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Slum Upgrading Finance

I. NOTES ON ASSUMPTIONS AND GOALS AROUND SLUM UPGRADING FINANCE

Case studies around the world suggest slum-upgrading finance can be abstracted into three categories:

1. THE PUBLIC SECTOR: State funded models, largely government driven models with funding obtained through international agencies or tax funding. The form of upgrading ranges from infrastructure additions to rebuilding.

2. THE PRIVATE SECTOR: Privately funded models, that largely need government subsidies or capitalize on the expected land value the settlement occupies to finance rebuilding.

3. THE COMMUNITY LEVEL: Community funded models that employ savings schemes and funding from donations and other sources to initiate upgrading schemes ranging from infrastructure upgrade to rebuilding.

Most cases employ a combination of the three models, with each type of funding playing a different role at different stages of the upgrading process.

Based on these case studies, it is clear that the source and stage at which a particular mode of finance enters the upgrading process plays a critical role in the community's control and agency in upgrading. This does not mean a rejection of either model of funding, but a calibration of when these sources of funding enter the process of upgrading taking into account their relative strengths and weaknesses. In our opinion, a suitable financial model would need to:
1- Fund large investments in infrastructure
2- Be financially sustainable in the long run
3- Encourage local control in decision-making

In our analysis of financial models, we have prioritized local control in decision making over other aspects as we feel that is the key to equitable and sustainable slum upgrading projects. Considering the context of Kenya--with its growing economy, concerns about corruption and ethnic capture of economic resources--we believe the role of private funding to be critical in the process. The role of the government is perceived as a facilitator of these actors in the slum upgrading process.

II. OVERVIEW OF TYPES OF FINANCE

THE COMMUNITY LEVEL

<u>-Community Saving Schemes and Microfinance:</u>
Slum Dwellers International (operating in 34 countries) saving federations create foundation that provide savers with more influence and scope for action that can scale up at the local, city, national and international scale, especially for women. Communities use the platform for community-relevant issues but generally to stop evictions and negotiate for basic services and a secure home (D'Cruz & Mudium, 2013). Savings foundations are based on the realization that savings and credit meet short-term and long-term needs and create track record to prove creditworthiness to external financial institutions. Dependent on the country and case, they also facilitate or are based on slum enumerations that create a database for negotiations with the government and can result in Urban Poor Funds for slum upgrading, combinations of community savings, donor funds and at times government money. One major advantage of saving federations is that they allow for saving small amounts that would not be operated within the formal banking sector.

In direct connection to this financing model, a consideration of Kenya's significant penetration of the telecommunications sector and mobile banking application M-PESA, operated by Safaricom, is appropriate. Kenya has witnessed the world's fastest uptake of mobile phone-enabled systems for value transfer and storage. More than 73% of Kenya's adult population use M-PESA (Chandy and Kharas, 2012). The service has shown to positively impact slum dwellers' livelihoods and health, and it carries the potential do so more substantially if it could devise strategies to encourage larger and longer-term savings and individual and communal wealth-building (Gossmann, 2012).

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-Chandy, L. & Kharas, H., 2012. The Innovation Revolution and Its Implications for Development, The 2012 Brookings Blum Roundtable Policy Briefs: 5-12.
-Gossmann (Fall 2012 for CP 256). M-PESA for Better Health: The Role of Mobile Banking for Health Equity in Nairobi's Informal Settlements, Department of City and Regional Planning, University of California at Berkeley.

THE PRIVATE SECTOR

<u>-International Market Bonds:</u>
International bonds, foreign currency bonds issued and traded across national boundaries, are traded on the international bond market and include eurobonds, foreign bonds and global

bonds. International bonds pay interest at specific intervals and repay the principal amount to the bond buyer at maturity. This market is particularly successful in attracting private sector investment. Emerging Market Bonds are a separate category of bonds, issued by governments or corporations of the world's developing nations and generally perceived as more risky due to the higher likelihood of economic swings, political instability and other financial market disruptions. Due to this risk, emerging market bonds offer higher yields than more established nations.

In the case of East Africa, Tanzania has recently, in February 2013, entered the international capital market with a US$600m seven-year private placement (US$600m is the maximum Tanzania is allowed to borrow from the international bond market under its IMF program). This particular move was widely criticized, since Tanzania has an unofficial mandate with Citigroup and a public Eurobond instead of a private placement. Although Tanzania's international market bond pricing was extremely low and hurried due to a demand for immediate infrastructure financing, international market bonds present a gateway to Kenya's economy. The Kenyan government has, in fact, announced plans in March 2013 to issue a sovereign bond in August in order to raise $1b from the international capital market. Similar to Tanzania, budget deficits for infrastructure financing are named as the main reason for the launch of this bond. The Kenyan government has been considering this launch for five years, and given the peaceful presidential elections in 2013, experts speculate that lenders will welcome the bond.

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Humphrey Liloba, Kenya Resorts to Bonds to Reduce Budget Deficits, published on 18. March 2013 on allAfrica. Available at http://allafrica.com/stories/201303190441.html (Accessed 12th of April 2013).

<u>-Social Impact Bonds:</u>
Social Impact Bonds (SIBs) are funding mechanisms for programs that invest in particular social outcomes for a well-defined group of households, instead of social intent. SIBs are useful financial tools for situations where a particular social outcome has the potential for financial impact--say, high savings in spending or high tax revenues-- for the government at some future point in time but requires investment beyond the current capacity. A bond issuing agency issues bonds to private investors to finance schemes with social impact. The agency enters into a contract with the government to either share the benefits of cost savings or revenue increases due to the program, or pay the agency a predetermined sum of money based on the extent of improvement in certain indicators. SIBs work for those social programs when there are measurable improvements in target indicators at the household level due to the intervention for which the investment was made.

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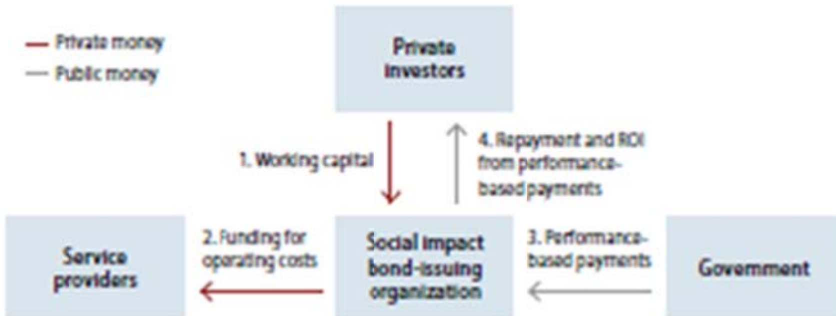
Social Impact Bonds have been considered suitable for countries where the payment due on bond maturity can be made against savings in social spending. For example, in the UK, a social impact bond that counsels and provides technical training to first time prisoners uses the expected future savings on preventing recidivism for the performance based payments. Similarly, in the US, social impact bonds are being planned for senior housing projects based on expected Medicaid savings to the state where the project occurs. In the Kenyan context, the possibility of using such a bond does not seem suitable.



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<u>-Low-Interest Loans with Intermediaries:</u>
Low interest loans address a critical market failure that affects the development of community driven low income housing: access to large scale credit. Most conventional financial institutions require collateral as a guarantee to provide low interest loans for development. For slum upgrading projects, collateral is hard to obtain for the resident communities and conventional loans are denied inspite of the community's ability to make payments. In the last couple of decades, innovative financial products like micro loans have developed group lending models that reduce cost of loans, but these are not scalable for high investment projects like housing construction or infrastructure upgrades.

Loans guaranteed by policy or deposits are effective tools to address both concerns of collateral and scale of borrowing. In Thailand, the central government directly lends to communities in informal settlements that seek to upgrade their neighborhoods through its slum upgrading agency. The central government's capacity to bear loss and its function to create policy for public good ensures that the loans are priced at rates below conventional loans from the market. Terms of the loan are negotiable in every case, and made suitable to the repayment level that the community can bear. Loans are paid back via community savings schemes.

Another model of providing access to credit is when loans are obtained from conventional financial institutions by Civil Society Organizations on behalf of the community that seeks upgrading. The CSO provides the collateral or deposits a suitable sum of money with the financial institution providing the loan, and repayments are made by the community to the CSO through savings schemes or periodic deposits.

From the Kenyan perspective, low interest loans backed by the central government may be a suitable method. The growth in Kenya’s economy and political stability over the last decade has improved access to international credit for the central government. Additionally, Kenya has access to loans from the World Bank and other international financial institutions that can be lent to communities that seek upgrading at nominal interest rates.

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Boonyabancha, Somsook. "Land for housing the poor—by the poor: experiences from the Baan Mankong nationwide slum upgrading programme in Thailand." *Environment and Urbanization* 21.2 (2009): 309-329.

-Tax Incentives:

Tax incentives in low income housing address the lack of access to affordable finance by incentivizing private investors to provide equity contributions to projects. An example of a program that uses tax incentives to finance low income housing is the Low Income Housing Tax Credit in the USA. The program provides investors to claim tax deductions over a pre-determined period of time equivalent to the amount of equity contribution made to the project at the time of construction. This process incentivizes large corporations to contribute to projects for the public good and take some of the financial burden of upgrading away from communities or the State. The loss of tax revenue for the state is made up by direct investment in low income housing.

From the Kenyan perspective, tax incentives might be an indirect form of public investment. However, the number of corporations in Kenya with large tax liabilities that could take advantage of such a program appears limited compared to the scale of funding needed for upgrading informal settlements all over the country. A tax incentive program might be suitable as one of many sources for funding upgrading projects.

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Kingsley, G. Thomas. "Federal housing assistance and welfare reform: Uncharted territory." (1997).

THE PUBLIC SECTOR

-Grants:

Grants for slum upgrading come from different actors within the nation and international community and are awarded and implemented at different levels. An example of a grant coming from Italy's development institution in form of debt relief demonstrates the variety of available grants: In October 2006, Italy agreed to write off half of Kenya's long-term debt (Sh4 billion or 44 million Euro) under a Debt-for-Development Swap scheme. The funds, meant to be spent on pro-poor development projects in health, education, water an sanitation, will be spent over the course of ten years and is supervised by a steering committee composed of representatives of the Kenyan Ministry of Finance, the Kenyan Ministry of Planning and National Development and the Italian Embassy.

Debt-for-development exchanges were first undertaken in 1987 and by 2007, it has resulted in the cancellation of US$5.7 billion of debt and the application of US$3.6 billion to development projects (Buckley, 2009). The development projects in the debtor nation that are chosen to benefit from the cancellation of debt are usually mutually determined. Debt-for-Development Exchanges are regulated by specific legislations, determined by the lender country.

References:
-Ross P Buckley (2009). Debt-for-Development Exchanges: An Innovative Response to the Global Financial Crisis, University of New South Wales Law Journal 32, 620-645. Available at: *http://www.conservationfinance.org/upload/library/arquivo20100525165906.pdf* *(Accessed 4th of April 2013).*
-Tom Mogusu, Kenya: Italy Signs Away Sh4 Billion in Debt Relief, published on 23. January 2007 in The Standard. Available at: *http://allafrica.com/stories/200701240412.html* *(Accessed 4th of April 2013).*

-Loans:

Loans, similar to grants, come from different actors within the nation and international community and are awarded and implemented at different levels. Sometimes organizations stand in as intermediaries to provide fiscal security to the lender.

III. CASE STUDIES & STEPS IN THE SLUM UPGRADING PROCESS

CASE	Mobilization	Enumeration	Plan of Action Preparation	Land Acquisition	Construction Planning	Capacity Building	Construction	Maintenance
Thailand	Community: Savings Scheme	Community: Savings Scheme	Community: Savings Scheme	Central Government (CODI): Low interest loan	Central Government (CODI): Low interest loan	Community: Savings Scheme	Central Government (CODI): Low interest loan	Community: Savings Scheme
Mumbai	CSO Funds	CSO Funds	CSO Funds	State Government: Land title transfer	Resident contributions/Coop membership fees	Resident contributions/Coop membership fees	Private Bank loan	Private Bank Savings interest + Resident income
Tanzania (Hanna Na	Community-managed Upgrading Project, initiated by Community Development	Community-led (CDC)	UNDP, EUF, Ford Foundation (UNCHS, UNV associated agencies)	Secure tenure not designed into upgrading, most of the land owners in Hanna Nassif held	UNDP, EUF, Ford Foundation (UNCHS, UNV associated agencies)	UNDP, EUF, Ford Foundation (UNCHS, UNV associated agencies)	UNDP, EUF, Ford Foundation (UNCHS, UNV associated agencies) +	Community-owned infrastructure and maintenance
Brazil	IADB + government: state and municipality level	IADB + government: state and municipality level	IADB + government: state and municipality level + community-level participation (POUSOs)	N/A Favela Bairro one of few slum upgrading programs operating without land tenure	IADB + government: state and municipality level + community-level participation (POUSOs)	Government: state-level: Fundo de Amparo ao Trabalhador	IADB + government: state and municipality level	IADB + government: state and municipality level
Kenya: KISIP & KENSUP	UN Habitat and government of Kenya (KENSUP); World Bank, SIDA, AfD and government of Kenya (KISIP)	UN Habitat and government of Kenya (KENSUP); World Bank, SIDA, AfD and government of Kenya (KISIP)	UN Habitat and government of Kenya (KENSUP); World Bank, SIDA, AfD and government of Kenya (KISIP)	KISIP preferred settlements on government land or with clear ownership status, land tenure not part of upgrading program	UN Habitat and government of Kenya (KENSUP); World Bank, SIDA, AfD and government of Kenya (KISIP)	UN Habitat and government of Kenya (KENSUP); World Bank, SIDA, AfD and government of Kenya (KISIP)	UN Habitat and government of Kenya (KENSUP); World Bank, SIDA, AfD and government of Kenya (KISIP)	UN Habitat and government of Kenya (KENSUP); World Bank, SIDA, AfD and government of Kenya (KISIP)

IV. DEVELOPING A HYBRID MODEL

The nature and stage at which a certain financial model is introduced is able to determine the control and agency that the community has in the process. From the case studies, it appears that control over the early stages of the upgrading process when the required scale of funding is low allows communities to have agency in decision making for the rest of the process as well. The momentum from institutional capacity built up in the early stages sustains till the end of the process.

The role of the state and private actors in funding brings up interesting questions as well. At what stage is financial profit the best motivator for a successful upgrading project? What level of government intervention can strike a balance between enabling large scale funding, yet keeping decision making localized?