United Nations Habitat and Human Settlements Foundation (UNHHSF)
Policy Framework for a Revolving Fund Facility Account (REFFA)

Purpose of the Policy Framework

The Policy Framework provides an overview of the short and medium-term strategy for revitalizing the United Nations Habitat and Human Settlements Foundation (UNHHSF). It serves as a reference document for the adoption by the Governing Council at its 21st Session of the “Operational Guidelines and Procedures” for the Foundation, pursuant to the Secretary-General’s bulletin on “Special annex for the UNHHSF to the Financial Regulations and Rules of the United Nations” of 20 July 2006. The Policy Framework proposes a phased approach to apply innovative finance systems that will support local actors in mobilising domestic investment for pro-poor housing and urban development. In this regard it also provides a framework to enable UN-HABITAT to scale up its policy and capacity building activities at local level through a revolving fund mechanism instead of grants, where appropriate. It is prepared within the context of the Medium-term Institutional and Strategic Plan for 2008-2013 (MTISP) and Resource Mobilization Strategy. These documents constitute a comprehensive effort by UN-HABITAT to achieve greater impact at country level in line with current United Nations reform efforts.

Rationale for a Revolving Fund Facility Account (REFFA)

The Revolving Fund Facility Account, hereinafter REFFA, seeks to fill a gap in the international architecture for financing affordable housing and related urban infrastructure. This gap is one of the major constraints to scaling up slum upgrading initiatives and to sustainable slum prevention. Public and private investment, including Official Development Assistance (ODA), currently make up less than 5% of the estimated resources required to “improve the living conditions of at least 100 million slum dwellers by the year 2020,” and to “reduce by half the households lacking access to safe drinking water”1. Two principal factors mitigating investment in human settlements are: (i) the lack of instruments to mobilize domestic savings and capital particularly for low income and poor people in developing countries, and (ii) the absence of catalytic mechanisms for coordinating the efforts of development organizations in this regard. A closely related factor is the lack of awareness on the part of policy makers of the benefits of investing public funds – be these ODA, State or municipal – to leverage community savings and private investment.

The Revolving Fund Facility Account of the UNHHSF is designed to overcome these obstacles to help meet the effective demand for housing and infrastructure by the urban poor. This entails working with cooperatives, savings associations, micro-finance institutions, and local service providers to scale up the efforts by the urban poor to improve housing, water, and sanitation. It involves establishing effective mechanisms to engage domestic financial service sector 2 to develop products commensurate with the affordability models of the urban poor who often pay more per unit cost for such services but lack verifiable income, credit history and tenure security.

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1 See Targets 10 and 11 of the Millennium Declaration
2 Mortgage institutions, building societies, pension funds, financial markets
Origin of the UNHHSF

UN-HABITAT derives its origins from two main sources: the upgrading of the former United Nations Commission on Human Settlements (CHS) and its secretariat, the United Nations Centre on Human Settlements established in 1976; and the United Nations Habitat and Human Settlements Foundation, established as an outcome of the 1972 Stockholm Conference, as a mechanism to assist developing countries with investments in meeting their housing and environmental management challenges. The new Rules and Regulations promulgated by the Secretary General in 2006 supercede the earlier Rules for the UNHHSF which did not provide a mechanism for establishing revolving fund systems as envisaged at the Stockholm Conference. They empower the Governing Council of UN-HABITAT to pursue the call by the General Assembly to strengthen the UNHHSF and its operational requirements to be implemented by the Executive Director of UN-HABITAT.

Comparative advantage of UN-HABITAT

UN-HABITAT is well placed to address the complexity associated with financing pro-poor housing and basic services. The organization has for over 30 years established networks with urban poor organizations, local authorities and departments of central government for land, housing, local government, water, sanitation, urban planning, etc. Its more recent programmes work with micro-credit and domestic finance institutions, service providers and utility companies. It has a proven capacity to forge partnerships between these different actors, and it uses this advantage to link policy development and pre-investment assistance with the lending operations of International Financial Institutions (IFIs) to assist Member States to finance pro-poor human settlements development. It is an agency of the UN system with extensive community and municipal level networks. These networks enable UN-HABITAT to broker or connect low income and poor people and smaller and middle-sized municipalities to mortgage and infrastructure finance provided by standard commercial banks, be they national, regional or international. UN-HABITAT is a founding member with the World Bank of the Cities Alliance, which provides pre-investment technical assistance to cities and municipalities. It also partners with regional development banks through its Water for African and Asian Cities programmes to ensure follow-up investment in pro-poor water and sanitation.

Lessons learned and pointers for the future

The Water and Sanitation Trust Fund (WSTF) and the Slum Upgrading Facility (SUF) are demonstrating how relatively small amounts of seed capital combined with technical assistance can leverage substantial amounts of domestic and international finance for pro-poor housing and urban infrastructure development. They reduce transaction costs and enhance aid efficiency by combining the resources of donors, governments, local communities and IFIs within a multi-year technical assistance and financing package. Both the WSTF and the SUF do so, however, on the basis of one-time grants.

3 In addition, UN-HABITAT established the Trust Fund for the Special Human Settlements Program for the Palestinian People, adopted unanimously by the Governing Council at its 19th Session. While not dedicated specifically to financial innovation, it includes resource mobilization initiatives in the West Bank and Gaza, and demonstrates the importance of lending the weight of the Foundation to address complex political conditions of human settlements in the Middle East.
The Revolving Fund Facility Account will extend the seminal work of the WSTF and SUF to further reduce transaction costs and perceived risks associated with slum upgrading and pro-poor urban development. This involves complementing the existing business model with innovative revolving funds and financial instruments that package different sources of finance, including community savings, public investment, domestic private capital, grants and international loans on a more self-sustaining basis. The REFFA activities will provide for the first time a mechanism to mobilize both international and domestic resources and to use them to scale up activities from one beneficiary group to another. At the same time the use of revolving funds enhances beneficiary responsibility and buy-in into the whole process.

Short-term scope and implications and of the new rules and regulations

The existing functions of the UNHHSF are assumed under two windows:

- The General Fund (or General Purpose Account) receives un-earmarked voluntary contributions from Member States and other donors to fund the core advocacy and policy development activities of UN-HABITAT’s work programme;
- The Special Funds (or Special Purpose Accounts) receive earmarked voluntary contributions for specific purposes or projects such as the Slum Upgrading Facility (SUF) the Water and Sanitation Trust Fund (WSTF), and the Palestinian Human Settlements Programme Trust Fund.

A new window of the Foundation – the Revolving Fund Facility Account (REFFA) – will be created for financing operations at the local or municipal level. This will be “the account to which resources are specifically made for reimbursable seeding operations” - at the local level through Local Revolving Fund Accounts hosted by local banks or finance institutions which assume accounting and fiduciary responsibilities, thus obviating the need for the UNHHSF to be involved in fiduciary functions directly. The Local REFFAs will be set up specifically to provide improved access to credit by local partners engaged in pro-poor housing and infrastructure development. It will cater for groups that would otherwise not be able to access such institutional credit because of lack of organizational ability and capability to do so on their own. Their primary purpose will be to combine the pre-investment assistance provided by UN-HABITAT and the seed capital provided by the Foundation to leverage local domestic capital. In this respect the Local REFFAs offer donors a new window of opportunity for more sustainable use of their grant funds at no new risk. On the contrary, by introducing revolving mechanisms, donor funds will be multiplied by the leveraging of domestic capital not possible under a pure grant system that is currently in operation.

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The new Rules define “reimbursable seeding operations” as the Foundation lending operation through provision, on reimbursable basis, to eligible public and private institutions, with special emphasis on developing countries and countries with economies in transition, of seed capital, loan guarantees, including housing loan insurance and equity investments, to support mobilization and effective utilization of domestic financial resources for human settlements, by local lending financial institutions, particularly housing finance and community based savings and loans organisations and other institutions engaged in low cost housing and slum upgrading programmes.
Each window of the Foundation will seek voluntary contributions from Member States and other potential donors, and each window will have its own current and reserve account. Funds deposited in the different windows will remain segregated and accounted for separately. A Lending Operations Review Committee will be established under the chairmanship of the Executive Director of UN-HABITAT to whom authority for the running of the Foundation has been delegated by the Secretary General under the oversight of the Governing Council.

**Longer-term scope and implications**

In the longer term, the 2006 Financial Rules and Regulation enable the *Revolving Fund Facility Account* to conduct ‘Foundation borrowing operations’ from Governments and governmental agencies and intergovernmental organisations. The Financial Rules further state that the limits of the funds to be borrowed shall be set by the Secretary General, from time to time, upon recommendation by the Executive Director and upon authorization by the Controller. The new rules specify that the liability of these “borrowing operations” cannot exceed the reserve account of the RFFA and will remain under the control of the Office of the Secretary General through the UN Controller. They further stipulate that no lender shall have any claim against UN-HABITAT or the UN, or any of its assets. They also state that this limitation of liability to the Foundation resources will be stipulated in all Foundation borrowing documents. Thus borrowing, if it were to come into force, would incur no liability to UN-HABITAT or to the UN.

**A phased approach**

In the short term UN-HABITAT will, between the 21\textsuperscript{st} and 22\textsuperscript{nd} sessions of the Governing Council, harmonize the existing and future elements of the Foundation in line with the Operational Guidelines and Procedures. It is envisioned that this will involve institutional adjustments to the Human Settlements Financing Division (Sub-Programme 4) including the co-location of the WSTF and the SUF, as envisaged by the Medium-term Strategic and Institutional Plan (MTSIP). This would facilitate the cross-fertilization of concepts and practices applied by the two leading operations of the Foundation. External advice will be sought to combine the infrastructure emphasis of WSTF with the affordable housing and upgrading emphasis of SUF; and how to link the IFI loan portfolio to be leveraged by the former with the community savings and domestic capital to be leveraged by the latter. The *Revolving Fund Facility* would be applied during this period as part of the Enhanced Normative Framework of the MTSIP in select cities where both WSTF and SUF are operational, offering Member States practical instruments to mobilize resources for comprehensive slum upgrading and/or prevention.

In the medium term, UN-HABITAT will embark on an intensive fund raising campaign to capitalize the *Revolving Fund Facility* as part of its wider effort to implement the Resource Mobilization Strategy. This will involve consultations not only with major donor countries but also with private foundations, non-traditional donors, and IFIs. Pending sufficient capitalization, UN-HABITAT will implement the Operational Guidelines and Procedures of the *Revolving Fund Facility Account* on a trial basis in a subset of the 25 target countries as anticipated in the MTSIP. Experimentation of this kind would offer UN-HABITAT an opportunity to test the provisional structure of the Local Revolving Fund Accounts including in countries where the WSTF and/or SUF are operational. In this way the Secretariat could assess the effectiveness of *Revolving Fund Facility*, determining how best local and national
partners can utilize the package of technical assistance, start up capital, equity investments, loans and loan guarantees. Further, UN-HABITAT could ascertain how seed capital used to kick-start one initiative can be applied to subsequent initiatives, facilitated by the domestic financial service sector in a given country. A mechanism for scaling up and multiplying donor funds could thus be established.

**Purpose of the Operational Guidelines and Procedures**

The 2006 Rules of the UNHHSF stipulate all requirements for accountability, liability and administration, including distribution of income and costs incurred for all windows of the Foundation. They require nonetheless a set of “Operational Guidelines and Procedures” to be established under the guidance of the Governing Council, including Terms of Reference for the Lending Operations Review Committee and the details of the “reimbursable seeding operations”.

The Executive Director thus requests the Governing Council at its 21st Session to offer direction on how best to consolidate the revitalization of the Foundation, and to chart a course of action for the medium and long term. UN-HABITAT is presently at the level of demonstration and field testing, evidenced by initiatives of WSTF and SUF. It needs to continue this work while preparing the ground to support Member States more effectively by leveraging public resources to mobilize savings and domestic capital. Structuring the Foundation appropriately will enable UN-HABITAT to play a catalytic role in bridging urban poor organizations and government at all levels with domestic and international financial institutions.

Of particular importance in this exercise is for the Governing Council at its 21st Session to promote the **Revolving Fund Facility** in three ways. The first is to endorse in principle the phased approach to enhance the capacity of the Foundation to meet the needs of Member States within the framework of the MTISP. The second is to take note of the Operational Guidelines and Procedures to be tabled by the Executive Director at the Governing Council in compliance with the promulgation of the UNHHSF rules by the Secretary General. The third is to support in principle the approach proposed by the Executive Director to capitalize the **Revolving Fund Facility Account**, ensuring continuity with the organization’s wider Resource Mobilization Strategy. Where feasible, donors to the SUF and WSTF will be urged to convert part of their existing grants from the Special Fund to the REFFA.

Figure 1 below summarizes all of the above in a financial flow framework of analysis. Attention is drawn to the three core fund accounts of the UNHHSF and their respective reserves. Presently the REFFA is missing. As a result, there is no mechanism to seriously address investment and scaling up issues at local level. Without the REFFA, there is also no clear mechanism for mobilizing domestic funds for pro-poor activities that are the hub of UN-HABITAT. The centrality and distinctive role of the Human Settlements Financing Division in organisational structure of UN-HABITAT should also be noted. Other core divisions of UN-HABITAT would thus be able to scale up their activities through the revolving funds managed by this Division.