Improving access to domestic capital for slum upgrading and low income housing projects
Field Testing Design Instruments for Financing Slum Upgrading and Low-Income Housing in Developing Countries

Slum upgrading vehicles, products and instruments

November 2005
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SUF: A Range of Financing Products and Instruments

SUF is developing a range of financing products and instruments based on normal financing practice but reconfigured to provide municipalities and their slum upgrading and low-income housing development partners with appropriate and usable products.

This paper considers, in detail, five particular financing concepts under consideration by SUF. These products broadly follow the typology set out below in Box 1, but will require individual development according to the circumstances in each country.

- **Property Unit Trusts** are one concept - they are a mechanism to attract Pension Funds as a Source of Finance for Municipal Low Income Housing Development Companies, and can be a Special Purpose Vehicles in Kenya, Sri Lanka, Ghana, Tanzania and Indonesia.

- **Expanding the Low Income Housing Market** is a second concept explored in this paper - Sale and Leaseback Transactions with first year capital allowances that can kick-start the process in Kenya, Ghana and Sri Lanka.

- The third concept is **Enhancing Municipal Borrowing Capacity** – there is potential in UN-HABITAT / Standard and Poors Cities and Municipal Credit Rating Initiative in Sri Lanka and Indonesia.

- The fourth concept is **Housing Associations** – this paper includes a proposed generic model for neighborhood governance of slum upgrading is considered.

- The fifth concept is **City-Community Local Development Funds** – utilising the experience of the UN-HABITAT/UNDP Urban Management Programme (UMP) City-Community Challenge Funds (C3), enhanced to become community-led development funds for Slum Upgrading and Low-income Housing Developments, to be known as C3+.

**BOX 1: SUF: Types of Financing Products**

**A. Product Types, and where they are being developed by SUF:**

**Accessible Low Income Housing and Home Improvement Loan Products** - This 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 – this is being developed by GoK with SUF inputs for KENSUP; likely in other countries as well, and featured prominently in the Belaggio conference and recent EGM on SPV Formation, held in Nairobi on 5-6 September 2005.

**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; SUF advocates this approach in all places.

**Municipal Bonds** for investments in housing land development, related
infrastructure, and slum upgrading 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 – negotiations for USAID’s Development Credit Authority to support the Accra model, and GuarantCo supporting Lusaka City Council.

**B. Technical Assistance and Capacity Building** to develop any of the above. Initially this is based on the expertise of the CPCs, and consultants, but will become more comprehensive with a range of local Capacity Building institutions that join the SUF system.

*Note: This list is not exhaustive, but provides an indication of progress made to date on field testing design instruments under the SUF Design Phase. All the examples are subject to change as the detail is worked out between the parties. Changes also occur when another development partner enters the arrangements.*
Field Testing Design Instruments for Financing Slum Upgrading and Low-Income Housing in Developing Countries

Barry Kulick, SUF Public Finance Consultant, November 2005

Property Unit Trusts

...a mechanism to attract Pension Funds as a Source of Finance for Municipal Low Income Housing Development Companies – Special Purpose Vehicles in Kenya, Sri Lanka, Ghana, Tanzania and Indonesia

1. **Background**

   The Concept Note suggests that a Property Unit Trust be explored as a methodology to facilitate pension fund investment in SPVs and that the possibilities to do so be examined during the SUF Pilot Phase in Sri Lanka, Ghana, Tanzania and Indonesia.

   The Concept Note also addresses the issue of pension fund inaccessibility to cities and municipalities seeking to finance slum upgrading and low income housing programmes.

   A Property Unit Trust is an open-ended fund whereby investors’ funds are pooled and used to invest in a portfolio of securities and other financial assets related to real estate development, with the beneficial interest in the assets of the trust divided into units. The unit trust managers guarantee the price of the units, redeeming units and issuing new units on a continuous basis.

   The legal form of an SPV will initially be a privately held limited liability joint-stock company organized under appropriate national legislation. In pension fund asset class language, its issued shares are an unquoted equity.

2. **Property Unit Trust, Pension Fund Investment and SPV**

   Two of the key difficulties for a pension fund manager to overcome when considering an investment in an unquoted equity concern liquidity and valuation: [i] liquidity, because there is no regulated market through which to dispose of the shares on demand as the shares are not publicly traded; and, [ii] valuation, because there is no freely traded market in which the shares are assigned a value.

   From a pension fund manager’s investment risk assessment perspective, it is presumed the SPV presents a sustainable and profitable organization over the long term whose financial obligations and operations are supported by suitable credit enhancements and a considerable asset base of high value fixed assets. The pension fund manager’s concerns then turn to liquidity and valuation issues.

   To address the issues of liquidity and valuation, the SPV should initiate parallel exploratory discussions with pension fund managers, unit trust managers and appropriate regulatory authorities. The discussions would explore the potential for one or more registered unit trusts to create a separate and dedicated Property Unit Trust approved by the appropriate regulatory authority which would serve as a suitable investment vehicle through which a pension fund would invest in the SPV.

   The Property Unit Trust would make a market in the units and guarantee the unit price, thereby solving the liquidity and valuation issues.
3. Pension Funds Currently Do Not Invest in City and Municipal Slum Upgrading and Low Income Housing Projects

Pension fund investment criteria take into account a number of factors, focusing critically on liquidity and valuation potential of the investment asset. A pension fund is unlikely to make a direct investment in city and municipal slum upgrading and low income housing projects because such investments do not present the opportunity for liquidity or valuation.

A pension fund making such investments through a financial service intermediary such as a Property Investment Trust does achieve liquidity and valuation objectives.

A pension fund would also be able to invest in a bond issued launched by a city or municipality to finance slum upgrading or low income housing development where the payment obligations were supported by suitable credit enhancements and demonstrable and predictable ring-fenced revenue streams.

4. Pension Fund and Unit Trust Snapshots: Sri Lanka, Ghana, Tanzania and Indonesia

Set out below are brief summaries of the pension fund and unit trust landscapes in Sri Lanka, Ghana, Indonesia and Tanzania.

4.1 Sri Lanka

a) Pension Funds

The Government of Sri Lanka has been faced with resistance from unions over its plans to liberalize the pension sector and lift its monopoly on pension funds by combining the Employees’ Trust Fund [ETF] and the Employees Provident Fund [EPF] into a single fund.

EPF is the single largest investor in the domestic capital markets, primarily investing in government securities, Treasury Bills, inter-bank call money market and government guaranteed debentures. ETF, in addition to investing in the same class of instruments, invests in corporate equities.

Total assets of both pension funds at end June, 2003, stood at Rs. 335. billion, of which 89% was in EPF1.

There has been a long delay as well in implementing the Government’s policy decision to release a part of EPF/ETF funds for deployment in the capital markets through professional fund management companies.

There are several privately managed pension funds, whose operations are similar to EPF, and it is anticipated that government will continue to encourage the private sector to expand its role in establishing pension funds.

b) Unit Trusts

Although underperforming, unit trusts are well established investment vehicles on the financial landscape. National Asset Management Ltd. is the country’s largest unit trust company.

Despite opposition to the Government’s announced liberalization programme, continued opening of the market to the private sector is expected to increase over the next 5 years2.

4.2 Ghana

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1 Financial Sector, Central Bank of Sri Lanka, 2004
2 Sri Lanka: Financial Services Forecast, Economist Intelligence Unit, 2005
a) Pension Funds

As of December, 2004, total assets of the Social Security and National Insurance Company [SSNIT] were valued at GHC 10.6 trillion [approximately USD1.1 billion].

Investments made in asset classes relevant to SPV objectives measured as percentage amounts of total assets were domestic equity as to 37% thereof, real estate as to 15% thereof (9% of which is invested in real estate development) and fixed income securities as to 11% thereof.4.

b) Unit Trusts

Unit Trusts are an integral part of the capital markets, governed by the Unit Trusts and Mutual Funds Regulations, 2001. HFC Bank own and manage 3 of the 4 licensed unit trusts.

4.3 Indonesia

a) Pension Funds

The state-owned pension firms Jamsostek under the Ministry of Labour with assets in 2003 of Rp. 26 trillion [USD2.7 billion], and Taspen under the Ministry of Finance with assets in 2003 of Rp. 12. trillion [USD1.4 billion], are the largest pension funds in Indonesia. Together, they own 5% of the corporate bonds listed on the Surabaya Stock Exchange, their investment valued at about USD6.3 billion5.

The pension funds are perceived to have made poor investment decisions and to suffer from a lack of disclosure, transparency and weak management systems.

To strengthen the regulatory regime for capital markets, the government had proposed to establish by 2006 the Financial Services Authority Institution [OJK], an integrated financial supervisory authority, under the Ministry of Finance. The OJK was to oversee the Bank of Indonesia, pension funds and other financial institutions. A clause in the amendment to the bill establishing the OJK stated that OJK could be set up by 2010 at the latest.

b) Unit Trusts

At end 2005, the mutual fund sector had grown to Rp. 73. trillion6. Fundamentals are perceived to be weak and many mutual funds do not follow international valuation norms, amid some concern that a loss of investor confidence may come about through recognition of a false sense of security among investors.

4.4 Tanzania

a) Pension Funds

The Pension fund scenario in Tanzania presents a challenge. There are 6 state-run pension funds and no harmonized regulatory or legal framework governing their conduct. 4 of the pension funds report separately to the Ministry of Finance, one to the Ministry of Local Government and one to the Ministry of Labour. Under a World Bank financial sector adjustment credit, Tanzania plans to undertake legislative reform of its financial institutions, including the pensions sector.

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3 Implementation of Investment Guidelines, a presentation made by Ras Boateng, Deputy Director General, Social Security and National Insurance Trust, Ghana, at the International Conference on the Investment of Social Security Funds held in Merida, Mexico, 27-28 September, 2005.
4 Ibid.
6 A Financial Sector Agenda for Indonesia, Bank Dunia/World Bank 2005
b) Unit Trusts

In 2003 the government formed the Unit Trust of Tanzania [UTT] to promote the opportunity for small investors to invest in Tanzania. In May, 2005, UTT launched its first scheme, the Umoja Unit Trust, [Umoja Fund] with the slogan “invest in order to be empowered.” Essentially, the scheme is intended to enable small savers including hawkers and shoe shiners to become investors in shares of the companies listed in Dar es Salaam Stock Exchange. The sale of Umoja Fund Units to the public started on May 10, 2005, and ended on July 29, 2005, and unit certificates were expected to be issued within one month.

While it is too early to gauge success of the effort, the response was perceived as extremely positive. It is important to explore how the response to Umoja Unit Trust sale of units was so positive despite low incomes and skepticism embedded in some sections of the population.

5. Pension Funds, Unit Trusts, SPVs and Efficient Resource Allocation

One of the more important roles of professionally managed pension funds wearing their capital markets hat is to allocate resources to the most efficient best practice investment opportunities in order to most effectively accomplish their long term financial objectives. Therefore, the less efficient investment opportunities find it more expensive and costly to raise funds, compelling them to operate on a more efficient best practice basis or lose out.

Unit trusts offer the opportunity for small investors to pool their funds and access investment opportunities generally open to only large investors. SPVs undertake financially sound operations which generate profits for investors or bondholders and develop low income houses for slum dwellers with the potential to transform lives. There is a marriage here. The marriage ceremony needs only to be arranged.
Expanding the Low Income Housing Market

... Sale and Leaseback Transactions with first year capital allowances that can kick-start the process in Kenya, Ghana and Sri Lanka

1. General

It could be said that the MDG targets are receding into the misty distance. Influential drivers of change are not pioneering sufficiently powerful or novel public sector/private sector/donor partnerships resulting in re-allocated resource delivery with noticeable poverty reduction and job creation impacts.

This report suggests that an innovative alliance of change drivers comprising UN-HABITAT, donors, the commercial banks and low income housing developers will propel the low income housing debate to center-stage by supporting harmonized modifications to certain SUF Pilot Programme Country tax laws and introducing implementation modalities to effect such changes.

The changes in national tax laws to be supported will enable implementation of Low Income Housing Sale and Leaseback [LIHSL] transactions [see Annex 1 attached].

2. Developing Country National Governments and Income Tax Law

Broadly speaking, developing country governments severely restrict corporate taxpayer access to tax deductions, tax credits and tax exemptions because such national governments [i] suffer from chronic and unpredictable budget shortages and can not afford the revenue loss; and, [ii] operate from the “foot-in-the-door” perspective, i.e., give a taxpayer room to reduce its tax liability and the taxpayer will abuse the tax benefit.

Developing country governments typically are reluctant as well to experiment with tax measures designed to incentivise re-allocation of resources to priority sectors because they lack experience in doing so.

3. Commercial Banks

Accordingly, the commercial banks have little wiggle-room when considering tax-planning measures to reduce their liability to tax. There are simply no tax avoidance measures available to consider.

4. Donors

Donors, in varying degrees and with varying effect, are in the process of coming around to the view that business as usual has not been a great success in meeting their development objectives or the MDG targets, measured by any combination of indicators.

Donor policy frameworks have been revamped to focus on poverty reduction, capacity building, skills enhancement and sector deepening rather than primarily economic growth. Donors are searching for novel partnerships presenting opportunities to access entry points in trade an industry to formulate and implement more immediate and direct interventions.

5. SPVs and Commercial Low Income Housing Developers

SPVs are credit-worthy vehicles supported by credit enhancements underpinning their payment obligations and may take advantage of LIHSL Transaction benefits. In the SUF Pilot Programme Countries, there are credit-worthy housing developers flourishing in the middle income and high income housing markets who may be motivated to move into the low income housing market in order to access the LIHSL Transaction benefits.
It would be expected that as the low income housing market expands with the introduction of LIHSL transactions, new players will emerge in the low income housing market as well as new Housing Banks motivated by access to the LIHSL benefits [see Annex 1 attached].

6. LIHSL Transactions - Implementation

The LIHSL Transaction Structure is more fully described in Annex 1 attached.

It should be noted that the LIHSL Transaction Structure is novel in the SUF Pilot Programme Country context and open to fiduciary risk and moral hazard. A carefully crafted legislative, regulatory and oversight framework is essential to ensure that targeted initiatives are the sole LIHSL transaction beneficiaries.

Implementation of an LIHSL Programme will result in a reduction of the amount of tax collected by the national revenue authority, although the revenue collection reduction reflects only a timing difference in the collection period [see Paragraph 6 in Annexe 1 attached].

It is envisaged that donors will in large part fund the revenue loss in a ceiling amount to be determined and will do so either out of Overseas Development Assistance (ODA) resources already allocated to substantially similar goals, out of a newly created basket fund or by way of a cost sharing endeavour with UN-HABITAT.

It is further envisaged that donors will facilitate the technical assistance necessary to support design and implementation of the LIHSL Transaction regulatory framework.

Among other things, criteria for identifying a “low income house” must be agreed, probably based on the maximum sale price of the house.

A number of issues need to be resolved in formulating immediate next steps and the way forward in each country, taking into account the need to harmonize the LIHSL structure within each country’s respective context.

7. SUF Pilot Programme Countries and The LIHSL Transaction

The SUF Pilot Programme Countries in which to experiment with the LIHSL transaction are Kenya, Ghana and Sri Lanka, which have experience with tax-driven investment strategies as briefly summarized below.

Those countries have already incorporated accelerated depreciation measures into their tax codes as a tool to incentivise re-allocation of domestic and foreign investment resources to strengthen certain sectors, evidencing a comfort zone with tax-motivated investment strategies.

Although unconnected with tax-efficient strategies, also included under each country heading below are highlights concerning current steps being taken in support of the SUF agenda.

7.1 Kenya

In order to support development of tourism and manufacturing, Kenya Government provides eligibility for 100% first year investment deductions in the year the investment is made for capital expenditures incurred on the construction of buildings and equipment used for manufacture, and, on the construction of hotel buildings⁷.

On the housing front, the Minister for Finance in his Budget Speech for Fiscal Year 2005/2006 made 2 key commitments in support of the SUF agenda:

a. In order to encourage SPVs raising long term capital through issuing asset backed securities, the Minister proposed to exempt SPV investment income from tax.

b. In order to allocate dedicated funds to the Kibera slum upgrading project, the Minister proposed to allocate KShs. 500 million to the Slum Upgrading and Low Cost Housing and Infrastructure Trust Fund established by Kenya Government.

7.2 Sri Lanka

In order to support the development of Sri Lankan computer software in the face of increasing competition from foreign imports, in Fiscal Year 2005 the Government of Sri Lanka granted 100% first year capital allowances in the year of purchase to purchasers of Sri Lankan developed software, while capital allowances for purchasers of imported software remained at 25%.

On the housing front, in Fiscal Year 2005 the Government of Sri Lanka initiated a housing loan scheme for government employees, and increased from 4 years to 7 years exemption from income tax on rental income derived from a newly constructed house not exceeding 1,500 sq. ft. in floor area.

7.3 Ghana

To maintain investment momentum in the mining and petroleum sectors faced with deepening international competition, the Government of Ghana in Fiscal Year 2005 granted 80% first year capital allowances to purchasers of buildings and equipment used in mining and petroleum exploration operations in the year of purchase plus 50% of the residue annually thereafter plus an uplift of 5% on the cost in the following year.

On the housing front, in Fiscal Year 2005 the International Finance Corporation [IFC] launched a two-year technical assistance project in Ghana with a view toward sparking new residential mortgage lending. The Swiss State Secretariat for Economic Affairs (SECO) has provided initial support.

IFC and four of Ghana’s major financial institutions - HFC Bank, Ecobank Ghana, Fidelity Discount House and the Social Security & National Insurance Trust - have signed a Memorandum of Understanding that calls for long-term local currency mortgage funding under uniform guidelines and practices, based on international standards. The framework will apply to all investors and lenders participating in the funding initiative.

8. Conclusion

This report presents preliminary and untested thoughts concerning the best suited use to which 100% first year capital allowances can be put to expand the low income housing market. Additionally, each country will present different challenges which will shape the 100% first year capital allowances financial structure and subsequent debate.

However, implementation of LIHSL Transactions would establish a predictable source of financing for low income housing development as well as a forceful strategy to redirect

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8 Section 117, Budget Speech for the Fiscal Year 2005/2006
9 Section 79, Budget Speech for the Fiscal Year 2005/2006
10 Major Economic Policy Changes and Measures: Jan-October, 2005, Central Bank of Sri Lanka
11 Ibid.
12 The Ghana Investment Promotion Centre Act (Act 478)
13 IFC to Explore Expanding Residential Mortgage Lending in Ghana, IFC publication, 2005
commercial bank funds from financing consumption to financing options for slum dwellers to improve their lives.
Enhancing Municipal Borrowing Capacity

... potential UN-HABITAT / Standard and Poors Cities and Municipal Credit Rating Initiative in Sri Lanka and Indonesia

1. General Context

A key SUF objective is to strengthen the capacity of cities and municipalities to attract commercial finance for funding low income housing projects and slum upgrading.

Credit ratings can play a significant role in promoting market confidence, leading to lower cost of funds and easier facilitation of financial execution in the effort to mobilize private sector resources.

2. SUF Pilot Phase

Standard and Poors [S&P] have extensive experience in Indonesia and Sri Lanka, having issued the sovereign credit rating to Indonesia and being now in the process of concluding the sovereign rating process for Sri Lanka.

During the SUF Pilot Phase, it might be useful to examine the potential role to be played by a credit rating or a structure rating [see below] to support [i] the financial model for the city-wide slum upgrading projects for Yogyakarta and Jakarta; and, [ii] the low income housing investment finance models for city-wide slum upgrading projects for Colombo and Moratuwa.

3. UNDP / Standard & Poors Sovereign Credit Ratings Initiative

S&P, one of the two largest American credit rating agencies, issues domestic and international credit ratings for sovereign states and local and regional governments.

In 2003, UNDP entered into a framework agreement with S&P calling for UNDP to promote the value of credit ratings with certain African Governments and to secure their commitment to engage in the credit rating process with S&P supported by UNDP funding. S&P have issued 10 sovereign credit ratings under the initiative. S&P’s relationship with UNDP is expanding in Africa and is spreading to Europe and Asia with donor support topping up UNDP resources.

4. Standard & Poors Cities and Municipal Credit Ratings

Outside the United States, S&P has assigned local and regional ratings to over 300 local and regional governments, including many in emerging markets.

S&P also issue “structure ratings”. A structure rating is particularly useful in circumstances where a city or municipal authority might not earn a satisfactory credit rating on a stand-alone basis but has sufficient credit enhancements in place to earn an investment grade structure rating for a specific financing transaction. Structure ratings rate the financial soundness of a transaction structure rather than the credit worthiness of the transaction beneficiary, focusing on credit enhancements supporting the beneficiary’s payment obligations.

City and municipal credit ratings and structure ratings reduce transaction cost and accelerate market acceptance of financial instruments financing slum upgrading and low income housing projects.

The rating process is a positive learning tool for building good governance and capacity at city and municipal level, setting new benchmarks for accelerating good governance procedures and structures.

In order to deepen a cities and municipal credit rating culture, S&P have agreed to issue ratings to cities and municipalities located in countries that do not have sovereign ratings.
5. **UN-HABITAT / S&P Joint Cities and Municipalities Ratings Report**

S&P issue annually a “Sovereign Ratings in Africa” report jointly with UNDP. S&P have suggested that UN-HABITAT may wish to consider issuing jointly with S&P a similar ratings report highlighting best practices among cities and municipalities.

6. **UN-HABITAT, UNDP and S&P Linkage**

S&P think there would be little difficulty in UN-HABITAT implementing a cities and municipal ratings programme under the current UNDP/S&P Sovereign Ratings Agreement, whereby UN-HABITAT funding would be intermediated by UNDP. Aside from the utility of UN-HABITAT funding the programme through UNDP, a joint UN-HABITAT/UNDP Programme would have the potential to enhance joint outputs and reduce joint transaction costs.

7. **Kenya Government Sovereign Credit Rating**

Funding for the Kenya Government Sovereign Credit Rating is in the UNDP Annual Workplan for FY2005, but S&P advise that Kenya Government does not wish to initiate the sovereign ratings process until 2006.

8. **Costs and Timing**

If the cities and municipalities to be rated are located in Sri Lanka, Indonesia, Tanzania, and Ghana, cost and timing depend largely on logistics and synergies achieved in grouping the targeted locations together and agreeing a common favourable time to carry out the ratings process.

Typically, an individual sovereign credit rating with things going reasonably well in terms of scheduled interviews as well as document and information delivery takes 3 to 4 months to complete from signature of the Rating Agreement.

S&P on an unnegotiated basis have informally estimated pricing per city or municipal rating at USD50,000 and an annual surveillance fee of USD40,000. As a point of comparison, the UNDP/S&P sovereign rating programme is priced at USD80,000 per rating and USD40,000 annual surveillance fee.

9. **Mobilization of Donor Resources**

It is open to UN-HABITAT to employ its traditional seed capital role in funding this initiative, actively engaging donors to top up UN-HABITAT’s seed capital resources.

10. **Next Steps**

S&P have suggested the next step in the process would be to arrange a conference call between UN-HABITAT and S&P senior management to explore opportunities where a credit rating exercise would be useful for raising capital from the domestic capital markets.
Housing Associations: A proposed generic model for neighbourhood governance of slum upgrading

Judith Allen, University of Westminster, November 2005

Purpose

To propose an organisational model for housing associations as a vehicle for slum upgrading in mixed income, mixed use areas. The model is designed to facilitate long run finance by local capital markets, support neighbourhood-based governance of upgrading, exploit potential value gaps in land development, and facilitate a variety of types of upgrading activity (housing, environmental and infrastructural works, and locally based economic activity).

The heart of the model is a two-tier housing association structure. Housing associations are non-profit, non-governmental organisations. A strategic parent association would:

- hold land transferred by local or central government inalienably and in perpetuity
- act as a banker for subsidiary organisations, borrowing from the in-country private capital market, using the SUF loan guarantee facility, for onward lending to subsidiary organisations
- provide master planning, treasury management and risk management services to subsidiary organisations

Filial housing associations, organised as operational property management companies, would carry out the variety of slum upgrading tasks appropriate to the locality.

Context

The proposals are designed for mixed-use areas near central business districts in large cities where the value gap between top-end development and existing residential settlement is particularly large. This value gap would be exploited to provide funding to upgrade the existing settlements while, at the same time, maximising the participation of existing residents. The idea is to create an organisational vehicle which is attractive to existing in-country capital markets. It is also important to recognise that the “property motivations” of residents vary in terms of the balance between use-value and exchange-value.

Aims

- To keep planning gain within the area, converting it into either a cash flow or an asset against which further cross-subsidised development works can be funded through the normal operations of local capital markets
- To create a community-based organisation (neighbourhood governance board) for managing housing and neighbourhood development which is able to support further activities as appropriate or desirable
- To create a generic model which is capable of being adapted to a variety of circumstances, in different countries, and over time within a single country.
The Generic Model

The model is a four-tier structure. This is illustrated in the figure. Each of the elements in the model is described in more detail in the table below:

<table>
<thead>
<tr>
<th>National regulatory body</th>
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<tbody>
<tr>
<td>National strategic parent association</td>
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<tr>
<td>Neighbourhood Governance Board</td>
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<tr>
<td>Neighbourhood</td>
</tr>
<tr>
<td>Filial property management associations</td>
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<tr>
<td>Housing filial organisations</td>
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<tr>
<td>Economic/community filial organisations</td>
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</table>

The base of the model lies in the complexity of property management required for upgrading a whole neighbourhood. Filial associations are of two types: Property management companies and economic/community companies. The variety of filial associations depends on the tasks to be done and local land tenure systems. While all land ownership rights are vested in the strategic parent association, each of the filial property management associations carries out specific functions within a framework of control over use and development rights granted by the parent association.

<table>
<thead>
<tr>
<th>Type of filial association</th>
<th>Comments</th>
</tr>
</thead>
</table>
| Social rented housing     | - Likely to require continuing subsidy to provide good quality housing at affordable rents (negative net income? Pressure on repairs and maintenance of properties?)  
- Sell tenancy rights to some occupiers as a form of subsidy?  
- Allow sub-letting of tenancies? |
| Shared ownership housing  | - Occupier part-rents and part-purchases  
- Purchased equity requires service charges  
- Rented equity requires rent payment  
- Viability depends on interest rates low enough to make total outlay for occupier similar to renting  
- Are mortgage lenders willing to enter this market?  
- Allow staircasing, ie subsequent purchase of further tranches of equity |
| Build for sale (middle income) | - Requires project management skills  
- Mortgage instruments/interest rates for leasehold property? |
| Commercial property management | - Assuming this is high end property and requires specialist day to day management skills |
• If it is purpose built, high risk unless land assembly and project finance is guaranteed
• Can include a housing element

<table>
<thead>
<tr>
<th>Mixed use property</th>
<th>Combining economic and residential uses</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>A single or two separate rent flows</td>
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</table>

| Infrastructure management | Construct and provide continuing management of collective infrastructure and environmental improvements |

The principle behind distinguishing different types of property filial property management associations is that each requires different day to day housing, project and generic management skills.

Other types of economic or community filial associations may also be appropriate:
• In the first instance, these could include companies providing specialist services to property management companies, eg maintenance services, development management services, security and cleaning services to high end properties, etc.
• They could also include other community services as appropriate: specialist welfare provision, community and/or co-operative businesses, environmental management, etc.

Key issues in the overall model:
• National regulation of the parent association and parent/filial relationships is necessary to assure private capital finance
• All land ownership rights must be transferred to the parent association and appropriately covenanted to assure private capital finance
• Separation of parent and filial associations is necessary for risk management
• Parental control over the terms on which filial associations may access other sources of funding
• The model is dynamic and implementation requires periodic strategic review and monitoring by an appropriate national regulatory agency

Key issues relevant to the filial associations collectively:
• Each of the filial property management associations has a different cash flow and financial risk profile. If the aim is to use high-end development (residential and commercial) to cross-subsidise low-income housing, then financial and risk profiles need to be matched overall.
• While land ownership rights (assets) are held by the strategic parent association, the model works on the basis of selling use and development rights. (Precisely how this would work is dependent on local legal frameworks.) However, there are important issues about the valuation of properties for the purposes of lending, eg social rented housing valued on a discounted cash flow basis or on the basis of comparable prices for other housing in the area? The valuation issues have implications for the security of use-rights in the properties.
• The model assumes that there are mortgage lenders willing to operate in this market. The assumption is that the management of the neighbourhood through the strategic parental association provides an element of security for mortgage lenders for specific uses.
<table>
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<th>Organisation and form</th>
<th>Functions</th>
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| National regulatory agency Quasi-autonomous non-governmental organisation | • Regulates activities of associations  
• Conduit for government subsidy  
• Provides strategic support | • Central government  
• National financial institutions  
• Local governments  
• Parent and filial associations | • Arm's length |
| Strategic parent association Charitable trust Non-profit, non-governmental organisation | • Landholding company  
• Banker for subsidiaries (bulk borrowing for onward lending, using SUF loan guarantee)  
• Treasury and risk management services to subsidiaries  
• Strategic plan for neighbourhood | • Local banks and financial institutions  
• Local government  
• Respected local organisations  
• Representatives of filial associations | • Representatives of subsidiary companies, elected by the Neighbourhood Governance Board hold 2 (?) places on the Board of the parent |
| Neighbourhood Governance Board Democratic forum for filial associations for conflict resolution | • Advise the parent association on strategies of upgrading  
• Identify need for and support setting up further filial associations as appropriate and desirable | • Parent association  
• Filial associations  
• Potential filial associations  
• Residents and community groups | • The NGB nominates members to the parent association  
• The parent association nominates 2 (?) members of the NGB |
| Filial housing associations  
• Property management companies  
• Economic and community development companies | • Manage, upgrade and develop residential and commercial properties  
• Provide specific services to property management companies  
• Contribute to the economic and social development of the neighbourhood | • Local and other organisations appropriate to the filial’s function and legal form  
• Residents and community groups | • Each filial association nominates representatives to the NGB |
Proposal for City-Community Local Development Funds (CCLDFs)

C3+: SUF Design Team, UN-HABITAT, Nairobi, November 2005

Proposal for City-Community Local Development Funds (CCLDFs), utilising the experience of the UN-HABITAT/UNDP Urban Management Programme (UMP) City-Community Challenge Funds (C3), enhanced to become community-led development funds for Slum Upgrading and Low-income Housing Developments, to be known as C3+.

The experience of the UN-HABITAT/UNDP Urban Management Programme’s City-Community Challenge Funds (C3) has been gained in Uganda, in conjunction with the Uganda Local Government Association; and in Zambia, initially with CARE International, and more recently with the City Council of Lusaka, and the City Council of Ndola.

The concept revolves around the idea that given access to funds, local communities are able to decide for themselves their priorities and needs for very local development action. This is enormously beneficial to slum upgrading.

The initial programme was developed by DFID’s former Infrastructure and Urban Development Department in conjunction with the UK’s Local Government International Bureau, and with a broad range of NGO based developed partners. In 2002 the coordination of the two country pilot projects was taken over by UMP at UN-HABITAT. A parallel evaluation process has been led by the London School of Economics (LSE), which broadly endorses the achievement of the concept, and the relevance of the projects to practical community development, but with reservations about its sustainability.

There is now the opportunity to see how the C3 experience can be captured in the SUF Pilot Programme to be launched in 2006 for a three year period. There is progress on the ground, and testing under way as follows:

Locations and Opportunities

1. Sri Lanka: The Women’s Savings Bank Federation has developed a working relationship with the City Council of Moratuwa, resulting in a Memorandum of Understanding, with an emphasis on the role of a Local Development Fund. This will build on the C3-type experience amongst the development partners, particularly Slum Dwellers International. The concept will be to leverage commercial investment finance using the combined inputs of the Federation’s Savings Scheme, and the land for development from the City Council as collateral (in effect a local guarantee). It is expected that the experience gained in Moratuwa will be taken up in Colombo and through the Society of Mayors of Sri Lanka generally.

2. Uganda: Uganda is the home of the C3, the City-Community Challenge Fund approach. It has been adopted by the ULGA – the Uganda Local Government Association as its spearhead approach for localised development opportunities. The process has been embedded in the local government system, utilising initial funding from DFID, also augmented by UMP, and in addition with DANIDA. In particular in Jinja the City Council has promoted and assisted the Jinja C3 process, dedicating land and infrastructure for very low-income housing developments. See Jo Beall’s assessment of this achievement. The City Council is keen to roll-out the process for the entire city. A City-Community Local Development Fund would provide the opportunity to capitalise on the experience gained to date.

3. Zambia: Although CARE International is no longer directly involved, the City Councils have continued their work with the C3 approach. There is an appetite for an expanded C3-type operation for slum upgrading and new low-income housing
projects. In both Lusaka and Ndola there are opportunities for the community organisations to work with the City Councils in spearheading such an approach. It would be important for both SDI in Zambia, and the Zambian Local Government Association to learn from the experience in Sri Lanka and Uganda.

In due course there will also be opportunities for Bangladesh, Cambodia, Ghana, Kenya, Senegal and Tanzania to see where this approach may be appropriate for their national slum upgrading operations.

**Approach and Requirements**

The Design Instrument that SUF is promoting would require the Community (in each of the three locations SDI is able to guide this process) and the City Council to agree the terms and governance of the Local Development Fund and its purpose. The Community would deposit its Savings Scheme into the Fund. The City Council would place the land holding in trust as a component of the fund, and where possible add a cash component. SUF would make a deposit to the Fund to match the cash components, thus augmenting its scale and effectiveness. The Fund would be used to leverage commercial finance for the agreed slum upgrading and rebuilding operations, prepared as "bankable projects" with business plans that show the repayment structure. Where appropriate other design instruments, including subsidies, will augment the basic plans.