



# The UN-HABITAT Slum Upgrading Facility

## NEWSLETTER

### The Slum Upgrading Facility:

*Improving access to domestic capital for slum upgrading and low income housing projects*

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## Guarantees & Slum and Settlement Upgrading Projects

**Guarantee:** A legal agreement to provide security for a loan. If the loan is not repaid according to the terms and conditions agreed, the guarantor must give up the security that has been provided. (McLeod, Mullard, 2006)

It's easy enough to define what a guarantee is. Harder to define is how to apply a guarantee, and how to make it work. Guarantees are not products to be promoted in themselves. In other words, they should not be part of the first discussions and negotiations with a bank when seeking a loan for slum and settlement upgrading projects. Nor would banks accept them as such, as slum and settlement upgrading projects are complex, and a guarantee by itself is not enough to address this complexity at the outset.

What makes slum and settlement upgrading so complex? Some of the factors are:

- There are multiple complex elements within each project, requiring a wide range of social, technical, and political inputs for successful implementation.
- Each project has to deal with a multiplicity of institutional and political actors in relationships that have little, if any, previous collaborative history.
- The financing required is usually medium to long-term in nature.
- There is no guarantee of complete cost recovery from the end borrower because the solution required costs more than they can afford to repay – so there will be cross-subsidy and blended finance to address this, adding to the complexity.
- Projects usually require access to several different kinds of financial products, many of which are not currently available within local financial markets.
- The borrowers usually lack significant balance sheets and have no established track record in technical project delivery.

Where guarantees are most effective, then, are as a tool to apply once the bankability and credit-worthiness of the project and the slum dwellers has been explored and explained. Guarantees can be thought of as a final incentive when the project assessment and analysis is positive, but, due to the “newness” of lending to slum dwellers for this kind of projects, and the complexity, banks still feel they need more comfort. They are a tool to address the fact that banks feel they do not have enough information to make a

decision in their usual way. They supplement the technical support that is provided to a project, and the community track record, as well as other non financial sources of comfort.

SUF Local Finance Facilities will use credit enhancement funds as guarantees in projects where this is deemed necessary. It is likely that all the SUF projects will ultimately need guarantees to begin with, and as the Local Finance Facilities establish a track record and demonstrate the “bankability” of slum upgrading projects, the need for these guarantees should decline. This will mean that more projects can be active through greater leveraging of guarantee funds as time passes.

*The Slum Upgrading Facility is preparing a working paper on Guarantees which will be available on the SUF website by November 2008.*



*Informal houses in Buki Duri, Jakarta Indonesia.  
© Suzi Mutter, February 2005.*

## Ghana

### *Amui Djor Housing project in Ashaiman, Ghana*

The SUF Pilot project in Ghana is progressing steadily and has reached an interesting stage with physical development work about to begin. Preparatory works for both facilities are far advanced with draft implementation plans in place. For the housing upgrade project for Amui Djor, the Local Finance Facility TAMSUF (Tema/Ashaiman Metropolitan Slum Upgrading Fund ) board set up a technical committee comprised of key representatives from the local government, the community and the board to review architectural designs, survey work and agreements between the traditional council and the community and advise on the best options. The committee included the Department for Rural Housing,



which did cost estimates and advised on housing technology options.



A Locals meeting in Amu Djor, Ghana. © Suzi Mutter, October 2007.

At this point in the Amui Djor housing project, transit housing has been completed for ten families currently occupying the demonstration site. The agreement between the housing cooperative and the Tema Traditional Council is also in its final stage awaiting comments from the council before the signing ceremony is done.

All the crucial issues regarding the land acquisition process have been carefully reviewed with all parties and comments incorporated in the revised agreement. As part of the new terms and conditions proposed by the Tema Traditional Council, they want a percentage of the dwelling units allocated to them under the same terms and conditions as the other beneficiaries. This is an interesting development and the board, together with the committee, accepted this condition. The chairperson of the TAMSUF board personally donated 50 buckets of assorted colours of paint towards the housing upgrade in Amui Djor. This gesture was very much appreciated and was a show of the real commitment of the leader. All the other members of the board have shown immense commitment towards the success of the project.

The Ashaiman Municipal Assembly (ASHMA) has also shown commitment and keen interest by demonstrating their readiness to see to the success of the project. They have incorporated the calendar of the board in their plan and provided the board with meeting space every month for meetings. The assembly is also discussing how to set aside a budget line to specifically support slum upgrading initiatives, since a vast majority of their jurisdiction is categorized as a slum.

It is envisaged that once the agreement is signed between the Tema Traditional Council and the Housing Coop and other parties, the land will be vacated and cleared so that work can begin. The assembly is also ready to assist with

the issuance of a building permit once all documentation is in place while the Tema Development Committee handles the titling aspect of it.

The community is eager to see the completion of the housing unit concept, which will be ground plus one. This is because they are so impressed with the transit housing which was funded by Slum Dwellers International and the Ghana Federation for the Urban Poor (GHAFUP) with labour provided by the community. They really look forward to either owning or renting one of those decent housing units which they can call their own and be proud of.

## Indonesia

### GUARANTEEING: SUF Pilot Team Indonesia experience – a work in progress

*'We need to design and implement a housing loan system for Solo slum dwellers so that the dwellers will not perceive that it is a 'UN-HABITAT grant' for them that need not to be paid back. The ... guarantee shall be used carefully to avoid opportunistic behavior of certain groups within [the] community. We don't want others to spoil our community'.*

*Eko Sulistyo, KOMPIP a local NGO leader in Solo*

The above remark is a typical comment made by Solo's local NGOs, informal community leaders, and local government officials. In Indonesia, a cautious approach to guarantees is welcomed. In the past, badly or quickly prepared projects have either led to failure or to opportunism. Through the SUF approach, local community projects will be taken through the due diligence of the banking process and formal loan repayment schedules will be applied. Where needed, guarantees can be used as a tool to make the loan more affordable – or even possible at all – by minimizing perceived risks of the commercial financiers.

But what do local financial institutions think of this? Bank Jateng Marketing Director Mr Bambang Suripno and Senior Credit Manager Mr Zulqarnain Mustaqim Ridwan feel that their bank would be more concerned with reputational risks rather than the potential of non performing slum upgrading loan. Any end-borrower's non-performing loan must be reported to the Indonesian central bank, affecting the bank's rating and reputation. Because of this, they feel that the guarantee scheme on its own has little to contribute, and Bank Jateng still insists its borrowers put their land or valuable goods as collateral with the main aim to discipline them in repayment.

Can SUF address this concern of non-performing loans? The guarantee is not just a guarantee of repayment but also a guarantee that the Local Finance Facility will provide the necessary technical assistance during the term of the loan. This would help prevent the loan from becoming non-performing in the first place.

This is important, because using land as collateral in slum upgrading projects, as banks traditionally prefer, is problematic. Besides land tenure being a difficult and unclear issue in slum areas, under the current land system in Indonesia, the transfer of ownership would often need new regulations. SUF hopes to use a guarantee in place of collateral such as land ownership. It will argue that this is more useful to the bank in the event of default, as small, often unregistered slum plots will not hold any value for the bank.



Hopeful children in an informal settlement at Bukit Duri, Indonesia.  
© Suzi Mutter, February 2005.

Is the SUF guarantee scheme enough to attract commercial banks to get involved in projects offering affordable housing loan? While Mr Bambang Suripno of Bank Jateng says no right now, he does so because he feels his bank can only get involved in bankable projects. The challenge for SUF is to ensure these slum upgrading projects are indeed bankable – this is, and has always been, the top priority. The guarantee is simply a tool to actually take the final step – that of “taking the project to the bank”.

Mr. Bambang also notes that there are slum dwellers who can repay housing loans; they just need technical assistance to help them demonstrate that they are indeed bankable – documentation of income and savings, for example. The SUF “Finance Plus” approach means that slum dwellers are getting the help they need to do this.

This resistance is an expected first response from a bank that has never done this kind of lending before. There is still work to be done to ensure that financial institutions become actively involved in the “Finance Plus” being offered by SUF. They are doing that in Indonesia – credit officers of

interested local banks have started to get involved in pilot projects on the ground. With this approach, it is expected that both local banks and slum dwellers will develop another perspective over what we usually call ‘bankable’ – and what it takes to prove it.

## Sri Lanka

### A New Market For The Commercial Banks In Sri Lanka

*“We need to understand that the LFSUS initiative is not only microfinance, where you focus on lending to the poor, but is more of a focus on financial inclusion to cover areas that include savings, credit, insurance and remittances. Particularly in the case of LFSUS, microcredit for settlement upgrading is a major investment in people for economic development.”*

*Chandula Abeywickrema Chairman of LFSUS and Deputy General Manager - Personal Banking and Network Management, Hatton National Bank*

The LFSUS (Lanka Financial Services for the Underserved Settlement) acts as the local financial facilitator of the UN-HABITAT Slum Upgrading Facility (SUF). According to Mr Abeywickrema, LFSUS brings together stakeholders to help enable the low income earners in the selected settlements increase their potential to be “bankable”. This is not an easy task – slum upgrading is complex in itself, and is further complicated with the prevailing economic conditions in Sri Lanka where the inflation rate is currently 27% (source Central Bank of Sri Lanka) with risks of increasing further. The task of obtaining finances becomes an increasing difficulty that needs to be overcome by LFSUS.

Yet the chairman, Mr. Abeywickrema, is confident that even with these complexities the SUF “Finance Plus” approach – building links with the households, communities, government and the local financial markets – helps make a strong, sustainable body that can provide the needed technical assistance and support both to get loans, and help ensure they are repaid. “This is the first time that a public/private partnership of this caliber has been formed in Sri Lanka and it is an honour and a privilege for me to be a part of this initiative” says Mr Abeywickrema, assuming that this kind of partnership will mitigate the diverse risks that are involved.

The settlements of Kirulapura and Siddarthapura, initiated by SAPSRI (South Asia Partnership for Sri Lanka), are two upgraded settlements from an earlier development plan with a few areas unfinished. This settlement was approved by LFSUS to pioneer the new partnership where commercial banks will provide a loan to the project partners (at grass-root level). Project partners include the Women’s Bank,

SAPSRI and others. Negotiations are currently underway with commercial banks for their participation and support for this project.



*Shanty House in Lunawa Lagoon, Colombo, Sri Lanka.  
© Suzi Mutter, January 2005.*

One of the main reasons these two settlements were chosen is that the residents in these slum areas are financially more capable. The next lending phase of the project concentrates on the other settlements like the Kuriniyawatta, Majid place and Walauwatta, which are still in the initial stages of upgrading projects. The settlements of Kirulapura and Siddarthapura will be able to generate confidence in the partnering groups and encourage them to join in the local finance facilities. "Of course I'm not saying that there are no risks involved" says Mr Abeywickrema. "This is a new area that has not been tapped yet. Therefore there will be unforeseen risks involved. We need to be able to recognize this fact and work accordingly and hedge the risks as they come."

Every market and venture has its own risks. What is necessary at this stage is for the commercial banks to understand these risks and see the potential of this new commercially viable venture. If slum dwellers are provided with the necessary technical assistance and the right savings support, as they will be through LFSUS, the benefits to all - slum dwellers, banks, and the community overall - could be very positive.

## Tanzania

### *Profile of a SUF Partner in Tanzania*

The SUF Design Team, in consultation with local stakeholders, determined the need for a national special purpose vehicle to support access by projects and organisations to bank finance for the purposes of housing, slum and settlement upgrading. The Financial Sector Deepening Trust of Tanzania (FSDT) with the overall aim of achieving greater access for more people to the financial sector in Tanzania, is also mandated to facilitate slum and settlement upgrading and is specifically aimed at benefiting low-income households. This is a very good fit with SUF objectives, and so a partnership has been born.

FSDT will serve as the local finance facility for SUF in Tanzania. This approach makes use of a successful existing institution but still leaves room for the SUF "Finance Plus" approach. A "project advisory committee" (PAC) made up of members from communities, the municipality and lenders, will be responsible for day to day activities, technical support and project review. This advisory committee will fit in the existing FSDT organisational structure, ultimately reporting to the overall Programme Investment Committee of FSDT.

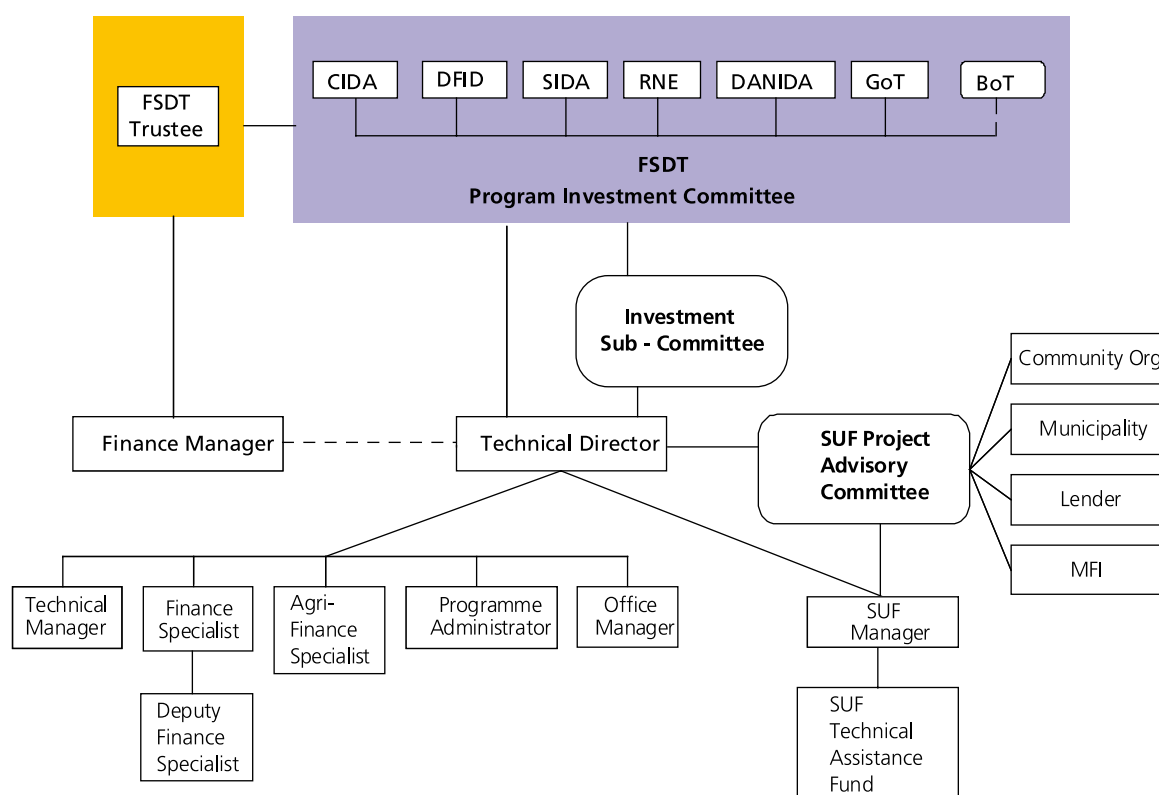
#### The Mutual Objectives of FSDT/SUF:

- To provide full, partial or other forms of guarantees to banks or other funding sources in order to secure lending to low income earners or housing societies formed by such groups, for the purposes of financing slum upgrading and settlement development projects.
- To provide full, partial or other forms of guarantees to banks or other financial sources to secure lending to micro-finance institutions, community based organizations or other such similar institutions for the purpose of facilitating access to home improvement loans by low income households.
- To take any other such actions that may facilitate low-income earners to access housing finance directly or indirectly from banking sources.
- To take any other such actions that may facilitate intermediary organizations such as micro-finance institutions, community based organizations and other such similar organization to access wholesale finance from banking or market based sources for on-lending to low income households seeking to upgrade their housing conditions.
- To, in cooperation with a wider advisory network, facilitate the exchange and sharing of experience and information on financing home improvement, slum upgrading and settlement development.



## Organizational Structure currently under discussion between FSDT and SUF

Figure 1 FSDT Service Delivery Mechanisms<sup>1</sup>



There will be other key benefits – SUF will benefit from the established trust structure of FSDT, and will bring, in return, additional housing and upgrading finance expertise. Sharing of information and coordination of projects will mean SUF projects will be higher profile, and potentially more easily mainstreamed and sustained.

There are three main projects being developed under the SUF umbrella in Tanzania, and this new partnership between SUF and FSDT will provide the support these projects need to go “all the way to the bank”.

In the Kurasini/Chamazi project, 30 acres of land has been purchased by the community in Chamazi and an organized housing association is soon to be formally registered. The boundary survey is complete and a preliminary community plan is underway. The Ministry of Housing has provided an architect who has developed several prototype plans for review by the community, who have met together to discuss the thorny issue of affordability. Work is underway on a financial model and first meetings with banks are also underway.

The Buguruni settlement upgrade has full support of the Mayor and would be a major undertaking, and potentially very interesting for SUF. A major part of the upgrade would be a new 9,000 sqm market facility. This would mean a comprehensive infra/market/livelihoods/housing approach, and has an economic driver in the form of the market facility that is in itself a potentially bankable project. The Mayor and the community are both actively involved and meetings and plans are ongoing.

Tameke Mwisho Redevelopment Site has completed a basic physical survey of the site and key partners have prepared a project concept document. The next step is a pre-feasibility assessment, which will be done in late September.

1. Funding for the Financial Sector Deepening Trust currently comes from five government donor agencies: Canadian CIDA, UK DFID, Swedish Sida, the Royal Netherlands Embassy and Danish DANIDA. The Government of Tanzania is expected to join the Trust shortly as a sixth funder, using World Bank / IDA funding.

# FINANCING SLUM UPGRADING

## ✓ DO

## ✗ DON'T

Ensure that financing for slum upgrading is recognised as a priority within national development planning and as a key investment element contributing to economic growth. This emphasis should be reflected in a slum upgrading budget line within national and local authority budgets.

Don't rely on one off poverty-focused upgrading projects.

Encourage local and international banks and micro finance institutions to become active participants in financing upgrading as part of their core business.

Don't rely solely on housing or government finance institutions.

Ensure that guarantees are available to encourage banks to lend to slum upgrading projects.

Don't provide guarantees that support interventions based on political patronage.

Build investment in slum upgrading on a firm foundation of community based savings and loan systems and local authority commitments to provide in kind and monetary allocations on an annual basis.

Don't assume that community involvement is best restricted to cost recovery and loan repayment and that local government has no responsibility for planning investment in upgrading.

Recognise that financing for slum upgrading requires a mix of short, medium and long-term loans, integrating finance for building, infrastructure and livelihoods.

Don't assume that one financial product fits all.

Provide mechanisms to blend municipal finance, cross subsidies and beneficiary contributions to ensure financial viability of upgrading projects and home improvement programmes.

Don't rely on government subsidies or on full cost recovery from slum dwellers.

Develop a process for sharing risk analysis and planning for risk mitigation and management with all the key stakeholders.

Don't expect residents of slums to be the only risk takers in developing new approaches to upgrading.

Plan projects on a mixed-use basis with revenue generating elements such as saleable residential units and rentable commercial space in order to maximise financial viability.

Don't assume that lending for slum upgrading will necessarily be asset-based. Where banks do lend for this purpose lending is more than likely to be revenue based.

Ensure that subsidies are effectively targeted so that the benefits reach those for whom they are intended and build on the basis of long term engagement.

Don't assume that all the problems of a slum can be addressed quickly with the framework of a single project.

Recognise that not everyone who lives in a slum is poor. Where an area upgrading strategy is to be implemented provision needs to be made for a range of income groups with steps taken to ensure that the poorest are not excluded.

Don't insist that interventions should only benefit low-income families.

Recognise that home ownership is not the solution to everyone's problems. Provision for the development of affordable rental property is an important component of financing slum upgrading.

Don't restrict interventions to developments based on clear land title and private ownership of property.

Make the real cost of finance very clear so that people clearly understand the commitments they are making to loan repayment.

Don't hide the real cost behind misleading promotional messages.

Where appropriate establish local upgrading finance facilities so that funding is locally available.

Don't assume that existing finance institutions will have the capacity to deliver the full range of financial services required.

Explore options to use land allocation, readjustment and sharing methods to release finance for upgrading.

Don't place unnecessary restrictions on land use.

# The Slum Upgrading Facility Newsletter

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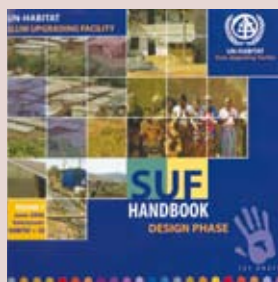
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- **Working Paper 8:** Finance facilities: What they are, why they are important and how they work, by Ruth McLeod, April 2008

For more information on SUF please visit the UN-HABITAT website at

# www.unhabitat.org

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