non-financial returns).

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
FOREIGN EXCHANGE RATE	Changes in the exchange rate of local currencies against the US$ and other hard currencies may be significant increasing the local cost of loan repayment if foreign exchange loans are used.	NGOs	Borrowers may default on loans	• Hedge against exchange rate risk by "buying forward". • Issue loans in dollar values with repayment in local currency dollar equivalents. Adjust dollar equivalents on a regular basis. • Negotiate for risk to be taken entirely or shared by donors and/or lenders.
HIV/AIDS	Illness and death resulting from HIV/AIDS	CBOs, NGOs	• Loss of organisational capacity. • Loss of leadership. • Increased loan default.	In conditions of high infection support non-judgemental dialogue on the issue so that organisational strategies can be developed to deal with the issue.
INTEREST RATE				
Variable or fixed rates.	Variable interest rates may lead to unanticipated financing costs.		Capital funds lose real value.	Link all loans to hard currency equivalents. Incorporate assumptions re. increases in interest rates over time into loan product planning.
Linked or individual bank savings	Individual savings accounts in banks attract low levels of interest but may have the advantage of more flexible access. Linked accounts can, in some circumstances be negotiated but often require commitments for minimum savings levels and restrictions on access.	CBOs	• Individual savings are rejected based on their relative administrative cost or savings fail to maintain their real value. • Requirements for linked savings prove onerous and reduce flexibility in use of funds. • Banks may require additional institutional deposits. • Banks may become insolvent resulting in a loss of savings.	• Up-front negotiations with banks incorporating planned growth in savings should be initiated. • As savings grow new agreements should be considered including options offered by competitor banks. Spreading savings across a range of financial institutions should also be considered to mitigate against potential bank failures. Banks should be asked to provide information regarding their own insurance against failure.
Cover full costs or subsidise	The trend in MFIs is to charge high enough interest rates to cover the full cost of administering loans. Housing and infrastructure lending usually requires, in addition, significant levels of technical assistance. Incorporating both factors into interest rates may make rates unaffordable. On the other hand not incorporating them can make funds unsustainable in MFI terms.	NGOs, MFIs, Banks and other financial institutions.	The lack of apparent sustainability may make it difficult to raise equity finance.	Review the unit of analysis used to calculate sustainability. If the unit is restricted to revolving loan fund levels medium and long term lending is likely to be assessed as non-viable. However broadening the unit of analysis to which cost-benefit calculations are applied may change the picture as it allows the incorporation of value added by communities in the form of non-financial processes and assets. The cost-benefit analysis should also incorporate a time factor to assess cost savings over time, for instance to municipalities on maintenance charges.
Benefits transferred to the rich	Subsidised interest rates may make the benefits of on selling to better off people more attractive to beneficiaries than the long-term benefit of retaining the physical asset that the	Poorer members of CBOs	That higher income groups will appropriate the benefits intended for the poor.	Do not subsidise the interest rate but provide direct technical assistance subsidies required by poorer groups. Design end products acceptable to the poorer groups but of no interest to the better off. In this case design in options for

	loan makes possible.			improvement/expansion over time

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
Inflation	Charging interest rates lower than the rate of inflation constitutes a subsidy. However the relevant rate of inflation will vary in different locations for different groups.		Interest rates based on national inflation figures may not give a true reflection of the real cost of funds over time for people living in informal settlements where local inflation may vary significantly from national inflation.	Develop a "basket of goods" appropriate for the borrower group and track changes in prices for this in order to determine local inflation more effectively. The price of cement and the daily rate for a skilled mason may be relevant categories to include.
Simple or complex interest rates	The "real" cost of financing may be different from the apparent interest rate. Calculating interest rates on the basis of starting rather than reducing balances can make a significant difference to the total amount paid in interest over the lifetime of a loan. The period over which declining balance is calculated is also significant.	NGOs, CBOs	• If interest charges are not explained very clearly many end borrowers can become confused and in some cases refuse to pay because they feel that they are being cheated. • The real cost of borrowing is not clear to borrowers.	• Ensure that all borrowers understand the basis on which interest payments are calculated and exactly how much borrowing the money will cost over time. • With project borrowing the cash cost of borrowing should be calculated on the basis of the form of interest rate applied so that the real costs of borrowing the money are clear to all.
LOSS OF LEARNING				
Knowledge development.	Project implementation is left in the hands of professionals and/or those with previous experience.	CBOs	• The skills and knowledge of communities are not enhanced and they remain dependent on professionals or a small elite for the management of future projects. • Financiers who develop understanding as a result of the project take their knowledge with them when they are transferred or leave their employment. • Options for scaling up are severely limited.	• Build into each project processes for enhancing, capturing, systematising and sharing knowledge through exchanges and dialogue with others. • Provide resources (e.g. cameras) for documentation of each stage of the project by key stakeholders.
Capturing learning	Investments are made in projects but no provision is made for capturing the learning that emerges or for systematising that learning within the institution.	CBOs, NGOs	Knowledge created as a result of the project is lost.	

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
MARKET				
Incorporating commercial project components	• Where commercial components are incorporated into initiatives, real estate prices will have a significant effect on returns. • There may be special features such as Transferable Development Rights in Maharashtra, India, that are subject to market forces. • Where community business development is incorporated into schemes there may be unrealistic and inadequate business planning		• Escalation in market prices may make planned initiatives unaffordable. • Reduction in market prices may make schemes non-viable. • Businesses likely to fail with consequent loss of investment.	• Develop and maintain information of relevant market rates. • Incorporate sensitivity analysis into viability assessment of initiatives incorporating commercial components. • Invest in focussed marketing. • Ensure adequate business planning and support in place before investing in community businesses.
Land	Urban land prices determined by market factors especially when under private ownership.	CBOs, NGOs	Land prices may escalate placing pressure on poorer households to sell out. Urban land for development may be unaffordable.	Communal land tenure and organisational forms incorporating bylaws regarding use of profits realised on sale of land. Land banking. Negotiation with state for access to land and/or mediation with private landowners.
Building materials	Escalation in building material prices.	CBOs, NGOs	Increases in costs may lead to project deficits.	• Wholesale building material procurement. • Cost escalation clauses incorporated into contracts.
Labour	Escalation in labour costs	CBOs, NGOs	Increases in costs may lead to project deficits.	• Incorporation of local labour into contracts. • Cost escalation clauses built into contracts.
NATURAL HAZARDS				
	Earthquakes, cyclones/hurricanes, drought, landslides, flooding, fire, volcanic eruptions.	CBOs	Catastrophic destruction of life, property, shelter, infrastructure and livelihoods.	• Assess vulnerability to natural hazards. • Where significant vulnerability exists develop options for increased safety including disaster preparedness and mitigation strategies where appropriate. • Negotiate for access to relief/recovery resources where disasters do occur and seek to influence state post disaster recovery strategies.

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
ORGANISATIONAL				
Seeing the trees not the forest.	The organisation focuses on individual projects and fails to monitor its overall investment portfolio.	NGOs	Financial controls are not applied and investment is reactive rather than strategic. Cash flow difficulties likely to result in uncontrolled organisational deficits.	• Develop and maintain financial overview of project portfolio. Assess new projects on the basis of overall portfolio commitments. • Segment project participants in order to track impact of different investments on different groups.
Mixing all the risks together.	High-risk projects are not ring-fenced.	NGOs	Failure in a high-risk project creates a domino impact on other work.	Ring fence high-risk projects by creating "special vehicle" instruments for their financing and management.
Financial management	Financial management systems are not adequately developed and monitored.	NGOs	Overspend, increased deficits and ultimately bankruptcy.	• Review financial systems and procedures annually and upgrade where necessary. Ensure adequate control within operational functions. • Allocate clear responsibility for all budget lines.
Internal management systems	Internal management systems are inappropriate for the commitments taken on by the organisation.	NGOs	• Very few people know what is happening so they are unable to intervene constructively. • Project reporting is poor. • Internal learning is limited.	• Invest in the development of customised Management Information Systems and review these on an annual basis. • Ensure team development of systems to facilitate connectivity between different functions and reduce key person risk.
Lack of cross-project learning	Lessons learnt on one scheme are not shared with others implementing new schemes	CBOs, NGOs	Mistakes are continually repeated, the wheel is continually re-invented wasting resources and time.	Ensure inter project learning through exchanges and shared documentation.
Failure to meet statutory requirements and expectations of communities.	Organisational reputation and credibility becomes vulnerable as a result of inadequate performance in terms of expectations of communities and failure to meet requirements of regulatory system	NGOs	• Poor people fail to invest in associated development initiatives • Capacity to negotiate with the state and financial institutions reduces. • Donor support is withdrawn.	• Ensure up-to-date information on regulatory requirements and systems to meet requirements unless there is a strategic reason to try and change them. • Do not promise what you cannot deliver.
Key person risk	When organisations are highly dependent on a small number of individuals the loss of those individuals through illness, death or job transfer can have a significant impact on organisational capacity.	CBOs, NGOs	• Individuals burn out as a result of personal pressure. • Organisational capacity and reputation reduces leading to lack of performance and consequent loss of credibility.	• Build support and nurturing values into the culture of the organisation so that pressure is not focussed unnecessarily on key individuals. • Build Cross-skilling into the culture of the organisation. • Use exchange and exposure visits to ensure that skills and knowledge are transferred to others. • Break down "individual" jobs into team capacities.

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
PARTICIPATION AND EQUITY				
The drive for efficiency.	A drive for efficiency can lead to the professionalisation of poverty management, disempowering organisations of the urban poor.	CBOs	• The poor become "objects" rather than "subjects" of development. • Valuable resources that the poor can provide are sidelined by initiatives dominated by professionals. • The solutions that are created are not "owned" by the poor and they accept no responsibility for maintaining, replicating or scaling them up.	Building capacity takes time and recognition that learning emerges from mistakes as well as success. NGOs can assist CBOs to develop capacity by creating and protecting a space for learning and by supporting the exchange of experience and knowledge as it develops. Community-to-community exchanges have proved effective in this area.
Go it alone or to create strategic alliances with professionals.	Solutions are restricted to "self-help" approaches that exclude the participation of professionals.	CBOs. NGOs	• Expensive mistakes are repeated as each group reinvents the wheel. • Poor quality design and construction.	• Professionals can work with the poor to provide assistance in translating community driven solutions into a form and language that bureaucrats and officials can relate to. However this requires that professionals invest time and energy in understanding the processes that have merged from community driven initiatives, are prepared to compromise, and are able to de-mystify their own technical language and tools so that they can be understood and assessed by other. Exposure of young professionals to community driven processes at an early stage of their training can greatly assist. • Successful partnerships have been established between organisations of the urban poor and professionals. The techniques and processes developed within these partnerships provide valuable insights that could usefully be incorporated into training programmes for professionals.
Assessing physical products rather than impact on people.	Project outputs are identified in terms of new physical assets rather than the impact that the process of creating the products, and the products themselves, have on the lives of the people whom they are intended to benefit	CBOs, NGOs, Donors, Local Authorities.	Projects appear to be successful but have no significant impact with respect to poverty eradication.	Identify impact indicators, at household, settlement and city level, that are meaningful to the urban poor themselves as well as to policy makers and donors.
To rely on current systems of representation or to create new democratic processes	Existing, formally elected or self-elected leadership is assumed to represent the views, opinions, hopes and aspirations of people within a given settlement.	CBOs, NGOs, Donors, Local Authorities.	The views, opinions, hopes, aspirations and resource base of less influential people, especially women, are ignored. The "solution" created does not constitute a real solution for them and their potential capacity to take a leading role in development is not realised.	Processes such as the establishment of community savings and loan schemes, and the implementation of participatory settlement mapping and enumeration provide a means for the skills and knowledge of non-leaders to emerge in a way that benefits the whole community. Options for new ways to develop and support leadership within communities emerge, based on commitment and practice.

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
To create a solution that works for the few or to ensure an approach that works for the many	Projects are developed that prove successful and efficient in terms of completion but that result in exclusion of the poorest.	CBOs, NGOs	Those with the greater assets take over the process appropriating any project benefits. Those that need more support or time find their position remains the same or worsens.	Planning for solutions that reach the poorest may mean excluding options prioritised by the better off. Control over the maximum size of plots or floor area of houses for example can ensure more equitable allocation of benefits.
POLITICAL				
Changes in political administration	• Urban, housing and infrastructure policies subject to change with political administrations. • Changes in planning and building regulations making the schemes, as planned, illegal and/or unviable.	CBOs, NGOs	Subsidies, partnership agreements and planning approvals may be changed and/or reversed leading to project cancellations and consequent loss of investment.	• Investment in building a critical mass of community-based support capable of exerting political influence. • Engagement in public dialogue on development, introduction and implementation of relevant policies. • Formation of strategic alliances with other local, national and international agencies with capacity to influence local policy development. • Long term investment in building relationships with key civil servants responsible for urban development, housing, infrastructure etc. who can act as supportive champions within government administrations.
Partnership with the state.	Formation of dependency relationships with state bodies.	CBOs, NGOs	Dependency on state agency support may compromise an organisation's ability to maintain independence and lead to political interference in allocation of project benefits.	Ensure diverse funding base. Develop and maintain public transparency regarding allocation of benefits.
Political Party allegiance	Organisations of the Urban Poor become linked to specific political parties	CBOs, NGOs	The constituency of the organisation is appropriated by one political party and becomes subject to the dictates of that party.	Retain organisational neutrality whilst accommodating individual political allegiance among the membership.
Eviction	Where there is no tenure security evictions/firings can drive people off the land they occupy	CBOs	Investments are lost and property destroyed.	• Campaign for secure tenure. • Defend settlement against eviction. • Develop a critical mass of residents' organisations linked across different settlements and constituting a significant political constituency able to resist eviction.

AREA OF RISK	CHARACTERISTICS	WHOSE RISK IS IT?	POTENTIAL NEGATIVE IMPACTS	MANAGEMENT & MITIGATION OPTIONS
SAVINGS				
Formalise for efficiency or design for diversity.	Rigid, inflexible savings systems are established with regular savings of fixed amounts made a pre-requisite for borrowing.	CBOs	• The poorest people, whose savings patterns are by necessity irregular, are excluded from the process. • Lending becomes a confirmation rather than a support for, and catalyst of asset creation.	Invest in group savings systems that incorporate flexible savings patterns and provide options for buffering external stresses across a group and over time,
Pooling	Savers are expected to contribute to pooled savings so that the group can make larger loans to individuals, invest in group initiatives or provide collateral against external borrowing.	CBOs	Pooled savings can be monopolised by individuals or sub-groups leading to a lack of equity and, ultimately to a loss of confidence in the group savings process.	• Early identification of core values and aims of savings groups can provide a basis for the development of appropriate ground rules. • Support in internal systems development can help groups to manage attempts to act on vested interest. • In linked groups the development of an internal audit support structure could be considered.
Fraud	Fraud and theft	CBOs	• Savings are stolen and confidence in savings systems destroyed. • Unrealistic expectations of “honesty” mean that inexperienced organisations are set up to fail.	• Accept that a level of theft and fraud is inevitable especially when systems are initially being developed and groups have had little opportunity to test and improve their own management systems. • Build management development costs into the system and incorporate financial safety buffers in the form of hedge funds and reserves. • Support exchange with groups that have had previous experience so that learning can be shared.
Using bank deposits	Savings are either banked, and therefore not accessible for loans on a 7-day, 24-hour basis or not banked and therefore unable to act as collateral for additional external funds.	CBOs	• Banking requirements may restrict access making “community” funds inaccessible for short-term use. • Community bankers may misuse savings leading to theft and/or to local clientelism and patronage.	Assess most strategic use of savings over time ensuring a balance between short term and longer-term needs within groups.
Entering the fiscal system.	Entering into formal banking relationships may create a visibility that brings additional costs in the form of taxation.	CBOs	Individuals and groups may find, especially in the short term, that the financial costs of, in effect, registering as a formal citizen outweigh the advantages of remaining invisible.	Strong, linked groups have a capacity to negotiate with the state to ensure that the long-term returns on citizenship provide a net benefit. However the short term advantages and disadvantages need to be carefully assessed within the context of the local political environment.