MAY 2006 • DIVISION FOR URBAN DEVELOPMENT AND
DIVISION FOR MARKET DEVELOPMENT

Report from Seminar, Stockholm
December 14–15, 2005

Creative Urban Finance for the Poor

Published by Sida 2006

Department for Infrastructure and Urban Development

Executive summary – Nils Viking, Royal Institute of Technology, Stockholm

Other chapters – Samuel Azasu, Royal Institute of Technology, Stockholm and Isabel Molina, Swedish Bulletin, Stockholm

Editing (partially) – Mikael Atterhög and Ebba Aurell, Sida

Layout – Anna Stuermer, Vallmo Arkitektstudio

Photos – Mikael Atterhög (page 4, 12, 20, 24, 34, 56, 62 and 77), Anders Gunnartz (page 10, 16 and 68), Anna Stuermer (page 1, 52 and 70) and SPARC/Homeless International (page 30, 40 and 44)

Printed by Edita Communication AB, 2006

Art. no.: SIDA29033en

This publication can be downloaded/ordered from www.sida.se/publications

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Executive Summary

New and creative methods to finance provision and upgrading of infrastructure, services and housing have emerged during recent years. Although programmes targeting the urban poor in developing countries have showed remarkable results, financial needs for these purposes have still increased dramatically even during this era of financial innovation. It has become clear that creative solutions are required to cater for the needs of more urban poor. It also appears that the most appropriate financing solutions may vary significantly between infrastructure and services, as well as housing. This document contains proceedings from the seminar **Creative Urban Finance for the Poor** that took place in Stockholm between 14–15 December 2005, where these questions were discussed. In addition, the proceedings have been compiled by the rapporteurs without formal editing and do not necessarily reflect the views of the presenters or Sida.

Opening the Seminar, Barbara Lee, emphasised its objective to share and discuss financing solutions, targeting the urban disadvantaged. Welcoming participants, Rolf Carlman declared Sida's long-term commitment to housing and associated infrastructure for a growing number of low-income earners, also recognition of the pivotal role of urban finance in achieving MDGs with a need for innovative financing instruments to tap local and international markets.

Diana Mitlin advocated equal weight of financial processes and finance itself; whereas those with 'somewhat secure tenure' need access to finance for incremental housing improvement, those with 'less secure tenure' – being prevented from individualised market solutions – need collective action to improve infrastructure and shelter with longer-term group lending, often coupled with regulatory change. Questions concerned worth of secure tenure in access to finance and collective action.

Stig Johnsson advanced that improvement of the financial system needs government involvement for it to benefit low-income earners. Government must co-operate on changes in laws and tax regimes, municipalities regarding provision of land and infrastructure, and, local bankers on financing. On questions: co-operatives were important in formation of financial institutions for the disadvantaged in Sweden.

Kathleen Wu saw private-sector-led growth as critical for achieving the Millennium Development Goals (MDGs). Whereas there is excess liquidity, credit access is limited. In a lack of deposits for acquiring government bonds, USAID offers global loans and bond guarantees for housing and infrastructure. Home improvement micro-finance loans are suitable to the urban disadvantaged. On questions: liquidity support is limited by lenders being forced to liability match; a 50 percent bank guarantee from municipalities is not enough; and, USAID does not charge a fee reflecting risk level, but it requires lenders to give foreign exchange loans only to borrowers who earn foreign exchange or provide fluctuation-hedging instruments.

Mark Hildebrand declared Cities Alliance's focus on city and nation-wide interventions. Rajivan Krishnaswamy advanced that the impoverished need to be empowered to leverage budgetary resources with domestic capital to invest in infrastructure. Challenges include sorting out a messy decentralisation process making cities now responsible for costly infrastructure without devolved financial and administrative powers. To counter declining public finds, donor commitments and private sector investments, cities must become proactive to raise revenue through empowerment and partnerships. Leveraging domestic capital, through local markets in a city credit relation with the private sector, can be strengthened with evolvement of debt markets and devolution. On questions: regulatory changes counter short-term political gains; and, spread effects of loans for community benefits act as incentives.

Malcolm Harper saw micro-finance as exaggerated expectations; micro loans are 'small, fast, frequent, expensive and for women' – finance for shelter infrastructure needs to be 'large, slow, infrequent, cheap and for men'. Although with advantages, like favourable location and reputation, MFIs are unsuitable for housing and citywide infrastructure finance due to high interest charges on retained savings earnings. Micro-finance could offer secured base loan credit – but sub-sector analysis, experimentation, willingness to fail, research and subsidies are needed. Whereas schemes must be self-financing, collective action is not critical in shelter finance provision. For cheap, long-term, shelter credit, MFIs need to know markets, find collateral substitutes, foster relationships with municipal and other authorities, and adjust loan amounts, terms and target returns. On questions: subsidies in micro-finance distract focus.

Franck Daphnis profiled micro-finance with short repayment periods – usually not collateralised – and priced to ensure provider's long-term financial viability. Housing MFIs may embrace informal sector entrepreneurs and salaried employees. In micro-enterprise, borrower's repayment capacity is assessed on future income. In housing micro-finance, it is assessed on current income. Loans may be secured through collateral substitutes, mostly co-signers. In absence of formal title, borrowers may need to show secure use of land over the repayment period. On questions: micro-finance should not reduce government's role, but be part of private sector response; and, group lending is complex.

Sheela Patel noted community initiated self-help shelter schemes. Yet, interventions do not build on low-income earners' identity, rights and presence in city problem solving. A relation with dialogue and negotiations for up-scaled interventions – where organisations of disadvantaged and banks know how either party functions, including risk management and mitigation – exists in India. Effective co-operation needs a community driven process, governments ready for change, banking system seeing informal sectors as market, local all-stakeholder solutions, and, familiarity with risks and mitigation. On questions: low-income earners' housing saving schemes show requisite financial credibility for external credit.

Anil Kumar gave a bank's experience of housing and infrastructure financing. Bank and home finance companies' lending to housing has increased mortgage debt value – with interest rates falling – but the disadvantaged are left with informal lenders at exorbitant rates; overall limited access to finance has led to a housing crisis. Partnership financing models exist, but replication depends on reputation of involved NGOs – with constraints of poor finances and balance sheets, but with implementation and credibility advantages. Future models will focus on groups with own micro-enterprise activities and joint guarantees for each other's loan, housing co-operatives, savings and risk sharing guarantee funds. On questions: bulk loans have low transaction costs; and, risks are pertinent for retail loans.

Cedric de Beer shared experience of a non-profit joint venture between government, Open Society Institute of New York (OSI) and National Urban Reconstructing Housing Agency, NURCHA. It assists small to medium size contractors and developers of housing and infrastructure with bridging finance; money is raised to provide loans from commercial banks in a relation between financial institutions and construction companies. Drawing funds from donor guaranteed revolving bank credit facility, the agency lends to contractors through intermediary paymasters. Subsidised housing is part of government's development strategy. Donor funds provide credit enhancement, easing financial institutions' lending. Ability to release commercial funds – and successful lending by financial institutions, sharing risk and its management – has resulted in reductions of risk premiums. On questions: NURCHA did not do rental housing; and, donor assistance would cease with evolvement of internal equality.

Michael Mutter stated that the objectives of UN-HABITAT's Slum Upgrading Facility (SUF) are to show that housing development or upgrading projects can access domestic capital markets for loans. Its aim is scaling up serviced land for housing development with finance for all. Multi-phased, SUF creates financial security to attract local private financing in the domestic capital market. Starting 2006, pilot project financing mechanisms will be tried in Ghana, Indonesia, Sri Lanka and Tanzania; domestic capital for low-income housing and home improvement loans is to be attracted in collaboration with local banks, housing co-operatives and Special Purpose Vehicle (SPV), i.e. joint ventures able to raise debt finance in local capital markets. On questions: municipal

SPVs are less susceptible to political pressure; and, subsidy need depends on national environment and system fit.

Alfredo Stein saw a need for donor harmonization to ensure financial rationality in budgetary support towards achievement of social equality and sustainable impact on financial operation and institutional capacity. In the reconstruction process after the 1998 hurricane, Sida and KfW consulted with beneficiaries and local government, resulting in FUNDEVI. A public foundation, it tested a subsidy scheme with micro-credit and infrastructure financing – accompanied by donor harmonization of procedures and reporting routines – for housing to become part of a Poverty Reduction Strategy (PRS). The approach opened for the Inter-American Development Bank (IADB) to pool in resources. On questions: if budgetary support prevails, donors could become irrelevantly involved instead of focusing on the disadvantaged.

Following presentations, seminar group work focused on how to make finance for housing and infrastructure available to the urban majority. Groups were encouraged to discuss differences and similarities – and related issues and implications – between finance for housing and finance for infrastructure. On role of financial institutions and markets – 'how commercial lenders can be encouraged to make finance available for housing and infrastructure for the urban poor' and 'how local private savings be mobilized by financial markets to provide finance' – infrastructure was distinguished as a public good and individual housing as a private. Low-income earners need 'slum' upgrading, containing both, but the market does not provide the financing required. Public goods must be facilitated through efficient municipal tax collection and finance management and with devolution of power. Related issues include demonstrable and credible revenue flows. Private goods depend on accessible information, recognition of shared risk, credit enhancement and a champion state-of-the-art bank.

Concerning role of donors – 'to increase finance for housing and infrastructure for urban poor' and 'how international development finance institutions can collaborate with financial institutions to increase access to finance for housing and infrastructure for the urban poor' – in staying out as much as possible, they should support triggers of change. Issues include commercial funding, bridging of funds and subsidy of housing delivery costs. Regarding infrastructure finance, there were no easy self-financing models, and 'most utilities are unviable'. Related issues include help with commercial model formulation to attract private sector participation, and difficulties with decentralization.

Regarding role of government – 'design of efficient housing subsidy schemes to encourage housing finance without distorting the market' and 'how national governments enable municipalities and communities to improve access to finance for infrastructure' –

issues include: government commitment for implementation with changes in legislation; design of subsidies that will increase opportunity for the disadvantaged; and, setting an environment with stable, predictable and transparent transfers from national to local governments with incentives for local governments to increase and borrow capital for infrastructure investments

On role of local communities – 'what local NGOs, communities and individuals can do to mobilize finance for housing and infrastructure development' and 'how local NGOs, communities and individuals can identify and apply good practices and methods for financing of housing and infrastructure development' – it was advanced that NGOs can assist communities in many ways including establish dialogue, pressurize politicians and demand transparency.

Concerning the issue of NGOs and CBOs being more cost-effective than the municipality, no difference was found. NGOs help community to access credit through teaching: technical skills, knowledge on legal aspects, lending practices and savings schemes. NGOs tend to work in too many different networks – there is thus a need for a 'network of networks'. Instruments to apply good practices and methods concern information access, Internet use, exchange promotion and demonstration models use.

A moderated panel discussion provided an opportunity to reflect on what had been discussed at the Seminar. It was recognized that micro-finance had expanded scope and role over time, but urban finance for the disadvantaged requires joint action; bringing together different disciplines create power synergies, leading to new knowledge, relationships, viewpoints and solutions. Participants could join and build on existing solutions rather than constantly inventing new. Was there weakening focus on urban poverty at donor agencies? More focus on land and finance would help clarify criteria for success, like inter-disciplinary communication between various actors, as well as increase in knowledge base on housing, land and infrastructure financing across different regions.

Closing the Seminar, Thomas Melin expressed satisfaction with quality of presentations, all of which had shown the complexity of issues discussed. He stressed that the urban finance issue is not a single problem requiring a single solution, and drew attention to challenges of donor harmonization and the substantial changes that will entail.

1. Opening Remarks

Barbara Lee, moderator, Infrastructure and Economic Cooperation Department (INEC), Sida, Sweden: Opening of seminar

She drew attention to the diversity of backgrounds and experience of the speakers and participants at the seminar. She emphasised that the goal of the seminar was to discuss and share experience on issues involving financing solutions that target the urban poor. She elaborated on a number of practical details on the programme: Day 1 involved mainly presentations, while day 2 was to involve mainly group work and panel discussions. Each presentation was expected to last for twenty minutes, with an extra ten minutes for questions and discussions. She also introduced the seminar organisers.

Rolf Carlman, Infrastructure and Economic Cooperation Department (INEC), Sida, Sweden: Welcome speech

In his opening remarks, he indicated Sida's long-term commitment to support low-income housing and infrastructure finance. As an example, he cited Sida's 20-year experience of supporting micro-finance programmes for housing and local infrastructure for low-income households in five countries in Central America, benefiting about six percent of the urban slum dwellers or three percent of the total urban population.

He reiterated Sida's recognition of the pivotal role of urban finance in achieving the Millennium Development Goals. Although the programmes have been successful, Sida has gradually realized that other financing instruments are required to reach a larger number of urban low-income households, as the needs for decent shelter and infrastructure are larger than ever today. In recognition of the growing interest of commercial banks and multilateral organisations in low-income finance for housing and infrastructure development in developing countries, he indicated Sida's interest in finding innovative financing solutions to tap local and international markets and increase capital available in local systems. He called for joint efforts in identifying the most appropriate financing instruments to cater for the needs of disadvantaged groups. He concluded by indicating that Sida regarded the seminar as an introduction of a renewed emphasis on urban finance and as preparatory work for the World Urban Forum in Vancouver in June-2006.

2. Presentations

Diana Mitlin, International Institute for Environment and Development (IIED), United Kingdom: Urban Finance and the Global Challenge of Poverty Reduction

She stated at the onset that the purpose of her presentation was to share her and IIED's experiences in urban finance and the global challenge of poverty reduction. Her initial observations included:

- The need to think about both housing and infrastructure finance
- The equal importance of financial processes and the finance itself
- The existence of strong and important synergies between financial and other mechanisms for poverty reduction.

Using a number of statistics from around the world to illustrate the urban poverty problem, she highlighted three characteristics of the urban poor, which she considered particularly relevant. They lack secure tenure and basic infrastructure including water and sanitation. They also have low incomes from working in formal and informal labour markets. In addition, the suffer from exclusion and the detrimental effects of anti-poor programmes e.g. in Zimbabwe.

In addressing these problems, she indicated that finance is critical, since it enables access to secure tenure and other services. In the short term, finance protects the poor against poor health, perhaps the most significant trigger that turns transitory poverty into chronic poverty. In the longer term, secure tenure serves as an asset that enables further accumulation. She pointed out the existence of indirect benefits they enjoy from social networks and neighbourhoods offering support and solidarity.

Using examples from the last two decades, she identified three categories of urban finance:

- The 'Northern whole housing' commercialised finance for land and infrastructure as a package, offering mortgage finance for those able to pay and who are in formal employment. This is usually provided by the market but may be supported by state subsidies.
- 'Southern individualised', small-scale lending for those with reasonably secure tenure, provided either by the market with/without state subsidies.
- 'Southern collective', small-scale loans for those with insecure tenure. These may also be market provided with/without state subsidies.

She noted that housing finance schemes have been expanding in some countries in Latin America and Asia (the Philippines, for example) due to the growing middle class and the increasing capacity of institutions to meet their needs. There are, however, limitations on this due to both income and employment, with the latter implying that poor urban households are unable to afford mortgage finance. They are seen as risky as it is not easy for lenders to repossess the house.

Constraints create the need for financing in the context of poverty – small loans for housing. These loans offer essential help needed for housing improvements (incremental housing). They are relevant to many with somewhat secure tenure. In addition to micro-finance agencies, this type of lending comes from informal lenders, family and friends. With regards to infrastructure, the investment requirements are of a scale that even the biggest households are unable to afford it.

An example of financing for the poor is micro-finance for shelter in the form of individualised loans for housing improvements and absolute/cross subsidies, lasting up to 7 years or longer. She noted this has been in existence for a while, and has been implemented by mortgage finance institutions and urban NGOs. Even though some of them were enterprise loans, she notes a tacit acceptance of the possibility that some of them ended up being housing loans. She cited Chile and Colombia as examples of countries where this has been implemented.

Diana Mitlin also observed that this type of lending has been growing and suggested both commercial interests and rising need as reasons for their growth. She explained that even though their success has made it popular, these institutions are constrained by capital. She draws attention to differences of opinion on the credit-plus model. Thus, even though this type of lending may be linked to enterprise lending, the terms may differ.

She stated that households with less secure tenure are generally poorer. This prevents the possibility of individualised market solutions. In the areas where these people live, infrastructure is very limited or non-existent. The need to improve tenure, secure infrastructure and potentially invest in housing means that the investment has to be collective which gives rise to the need for group lending, e.g. Mexico. In some cases, infrastructure/housing development may not be affordable due to a need for regulatory change, citing Namibia as an example.

She described a number of initiatives to meet the needs of this latter group:

- Group loans, generally with subsidies, up to 25 years (mostly less), to finance the purchase of land and the provision of infrastructure.
- Long established innovations whose use has increased in recent years, for example the Network Shack Builders International.

Rather than micro-finance agencies, the providers may be state and/or civil society organisations. The latter often do business with established groups in need of secure tenure and may be part of an integrated development programme – as multiple sources of funding or more conventional micro-finance for housing/enterprise.

In conclusion, she emphasised the need for national governments and development agencies to take into account the medium and low-income people as well as the very poor in fashioning solutions. Even though they need the market to play its role, it is important to recognise that the market does not work that well for the poorest. This means the right kind of state intervention is needed: help to access land and incrementally develop housing. Citizens need to be active to ensure the right kind of interventions. For the poor, this means collective activity. She explained that when poor people are organised, they can make a considerable contribution to poverty reduction.

Discussion

There were a number of questions following her presentation, the first of which referred to whether secure land tenure would improve access to finance. In response, she explained that mortgage companies typically want to recover their loans rather than repossess the assets of defaulters, since repossession costs are higher than mortgage costs. Formal incomes help improve their credit worthiness since the loans can be automatically deducted from their salaries. In conclusion, she stated that land titles might be necessary but not sufficient; thus, possession of land titles does not guarantee access to housing finance.

Pressed on the issue of collective actions, she reaffirmed her belief that, if the poor believe that community organisation can help solve their problems, they are usually willing to participate. There were a number of further comments on the issue of collective action: Michael Mutter wondered if there is enough leadership to champion collective action. Rajivan Krishnaswamy pointed out that sometimes, the incentives of the poor for collective action are blunted by their lack of power. The powerful, on the other hand, have weak incentives to engage in collective action that benefits the poor. Collective action may thus falter over the long term. He cited the example of the privatisation of public housing in Romania, pointing out that the lack of an institutional mechanism to maintain privatised housing, led to the deterioration of the housing units.

Stig Jonsson, Urban finance to the poor in a bank perspective Swedebank, Sweden: Urban finance to the poor in a bank perspective

He presented the micro-finance industry from a banker's perspective. He made a number of preliminary observations. Savings forms the basis of a sustainable financial system. He stated that even poor people can, and do save. Local savers thus play an important role in the evolution of micro-finance institutions. However, there is the need for legislation to create trust in the system. Legislation will address the issue of property rights which will lead, for example to the registration of the banks' underlying assets, and set the rules for repossession. It should also be possible to undertake risk analysis: both financial and credit risk.

He described the financial system in principle as consisting of traditional banks, MFIs, mortgage banks as well as securitization as the institutions and processes by which funds are channelled from investors/savers to customers/consumers of loanable funds. The mortgage market in principle consists of investors, mortgage and retail banks and the customers. The chain of interaction starts from investors to the mortgage banks to the retail banks and eventually the customers.

Using the Swedish mortgage system as an example, he showed that the mortgage institutions obtain funding from insurance companies, pension funds, municipalities, among others, and the mortgage institutions; in turn, lend to condominium associations, owners of single and multi-family housing, owners of individual condominiums, owners of commercial buildings, the agricultural sector and condominium associations.

He analysed the mortgage market in Sweden in terms of market size, interest level and mortgage terms. In terms of market size, he stated that mortgage lending was 40 percent of total lending to the public as of December 2004. Using SPINTAB, Swedebank's mortgage arm, residential properties and condominiums formed part of the largest share (60%) of mortgage lending, as of September 2005. He stated that the typical single-family house was 10 percent equity financed; the first mortgage, granted by a mortgage institution, covers 75 to 85 percent of the value. Interest rates have declined steadily, on average, since mid-1995. As of September 2005, interest rates have ranged from a variable rate of 2,54 percent to a 12-year rate of 4,59 percent. Amortisation can last up to 50 years; however, there are also interest-only loans.

In Sweden, infrastructure finance is done either by municipalities or community associations. He explained that the difference between this and other countries is that the community association is a legal entity with preferential access to loans.

Stig Jonsson identified the cornerstones of a financial market: capital, risk management and legislation. In relating to what he termed as importance experiences of the ground roles of a financial system, he re-stated that savings is fundamental to a healthy financial market, since everyone can save and savings is usually the first step towards becoming a bank customer. In addition, savings increase the banks' lending capacity and stabilises the bank system. In this sense, cooperative solutions are very important. He cautioned, however, that grants and subsidies must be kept at the barest minimum to avoid throwing the system out of balance. He called for the provision of technical assistance in all its forms, as well as investments in infrastructure.

He conceded that different conditions prevail in different countries, which means adjustment to local conditions is valuable and there are many valuable experiences to learn from. When it comes to housing finance for the poor, Mr. Jonsson called for cooperation between the following actors

- Government using laws and tax regimes, etc.
- Local government in providing land and infrastructure
- Developers
- Bankers in providing financing using their knowledge of the local situation
- NGOs
- International agencies
- Private companies/employers

As far as micro-finance/housing finance for the poor is concerned, the main differences, he noted, between Sweden and less developed countries is often the lack of institutionalised savings, adequate legislation as well as limited possibilities for risk analysis. He pointed out, that sustainable financial development demands improvements and further development of the financial system as a whole, not only for the poor, with active government participation if the intention is to improve the lot of the poor in a big way. Stig Jonsson challenged the research community to come up with ways of reducing poverty without endangering the financial system. He concluded by calling for investments not only in infrastructure but also technical assistance.

Discussion

Esse Nilsson observed the large proportion of single family housing in the loan portfolio of Swedebank's loan portfolio and wondered why there is a wide perception of their owners being disadvantaged in the sense of being able to access housing finance. In response, Stig Jonsson pointed out that rising house prices coupled with declining interest rates lie behind the relative importance of single-family house lending. In explaining this he emphasises that risk analysis focuses on the ability to repay. He stated that current repayment ability of most households is good since interest rates are low.

Another participant wanted to know over what time frame the formalised system of risk analysis was developed. In response, Stig Jonsson noted that the system of risk analysis started over 100 years ago. However, until 15 years ago, when a financial crisis in Sweden occurred, the emphasis was on the borrower's collateral. Since then, the methods of risk analysis have changed.

Another participant wanted to know about the experiences with Municipal finance. He responded by pointing out that by law, Swedish municipalities could not go bankrupt, making them the safest borrowers.

The last question was on the extent of involvement of cooperative organisations in the formation of financial institutions in Sweden. Stig Jonsson responded by stating cooperative organisations played a very important role initially for less affluent households but that gradually they have been absorbed by merger and acquisition activities


VEHICULOS
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PRECAUCION

Kathleen Wu, United States Agency for International Development (USAID), USA: Leveraging Local Capital for Urban Infrastructure

Her presentation was on the process of leveraging local capital for urban finance. In her opening remarks, Kathleen Wu noted the recognition by the international donor community that private sector led growth is critical for development. If the Millennium Development Goals (MDG) is to be attained, donor assistance will not be enough. Private sector finance fuels growth; developed countries enjoy higher growth because of robust private sector finance. She elaborated by stating that whether one wants to start a new business, grow an existing business, purchase a new home or invest in infrastructure, one will need access to finance.

Even though domestic credit provided by the banking sector in high-income countries averaged 168 percent, in sub-Saharan Africa, it stood at only 65 percent1. Credit markets in developing countries are characterised by:

- Low levels of intermediation in spite of savings
- Capital flight
- Mattress savings
- Banks' dominance of intermediation and possession of large liquid assets, and
- Growth impeded by lack of access to credit

The past and prevalent condition is one in which availability and access to credit is limited due to inefficient and underdeveloped financial markets, leading to stagnation of local economic growth and creating the need for expansion into new sectors. However, when one looks closely, one would discover abundant excess liquidity, creating a potential for further development of financial markets. She emphasised that investments have profit potential; however, there is the need for effective methods to leverage the requisite funds.

- She then identified the following factors as explanations of the reluctance of banks to lend to the private sector:
- The poor judicial and legal environment makes contract enforcement difficult. High risk of default leads to high collateral requirements.
- Banks make a good profit when they attract deposits and use them to purchase safe government bonds

[1] As a percentage of GDP in 2002

- Banks find it difficult to determine the credit status of potential borrowers, creating a situation of information asymmetries between borrowers and lenders

- The limited capacity for risk analysis of banks, among other features, limits their experience in lending to the private sector. This hinders financial intermediation.

Kathleen Wu then proceeded to recount USAID's experience of infrastructural finance from various parts of the world. She described USAID's partial credit guarantees as a catalyst for private financing in new sectors and projects. Under this scheme, USAID offers loans as well as portfolio and bond guarantees, covering up to 50 percent of the loss to private lenders from local currency loans for development activities. Projects are identified and designed by USAID missions in the field with support from USAID offices in Washington. The guarantee portfolio is global in scope, with operations in South America, Africa, the Middle East and Asia. The portfolio covers water, agriculture, housing, infrastructure, environment, education, health, SMEs as well as lending to micro-enterprise and micro-finance institutions.

She illustrated USAID activities using a number of examples:

- A $28.5m portfolio of loans and bonds to finance infrastructure projects in the Philippines, with the loans/bonds covered by a primary guarantee from the Local Government Unit Guarantee Corporation (LGUGC). The assistance is to help establish the credibility of LGUGC with the local private financial sector.

- Another arrangement in South Africa where ABSA bank, a local bank, provides a 175m Rand loan to GJMC to finance infrastructure and housing projects, with USAID providing a 50 percent guarantee on principal and interest payments.

- A $40 million loan portfolio guarantee to CIB (Egypt) to expand and improve water and wastewater service delivery to people living in outlying areas as well as facilitating utilities' capacities to initiate private sector provision of services

- A new $21.7m infrastructure bond in India to improve and expand the provision of water and sewerage services. The Karnataka bond issue is the second pooled municipal bond in the marketplace. Kathleen Wu informed that there are a number of new projects being prepared and are at different stages of implementation, serving a variety of purposes in Zambia, India, the Philippines and South Africa.

Kathleen Wu described the various financing models in existence: (1) The conventional municipal finance model entails bond investors and banks providing bonds/loans and Development Credit Authority (DCA) guarantees to the municipal authority or utility provider who then invests in infrastructure projects. (2)

Structured finance differs from the traditional model in the sense that the bonds, loans and DCA guarantees are granted to a Special Purpose Vehicle (SPV) that is contracted by the municipality to implement the projects. (3) A bank can provide loans and DCA guarantee to a Private-Sector Service Provider (PSP) who is under a management service contract with the municipality. (4) Finally, another scheme is pooled financing in the form of the establishment of a state revolving fund scheme under which bond investors issue DCAs to a state bond bank, while the state government offers guarantees. The state bond bank, in turn, lends to small and medium municipalities, who are the ultimate borrowers.

Turning to housing micro-finance, Kathleen Wu noted that it is an important tool in the struggle to help meet the housing needs of the urban poor. She pointed out that what poor households need are home improvement loan products rather than mortgages. She gave an example of a DCA scheme in Morocco for housing loans.

She disclosed the introduction of new USAID guarantee activities: enhancing USAID guarantee products, spearheading the introduction of financing technologies and developing a local currency tier II capital investment initiative. She called for collaboration between the donor agencies, explaining that this would lead to catalytic responses in the recipient communities. She specified areas of joint collaboration – technical assistance and feasibility studies, areas for which she indicated the need is great. The result, she expects, is an environment for sustainable lending for infrastructure projects.

In conclusion, Kathleen Wu suggested that USAID had that what works best is a comprehensive approach consisting of guarantees, regulatory and other reforms as well as feasibility studies. Sustainability is crucial, especially when it comes to risk assessment. Finally, flexibility is key to helping the private sector manage risk

Discussion

Franck Daphnis commended USAID for being a good example of what donors should do in leveraging private capital in recipient countries. Concerning tier two instruments, he wanted to know about the provision of liquidity support for housing finance. Another participant wanted to know about which guarantees private banks were requested from municipalities. Per Ljung also commended USAID for developing and implementing outstanding and sustainable programmes. He then asked for clarification about how risk assessment is related to setting the fees that should be charged for guarantees. Another participant wanted to know about who carries the foreign exchange risk and how the guarantees are being called.

In response, Kathleen Wu stated that what experience shows is that even though lenders are willing to lend to municipalities or businesses, they are concerned about violating the Basel Accord on liability matching; this reduces the usefulness of bank lending. In response to this USAID provides what is essentially a standby letter of credit to address the mismatch by giving the banks the flexibility to offer longer-term loans. What is yet to be done is to model the cash flows.

Concerning bank guarantees from municipalities, she stated that for banks, a 50 percent guarantee is not enough. The aim of the DCA is to share the risk from principal loss, the rationale being providing the banks with the right incentives to do the requisite due diligence. When it comes to fees, she stated that USAID charges fees, but these fees do not reflect the level of risk. She explained that USAID is not required to use fees to cover administrative expenses; instead, the fees are meant to extract committed participation from lenders and also preventing the lenders from passing on these fees to borrowers.

On the issue of exchange rate risk, she explained that USAID requires that lenders give foreign exchange loans only to borrowers who earn foreign exchange; otherwise they need hedging instruments to cover the risk from foreign exchange fluctuations.

Mark Hildebrand and Rajivan Krishnaswamy, Cities Alliance, USA: Empowering Cities to Finance Infrastructure

In his opening remarks, Mark Hildebrand stated that in terms of scale, Cities Alliance focuses on city and nationwide interventions as well as sustainability.

Rajivan Krishnaswamy started by summarising the needs of the urban poor, as well as major historical trends that cities in developing countries have to contend with. Many cities have huge backlogs in terms of water, sanitation and solid waste management infrastructure. Worldwide, 900 million people live in urban slums, an estimated 1 billion do not have adequate access to water, and 2 billion lack adequate access to sanitation facilities. On a regional basis, 38 percent of Africa's population are without access to safe water and 40 percent has inadequate sanitation facilities. In Asia, the corresponding percentages are 19 and 52 respectively, while in Latin America, the numbers stand at 15 percent and 22 percent respectively. Citing the Camdessus report2, he disclosed that annual investments in water and sanitation are $17b and $32b respectively. In cities, therefore, the urban poor needed to be empowered to leverage budgetary resources with domestic capital to invest in infrastructure.

In addition to the above, he cited three major challenges that cities in the developing world have to cope with:

- Globalisation places on them the need for quality infrastructure to attract investment, stimulate growth and employment
- A messy decentralisation process which places on cities the responsibility for costly infrastructure, often unmatched by devolved regulatory, financial and administrative powers
- A growing influx of poor people whose contribution to the economy exceeds their access to basic infrastructure

Continuing, Rajivan Krishnaswamy noted that public expenditure still accounts for about 70 percent of infrastructure funding. As a share of GDP, spending on infrastructure is considerably below the levels seen in the 1970s. What is more, bilateral and multilateral donor commitments for infrastructure have declined both in absolute terms and as a percentage of total commitments. The decline in donor and public funds had not been offset by private sector investments; the latter declined as well.

Given these trends, he called for cities to become proactive in developing urban infrastructure rather than serving as passive service providers. He identifies empowerment as key to this transformation of cities' role. This would include the mandate to

[2] "Financing Water For All", presented in 2003 by the World Panel on Financing Water Infrastructure at the third World Water Forum chaired by Michel Camdessus, former Managing Director of the International Monetary Fund and later Governor of the Banque de France.

raise revenue, create and maintain infrastructure, while remaining capable of paying for their costs over time. He argued for an urban reform agenda that includes:

- City development strategies, investment plans with pricing policies based on the consent of the governed
- Mainstreaming the needs of the urban poor into on-budget investments
- Sustainable financial structures which link domestic capital markets with city financing needs

He inferred from a survey of global trends, that sustainable financing requires policy actions, which are based on partnerships between cities, national governments and their development partners.

He drew a comparison between traditional urban finance and recent innovations. In the case of the former, a city gets loans/grants from government or government-owned financial institutions on the basis of guarantees. The projects are then implemented by parastatals/cities with no clear duties and responsibilities for servicing debt or asset maintenance. The user charges levied rarely cover operating and maintenance expenses of the facilities. This usually results in drying up of institutional sources based on state guarantees on account of ceilings on national liabilities. Low cost equity or grant type funds are also hardly available, in the face of excess supply of commercial funds. The overall result is that cities investment in infrastructure has little impact on urban poverty.

Rajivan Krishnaswamy observed that innovations towards sustainable financing through leveraging of domestic capital have emerged since the 1990s. He cites examples of larger cities like Johannesburg, Ahmedabad and Ho Chi Minh City, with medium-term investment plans repeatedly accessing local markets and establishing a credit relationship with the private sector in the process. Smaller and medium-sized cities mobilised domestic capital through intermediaries like Findeter in Colombia, INCA in South Africa and TNUDF in India. He also cited serious efforts to provide a greater domestic market orientation for municipal intermediaries like CAIXA in Brazil, MDFO in the Philippines, and FEC in Morocco.

He discussed the lessons learnt from linking cities with domestic capital markets. He argued that for urban finance strategies to be viable, there is the need for rational and predictable devolution which is largely formula based as in South Africa, India and Mexico. Viability also requires the requisite legal framework for borrowing, such as the Municipal Finance Management Act (MFMA) in South Africa, Urban Local Bodies Act in Tamil Nadu, and Master Trust Structure in Mexico. Instead of foreign donors, he called for domestic market oriented financial intermediaries similar to those working with cities such as DBSA and INCA in South Africa, TNUDF in India as well as Dexia in Mexico. He also suggested that the appropriate fiscal space allowing affordable long-term interest rates for financing city infrastructure is created.

Mr Krishnaswamy suggested a framework for implementing urban finance depending on three possible scenarios:

- When the domestic debt markets are yet to mature and the devolution framework is weak, he suggested cities should be assisted with a mix of loans and grants while improving the devolution system.

- When debt markets are constrained by fiscal space, but devolution has been successfully implemented, he suggested more secure-work with domestic financial institutions to lengthen maturities and reduce transaction costs.

- As Markets begin to mature, and devolution is secure, he suggested the provision of instruments to link city financing with domestic markets, especially for small and medium cities.

He then proceeded to describe recent initiatives of Cities Alliance around the world:

- Assisting existing Municipal funds develop a sustainable domestic orientation – Brazil, Philippines, Colombia.

- Facilitating the more effective leverage of existing government grants – Bangladesh, Pakistan.

- Enabling markets to carry out transactions where such opportunities exist – China, India, Russia, and South Africa.

- Address demand and supply constraints to the flow of domestic finance for cities through MFTF.

Using the specific example of Ghana, he showed how they are systematically working on demand and supply, with the active participation of the key actors: central government, the cities and the financial institutions. Among other steps they have encouraged the national government to develop the appropriate legal framework in order to define the purpose, scope and limits for borrowing at the national level. They also defined a process for cities to obtain internal consent for borrowing including pricing. In addition, they unblocked existing supply constraints on Insurance and Pension Funds. Finally, they assisted in securing a potential blend of long-term institutional finance with domestic market.

Commenting on the role of development agencies, he proposed that they act as facilitators for private capital to finance public assets. Development agencies should also allow domestic institutions to integrate cities financing needs with national debt markets and/or commercial lending. Finally they should work with cities and national governments in identifying a rational, predictable devolution of powers and revenue streams. He argued that this would provide greater leveraging of scare bilateral and multilateral financing.

He called on Cities Alliance members to contribute towards creating a new market, which supports demand and supply side products. Financial devolution will promote rational and stable fiscal transfers that create incentives for local government performance. In conclusion, he called on Cities Alliance members to work towards:

- The formulation of city development strategies, which incorporate pricing and improved financial systems
- Implementing coherent institutional arrangements that include parastatals
- Formulating and implementing municipal finance recovery action plans
- Promoting pooling to assist small and medium cities' access to credit
- Encouraging national-level reforms to enable a sustained flow of long-term domestic capital (insurance funds, pensions etc) into city investments
- Assisting existing funds achieve greater domestic market orientation

Discussion

Alfredo Stein wanted to know the reasons for the decline in donor finance. Another participant used the example of Kerala to show how a successful housing scheme for the poor was implemented without a satisfactory scheme for the provision of water. He thought that this is a result from corruption and conflict. The question, therefore, was how one can fight through political conflict to improve water access for poor people, alongside good housing. Franck Daphnis cited India as an example of how urban finance, micro finance and municipal finance converging. He wanted to know if there are other places where this convergence is replicated. Sheela Patel wanted to know what elements incentivise people to innovate and what impediments exist to innovation.

In response, Rajivan Krishnaswamy explained that the Kerala case is an example of functional fragmentation caused by bad devolution. This, he stated, is an example of the impact of failed decentralisation on local governments' ability to provide infrastructure, in this case, water. The solution, in his opinion, is to provide grants to the city government to invest in infrastructure. This situation can also be resolved by regulatory changes.

On the convergence issue, he stated that several examples exist where micro finance, housing finance and municipal finance converge; however, there are even more examples where no such convergence occurs.

Regarding the next question, he stated that from the lender's perspective, when you make a loan to the municipality, two things seem to work: the spread effects of the loan and the extent to which the communities try to benefit. Tariffs should be based on future repayments. Concerning lending for water and sanitation, since these projects have long gestation periods, there are no incentives for lenders to finance it.

Malcolm Harper, Cranfield School of Management, United Kingdom: How can Micro-Finance Institutions access the funds they need to scale up and satisfy the needs of the urban poor?

He wanted to discuss how MFIs could access the funds they need to scale up and satisfy the needs of the urban poor. In addition to this, he also wanted to discuss the relevance of micro finance to housing finance. He justified the premise of his presentation by pointing out that in India where he has a lot of experience working with micro finance, he realised micro finance supports many things. His central argument was that micro finance is a case of exaggerated expectations. He started by challenging traditional assumptions about poverty and micro-finance:

- Credit is a human right
- Poor people can pay private school and hospital fees
- Micro finance is great but by itself cannot eliminate poverty

Using a selection of facts as a backdrop to the rest of the presentation, he reminded the audience that one billion of the world's poor currently live in cities; by 2020, about half of India's population will live in cities. In the meantime, half of Asia's city dwellers have no access to piped water; most have no security of tenure, even if title is not the whole solution.

He showed that an asset mismatch exists between micro credit and urban shelter. Micro loans are small, fast, frequent, expensive and for women. If infrastructure is going to be involved, he argued that shelter finance needs to be large, slow, infrequent, cheap and for men. On the liability side, a mismatch existed too. Only banks are allowed to raise savings and this is costly for MFIs to do. MFIs can use retained earnings only if they charge high interest rates, which make it unsuitable for housing finance. Bulk loans are usually provided by the banks and only for the strongest.

In spite of this, Malcolm Harper noted some advantages of MFIs. They are favourably location, and they have the systems, staff and reputation. They have millions of urban poor customers and they have, in a limited and modest way, group mechanisms, with some potential for scaling up into housing associations. He illustrated this with an example from Hyderabad in India.

Explaining further, he conceded that currently micro finance is used in 'progressive housing', but characterised it as slow, unjust, unhealthy and inadequate in solving citywide issues. He deems it inappropriate for the provision of water, roads and drainage.

He stressed that MFI clients need shelter finance, since good shelter is healthy and promotes a decent life for them. He argued that it is in the interests of the MFIs themselves to have clients who have access to better housing. This would enable them to have home-based businesses that allow them to earn enough to repay the micro finance loans. He called for MFIs to offer sustainable housing finance as secured base load credit to replace petty trade credit as clients graduate to employment.

He gave examples of current solutions:

- Bangladesh – BRAC, ASA, GRAMEEN: 1 million houses, all of them individual.
- Philippines – where community mortgages are given out for 25 years at 6 percent
- Thailand – government fund loaned out at 3 percent plus community action
- South Africa – bridging loans, 20 percent of it subsidised, plus community action
- India – Mumbai etc, SPARC/homeless international involving bridging loans and value capture

Malcolm Harper argued that the current micro finance schemes are not doing enough; they need to meet needs that promote livelihood. He made a number of recommendations in this regard based on his experience from India. He urged a thorough sub-sector analysis, in order to find the right buttons. He also called for experimentation and a willingness to fail. There must also be an initial investment including research and development subsidies. He strongly advised that there must be collaboration between all the actors; in addition, there must be strong leadership with one co-ordinator. He also called for the use of revenue models, explaining that schemes must be self-financing.

His question was whether any of the above steps were applicable to urban shelter finance. Malcolm Harper made a number of proposals for consideration by urban MFIs. They need to understand the shelter market and find collateral substitutes. They also need to foster close relationships with both the municipal and other authorities. He urged them to adjust loan amounts, loan terms and their target returns on investments. He encouraged them to test housing finance products to determine their feasibility and build on their experience in the process. They also need to look for shelter credit lines, which are cheap and long-term enough to satisfy these needs.

In conclusion, he argued that his previous remarks would sound like minimalism and to be consistent and idealistic, he would prefer to see financing mechanisms that would not depend on "saints": people who are very special and do amazing things, but are not the key to developing a system. He also urged the development of schemes that do not entail the use of subsidies. He rejected the notion that collective action is critical to efforts to provide shelter finance.

Discussion

Diana Mitlin wanted to know if different solutions to the urban poverty problem would occur if one separates housing finance from shelter finance. Robert Buckley also wanted to know why micro finance could not be combined with subsidies.

In response, Malcolm Harper stressed that anything, which distracts the institution's focus of providing financial services, should be treated with caution. He disclosed he had not yet come across any business model, which combines financial service provision with subsidies. In a seemingly supportive comment, Franck Daphnis stated that Sida's own study of five countries in Latin America showed that a combination of subsidies and financial services did not work well. He conceded the possibility of MFIs to deliver subsidies but was uncertain if they were the best institutions that can deliver a subsidy-finance mix.

In his last comment, Malcolm Harper noted that development is a search for delivery institutions; however, he urges caution in burdening MFIs with subsidies, which is separate from their basic functions.

Franck Daphnis, Development Innovations Group (DIG), USA: Housing Microfinance: The State of the Practice and the Way Forward

In his opening remarks, he stated that the product of micro finance lending is incremental housing or habitat improvement. He also stated that housing micro finance is not an answer, but a complementary tool for solving the urban poverty problem. He then disclosed that he intended to review and discuss the emerging approaches, products and issues of housing micro finance in his presentation.

Mr Daphnis defined housing micro finance as a subset of housing finance. He characterised them as initiatives that can target the habitat needs of the very poor and extend relatively small loan amounts based on an estimate of repayment capacity. They carry a short repayment period and are not usually collateralised; instead have co-signers, for example. What is more, they are priced to ensure long-term financial viability of the provider and incorporate systematic due diligence and follow up procedures. Housing micro finance is thus the meeting point between housing finance and general micro finance. It is sometimes accompanied by assistance with construction and securing land tenure.

The clients of housing Micro-Finance Institutions (MFIs) are their existing clientele – urban poor entrepreneurs who work in the informal sector; however, they are diversifying to include salaried employees. In general, their clients are poor households that do not enjoy access to traditional housing finance. The providers of financing, on the other hand, are MFIs, home lenders, NGOs and banks.

He gave examples of the improvements that can be financed by housing micro finance. These he divided into minor and major improvements. Minor improvements include finishing work, carpentry, plastering and painting, as well as the installation of doors, windows and security bars. They also include energy efficiency improvements like installing insulation and double paned glass, as well as water, sewerage and electric connections.

Major improvements, on the other hand, consist of significant renovation or addition of bathrooms, kitchens and living space; retrofitting homes with hurricane resistant technology as well as major repairs or replacement of walls, floors, roofs and sanitary fixtures.

Housing micro finance is thus a complement to traditional housing/mortgage finance. It can be part of a post-emergency housing finance strategy3 and as a carefully designed complement of a government housing strategy. It sometimes forms part of a

[3] Citing El Salvador as an example.

slum upgrading strategy and is used to enhance and supplement larger community infrastructure programmes.

Franck Daphnis then proceeded to compare micro enterprise lending with housing micro finance. Micro enterprise loans impact the borrower's income. They may offer very small loan amounts and may be fungible4. They can be individual or group loans and assessment of the borrower's repayment capacity is based on the generation of future income. Housing micro finance, on the other hand, impacts the borrower's asset base and may impact income. It involves relatively larger incremental loan amounts. It may be fungible and is not fungible if construction assistance is required. The assessment of repayment capacity is based on the borrower's current income.

He cited research, which showed two families of products used in housing micro finance: linked housing micro finance, and stand alone housing micro finance. In linked housing microfinance, a housing loan is provided as part of a graduation process after the client has established a lending or savings history with the MFI. The client's savings and loans history with the MFI offers a good method for repayment capacity analysis.

He used the USAID/DAI (2000) table shown below to illustrate instances where housing micro finance is used as part of a sequence of steps in the financing of micro entrepreneurs.

Organisation	Average Loan Size	Maximum Repayment Period	Security/ Collateral	Required Time with Programme	Savings Required	Solution Type	Technical Advice to Clients
Grameen Bank	$100-$600	120 months	5 co-signers with Centre guarantee	Two years minimum	Yes	Fixed (including latrine)	No
SEWA Bank	$532	60 months	One year savings as lien; 2 co-signers	One year minimum	Yes	Variable	No
CARD	$359	12 months	Five co-signers	One and a half years	Yes ($39)	Variable	No

[4] Meaning freely exchangeable for another of like kind.

As a stand-alone incremental product, Daphnis explained that housing micro finance schemes provide housing loans based on generally accepted micro finance principles, i.e., a short repayment period and relatively small amounts that are based on repayment capacity at market rates. It works from the perspective of housing as one of the products MFIs can offer the poor, alongside more established products. He cited its usefulness as a tool for diversification (and retention) and risk management. He raised the need for rigorous client qualification given the absence of prior history of transactions with the MFI.

Elaborating on this type of housing micro finance scheme, he disclosed that its purpose is to typically improve the condition of the existing structure. Regarding repayment capacity, the requirement is for periodic payments that do not exceed 25 percent of income, with the total debt burden not exceeding 40 percent of income. Typical repayment period is one to three years; but this can go up to five years. The loan amount is based on cost, repayment capacity, repayment period and the market interest rate. He indicated that loan amounts could range from $250 in Ecuador to $8000 in Eastern Europe and Gaza.

These loans are secured through collateral substitutes (mostly co-signers) or actual collateral for larger loans. If the capacity to pay is borderline for a stand-alone product, a 'savings' or pre-payment requirement could be introduced.

Organisation	Average Loan Size	Maximum Repayment Period	Security/ Collateral	Required Time with Programme	Savings Required	Solution Type	Technical Advice to Clients
ADEMI Dominican Republic	$4000	36 months	Loan is collateralised	None	No	Variable	No
FUNHAVI, a Mexican NGO	$3000	20 months	2 co-signers	None	No	Variable	Yes
CHF/Gaza in Palestine	$4800	36 months	2 co-signers with salary transfer	None	No	Variable	Yes

He also used another result of a housing micro finance survey to illustrate stand-alone micro finance products:

Concerning non-financial assistance to clients, he explained that housing micro finance products might require construction assistance. This assistance can include:

- Evaluating the technical feasibility of the proposed improvement
- Preparing cost estimates
- Providing technical assistance as needed in improvement design and construction
- Providing construction oversight

He also touched on land issues – land security versus land tenure. He explained that one issue is if borrowers can enjoy the use of the land over the repayment period in the absence of outright ownership. If a formal title cannot be produced, land security can be demonstrated by:

- A written agreement between the buyer and the seller of land
- Long term rental agreement between the client and the government
- Based on local laws, years on the property qualifying as de facto ownership
- Accepted tax payments on property

In conclusion, Daphnis called for the documentation and dissemination of new best practices. He also appealed for the update of case studies and development of new ones. To facilitate the transfer of know-how, he appealed for the design of copyright-free operations toolkit in the form of basic forms, operations manuals and staff training instruments; he decried the current situation where information is closely held and copyright protected. He also emphasised the need to nurture a community of practice (real and virtual) through which information on housing microfinance can be easily found and shared. He also called for stronger ties between housing microfinance and housing and infrastructure finance.

Discussion

One participant wanted to know what Mr Daphnis' opinion was on the perception that micro finance lets the state off the hook and does not address the structural causes of poverty. Kathleen Wu also observed that group lending contradicts theoretical predictions, that individual lending should be preferred to group lending in micro finance. Ruth McLeod remarked that there seemed to be no limits on the issues being discussed under urban finance. She wanted to know the range of financial products and policy instruments that exist for dealing with the urban poverty problem. She was under the impression that micro finance is being sold as if it could fix everything. She also sought clarification on the exact role of microfinance in the complex problem of urban poverty. Per Ljung also wanted to know how MF could be scaled up.

In response to all the questions and comments, Franck Daphnis started by conceding that microfinance will not fix every facet of the urban poverty problem. It would and should not replace the role of government but rather form part of a private sector response to the urban poverty problem. He also acknowledged that sometimes, microfinance complicates the efforts of government. Microfinance can only alleviate the poverty problem but will not exempt government from its developmental obligations. He also explained that group lending is not preferred because it is complex for small amounts but housing loans, which are larger, lend themselves more readily to individual lending schemes.

In response to the scaling up issue, he explained that MFIs need to be regulated to enable them to mobilise savings. This is because banks usually scale up by capturing savings and lending or borrowing. The only way unregulated MFIs can mobilise savings by charging higher interest rates.

Sheela Patel, Society for the Promotion of Area Resource Centres (SPARC), India: Wooing financing for slum housing and infrastructure – Risk, trust and relationship management by the organized urban poor

She wanted to discuss and share her experiences on how the poor and informal organisations interact with formal institutions. Specifically, she wanted to relate the process by which organisations of the poor enable formal financial institutions and state agencies and processes learn to deal constructively with their ideas and strategies. She started by introducing a network of organisations in Asia, Africa and Latin America, Shack Dwellers International, of which her organisation, SPARC, is part. In her opening remarks, she stated that in many of the poor communities of the world, one can find locally initiated self-help shelter schemes. In spite of this, developmental interventions for shelter provision have not learnt to build on what the poor know and do; on many occasions development agents including government needlessly destroy this asset creation process through demolitions.

Interestingly, the opportunities to take on construction, change policy and negotiate for land emerge from the federation process. They are viewed as strange and unknown by formal institutions that seek intermediaries to relate to them. The challenge therefore is how to create a relationship with the financial sector that is unfamiliar with this process. She indicated that no scale is possible otherwise unless the organisations of the poor and the banks understand how either party functions, manages risk and mitigates them.

She explained that the process seeks to focus on:

- Creating an identity for the urban poor
- Demonstrating their capacity to add value to citywide solutions
- Give them the right to choose and have aspirations
- Foster entrepreneurial behaviour among the poor
- Bring them onto the problem solving table in cities
- Envision an institutional framework that will allow organisations of the urban poor to relate to the formal institutions for land, infrastructure and housing

Sheela Patel disclosed that in India, over 500,000 slum households participate in activities that generate information about themselves, save and lend money to each other, explore innovative ways to solve their problems and dialogue with the government to solve these issues. While they do this, they learn and motivate each other. They thus form the critical mass that creates the foundation for dialogue and negotiations for the poor to formalise their houses.

Using the example of Nirman, an Indian organisation of the urban poor, she explained that the challenges of the organisation were two-fold: internally, they had to find ways to be perceived as a trusted member of the Alliance of SPARC, Mahila Milan and NSDF. They also had to strengthen the federation's risk taking and mitigation strategies through strategic management of precedent setting projects that Nirman takes on with communities. Nirman also had to refine and develop clear 'products' from projects to producing financing for scale.

Externally, they had to find ways to engage government agencies, municipalities and donors to understand and support such activities, processes and projects. They also had to develop strong linkages with financial institutions to leverage the social and organisational capital with finance.

In describing the projects taken up by the alliance, she explained that SPARC's goals were to scale up successful projects by leveraging the resources of city and state governments. They also wanted to enrol banks into financing projects in different cities, as well as produce scalable models that can be emulated by others.

These projects were characterised by the desire to seek cost recovery through the blending of resources, maximising what communities and NGOs can contribute to make them financially viable and secure the involvement of local banks in these activities and developing models. They achieved their goals by starting with what was feasible, then built and refined it. They then drew lessons from it, which they shared with all stakeholders. They also built and sustained the grassroots organisational process as a way of sustaining the process of creating opportunities for other projects.

She gave a number of examples of how lessons learned in India were shared with organisations from across the world. A federation living along the railway track, showed Methodist clergy from South Africa how they did enumeration. This information was to be used to work out ways in which the landless poor can access land in South Africa. The Housing Minister from the Philippines also visited to learn about how housing norms could be changed. Sheela Patel also gave example of projects that blended subsidies and loans, as well as projects developed within the framework of partnership with private landowners and established contractors. SPARC's latest project, financed with commercial bank lending is the Oshiwara II project.

She then proceeded to explain the difference between the formal and informal housing development process, using a framework developed by Ruth McLeod of Homeless International. In the formal process, people start by obtaining legal tenure of the land, put in infrastructure, build a house and then occupy it. The informal process works in reverse: move onto the land, build a house, have government or donor agency put in infrastructure and hopefully then secure legal tenure of the property. She next explained that sometimes the institutional relationships involved in the projects she illustrated are complex.

Turning to why and when banks start exploring projects with the alliance, Sheela Patel explained that the organised poor are seen as bringing their non-financial equity into projects that neither the state nor the banks can replace. She indicated that a local authority and state is ready to explore change and a stable and developed banking system is ready to see the informal sector as a market when a strong foundation of a community driven process is in place.

Banks in India want to explore projects when they are ready to move beyond micro credit for livelihood for lending to the sector, and when they see today's poor as potential future customers. Other important requirements for bank willingness to do business with organisations of the poor is the credibility of their leadership, and a gradual but increasing familiarity with who takes risks and how they are mitigated.

In conclusion, she stated that effective cooperation between poor people's organisations and formal institutions occur when:

- There is a strong foundation of a community driven process
- Local and state governments are ready to explore change
- A stable and developed banking system is ready to see the informal sector as a market
- Locally relevant solutions get piloted and reviewed by all stakeholders and
- There is a gradual but increasing familiarity with who takes which risks and how these risks are mitigated

In conclusion, Sheela Patel identified two roles of international development organisations. They can facilitate the strengthening of all stakeholders and encourage formulation of local solutions. They can also move from best practice to assisting co-creation.

Discussion

A participant wanted an explanation of how small savings could be used to leverage bigger financing, while another wanted to know about the challenges the poor face when the upgrading takes place. Sheela Patel was also asked to comment on how the slum upgrading process can be transferred to smaller secondary cities.

In response, Sheela Patel stated the goal of the savings scheme was to demonstrate the willingness of the poor to participate in exploring housing solutions. It required volunteers to collect savings from 15 to 50 households. These savings would come from their leftover income, and the women borrowed from that. It created financial literacy among poor illiterate women. The transactions were documented and published at the community centre.

The result was that the savings led to the financing of goods and services that were previously unaffordable. It also created credibility for women collectives. Gradually, as their needs exceeded the savings that were being mobilized, external lines of credit were sought.

She also explained that the alliance operates among the bottom 20 percent of the population. She reminded the seminar that people opt for collective effort not for its own sake but because they see their own powerlessness as individuals. The resulting demonstration and their experience of the benefits is what sustain collective effort. Touching on the issue of replication, she stated that fifty percent of the construction is in small towns. Usually, it is success in small towns, which enables replication in larger metropolis.

Anil Kumar, ICICI Bank, India: Innovative financing models for Community Led Initiatives for micro housing and slum infrastructure

He presented an Indian bank's experience of some of the innovative financing models used in community-led initiatives for housing and infrastructure provision. In his opening remarks, he stated that 11 percent of the world's urban population is in India. Three of the ten largest cities in the world are in India and 35 cities have a population of one million each. In 1994, the population of the urban poor was 76 million. This has led to a huge demand for housing. In urban areas, the housing deficit stands at 17 million units and reduction of this deficit will require an investment to the tune of $34b. Moreover, 40 million of the urban poor have no access to toilet facilities.

Bank and home finance companies' lending to housing has expanded steadily over the past five years. The value of residential mortgage debt increased from $1.84b in 1994 to $12.26b in 2004. Interest rates have fallen from 17 percent per annum in 1996 to 7.5 percent per annum in 2005. The bulk of the clientele are salaried and self-employed people.

In spite of this expansion of residential real estate finance, the poor have been left out. Banks simply do not find it lucrative to directly finance slum housing projects. Most of the finance for the urban poor comes from government coffers. The poor can only access funds from informal lenders at exorbitant rates. Limited access to housing finance, coupled with the inability of the private and public sector to provide affordable housing has led to a housing crisis. The mushrooming of shantytowns, the most visible sign of the widespread poverty, puts large populations at risk.

Anil Kumar introduced three financing models being used to finance housing and infrastructure for the urban poor in India:

- For slum housing rehabilitation, the Transferable Development Rights (TDR) model is being used. It involves an investment of $18m and will be used to build 2,164 tenements for the beneficiaries, 81 society offices or welfare centres, covering an area of 787,090 square feet. It will last for two years.

- The Urban Local Body (ULB) linked model for the construction of a $10m, 320-toilet block project in Mumbai's slums by Mumbai Municipal Corporation for the same duration.

- The Kudumbashree5 model, which contains a housing micro finance scheme

[5] The State Poverty Eradication Mission – Kudumbashree, launched by the State Government of Kerala with the active support of Government of India and NABARD – aims at eradicating absolute poverty by 10 years under the leadership of Local Self Governments.

With regards to partnership replication, he stated that a few NGOs, SPARC, IASC, Gram Vikas, and Kudumbashree are involved in housing and sanitation facility provision. Besides, these partnerships depend on the reputation of the NGOs. He identified the following as the constraints facing NGOs in their attempts to partner with the banks: they have poor balance sheet and finances and experience difficulties in benchmarking. Besides, they engage in unsecured lending.

Anil Kumar identified the following factors, which mitigate the constraints: implementation strengths, the credibility of the specific organization, customized products like Escrow accounts, letters of credit, leveraged guarantees and bridge funds.

In conclusion, Anil Kumar suggested the following models, for the future:

- Group model6, in which five to fifteen individuals pursue their own micro enterprise activities and provide joint guarantees for each person's loan.
- Urban housing cooperative model
- Savings led model (tried in Europe). The savings-led approach emphasizes asset building rather than the creation of a larger base of debt, one of the most prevalent obstacles facing the developing world
- Guarantee funds to share risk

Discussion

One participant wanted to know how they manage administrative costs and mitigate risk at once. Per Ljung remarked that SPARC projects depend on government payments with implicit and explicit subsidies. He thus wanted to know how this would work when they make the transition to more permanent financing.

In response, Anil Kumar disclosed that administrative costs and risks more pertinent for retail loans. He further explained that the loans in question were bulk loans with low transaction costs.

[6] The Group Model's basic philosophy lies in the fact that shortcomings and weaknesses at the individual level are overcome by the collective responsibility and security afforded by the formation of a group of such individuals. The collective coming together of individual members is used for a number of purposes: educating and awareness building, collective bargaining power, peer pressure etc.

Cedric de Beer, National Urban Reconstruction and Housing Agency (NURCHA), South Africa: Blending donor and commercial funding: Financing construction entrepreneurs and promoting economic renewal

He started with a number of preliminary comments: He expressed his gratitude to Sida for the events of the previous evening. He also disclosed that he had a five or six page paper, which covered more explicitly what he would present and offered to have it mailed to anyone who was interested in it. He then commended the speakers of the previous day for the quality of their presentations and indicated he would make reference to some of that in his own presentation.

He recounted how much of a puzzle South Africa is for donor agencies. Even though some, and Sida in particular, had a very committed and a commendable history of principled opposition to apartheid and support for the liberation movement over many decades, something rather strange and odd happened in a very short period of time. From 1989 to 1994, there was a rapid transition from dictatorship to a model democracy. The speed of the transition took many by surprise. In his opinion, the confusion for the aid agencies was that South Africa being a middle-income country with a highly developed economy with vast amount of natural resources, had and still has a very vast gap between the rich and the poor. This is what presented challenges for development agencies. In telling the story of NURCHA, Mr. de Beer wanted to present an experience of how donor funds are being used to achieve things that are of lasting benefit to the society.

NURCHA, National Urban Reconstructing Housing Agency, was founded in 1995, as a non-profit company, a joint venture between the South African government and the Open Society Institute of New York (OSI), which is part of the Soros Foundation. It is now a public entity, which means that, although they are independent, they are accountable to the Ministry of Housing for the use of government funds that they receive. They were established for the task of attracting banks back to low-income housing7.

The mechanism was in the form of a 50 million dollar guarantee. It was not cash but letters of credit that NURCHA had to match by 3 to 1. Sida was the first donor to help liberate some of theses resources from the Open Society Institute. Very rapidly their task moved from attracting banks to low income housing to specifically enabling contractors who are involved in building low income housing, and in particularly housing built on time with subsidy to excess project bridging finance via guarantees.

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[7] He drew attention to the highly political nature of housing in South Africa and its roots in apartheid. Apartheid resulted in unequal access to housing and loans and also influenced the attitudes of the banking sector.

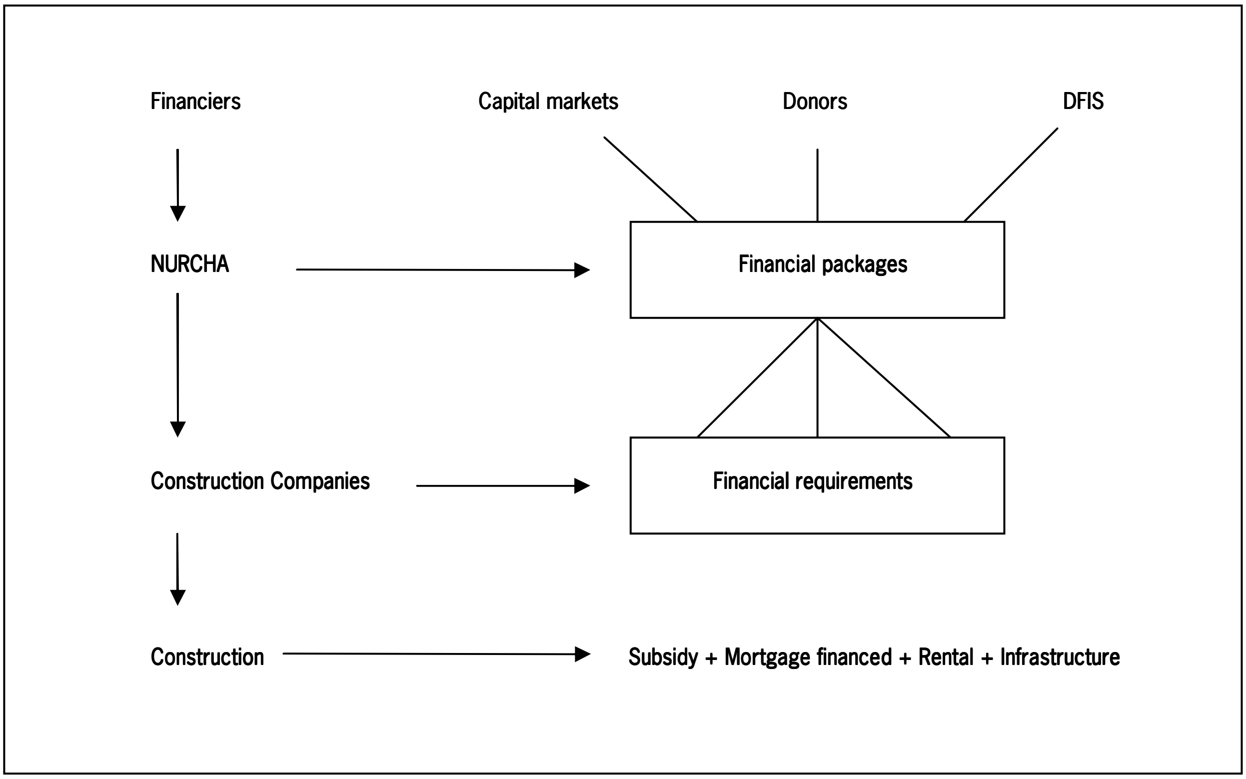
He disclosed that their current mandate is to ensure the availability of project bridging finance to small and medium size contractors and developers who are building houses, infrastructure and community facilities necessary for the development of sustainable human settlements.

Since 1996 NURCHA has supported 700 housing projects with bridging finance. Those projects contained 175 thousand houses of which 155 thousand have been built, with NURCHA facilitating these projects to the tune of 3.2 billion Rand. This represented about one tenth of the housing delivered in South Africa for the low income housing in the preceding eleven years. De Beer noted the South African government itself provided subsidies for housing, and about 1.5 million houses have been built or are currently under construction.

The important point about that according to de Beer was that although there was obviously a project aim to provide shelter to many people without shelter or with inadequate shelter, the project is increasingly becoming part or the economic development strategy of the government. The contracts to build those houses are being given to black entrepreneurs, previously excluded from the economy and from business opportunities in South Africa in order to lay the foundation for the growth of a new generation of construction entrepreneurs.

Mr. de Beer gave account of two very important transitions in the process: Firstly they started off providing guarantees to banks for overdrafts to contractors. They found this was not a good way to finance contracting, especially for people who had very limited business experience. They then switched to guaranteeing a portfolio of much more tightly managed loans with one or two financial institutions that were willing to experiment with them in creating a learning process that was more controlled and was better managed. That worked well for a few years, until they overreached themselves, got too ambitious, forgot the rules that had been established and the program went bad. Quite a lot of money was lost in the process.

The next stage was to move to a process of making loans to contractors themselves. NURCHA now raise money from banks in order to be able to lend to the contractors and to developers. He stressed at this point that what was worth recounting was the process of raising commercial funds in order to execute the project and the absolutely critical role that the donor finances played in that process. He then used the diagram below to illustrate the idea behind the financing process.



NURCHA's role is to create a relationship between the financial institutions and the construction companies by packaging finance in ways that creates the risk profile that the financial institutions are willing to accept and which will gradually turn into a commercial activity rather than remain a donor funded activity.

He gave two examples of this financial practice, to explain how NURCHA has done this. First there is a program support with guarantees from Overseas Private Investment Corporation of the United States (OPIC) and the Open Society Institute (OSI) who, between them, put together a $20 million guarantee, into one of South Africa's largest four banks.

NURCHA draws funds from this 200 million Rand (R200m) revolving credit facility and lends the money through a series of intermediaries, which are simply administered by paymasters who administer the loans that NURCHA makes to contractors. The administration of some aspects of those loans is outsourced and the funds go to the contractors. Into this mix they needed to put a first R20 million grant first loss guarantee, using some of the original Sida funding from 1996, which provided a credit enhancement to OPIC.

Cedric de Beer presented another financing model, which they completed at the beginning of 2005. He characterized it as a bit more complicated than the previous one and involved the contractors, the First National Bank (FNB), NURCHA, and OSI (a NURCHA subsidiary). OSI gives a guarantee of R5 million to FNB who, in turn, gives out a R85 million revolving loan to the NURCHA subsidiary who then gives out the loans finally to the contractors. NURCHA puts in R20 million which effectively are subordinated to equity. The beneficiaries are contractors with a little bit more experience, who can put up some risk capital, with three years of financial statements, so the process of the loan is different.

He concluded by stating that there is a virtuous cycle through the use of donor funds. In the first place, donor funds provide credit enhancement, making it easier for the financial institutions to lend. Secondly NURCHA has developed risk management systems that are considered state of the art in terms of highly controlled cash flows for black contractors with limited experience. Very important in the South African context for the last couple of years is the political pressure on the banks to show that they are interested in the transformation of society for a new kind of economic order.

A combination of the ability to release commercial funds, a track record of successful lending by financial institutions willing to take part of the risk, and the risk management done by NURCHA have resulted in significant reductions of the risk premiums. This led to the release of more commercial funds. He conceded that it would be premature to claim this was a commercial success since they had not considered administrative costs. He concluded by stating that their operations were a creative way of using donor funds and commended Sida for being the firs donor outside George Soros to participate in the process.

Discussion

The first question was about the fraction of total construction that consisted of rental housing. Malcolm Harper wanted to know if their main aim is to develop new contractors or build more houses, and the extent to which the latter goal is compromised. Diana Mitlin stated this was a good description of how donor funds enable a potentially commercial, but essentially a political opportunity to put pressure on the banks to lend to the housing sector, to show them how they could do so commercially, rather than philanthropically. She added this was always how she had heard some African banks described towards the end of the 1990s. But she wanted to know if there could be continued justification of the use of donor funds given that there is no shortage of internal finance in a country like South Africa.

Sundar Burra wanted to know if they finance green field development or if there was any element of slum upgrade. Another question was related to the role of subsidies from the government, how it is managed, and the extent to which it interferes in the process.

Starting with the question of subsidies, Mr de Beer disclosed that the houses are built with government subsidies. The government does not release money to the contractors in advance for the houses. So the question is how the contractors get the work done so that they can be paid. By and large that means they need to borrow money. He was of the opinion that government should pay NURCHA to administer the subsidies rather than to turn to borrowed money to the contractors, but indicated they were currently not willing to do that.

He conceded that they were not leveraging funds for the poor in the sense of attracting additional money for housing. The South African government was committing five or six billion a year for houses. NURCHA's hope is to achieve a couple of objectives at the same time. One is to provide housing. The other is doing it in a way that creates a new successful generation of entrepreneurs. He pointed out that these goals are not mutually exclusive, even though there may sometimes be a tension between them. This would lead people to think that it would just be better to pay the big construction companies to come in and build, but what is left behind is an opportunity to transform the economy and provide access into the entrepreneurial class that would not have been there without this kind of support. Furthermore NURCHA does not just lend money but creates cash flow controls, financial management controls, costing exercises and administer the support effectively, becoming the back office of the contractors. He also argued that job creation and entrepreneurial development is a contribution to reducing poverty.

In response to whether continued participation of donors could be justified, Mr. de Beers stated that at some point that will have to cease. He indicated that internal equity would be forthcoming to sustain the process. He also stated they do not do a lot of rental housing. They have financed some, but most of their lending is of much longer term than that. They have short-term investments with another sister organization that does finance rentals.

Concerning risk, he disclosed that they have a complex system in place to ensure that the money is released only when work is already done. This would mean that it was money already due to be paid.

Michael Mutter: Slum Upgrading Facility (SUF), UN-HABITAT, Nairobi, Kenya. Field-testing design instruments for financing slum upgrading

His presentation was on field-testing design instruments for financing slum upgrading. He stated in the beginning that details of the presentation were contained in a paper he had provided. He described the UN-Habitat Slum Upgrading Facility as a new global facility at the UN headquarters in Nairobi. Its goal is to demonstrate that housing development or upgrading projects can access domestic capital markets for loans. In the context of the Seminar, he explained its relevance by stating that slums are growing at an alarming rate in developing countries and their improvement is part of the Millennium Development Goal 7 target 11 requiring sustainable finance; that is, preventing new slums through a massive scaling up of the provision of planned serviced land for housing development with finance within reach of all citizens.

He then described the various stages of introduction of the SUF: design, field-testing and pilot phases. At the design phase, they created an instrument as a financial product, instrument or security that is able to attract and utilize local private financing from a country's domestic capital market.

He defined SUF field-testing phase as the design, introduction and implementation of this design instrument to assess its feasibility. The field-testing was carried out in ten countries located in four regions: West Africa, East Africa, South Asia and Southeast Asia, which allowed them to come down to four countries: Ghana, Indonesia, Sri Lanka, and Tanzania. They believe these countries are the ones that are the most ready for them to carry out these experiments. When these experiments succeed they will be extended to other countries in the respective sub-regions.

He disclosed that they were ready to enter into the pilot phase at the beginning of 2006. When they move from the design phase to the pilot phase, the way in which SUF is funded will change. During the design phase it was mostly DFID and SIDA putting some finance up-front for developing the program management unit dedicated to the SUF. At the pilot phase they will have a collaborative funding process with the Cities Alliance.

He then proceeded to describe the various financing mechanisms, the first three of which, once they are put together, offer huge advantages in attracting domestic capital:

- Accessible low-income housing and home improvement loan products, which is being undertaken in Ghana with HFC Bank, with National Development Bank in Sri Lanka, and in Indonesia.

- Credit facilities for housing cooperatives for retailing amongst members such as with TAWLAT and Azania Bank in Tanzania, and with CoBILD in Indonesia; likely also in Kenya, Sri Lanka and Ghana.

- Special Purpose Vehicles (joint venture development companies able to raise debt finance – loans and bond products on local capital markets) that can spearhead housing developments with Housing Cooperatives. The Government of Kenya is developing this with SUF inputs for the Kenya Slum Upgrading Programme (KENSUP).

- Enhanced revenue streams to service debt instruments for municipal-led slum upgrading and associated infrastructure, as in Accra Metropolitan Authority, Ghana; and in Lusaka, Zambia.

- Municipal Bonds for investments in housing land development, related infrastructure, and slum upgrading – an outcome of Type 4 in Accra, Ghana, and Lusaka, Zambia,

- Credit Enhancements for lowering the perceived risks to any of the above (as with the TAWLAT Loan Guarantee Facility), for example the case of a proposed shared-risk Development Fund in Sri Lanka subscribed by SDI, SUF and the Municipalities.

- Guarantee facilities for any of the above lending products – USAID's Development Credit Authority could support the Accra model, and GuarantCo may support in other places.

He then cited a case study they made of Sri Lanka. He explained that the reasons for choosing Sri Lanka, as a case study, form the guiding principles for introducing a SUF in any country. In the first place, the beneficiary country must have a relatively sophisticated, stable and liquid capital market. It must also have an organized local government system that promotes slum upgrading projects. Finally, there must be innovative local community based organizations that sponsor saving schemes that can mature into housing cooperatives for housing development projects.

Discussion

Per Ljung wanted to know the difference between the Municipal Special Purpose Vehicle and, say, a traditional national housing corporation. Diana Mitlin wanted him to clarify if subsidies were not needed in the process. Rajivan Krishnaswamy indicated he had two questions, one on the supply side and one on the demand side. Taking the example of Ghana, the longest maturity government bond is, typically, for three years. What he wanted to know was how they could get the capital market to finance a 10–15 year infrastructure projects. On the demand side, he suggested there would hardly be an institution that is willing to enter a joint venture with a municipality. Malcolm Harper wanted to know if they implemented pilot projects or if they only advise.

In response to the question of if any difference exists between an MSPV and a national housing corporation, he stated that the difference was minor. He pointed out that they were not promoting any one of these or even suggesting there has to be a sequence between all of the instruments he listed in his presentation. These are opportunities that can be applied if the circumstances are right.

National housing corporations are not able to access the capital market in any of these countries due to the confidence element. The municipalities they have observed are introducing more focused, easier to run processes that capital markets find it easier to finance. He also suggested that municipalities are relatively less susceptible to political pressure from central government.

On the issue of subsidies he indicated that in most circumstances, one would want to see how the national environment and its subsidy systems would fit in with the products that are being designed in those four countries.

He acknowledged Krishnaswamy's concerns using Ghana as an example; but he pointed out that they were not necessarily advocating a particular product but introducing a number of alternative financing options. Furthermore they want to investigate where projects can develop with a range of options and opportunities that relate to the capital markets.

In response to Malcolm Harper, he explained that what they do is to provide the focal point for the packaging activity. They are not building a large work force within UN-Habitat. There would be a pilot team of four people covering all of the operations in the four countries and in the neighbouring countries that may come on as funding becomes available.

Alfredo Stein, Programa de capacitación para el Mejoramiento Socio Habitacional (PROMESHA), Sweden: Financing the poor, harmonising the donors: lessons from Central America

He started his presentation with an explanation of the need to discuss the issue of donor harmonization. In his opinion, harmonization is important because of the transition from project-based support to sector-wide program approach (SWAP) and ´budgetary support´ in the development assistance process. This is because he believes harmonization would lead to reduced transaction costs, increased flexibility of development assistance disbursement and delivery as well as the achievement of a better fit with the priorities of the recipient country.

He expressed concerns about the need to ensure that this process actually achieves social equity, and that the financial rationality that is being set up in this budgetary support is actually compatible, or at least does not prevent the attainment of the needs and priorities of the poor.

Alfredo Stein justified the use of experiences in Central America by saying that this part of the world has seen a lot of collaborative efforts by bilateral and multilateral agencies working in low income housing and infrastructure, which presents great opportunities for analysis. Central America also demonstrates the impact of the harmonization process on the financial sustainability and operation and institutional capacity of the recipient executing agencies. This analysis therefore would allow an identification of key issues related to the harmonization process that are required between the transition from project support to budgetary support.

Like many parts of the developing world, Central America is also experiencing rapid population and urban growth, with serious disparities in access to wealth and land. There are inadequate infrastructure and services. Moreover these economies are plagued by corruption and lack of transparency. There was also massive environmental degradation, and that became very evident with Hurricane Mitch in 1998 which, in the case of Honduras, produced 12,000 deaths, the destruction of 50,000 houses and 1700 water systems.

Alfredo Stein identified the following difficulties of reconstruction that were encountered during the housing reconstruction process:

- Acquisition of suitable and uncontested land for resettlement
- Installation basic infrastructure and services
- Systems for evaluating projects and issuing environmental permits were almost nonexistent
- The absence of planning and construction standards and codes

- Unclear criteria to determine who was eligible for assistance
- No clear criteria for deciding on temporary versus permanent solutions
- Aid organizations with little or no prior experience in the country
- Competition between NGOs for donor resources, for land and even beneficiaries
- The introduction of schemes that generated passivity among recipients
- Conflicts between those families that were affected by Mitch and historically poor families that had been excluded from many housing processes
- Little or no reflection on what was happening

Alfredo Stein then described two specific housing programs in Honduras, one rural and one urban, which were supported by KfW[8] since the early 1990's. As a consequence of Hurricane Mitch, Sida entered into the reconstruction process, taking advantage of previous experiences of programs in Costa Rica, Nicaragua and El Salvador, and started supporting these two programs. The two donors (KfW and Sida) also started collaborating.

Drawing on his experiences as a Program Officer at that time at the Embassy of Sweden in Honduras, he explained how they wanted to show that incentives for cooperation, cost sharing and cost recovery could create long term sustainable finance and institutional models. KfW and Sida also wanted to show that it was possible to create consultation with beneficiaries and local government in arriving at better housing solutions.

Using a chart he showed that, in the beginning KfW was only giving resources to revolving funds for new housing and improvement to those two programs. When Sida joined the process, the idea was also to test new packages and new products. They wanted to use the reconstruction process to test the housing subsidies and resettlement, and also test how governments could focus public resources. The result of this collaborative scheme between KfW and Sida was the transforming of these programs into a public foundation that is currently called FUNDEVI.

Elaborating further on the objectives of their collaboration, Alfredo Stein explained that they wanted to take advantage of the reconstruction process not only to reconstruct houses but also to transform the institutional structures that existed on a more permanent basis. FUNDEVI was thus an institutional public

[8] A German financial institution

foundation that resulted from two programs: PVMR and PRIMHUR.

The subsidy scheme was tested and new financial products were introduced such as micro credit and infrastructure financing. This was accompanied by demands on the executing agency for the harmonization of procedures and reporting routines. They also started working together with this now transformed institution in trying to influence policies that will allow housing to become part of the Poverty Reduction Strategy (PRS) because until that time housing and infrastructure, especially in urban areas was totally neglected. They also saw that it was important to strengthen the institutional capacity of governmental organizations so that they were more able to work with low-income housing.

This later opened the door to the participation of the Inter-American Bank (IADB). They had a program that was approved in 1999. However, for 3 years the institutional framework that would channel the resources did not exist. What was important was that this collaboration of Sida and KfW, two bilateral agencies with a very important executing agency, also opened the door for a multilateral agency to come and put resources into this process.

Alfredo Stein disclosed that IADB had given resources for housing subsidies and technical assistance to the housing sector in Honduras. In addition, there was a new set of products including housing improvements and construction, as well as micro credit, infrastructure and basic services. This also created an opportunity for expanding collaborative efforts between Sida, IADB and KfW and other donors, channel resources not only to the housing sector but also other social sectors in Central America.

Using examples from Honduras, El Salvador, Nicaragua and Guatemala, he showed instances of collaboration between Sida and a number of other donor organizations in various housing and infrastructural projects.

Alfredo Stein devoted the last parts of his presentation to the lessons learned about the harmonization process. Firstly, when donors come together they can scale up and make an impact if they have a good program or executing agency, without necessarily providing budgetary support. Disasters can also be opportunities for institutional and financial change. He believes that it is possible to harmonize procedures at executing agencies if donors agree beforehand on common objectives.

He warned against an impulsive transition from project support to budgetary support since it could lead to lost possibilities of accountability and transparency. It is also important to recognize the comparative advantage of bilateral agencies that multilateral agencies can take into consideration when scaling up, but he advised recognition of a lead agency. He acknowledged that it could be difficult for multilateral agencies to recognize that a bilateral agency can also be a lead agency.

He drew attention to the need to deal with disbursement pressures. Citing an example of Honduras he explained that because of a three-year delay in the implementation of an IADB program they were under pressure to disburse in two years what was supposed to be disbursed in four years. That creates a lot of pressure in the executing agencies that sometimes could have a long-term impact on their financial sustainability.

Alfredo Stein advised timely reimbursements. Using examples from India and Central America, he explained how this works: an executing agency starts financing the multilateral agencies. Instead of having set capital to start with, the executing agencies usually try to give them funds, which take a long time to recover from the multilateral agency. He also called for good governance and leadership structures at the institutional level of the executing agencies as well as a common vision between the field offices and the headquarters of an agency.

Discussion

The first question was about the vision of an organization like FUNNED and the risk that it might lose its focus in an attempt to provide too many products. Diana Mitlin made a number of observations and asked a number of questions. The first concerned the donor harmonization process. She acknowledged that different donors seem to be seeking different development strategies at a global level based on different models that are sometimes disputed within Europe and North America. She wanted to know whether that posed a difficulty in the course of what they were trying to do or if that is what he alluded to when he touched on the conflict between the field offices and headquarters. She also wanted to know if they, as the executing agencies, have at times felt their room for maneuver being constrained, because instead of dealing with individual donors they found themselves dealing with a much more coordinated and coherent group of donors.

Alistair Wray also made a number of points. He started by acknowledging that bilateral donor working together can do a lot in terms of promoting harmonization and the use of grant founds to strengthen harmonized systems. What he thus wanted to know was the extent to which the grant funds are also utilized to leverage other forms of finance. With respect to the benefits of going from projects to harmonized programs as a step on the way to budget support, he also wanted to know what steps are actually taken in the countries that they are working, in terms for preparing the ground for budgetary support. Another participant also drew attention to the need to discuss issues of people participation.

In response, Alfredo Stein explained that the vision of FUNNED is to be a financially sustainable institution with or without subsidies.

In terms of the impacts of donor consortia, demanding purely financial indicators of viability is too narrow. He also stressed that financial sustainability requires a lot of other complementary issues including participation of the poor who, at the end of the day, make key important financial contributions. He expressed concern that these programs will become more and more irrelevant if this idea of budgetary support prevails, because nobody would be interested in setting up these structures. Development agencies would become more directly involved with governments and finance ministries, instead of poor people.

3. Groupwork

The aim of the group work was to look at how to make finance for housing and infrastructure available to the urban poor. For that purpose, seminar participants were divided into groups. Each group was assigned a moderator to facilitate the discussion and present the group comments in the plenary. Each group discussed the questions assigned to them and selected a limited set of comments for the plenary presentation. Groups were also encouraged to discuss the differences/similarities – and related issues and implications – between finance for housing and finance for infrastructure. The following is a summary of the plenary presentations.

Question A: The role of financial institutions and markets

- How can commercial lenders be encouraged to make finance available for housing and infrastructure for the urban poor?

- How can local private savings (individual savings, remittances, pensions, etc) be mobilized by financial markets to provide finance for housing and infrastructure for the urban poor?

A basic distinction is the difference between public and private goods. Infrastructure is a public good and individual housing is a private good. The urban poor really need slum upgrading. Unfortunately, the market does not provide all the financing required and the collective assistance is poor.

Questions to be made:

1. Is there a real business case to be made? (Usually not if the financial market is not developed)
2. Is there an enabling central bank/regulatory framework?
3. Are there other frameworks in place: land tenure, city development strategies?

Regarding public goods, it is important that municipalities are efficient (e.g. tax collection managing finance) and that there is effective and reliable devolution of power. Some of the key issues are demonstrable and credible revenue flows, as well as package information. Some of the key issues regarding private goods are easily accessible information. a recognition that risk has to be shared, credit enhancement and a "champion" state-of-the-art bank.

It is important to pick winners and generate learning. It has to be recognized that the wealthy should not be subsidized and that playing field should be level (e.g. through tax incentives). In addition, the need for a continuum of credit enhancement and financial products should be recognized. If financial markets are not developed, then structured financing should be created with risk being managed at different levels.

The groups ended their joint presentation with a proposal:

Get the "information story" out. Document existing lending arrangements to identify how risk had been analyzed, mitigated and managed up-front. Disseminate this information to both lenders and borrowers. It is much more credible to use practitioners as the agents.

Question B: The role of donors

- What is an appropriate role for donors to increase finance for housing and infrastructure for the urban poor?
- How can international development finance institutions collaborate with financial institutions in our partner countries to increase access to finance for housing and infrastructure for the urban poor?

The first group stressed that, in general, donors should stay out as much as possible so that change can come locally. If needed, donors should support triggers of change. Donors also need to learn from their own history.

There were many options for donors: (1) Work at the individual level only; (2) Bridge finance and guarantees; (3) Capacity building of local organizations which can interface and work with formal institutions; (4) Support government in more efficient delivery of infrastructure (governments as facilitators); (5) Influence policy processes (corruption/weak government); (6) Could promote the notion of capital cost. Usage should be paid by users and maintenance by government.

The second group highlighted out the differences between finance for housing and infrastructure. The following are key issues for collaboration between donors and local finance institutions regarding housing finance: (1) Commercial funding and viable models; (2) Demonstration and pilot projects; (3) Capacity building; (4) Need to strengthen legal frameworks; (5) Bridge funds; (6) Partial guarantees; (7) Harmonization from donor to client level; (8) Land title related issues – title insurance; and (9) Subsidy of housing delivery costs.

Regarding infrastructure finance, there are no easy self-financing models and must utilities are actually unviable. Moreover, it is important that that the role of each stakeholder (e.g. NGOs, finance institutions, donors, governments, and clients and communities) is clear. The following are key issues for collaboration between donors and local finance institutions: (1) Help commercial model formulation; (2) Learn from experience and political culture; (3) Attract private sector participation; and (4) Decentralization difficult since municipalities are unable to tap funds (Low credit ratings).

Question C: The role of governments

- How can governments design efficient housing subsidy schemes to encourage housing finance without distorting the market?
- How can national governments enable municipalities and communities to improve access to finance for infrastructure?

The first group highlighted three issues that governments should consider:

First, the need of decent policy for government development. Important factors are: (1) An inclusive policy (Government, municipalities, communities, private sector); (2) Enabling framework for local solutions; and (3) A government commitment for implementation (Including changes in the legislation).

Second, the need to learn from experience. There are a few mistakes that should not be repeated: (1) Separate housing from poverty policy; (2) Separate infrastructure and land from housing; (3) Do not think small; and (4) Expect poor to pay bulk.

Third, a set of minimum requirements must to be in place or the project should not be initiated. The issues that governments should not forget were: (1) Target the poorest (not only the poor but the poorest); (2) The aspirations of other interest groups; (3) Target projects; (4) Drivers of change; and (5) To monitor and apply lessons.

The second group made the following recommendations: (1) Target subsidies to the slum (infrastructure); (2) The subsidies should be direct; (3) Design subsidies that will increase opportunity for the poor (supply and demand); and (4) Collective actions for information dissemination.

They also discussed how national governments can enable access to finance for infrastructure. There is a need for: (1) Setting an environment with stable, predictable, transparent transfers from national to local governments; (2) Including incentives for local governments to increase their revenues (also as a means to borrow capital for infrastructure investments); (3) Incentives for local governments to improve accountability for service delivery (including mechanisms in the "city council" to prioritize investment needs; and (4) Create regulated pooling mechanisms for "small" towns and "small" infrastructure investments.

Question D: The role of local communities

- What can local NGOs, communities and individuals do to mobilize finance for housing and infrastructure development?

- How can local NGOs, communities and individuals identify and apply good practices and methods for financing of housing and infrastructure development?

The first group pointed out the role of NGO's is to assist the community to organize, train, design solutions and dialogue. The role of NGO's varies due to size, time, and location (rural or urban). Some NGO's also have the capacity to negotiate with lenders should the community already be organized. In addition, NGO's can also be effective in tackling corruption as it can (1) Put pressure on politicians; and (2) Address transparency. Transparency should be demanded not only from companies, but also from politicians. Furthermore, can also help to mobilize communities by, for instance, sorting out security issues and informing the community on the perception of risk which financiers are facing as well as assist in calculating the cost of the project.

The group had a special discussion on whether NGOs and community based organizations (CBOs) are more cost-effective than municipality. The group concluded that there is no generic difference, not even regarding larger projects.

NGOs can have an important role in providing training on issues that improve opportunities to access credit; such as technical skills, lending practices and savings schemes.

NGOs, municipalities and individuals all have important roles in improving housing situations and they need to work together. Yet even communication between NGOs within the same city is often poor. In addition, modern technology could enable improved cooperation. Another issue is that NGOs tend to be working in too many different networks and there is therefore a need for a network of networks.

Finally, NGOs often need to learn how to overcome legal constraints in financial transactions. There is a general lack of legal and fiscal empowerment of NGOs/CBOs on the local level.

The second group discussed how to mobilize finance for housing and infrastructure: (1) Access saving schemes; (2) Organize communities; (3) Show they are able to payback; (4) NGOs: assistance to formulate business plans; (5) Leverage of savings to tap subsidies; and (6) Work with community organizations that exist.

The following instruments could be used to apply good practices and methods: (1) Accessing information; (2) Use Internet/Promote Exchanges; (3) Knowledge sharing (through NGOs); (4) Peer levels exchanges and confidence building Increase training; and (5) Use effective demonstration models (housing exhibitions) to influence policy change.

How should the recommendations be used: (1) Next World Urban Forum; (2) Improve interactive Habitat Jam structure; (3)

Participation in professional financial meetings; and (4) Use capacity building programmes at, for instance, universities and institutes. Moreover, the group felt that it is important to use positive experiences such as, for example, CLIFF and SUF in Asia and Africa, and the Sida-supported Central American programs on housing and infrastructure finance. It is also important to support dissemination instruments such as (1) IIED (The Journal on Environment and Urbanization; HiFi News); (2) HDM Building Issues; (3) Global television (Television Trust for the Environment (TVE)) as well as to prepare films for the 'Hands on' series within the Earth Report.

This group also presented a table depicting the possible actors (NGOs, communities and/or individuals) in collating some specific financing instruments for both housing and infrastructure investment.

Table 1: Actors for housing and infrastructure investment compared to various financing instrument

Actor / Instrument	NGO's	Communities	Individuals
Savings		X/Y	X/Y
Loans	X	Y	X
Remittances	X	Y	X
Matching funds	Y	Y	
Bridging finance	X/Y	X/Y	X

(X) = Housing; (Y) Infrastructure

4. Panel Discussion

The panel consisted of Franck Daphnis, Sheela Patel, and Diana Mitlin. Barbara Lee indicated at the outset that it was a not a Q&A session, but rather an opportunity for participants to share their reflections and experience, especially based on what had been discussed during the Seminar.

Franck Daphnis opened the discussion by acknowledging the professional benefits of the Seminar. He pointed out that very often, micro finance has been done in isolation. He was, however, gratified to note that its scope and role has been expanding over time. He also noted how interconnected all the presentations have been, citing as an example, the SUPs in India. He stressed the need for all to recognize that urban finance for the poor requires different players acting together. He expressed the hope that the convergences and knowledge that have been demonstrated can be sustained and disseminated within the development community.

Sheela Patel acknowledged the power of bringing together professionals from different disciplines – the synergies created lead to the generation of new knowledge, relationships, viewpoints and solutions. She expressed the hope that this process will continue. She disclosed that the CLIFF process committed itself to forming a partnership to explore options of involving the poor in solving their own problems. She went further to challenge the development agencies to go beyond individual, geographically dispersed projects and solutions. She also called for research and dissemination of knowledge on risk sharing in micro finance.

Diana Mitlin acknowledged the diversity of disciplines represented during the Seminar, the depth of experience of the participants and the quality of their presentations. She requested the preparation and dissemination of an e-mail list of the participants. She indicated her appreciation of the complex nature of the urban finance problem and expressed her desire to deepen her understanding and extension of its relevance to all communities around the world.

Anil Kumar expressed the hope that the Seminar will elicit follow up action from international organizations, especially Sida. Gabriel Marin-Castro expressed the same sentiments. Malcolm Harper observed that India and South Africa's financial systems are very strong, making their situations a little unique in terms of their ability to mobilize internal finance. He indicated his desire to learn about how things play out elsewhere in the world.

Ruth McLeod urged the group to join up and build on existing solutions rather than constantly inventing new ones. She expressed the fear that the focus on urban poverty is slowly disappearing. Kathleen Wu, on her part, indicated she would have liked to share more success stories from USAID programmes. She reiterated USAID's preparedness to collaborate with other donors in different fields. She disclosed the establishment of a new Global

Development Alliance, a sector-flexible funding scheme. Mark Hildebrand urged caution with respect to what is known about urban finance and its impact – he urged more focus on land and finance, arguing that this would help clarify the criteria for success. He also expressed the need to expand the options on finance. He agreed with Ruth McLeod about the weakening focus of some donors on urban poverty.

Alistair Wray called for more interdisciplinary communication between the various actors, as well as an increase in the knowledge base on housing, land financing and infrastructure across different regions in the matrix format. Robert Buckley stated how important it is that slum and upgrading issues need to be discussed together. He also stressed the need to make risks as explicit as possible among institutions that engage in urban finance.

5. Closing Remarks

Thomas Melin, Urban Development Division/Sida, Sweden

He thanked the moderator Barbara Lee and commented that this was the first joint seminar between the Urban Development Division and the Market Development Division of Sida. He expressed his satisfaction with the quality of the presentations, all of which he said has shown the complexity of the issues discussed. He disclosed that Sida's rationale for hosting the Seminar was to create an enabling environment for sharing good and positive experiences.

Thomas Melin explained that land issue was omitted because there had been a seminar two weeks earlier about land. He stressed that the urban finance issue is not a single problem requiring a single solution. He also drew attention to the challenges of donor harmonization and the substantial changes it will entail. Moreover, participants were invited to engage themselves more fully in the practical implications of the issues discussed in order to have a discussion of progress made during the upcoming Seminar in Canada. He concluded by challenging the participants and the organisations they represent to be ambitious in tackling the issue of urban poverty.

Appendix 1: Seminar Programme

14 December	
0830–0900	Registration
0900–0915	Moderator Barbara Lee opens seminar
0915–0930	Rolf Carlman: Welcome speech
0930–1020	Diana Mitlin: Urban finance and the global challenge of poverty reduction
1020–1110	**Coffee break**
1110–1140	Stig Jonsson: Urban finance to the poor in a bank perspective
1140–1210	Kathleen Wu: Leveraging Local Capital for Urban Infrastructure
1210–1240	Mark Hildebrand and Rajivan Krishnaswamy: Empowering Cities to Finance Infrastructure
1240–1400	**Lunch**
1400–1430	Malcolm Harper: How can Micro-Finance Institutions access the funds they need to scale up and satisfy the needs of the urban poor?
1430–1500	Franck Daphnis: Housing Microfinance: The State of the Practice and the Way Forward
1500–1530	**Coffee break**
1530–1600	Sheela Patel: Wooing financing for slum housing and infrastructure – Risk, trust and relationship management by the organized urban poor
1600–1630	Anil Kumar: Innovative financing models for Community Led Initiatives for micro housing and slum infrastructure
1900	**Buffet dinner at Mariahissen**

15 December	
0900–0910	Moderator Barbara Lee re-opens the seminar
0910–0940	Cedric de Beer: Blending donor and commercial funding: Financing construction entrepreneurs and promoting economic renewal
0940–1010	Michael Mutter: Field testing design instruments for financing slum upgrading
1010–1040	Alfredo Stein: Financing the poor, harmonising the donors: lessons from Central America
1040–1120	**Coffee break**
1120–1240	Group work
1240–1400	**Lunch**
1400–1500	Presentations by each group and plenum discussion
1500–1520	**Coffee break**
1520–1555	Panel discussion: Franck Daphnis, Sheela Patel and Diana Mitlin
1555–1600	Thomas Melin: Closing of seminar

Appendix 2: List of Participants

Creative Urban Finance for the Poor
Sida Seminar, 14–15 December 2005

Speakers

1. Cedric de Beer
   National Urban Reconstruction and Housing Agency (NURCHA), South Africa
2. Rolf Carlman
   Infrastructure and Economic Cooperation Department/Sida, Sweden
3. Franck Daphnis
   Development Innovations Group (DIG), USA
4. Malcom Harper
   Cranfield School of Management / Homeless International, United Kingdom
5. Mark Hildebrand
   Cities Alliance, USA
6. Stig Jonsson
   Swedebank, Sweden
7. Anil Kumar
   Agribusiness Group / ICICI Bank, India
8. Barbara Lee
   Infrastructure and Economic Cooperation Department/Sida, Sweden
9. Thomas Melin
   Urban Development Division/Sida, Sweden
10. Diana Mitlin
    International Institute for Environment and Development (IIED) and Institute for Development Policy and Management (University of Manchester), United Kingdom
11. Michael Mutter
    UN Habitat, Kenya
12. Sheela Patel
    Society for the Promotion of Area Resource (SPARC), India
13. Krishnaswamy Rajivan
    Cities Alliance, USA
14. Alfredo Stein
    Programa de capacitación para el Mejoramiento Socio Habitacional (PROMESHA) / Housing Development & Management (HDM), Sweden
15. Kathleen Wu
    United States Agency for International Development (USAID), USA

Other Participants

16. Mikael Atterhög
    Division for Urban Development, Sida
17. Ebba Aurell
    Division for Market Development, Sida
18. Tamara Bengesai
    Royal Institute of Technology, Stockholm, Sweden
19. Karin Billing
    WSP Groups, Stockholm, Sweden
20. Robert Buckley
    World Bank, USA
21. Sundar Burra
    Society for the Promotion of Area Resource (SPARC), India
22. Godfrey Chikumbi
    Royal Institute of Technology, Stockholm, Sweden
23. Armando Costa Pinto
    Swedish Cooperative Centre, Stockholm
24. Melinda Cuéllar
    Orgut Consulting AB, Sweden
25. Stig Egnell (14/12)
    Stig Egnell AB, Gothenburg, Sweden
26. Jan Engström
    Engström U-consult HB, Stockholm
27. Åke Finnström
    National Land Survey of Sweden, Gävle
28. Per Fröberg
    Division for Urban Development, Sida
29. Roger Garman
    Division for Market Development, Sida
30. Kurt Granberg
    Division for Urban Development, Sida
31. Ola Göransson (14/12)
    The National Housing Credit Guarantee Board, Stockholm, Sweden
32. Christina Hartler
    Division for Market Development, Sida
33. Göran Henriksson
    International Cooperation Swedbank, Sweden
34. Jonathan Howard
    Africa Groups of Sweden, Stockholm
35. Stefan Jansson
    GuarantCo, Sweden
36. Joyce Kimwaga Lundin
    Network for entrepreneurs from ethnic minorities (NEEM), Sweden
37. Tore Kiøsterud
    The Ministry of Local Government and Regional Development, Norway

38. Emilia Liljefrost (14/12)
Uppsala University, Sweden

39. Per Ljung
PM Global Infrastructure Inc., USA

40. Gabriel Marin
The Swedish Institute for Public Administration (SIPU), Stockholm

41. Ruth McLeod
Homeless International, UK

42. Ian Morris
Homeless International, UK

43. Annika Nilsson
Economic History, Lund University, Sweden

44. Esse Nilsson
Policy and Network Department/Sida, Sweden

45. Helen Nordensson (15/12)
Embassy of Sweden, Pretoria, South Africa

46. Amos Nungu
Royal Institute of Technology, Stockholm, Sweden

47. Joakim Olsson
Swedish Cooperative Centre, Stockholm

48. Saif Omar
Forum Syd, Stockholm

49. Charles Pello Esso
Africa Union

50. Colin N Raynor
International Financial Institutions Department, United Kingdom

51. Lars Reuterswärd
UN Habitat, Kenya

52. Henrik Riby
Division for Market Development, Sida

53. Carlos Rivas
Sida, Honduras Central America

54. Ola Sahlén
Division for Market Development, Sida

55. Nils-Gunnar Smith
The Church of Sweden, Uppsala, Sweden

56. Göran Tannerfeldt
Consultant, Stockholm, Sweden

57. Bengt Turner
Institute for Housing and Urban Research, Uppsala University, Sweden

58. Nils Viking
Department of Urban Studies, Royal Institute of Technology (KTH), Stockholm

59. Hanna Wetterstrand
Swedish Cooperative Centre, Stockholm

60. Alistar Wray
United Kingdom Department for International Development

61. Per Åhren
The Norwegian State Housing Bank, Norway

62. Johnny Åstrand
Housing Development and management, HDM, Lund University, Sweden

63. Tommy Österberg (14/12)
Swedesurvey, Gävle, Sweden

Rapporteurs

64. Samuel Azasu
Royal Institute of Technology, Stockholm, Sweden

65. Isabel Molina
Editor, Swedish Bulletin, Stockholm

Halving poverty by 2015 is one of the greatest challenges of our time, requiring cooperation and sustainability. The partner countries are responsible for their own development. Sida provides resources and develops knowledge and expertise, making the world a richer place.

SWEDISH INTERNATIONAL
DEVELOPMENT COOPERATION AGENCY

SE-105 25 Stockholm Sweden
Phone: +46 (0)8 698 50 00
Fax: +46 (0)8 20 88 64
sida@sida.se, www.sida.se