GSDR 2015 Brief

SLUM UPGRADING

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Related Sustainable Development Goals

Goal 01	End poverty in all its forms everywhere
Goal 03	Ensure healthy lives and promote well-being for all at all ages
Goal 06	Ensure availability and sustainability management of water and sanitation for all
Goal 08	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
Goal 11	Make cities and human settlements inclusive, safe, resilient and sustainable
Goal 17	Strengthen the means of implementation and revitalize the global partnership for sustainable development

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Introduction

Currently, every seventh person worldwide lives in an informal urban settlement, summing up to 850 million people globally.[1,2,3] In some megacities of low- and middle-income countries almost 80% of the total population lives in slums.[4] Fast urbanization is observed worldwide but in developing countries it is expected adding up to 1.5 billion in 2025 people living in slums.[5,6] Three-quarter of the world's population is expected to live in an urban environment by 2050, whereby urbanization in developing countries will be the most significant.[7,8] These facts illustrate that immediate action is required and this issue cannot be neglected, since slums will not be resolved but in fact increasing over the coming years. Based on the UN Millennium Goal Number 7 (directly 7D) on the improvement of slum dweller living conditions, several UN post-2015 Sustainable Development Goals (SDGs) are also trying to address this complex issue.

Informal settlements, also referred as slums or favelas in parts of Latin America, are unplanned, densely populated and neglected parts of cities where living conditions are extremely poor. The process of slum upgrading involves the improvement of both physical and social environment. In order to direct financial investments to the right place and problem, one must recognize the linkages between the undermining issues (Table 1).[9] Yet, the different interplays of actors is also crucial for the holistic success. Projects show that tri-sector partnerships, include the state, private and voluntary sectors have to cooperate in order to overcome slum upgrading challenges (Appendix 2).[10] Even though the enumerated parties show commitment, the urgent needs of individual slum dwellers and local communities also have to be considered. In order to make slum upgrading successful on the long-term, enduring and strategic planning must be addressed in all financial, institutional and regulatory decisions to certain level.[11]

FACTS & FIGURES

- By 2050, three-quarter of the world's population is expected to live in urban areas, with the highest urbanization rate in developing countries.
- Community funds is the only instrument out of the demand-led approaches that has the potential to reach marginalized poor

The fundamental issue in urban development and slum upgrading is related to the growing number of urban residents and how housing and infrastructure services can be financed for the future urban generations. Slum upgrading is complex and unclear, because several interrelated components (both physical and social environment) must be addressed that entail significantly different financial consequences: (a) infrastructure components like housing, water, sanitation, roads and footpaths, storm drainage, lightning or public phones, (b) service components like waste collection, schools, medical centers and (c) other services like social integration buildings, public spaces, peace building and poverty reduction programs.[12,13,14] There are several, individual aspects, which contribute to the understanding of the global challenge (Table 1).

Notwithstanding the fast and semi-fast economic growth in most developing countries, extensive poverty remains the prime concern. Especially in urban poverty, the lack of well-paid employment is the most important factor. From the issues and challenges mentioned above, it can be concluded that conventional sources of finance will not be enough to meet the predicted requirements for urban infrastructure and housing.[15] The present financial system is not efficient. Therefore, we identified the following four reasons: (a) national subsidies are not effectively targeted to urban poor, (b) lacking land tenure rights usually exclude the very poor to access governmental subsidies and funds, (c) international funds are usually distributed through a ministry of finance and therefore top-down and centralized and (d) there is a limited usability of international and national funding for several purposes (earmarked funds).[16] Consequently, it is very important to note that **financial innovation** to reduce urban poverty and to upgrade slums is essential and it must occur with a policy shift from supply-driven to **demand-led approaches.**

In this brief, a community-driven case study is described to show recent success in slum upgrading. Furthermore, different financial options for urban low-income households are listed and briefly explained by the use of real examples leading to a description of broad finance mechanisms. The brief will end with the opportunities and risks of blended finance of current slum upgrading finances are clarified and linked to the SDGs.

Table 1. Sector-specific Issues and Challenges in urban development[17]

Issues & Challenges					
Demographic	**Socio-behavioral**	**Economic**	**Environmental**	**Financial**	**Governance**
Increasing demand for urban housing and infrastructure services due to more urban citizens in the future. Cities as center location of financial services and knowledge economy but performance is related to livelihood: the quality of urban housing and infrastructure.	Increase of social differentiation and increase of heterogeneous communities in urban areas: education, consumption and culture. Moving away from collective to individual cultural values due to growing ethnically diverse cities. Ethnically homogenous groups might exclude other communities. Unsecure tenure of slum dwellers.	Domestic macroeconomic growth needed to provide the basis of urban development, but citywide microeconomic is as important as macroeconomic performance. Housing and infrastructure are critical key factors of the economic production function of cities yet national budgets for investment are generally too low. Global inequality between rich and poor. Paradox: Cities are the center of productivity but also of increasing poverty linked to a lack of housing and infrastructure services.	Growing demand for infrastructure puts pressure on natural resources. Increasing costs of potable water. Consumption of natural resources of urban residents is often faster than the environment's ability to reproduce. Management of human and solid waste.	Current level of FDI, IDA and government financing are not meeting the demands for upgrading. Only a small part of the funding is addressing upgrading slums. Maintenance of housing and infrastructure services is frequently not included in budget plans, which would eventually decrease the new annual domestic investments. Formal financial institutions have no interest in general to go down-market and extend their lending to lower-income groups.	Centralized and strict top-down approach to urban governance. Limited participation of low-income groups in the national upgrading programs.

Case study

The Asian Coalition for Community Action (ACCA) illustrates a successful case of a community fund saving instrument. It is demand-oriented in the provision of housing and infrastructure for low-income communities. ACCA was founded in 2008 by the Asian Coalition for Housing Rights (ACHR) and it has contributed to community-driven slum upgrading in more than 165 cities in 19 different Asian nations ever since.[18] ACCA applies a clear budget ceiling strategy: it supports every city with a total amount of USD 58,000.[19] In addition, it provides seed funds for community development funds (CDF) and a regional USD 50,000 revolving loan fund for every city. Each community has the freedom to decide for which purpose the resources should be used.[20] This small amount of money represents a motivation for slum dwellers to engage with the local municipality to leverage further public subsidies.

Community finance mechanisms implemented by ACCA offer a reliable alternative in the provision of housing and infrastructure for marginalized communities, who are actually excluded from financial solutions and access to public services by the macroeconomic and institutional context.[21] Compared to other forms of finance, community finance tends to be for shorter term and lending is collective to community members who borrow (Appendix3I). Together, the ACCA funding and regional community saving groups deposit money into the CDF, to which also the formal finance sector, such as governments, banks and international aid agencies contribute.[22] In this way, two main things are accomplished: first of all, slum dweller community groups get a voice in projects by networking with various local or national authorities and development agencies. Secondly, bridges are built between the formal financial sectors and the community financial mechanisms. Therefore, it can be stated that CDF is used as an additional platform to enhance the access of urban poor to finance and overcome the market failure in the provision of finance to high return investments.

Financial Instruments

Financial instruments are types of financial products or policy tools through which finance is delivered. There are four financial options differentiated for the urban poor: (a) mortgage finance, (b) microenterprise finance (c) shelter microfinance and (d) community funds (Appendix 3).[23] Mortgage finance was applied successfully for instance in Zambia and the Philippines.[24,25] In both cases the state was involved via government support, since private entities only provide loans to average or high-income households to minimize their risk. This highlights the greatest issue with mortgage finance: it does not reach out to the marginalized poor.

Micro-entrepreneurs finance allows the poor to build business assets to increase their income and reduce vulnerability via helping individual entrepreneurs and small and middle-sized enterprises (SMEs) to access finance.[26,27,] Globally, 200 million SMEs are in need for financial services.[28] Yet, the finance of SMEs' is greater than microcredit agencies can bear, and large banks tend to avoid this market because of high administrative costs, limited information and unreliable credit risk.

Shelter microfinance also supports low-income households to reduce their vulnerability but in this case the sole purpose is housing. One of the largest microfinance institutions is the Mibanco in Peru (MFIs) in Latin America with 70,000 active borrowers. Here, the same issue arises as with microenterprise finance that it does not empower the marginalized communities or tackle poverty effectively because only 5% of the observed participants were able to fight poverty by applying microfinance.[29]

Community funds, as it was explained above, provide communities with loans that support investments on projects that the group decides. As the ACCA case study showed in the previous section, this is the only instrument out of the demand-led approaches that has the potential to reach marginalized poor. By demand-led approach we mean an alternative approach where a given community can decide what is the most needed for them and on what they would like to spend money on. There are a number of global examples when slum dwellers form community saving groups in order to achieve improvements. Originally only women participated in these projects like in Harare, Africa, however after years of success now men are also engaged.[30]

Finance Mechanisms

Financial mechanisms are the different financial approaches to address methods and sources of financing. The various financial instruments, listed above, address these approaches. One approach can use several instruments. There are a number of emerging issues around the financial flows and decision-making processes of slum upgrading (Appendix 4).

The traditional way of financing development is the supply-driven approach, which is mostly done in a top-down way. Extensive amounts of money come from International Development Aid (IDA) or Foreign Development Investments (FDI) and go through bi- and multilateral aid agencies such as the World Bank Group or philanthropic organizations. Supply-driven approaches have proven to be less effective for slum upgrading, because they do not involve the slum dweller communities to take their needs (both cultural and social) into account.[31] In fact, aid agencies were set up to support acknowledged national governments and not small-scale non-governmental organizations (NGOs) or community-based organizations (CBOs) including informal community saving groups.[32]

Innovative financing refers to non-traditional mechanisms to channel external funds via alternative ways such as micro-contributions or public-private partnerships (Appendix IV). In the Monterrey Consensus of 2002, member states agreed to establish Official Development Assistance (ODA; 0.7% of Gross National Income), which achieved a total net amount of USD 134.8 billion in 2013.[33,34] ODA maintain delivering essential financial and technical cooperation to many developing countries, which represents two-thirds of international resource flows and one-third of government revenues.[35] Nevertheless innovative finance will not be enough to support development in developing countries. Additional innovative financing mechanisms have the potential to increase funding meaningfully to bridge the gap to achieve the SDGs. Yet innovative financing is not a substitution for ODA, since it is more considered as a gap filler. As development financing has already been highly complex, the role of innovative finance should raise new funds for existing public and private organizations.[36]

It is important to note that while additional top-down finance is crucial from any actors in order to act as a catalyst in slum upgrading and achieve development, demand-led approaches work more effectively than one-off, supply-driven approaches that are in most cases financed by one set of actors[37,38]. The actual need of the urban poor and marginalized communities is often omitted.

To sum up, due to the complex financial structure of slum upgrading, a blended financial composition of all different actors and instruments has the potential to leverage additional private finance (Appendix 2, 4). Challenges arise from the lack of understanding on how parallel financial blocks can be effectively and appropriately coordinated. All sources of finances need to address poverty eradication and improvement of urban human settlements, but local public finance alone is insufficient to fill the financial gap in urban settlement improvements, so funding is combined coming from grants, loans and equity to leverage additional non-grant financing to support projects.

Opportunities and Risks of blended finance

A long-term blended finance approach has the opportunity to leverage funds with private capital, sharing risks and returns and engage in concerns in the public domain.[39] On the other hand, if it is poorly designed the public partner ends up bearing the costs while the private partner still benefits from the PPP contract. Blended finances are used in a range of areas that involves both the physical and social environment of slum upgrading. Furthermore, it also has the potential to enhance projects that are below the margin of commercial viability and it cannot be simply solved by policy implementation or the change of institutional environment.

A success story example is the "slum to neighborhood" project in 1995, which was funded by the Inter-American Development Bank with USD 180 million for infrastructure upgrading and service increases. It included 253,000 residents in 73 communities. Blended finance was key to the success of this large project that involved the flexible city government several partnerships with NGOs, the private sector, churches, and the general population. Furthermore, grass roots level infrastructure upgrading experts were hired as project managers because they could work easily with both the government and with the community members.[40]

In conclusion, win-win situations in slum upgrading do not exist and jumping into quick solutions tends to cause an even greater problem than it was at the first place.[41] The comparative review of the approaches, presented through the different cases, highlights the emergence of several new trends: the broadening of locally generated revenue sources; the strengthening of local financial management; partnerships in the financing of capital investments; and the enhancement of access to long-term credit for municipalities.

Building on these we would like to make the following recommendations:

- Top down financing should not be earmarked but follow a demand-led approach instead
- CBOs should strengthen their network both to build new collaborations and to build new communities in slums where the population is heterogeneous
- Draw lessons from ACCA and other projects such as the Urban Poor Fund International by Slum Dwellers International and realize that seed money matters and can make a significant difference

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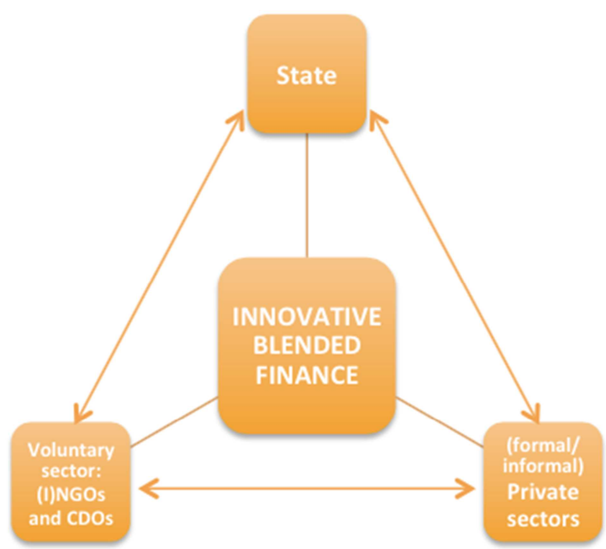
Appendix 1: Research methodology

The research for this Financial Brief has been conducted through literature study and expert interviews. The topic of the Financial Brief is based on personal background and personal interest. The content is informed by extensive literature research and exploratory interviews with experts on the topic of financing slum upgrading. Experts were selected on the basis of their knowledge and involvement with the topic in question. Their expertise was identified by the relevance of their publications. Semi-structured interviews were conducted with Anna Walnyicki via Skype, who is a researcher of the Human Settlements Group at the International Institute for Environment and Development and in person with Monique Nuijten who is a development sociologist at the Wageningen University and Research Centre. In-depth case study analysis was done of the different alternative financing approaches in order to highlight success stories and examples of failure.

Appendix 2: Tripartie relationship between stakeholders in blended finance

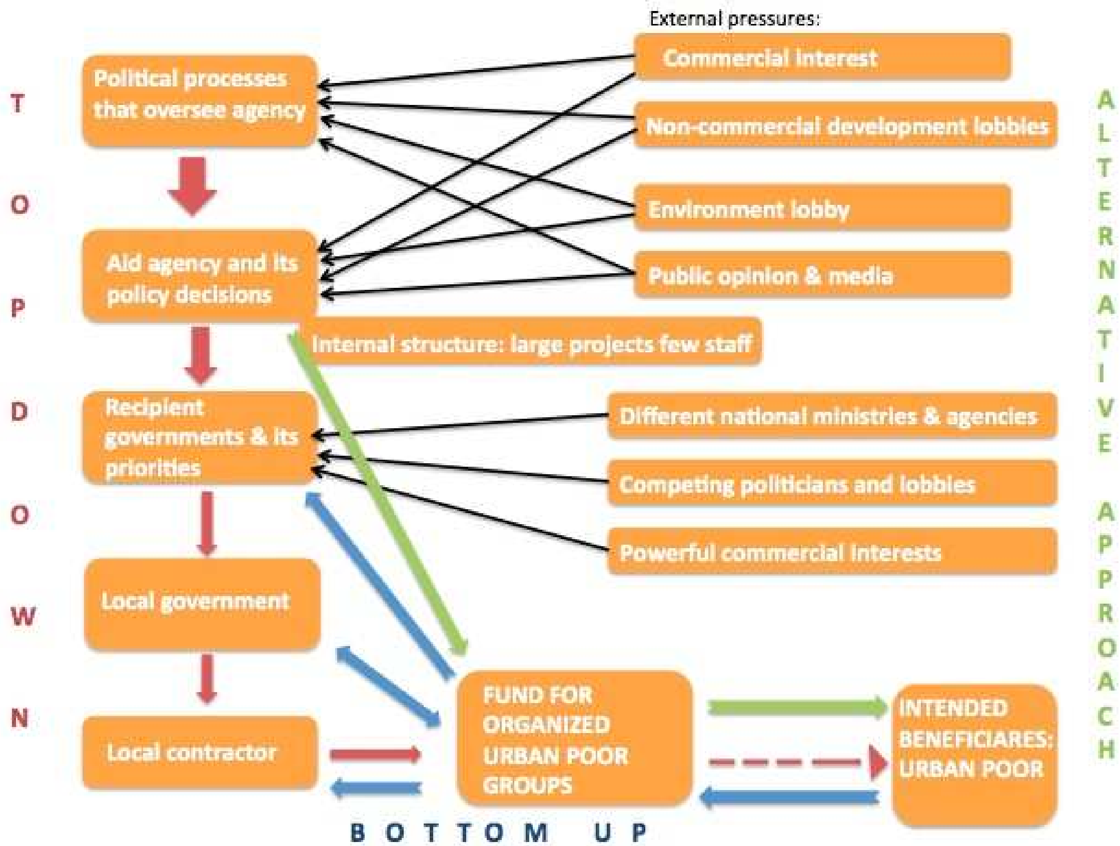
(Based on: Otiso, K.M. (2003). State, voluntary and private sector partnerships for slum upgrading and basic service delivery in Nairobi City, Kenya. *Cities* 20(4), 221-229)



Appendix 3: Financial options for urban poor
(Retrieved from: World Bank (2014). The Asian coalition for community action's approach to slum upgrading. World Bank Group, Washington, DC.)

	Mortgage Finance	**Microenterprise Finance**	**Shelter Microfinance**	**Community Funds**
Objective	Provide long-term housing finance	Provide investment finance for enterprise development and enable income growth	Provide housing improvement and improve well-being	Enable the poor to secure shelter assets, particularly land and infrastructure
Borrowers	Upper- and middle-income households	Micro- and small entrepreneurs	Those with land who need to improve the dwelling	Those without secure tenure, basic services and adequate housing
Use of loan funds	Acquisition of property	Development of business	Housing improvement	Land, infrastructure and occasionally housing improvement
Role of savings	Deposit required; savings process not important	May be required	Savings & deposit may be required	Savings generally essential; deposit may be required
Additional support	Irrelevant	Generally not	Possible	Nearly always considered necessary because of complexities of land development
Attitude to the very poor	Avoid	Generally avoid; some specialist programs	Depends on orientation; but requirement for land likely to exclude the poorest	Generally seeks to help the very poor if they are residentially stable
Purpose of the collective (community organization)	None	May be used as guarantor	May be used as guarantor; sometimes additional community support is a part of the process	Lending is collective and the role of the group is seen as essential to address the exclusion of the poor
Amount	Generally over US$10,000	Generally under US$500	Generally between US$100-$5,000	Generally under US$1,000
Interest rate	Inflation +Margin of 8-15%	Inflation + Margin of 15-45%	Inflation + Margin to cover the costs of 10-20%	Inflation + Administration
Term	15-30 years	< 1 year	1-8 years	3-20 years (generally shorter)
Collateral	Mortgage	Personal guarantees, goods, co-signers	Personal guarantees, goods, co-signers, mortgage	Can be title deeds but emphasis on collective loan management
Financial Sustainability	Generally considered essential, but may be state subsidies	Desired – support for product development	Desired – support for product development; occasionally integrated with subsidies for land development	Seek state support to offer subsidies for land development and services in order to include lower income families
Linking role	None	To other financial institutions	To other financial institutions; may involve the municipality in slum upgrading program	To state and municipality

Appendix 4: Approaches in development finance



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