

FACING THE ENVIRONMENTAL CHALLENGE

FINANCING URBAN HOUSING: UNITED NATIONS GLOBAL REPORT ON HUMAN SETTLEMENTS

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More than 2 billion people will be added to the number of urban dwellers in the developing countries over the next 25 years. This implies an unprecedented growth in the demand for housing, water supply, sanitation and other urban infrastructure services. This new challenge exists in a context of already widespread poverty and inequality in cities, with millions of people living in slums without adequate basic services. Providing these services to new residents will be essential if this additional population is not to be trapped in urban poverty, poor health and low productivity. It is an urban problem with significant macroeconomic consequences. This Global Report examines the urgent challenge of financing urban shelter development over the next generation. The report is divided into four parts. Part I presents the macro-economic, shelter policy and urban finance contexts of financing urban shelter development. Part II describes and assesses recent global trends in shelter finance, including mortgage finance, financing for social housing, shelter microfinance and shelter community funds. Part III provides an overall assessment of the shelter financing systems analyzed in Part II and examines policy directions towards sustainable shelter finance systems. The Epilogue in Part III examines the implications of the report's findings on sustainable urban shelter policy. In Part IV, the Statistical Annex comprises 16 tables covering three broad categories: demographic indicators and households data; housing and housing infrastructure indicators; and economic and social indicators. These tables are divided into three sections presenting data at the regional, country and city levels.

PART I: ECONOMIC AND URBAN DEVELOPMENT CONTEXT

Chapter 1 – Challenges of Sustainable Shelter Development in Macro-economic Context

By presenting the latest global demographic projections, Chapter 1 highlights the major social and economic challenges of urban shelter provision in the next 25 years. The chapter also presents a macro-economic framework within which to situate the problem of financing urban shelter and to understand its broader implications. While most of the urban population growth will occur in East and South Asia, particularly China and India, many places around the world will experience the urbanization of poverty and inequality between rich and poor.

Understanding urban shelter development challenges

The current global backlog of slum dwellers is about 925 million people. When this figure is combined with the projected 1.9 billion additional urban population, it is apparent that 2.825 billion people will need housing and urban services by 2030. The demand for housing – just to accommodate the increase in the number of households over the next 25 years – is estimated to be 877 million housing units.

This challenge is not just about the quantity of population, but also its composition. Cities are changing rapidly, especially in terms of both the scale and rate of demographic, social and economic transformation. This pattern of growth will also place additional strains on environmental resources needed for cities, such as clean water and clean air. Growing demand for infrastructure services places immediate pressures on natural resources. Environmental studies show that cities have important impacts upon the natural environments in which they are located, what is known as their 'ecological footprint'. Consumption of natural resources by urban residents – for example, firewood in Africa – is frequently growing faster than nature is able to reproduce those resources. This pressure on natural resources is most dramatically shown by the increasing cost of potable water in almost every city in the world.

With this backdrop, it is clear that the capacity of developing countries to finance their needs depends largely upon their level of future economic growth and development. If countries are able to generate employment and incomes for growing populations at an accelerated rate, they will be able to generate and mobilize the savings and investment to finance housing and infrastructure services. Two key factors are needed to translate macro-economic growth into finance for urban development. The first is governance – how public, private and non-governmental institutions work together to plan and manage cities. These institutional challenges range from establishing the laws and regulations governing life in the city, to developing new residential areas for the growing population, to decentralized problem-solving at the community level. The growing trend towards decentralization in most national governments in developing countries has transformed the roles and responsibilities of these institutions over the last two decades. However, this process is also insufficient to provide the needed housing and infrastructure services for growing populations. The second factor, finance, is essential for this process. While the financial challenges are introduced in Part I, they are the subject of the body of this report.

The macro-economic context of urban shelter development

The second part of Chapter 1 examines the macro-economic context for urban development. It addresses the following factors: patterns of economic growth; sectoral performance and productivity; income distribution and inequality; poverty and employment; savings; external debt; patterns of investment (public, private, and foreign); impacts of external factors upon macro-economic performance; and the urbanization of national economies.

A period of unprecedented economic growth at the global level occurred during 2004-2005. All developing regions grew at a pace faster than their growth rates of the 1980s and 1990s. Global trade also expanded considerably, with China's demand for imported raw materials and food spurring exports from other developing countries. The most striking feature of economic growth has been the high rate of growth for the developing countries, going above 6 percent for the first time. However, the distribution patterns are worrying because they continue the trend towards greater disparity in income levels between the regions, as well as between developing and developed countries. Global inequality between rich and poor countries, therefore, continues to worsen, even when there have been extraordinarily high rates of economic growth. The most questionable aspect of this growth in 2005, however, is whether it is likely to be sustained in the future.

The growing importance of world trade means that 'tradeables', whether manufacturing products or commodities, have become increasingly central to the economic growth of all countries, whether developed or developing. While this places great emphasis on agriculture and production of raw materials, it also requires improvements in the efficiency of infrastructure in telecommunications, transport and key services such as electricity and water supply needed for manufacturing and other industries.

Despite the impressive economic growth of the past few years, the enduring problem of massive poverty in the developing countries remains the top priority problem facing the world today. The incidence of poverty at the national level is highly correlated with low levels of education and poor health status, as well as lack of access to basic infrastructure services such as clean water supply, sanitation and electricity.

The most direct and important factor contributing to urban poverty is the shortage of well-paid employment in cities. The challenge here is both the creation of jobs and the level of wages. The generation of employment depends generally upon savings and investment within the macro-economy and local economies, as well. One problem that is associated with high levels of poverty is a lack of domestic savings within national economies. Low levels of domestic savings – both public and private – contribute to low levels of capitalization of the financial institutions in poor countries. They are also reflected in low levels of tax revenue collection and therefore place great limitations on public expenditures and public budgets. The issue of savings is particularly important to the financing of urban infrastructure and housing.

The legacy of external borrowing for diverse purposes has left many countries with unsustainable levels of external debt service. In some countries, particularly in Africa, the debt service to gross domestic product (GDP) ratio has reached over 400 percent. These levels of debt immediately reduce available domestic capital for investment. Given the above, the patterns of investment in the developing countries have changed markedly over the past decade. At the same time, there has also been an important segmentation in the global financial markets, with some countries – particularly the East Asian countries – being able to attract high levels of foreign direct investment (FDI). Public investment as a share of GDP is also low in most developing countries. They have relatively large deficits in their public budgets, with items such as the maintenance of infrastructure being a low priority in most countries.

The lack of resources for public investment in the poorest countries poses a serious dilemma. Many of these countries do not qualify for FDI. They are dependent upon official development assistance (ODA) as the major source of financial support for economic development. Yet, ODA is also severely limited. Even with promises of additional finance, the actual levels of official development aid are constrained by lack of domestic political support in the developed countries, or by the restrictions of macroeconomic agreements with the international financial institutions.

Here, urban development must compete with other priorities in the fund allocation at international and national levels, which are clearly politically determined within individual governments. Many governments increasingly assign responsibility for housing and urban development to the provincial, state and local levels, rather than to the national level. The weaknesses of the public sector and its inability to mobilize substantial resources for urban development therefore point to the need to give greater attention to private sources of finance, including the role of privatization of infrastructure services.

A final characteristic of the macro-economic context for urban development is the urbanization of national economies themselves. Abundant evidence exists to demonstrate the growing importance of cities in the overall productivity of countries. The increasing share of national GDP produced in cities has been well documented. Despite historically rapid rates of economic growth, there is little likelihood that conventional sources of funds will be available for investment on the scale needed to meet the projected demand for urban shelter and related infrastructure.

Chapter 2 – Shelter Policy and Finance: Retrospective Overview

Discussing the general trends in housing and urban development policy, this chapter highlights the paradigm shifts that have occurred – particularly in the policy context of urban shelter finance.

Between 1972 and 1982: Habitat I

By the early 1970s, the concept of intermediate technology had been developed and became popular, with the recognition that different technologies were appropriate in different contexts. Between 1972 and 1982, the focus of financing was on low-interest loans, loan guarantees and subsidies as a means of making housing affordable to low-income people. Interventions in this period concentrated on demonstration projects of limited size, with regard to a city or region, and were usually confined to a particular neighborhood or group of neighborhoods.

Projects tended to be outside of municipal control, to have different standards from elsewhere, different means of implementation and to have little effect 'outside the fence'. Projects generally focused on self-help, providing a context in which the spare time and energy of low-income people could be devoted to house construction or infrastructure provision. They were broadly of two types: sites-and-services projects for new housing provision; and settlement upgrading for bringing squatter and other informal settlements up to an acceptable standard of servicing and public space provision.

The concept of adding value through physical work, referred to as 'sweat equity', was strongly ingrained in the projects of the 1970s. Participants in sites-and-services schemes were helped in their construction

efforts by project staff that provided a range of services. However, evaluations have shown that many participants used professional building workers in lieu of sweat equity.

In addition to finance by sweat equity, there were many subsidies. Some were declared in the project (on budget) and others were hidden (off-budget). The participants in sites-and-services schemes tended to have rather higher incomes than the rhetoric and intention implied. Dwelling owners in upgrading schemes, on the other hand, tended to be among the low-income groups and their tenants were probably in even lower income echelons.

Many beneficiaries found themselves unsuited to the project and bought their way out by selling to richer households, ignored some of the project requirements to better suit it to their needs, or defaulted on payments to make it affordable. Tenants did not benefit much as their rents would rise and tended to move out to other non-upgraded settlements where rents were still affordable.

The projects were often too complex for the municipal authority to implement. The great majority of citizens – those outside the project 'fence' in the cities affected and those not finding work in the project – benefited hardly at all.

The 1980s to the 1990s: Towards financial sustainability

For all the efforts aimed at improving housing, the unserved informal settlements appeared to be expanding rather than in decline. The limitations of this approach sequenced a low impact upon overall urban economic development, restrained institutional reforms and the funds were restricted to 'retail' rather than 'wholesale' roles.

The 1980s saw 'step-by-step moves towards a more comprehensive whole housing-sector approach'. There was a perceived need to incorporate housing within the wider economic environment. It was recognized that the individual sites-and-services and slum upgrading projects alone could not affect the growing housing need and that a well-functioning finance system for housing for the majority was necessary.

This generated a paradigm shift from multi-sectoral but quite localized projects, affecting a fortunate few, to an emphasis on creating a sustainable capability for housing supply and urban development affecting most residents and congruent with the overall policy and economic environment. The locus of borrowing changed from almost exclusively public-sector institutions to financial intermediaries. In parallel, attention shifted from the physical asset financed to the institutional structure of the implementing agency and its ability to mobilize the development required.

Reviews of housing policy transition have shown that there was a fulcrum of policy change during 1985 to 1987, a mid point between the two United Nations world conferences on human settlements. By the end of this short period, the enabling approach had been put together and launched on the international agenda, at the same time as macro-economic structural adjustment program (SAP) initiatives designed to enable governments to recover from years of decline were being implemented.

The enabling approach treated housing and urban development as a multi-sectoral issue, affected just as much by efficiencies and inefficiencies in finance as in the construction industry or land tenure systems or the regulatory framework. The task of the state was seen as creating the legal, institutional and economic framework for economic productivity and social effectiveness, in which efficient settlement development could then flourish.

The mid 1980s also saw the birth of sustainability as an overarching rubric for development activity. From that time on, no agency could ignore the need to consider environmental impact alongside social and economic benefits from its projects. Chapter 7 of Agenda 21 reiterated the overall objective of improving the social, economic and environmental quality of human settlements and the living and working

environments of all people, particularly the poor. At the same time, there was a realignment of emphasis from 'ability to pay' to 'willingness to pay' as a result of economic analysis which found that the latter produced much more accurate estimates in shelter-related cost-recovery calculations.

By 1988, the Global Strategy for Shelter to the Year 2000 (GSS) had been formulated. It recognized that governments had an obligation to ensure that an appropriate environment was created for the mobilization of finance for housing. The objectives of such an effort were seen as promoting and mobilizing savings, reducing costs, improving the efficiency of financial intermediation, and assisting the free movement of capital through the national economy. Housing finance reform, which is a key component of a shelter strategy, was seen as part of a broad effort to reform and develop the financial sector.

The GSS had a laudable but over-optimistic objective of 'decent housing' for all by 2000. Later in the decade, this term was replaced by 'adequate housing'. The need for adequate housing has also been included in many United Nations summit recommendations and closing declarations. The new paradigm encouraged institutional reform and development. This coincided with the spread of decentralization of power from the centre to regions and municipalities and the growth of a local sense of responsibility for urban conditions.

Reflecting the globalization beginning during the early 1990s, the need for housing finance institutions to be able to compete for deposits and investments on equal terms with other financial institutions was emphasized. Thus, lending had to be at positive, real interest rates and deposits had to be of sufficient term to support long-term lending.

During the 1990s, some developing countries developed proactive and well-integrated housing finance policies and institutions. There was a recognition that purely government-managed finance institutions had failed in their laudable aims and become bureaucratic, inefficient and prey to exploitation by insiders.

Mortgage finance is now available in most countries, but its limitations are obviously militating against its being the solution for most low-income households. In filling this gap, micro-financing has progressed from being only enterprise focused to being an important feature of the housing finance system.

Strategy for the new millennium

Just before the turn of the millennium, the Habitat Agenda was adopted at the United Nations Conference on Human Settlements in Istanbul in 1996. The agenda provides a basis for international and national housing and urban development policy for the 21st century. With regard to finance, the member states agreed to strengthen existing financial mechanisms. The importance of developing innovative approaches for financing the implementation of the Habitat Agenda was also underlined.

In addition, the United Nations Conference on Human Settlements reinforced the commitment of states to the full and progressive realization of the right to adequate housing, as provided for in international instruments. Any retrogressive measures, such as forced evictions, are regarded as violations of the right to housing. Indeed, states are seen as having a duty to respect, protect and fulfill housing rights. However, none of this is considered to entail a state obligation to provide everyone with free housing but, rather, to set up the legal, social and economic environment in which households have adequate chance to fulfill their needs.

Chapter 3 – Financing Urban Development

Highlighting the key issues of municipal finance systems, this chapter analyses the main sources of municipal finance, municipal spending patterns and privatization of municipal services. The chapter emphasizes the relevance of urban development finance for shelter development. The comparative review of the approaches developed all over the world reveals 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.

Sources of municipal finance

The sources of municipal finance – such as central government transfers, taxes on property and businesses, user fees, betterment taxes, development exactions, borrowing and income-generating enterprises – vary within the regions and from one municipality to the other. The main revenue sources at present are from central government transfers; locally generated revenues which include taxes on property and on economic activities; user fees for the delivery of services and the improvement of infrastructure; and loans borrowed to finance long-term investments.

Municipal spending patterns

Municipal budgets, which reflect the policies and strategies for the delivery of mandatory and locally approved public services, should be capable of demonstrating the extent to which the financial results have been realized, the intended activities performed and the anticipated outcomes achieved. The analysis of municipal spending patterns in relation to the local government budgeting, which includes participatory budgeting and multi-year capital budgeting, shows that these are rarely achieved.

With regard to local government budgeting, problems arise from the lack of financial management skills at the local levels. Reliance on central government transfers also results in a number of constraints. The controls meant to improve efficiency and collection, or equity in distribution, sometimes also stifle local initiative and negate some advantages of decentralization and democratic governance. Most local capital budgets reflect immediate needs or political expediency rather than a long-term development strategy, and most municipalities in developing countries are unable to borrow long-term funds from capital markets.

Participatory budgeting has emerged from the growing demands for accountability and transparency in municipal budgets and financial management, especially in the allocation of scarce local resources and their utilization. Most developing countries lack funding for maintaining existing assets. Thus, 'preventive maintenance' has to increasingly become 'crisis management'. The undue importance laid on operating expenditures often leads to the deferment of expenditures on maintaining existing assets.

The experience in many countries has shown that decentralization policies do not necessarily lead to responsible financial management, as demonstrated by budget deficits, accumulated debts and the inability to repay loans. Accountability for performance is a cornerstone of good governance and a major tool in financial management. It places as much emphasis upon transparency as upon financial management. Demands for greater accountability and transparency by voting and taxpaying constituencies have combined with the constraints on the financial resources available to the public sector to exert political pressures for improving municipal financial management. Indeed, increasingly, mayors, councils and city managers are held accountable for financial outcomes, as well as for the qualities of the services they deliver and the projects they implement. Reforms of existing systems and the introduction of newer concepts and techniques have provided useful alternatives in financing and operating public services.

Privatization of municipal services

In both developing and advanced economies, privatization has resulted in revenue-producing services, including water supply and solid waste management, being gradually taken over in the larger urban centers by specialized multinational firms serving many local government units. Formal privatization in many cities has not benefited lower income communities, which underscores the need for the public sector to have a role in the delivery of essential services.

In the effort to deliver services effectively and efficiently, public-private partnerships have been used under joint-funding ventures. Such partnerships range from the granting of concessions, to joint venture agreements, to build-operate-transfer (BOT) or build-own-operate-transfer (BOOT) schemes. Of special interest to poorer countries are solutions based on partnerships between municipalities, non-governmental organizations (NGOs) and community-based organizations (CBOs). In these countries, integrating poorer communities into the city fabric and giving the poor access to basic services is hampered by the spread of chaotic urbanization, the mounting densities in the central zones, the obsolescence of existing conventional systems and the lack of resources to maintain and upgrade existing systems.

Municipalities are particularly reluctant to delegate authority or share revenue with their peer entities. This reluctance is attributed to the difficulties encountered in getting municipalities to collaborate in joint initiatives. Moreover, formalizing collaboration through negotiated agreements and inter-municipal compacts is an even more challenging task since there are no institutional incentives fostering such strategic associations.

Decentralization and the privatization of services are facing a number of constraints in developing countries, as opposed to advanced and transitional economies. Developing economies have not been able to enact and implement successful decentralization policies that redistribute resources effectively. While privatization has forced governments to examine entrenched practices and to consider alternatives for their modification or replacement with considerable success, it is not a panacea.

The major challenges that must be addressed include the large numbers of smaller, financially weak municipalities; asymmetrical decentralization; retrenchment of central transfers; weakness of local revenue sources; lack of strong domestic capital markets; impediments to the development of municipal credit institutions; inadequate capacity and rules for sound financial management at the local level; lack of mechanisms to finance urban investments; and lack of funds for maintaining existing assets.

In conclusion, the following recent trends in municipal finance may be highlighted:

- Financial discipline and the commercial outlook of competing private enterprise have, in some countries, forced public administrators to lower costs, achieve greater efficiency and improve the quality of outputs.
- Opening up of public services to market participation has created more opportunities for competition in the delivery of these services than previously.
- A growing demand for accountability and transparency in municipal budgeting has accompanied political and fiscal decentralization. There is a marked trend for more rigorous financial management, clear procedures for the allocation of resources, and the participation of residents in decisions that affect their communities.
- Public-private partnerships, which require significant delegation of authority and can be very productive, have been on the increase. Some locally based partnerships involving CBOs and micro-enterprises have been found to provide successful means for empowerment and social inclusion, especially in the developing countries.

PART II: SHELTER FINANCE – ASSESSMENT OF TRENDS

Chapter 4 – Mortgage Finance: Institutions and Mechanisms

The cost of a complete dwelling could be between 2.5 to 6 times the average annual salary. To purchase property, it is very difficult to finance such costs without a loan and, generally, such loans will need to be long term. When the repayment period is to stretch for such a considerable period, a legal framework is required for lenders to be confident about the security of their finance – hence the significance of mortgage finance in which the loan is secured on property.

Chapter 4 first considers emerging trends in the provision of mortgage finance and summarizes the current terms and conditions of such finance. Second, it looks particularly at the situation with regard to lower income households who might be seeking mortgage finance and the affordability of such options for these households. Third, it examines emerging tensions and opportunities in current mortgage finance and assesses its potential contribution to addressing household needs for housing finance.

Providing mortgage finance

In general, governments have sought to encourage homeownership and have, in many cases, provided preferential financing to influence consumer choice. There has been a general shift towards market-based mechanisms for providing housing, with attempts to reduce subsidies and deregulate markets. In part, this is due to the past ineffectiveness of housing strategies that have depended upon direct provision by the state. This trend is also consistent with the overall direction of macro-economic strategies during recent decades.

The importance of deposits to the bank system is widely acknowledged. Deposits account for 62 percent of the funding of all mortgage loans within the European Union (EU) countries, and this percentage is even higher in the transition countries. However, if the only source of finance available to the mortgage lenders is deposits, then even if they can secure sufficient funds, lenders face a risk when committing long-term loans with short-term finance. As an alternative to short-term deposits, there are several sources of longer-term finance. One source is the state itself and the direct contributions that it might make. A second source is private funds institutionalized for housing finance through specialist saving schemes. A third source is private commercial investment. Despite these multiple sources, the availability of long-term finance is limited in many countries.

The secondary market in mortgage finance developed in order to cope with the risks associated with short-term deposits and longer-term loans. The US has led developments in secondary markets, which have become notably significant from the mid 1980s onwards. For the last 25 years, there have been significant changes in mortgage finance with the growth of the involvement of capital markets; this began in the US and spread to Europe and, more recently, is being explored in Latin America and Asia.

A number of measures have been taken in Africa to strengthen secondary markets and, specifically, securitization. In Kenya, a recent draft national housing policy aims to create a secondary market to ensure additional capital from overseas and a reduction in the costs of borrowing.

A further and remaining source of finance, despite frequent criticisms on the grounds of economic efficiency and ineffectual targeting, is the state. Governments have over many decades intervened in housing markets with the intention of widening access to housing finance, and they continue to have a major role in housing finance through the continued use of subsidies.

There are several motivations for state involvement. With respect to the welfare of households, motivations are, notably, to promote homeownership as a whole and to specifically address the needs of those with inadequate housing. The state may also have systemic interests to ensure that the financial markets for housing are stable.

The common strategies to increase homeownership through the enhanced provision of finance are:

- mortgage interest relief;
- interest subsidies;
- housing savings schemes;
- guarantees;
- subsidies for 'key' public-sector workers; and
- intermediate tenures.

A more recent shift has been subsidies designed to augment the payment capacity of the poor (direct-demand subsidies).

One of the most far-reaching systems of state intervention through direct construction has been used in the case of Singapore, where 96 percent of the households are living in homeownership apartments. The strategy has been based on the provision of subsidized mortgage finance (primarily through the interest rate), combined with a dedicated supply of funds through already existing provident/pension funds. However, there are many examples of failed public housing policies. One example is the National Housing Corporation in Kenya, whose production was well below need, with only several thousand units a year. Two parastatals in Cote d'Ivoire together constructed 41,000 units between 1960 and the 1980s before being wound up.

Taxation-related incentives

In many West European countries, mortgage interest payments are, to some extent, tax deductible. Interest rate subsidies have been a popular way of enhancing housing finance affordability. Occasionally this policy has been criticized as acting as a substitute for prudent macroeconomic management. Interest rate subsidies may be associated with savings schemes for housing investments.

However, the case against interest rate subsidies has been strongly made. It has been argued that direct subsidies are a preferred way of offering assistance with housing costs as they can be more precisely targeted on those in need. Interest rate subsidies inevitably favor those who can afford loans and larger subsidies go to those who are able to afford larger loans. In spite of this, interest rate subsidies appear to continue to be used.

In addition to direct assistance to households to increase the affordability of housing finance, governments have sought to ensure the stability of the system and to reduce the risks for lending institutions when they extend services to lower income households. As the greater availability of finance has been reflected in growing levels of owner occupation, risks have increased.

Regional highlights

Homeownership is now the majority tenure across Western Europe, with exceptions — notably in Germany. Nevertheless, levels of owner occupation vary considerably, being highest among some of the Southern European countries (Spain and Italy) where homeownership can be described as being 'dominant'. Homeownership is relatively high in several other countries, notably the UK, at around 70 percent. In countries such as France, the Netherlands, Denmark, and Sweden, homeownership has been established as the 'majority' tenure without being especially high or dominant. There is little evidence of convergence in homeownership levels, either in the sense that they are moving in the same *direction*, or that they are converging towards similar *levels*.

In 2003, the European market as a whole continued to grow, with the total value of residential mortgage debt increasing by 7.4 percent, a little below the 10-year average of 8 percent. The total volume of mortgage loans in Europe at the end of 2003 was US \$3.4 trillion. This figure has grown rapidly and it now accounts for 42 percent of EU GDP. This rapid expansion in lending has been encouraged by lower interest rates. However, it should be remembered that the rise in the volume of lending is not necessarily associated with increasing access, as one further trend has been rising house prices, with capital gains for current homeowners and increasing difficulties for those seeking to become homeowners for the first time. In the US, homeownership grew on average, as did income, throughout the largely prosperous 1990s and now stands at a record high.

The transition countries face a particular problem in that commercial housing finance markets were previously non-existent. There has been state support to the development of housing finance systems, with the expectation that the commercial sector will become an increasingly significant provider.

Unfortunately, much of this support has been to the benefit of higher income groups who are the only ones able to afford such finance.

Volumes of housing loans are low in the transition countries. However, there are indications that housing loan markets are growing rapidly; for example, in Estonia the scale of housing loans doubled between 1997 and 2000, and in the Czech Republic the scale of loans grew more than sixfold during the same period. During 2002 and 2003, mortgage lending grew particularly strongly in Hungary, Poland, and Latvia (by more than 85 percent).

The privatization process that took place resulted in the transfer of significant numbers of dwellings into private hands. Owner occupation is now close to or above 90 percent in Hungary, Bulgaria, Estonia, and Romania, while in Poland, Slovakia, and Slovenia it is above 70 percent. However, despite this increase in homeownership, the financial systems needed for such ownership have not developed.

The problems of affordability in the South are considerable. The supply of mortgages in Southern countries has been limited by a large number of factors, including low incomes that barely cover subsistence needs for a considerable proportion of the population, a lack of formal financial institutions that can capture people's savings, as well as macro-economic instability. The recent financial crises have had negative impacts upon the formal housing finance systems in a number of countries and have particularly deterred commercial provision of mortgage finance. However, there are signs of a recovery in lending in both Asian and Latin American countries.

In China, the system of housing finance has been significantly redeveloped. The previous system was one in which dwellings were primarily provided through work units that housed employees in return for a nominal rent. In 1995, the government introduced two major programs to encourage home purchase, the National Comfortable Housing Project and the Housing Provident Fund.

In Latin America, less than 30 percent of dwellings are produced by the formal housing market. Residential debt is in general a fairly low percentage of GDP, indicating that mortgage lending is not extensive. Significant difficulties of foreclosure, with long foreclosure periods taking over one year, are just one set of the problems that has reduced the attractiveness of mortgage finance in this region. During the last decade, the core issues facing governments in Latin America appear to be the longstanding problems of macroeconomic performance and, notably, inflation, the specific economic difficulties of the late 1990s and the need to extend finance to those with lower incomes. The related strategies have been titling, direct-demand subsidies, the use of specially defined units for housing investment, and the expansion of capital into the system through strengthening of the secondary market.

While there are continuing problems of underdeveloped housing finance systems, in part as a result of the economic difficulties of recent decades, there are some positive trends in Chile, Costa Rica, Panama, Mexico, and Peru, with uneven progress in Colombia, Bolivia, and Ecuador. These improvements include financial-sector reforms to facilitate the expansion of mortgage financing, judiciary reform to facilitate the recovery of collateral, and increases in housing production/finance in the private sector. They also involve attempts to have public housing agencies working more effectively with the treasuries, private banks, and developers to address the housing needs of beneficiaries.

The situation in sub-Saharan Africa divides between South Africa (and, to a lesser extent, Namibia, and, until recently, Zimbabwe), where the commercial banking sector is significantly involved in mortgage lending, and the rest of the continent. South Africa's mortgage market is about 198 billion rand (US\$30.7 billion). Most of its housing finance is provided through bank mortgages. Despite this scale of finance, there is evidence to suggest that the lower income households remain excluded from the market. While those who are in formal employment can use their provident funds to guarantee housing loans, many work in the informal sector. Moreover, mortgage finance is unaffordable to many.

Although state housing finance institutions have continued in some cases, the greater emphasis on cost recovery and operating efficiency during the 1990s has given them considerable problems in securing finance. Generally, those that do exist have been heavily regulated and have also been seen as social instruments, rather than financial mechanisms. More recently, the state has withdrawn from this area and some housing finance institutions have withdrawn as well. A particular and continuing problem faced in Africa has been a lack of effective institutions and instruments to mobilize savings and to channel them into housing investment. For the most part, housing finance institutions have remained dependent upon deposits and have not been able to secure long-term finance.

Terms and conditions

Mortgage lending is associated with a standard package of terms and conditions which specify the contribution of deposits, in some cases the period of savings, the interest rate to be charged on the loan (and if it is fixed or variable), the period of the loan (potentially with penalties for early and late repayment), and loan-to-value ratios (the maximum percentage of the loan against a verified value of the dwelling). A further important factor is the amount that the loan institution is willing to lend in relation to the borrowers' income(s).

The increased diversification of housing loan suppliers has reduced the general significance of savings activities that are specifically linked to housing; but some form of saving remains essential if mortgage loans are offered for less than the full cost of the property.

Considerable effort has been made to extend opportunities to secure housing finance during recent years. This is the product of two related factors. On the one hand, the housing finance market has become more competitive as new providers have been encouraged to enter the market. Such providers have been seeking new customers to extend their activities. On the other hand, the state has been looking to the market to address housing need. Faced with considerable housing problems and seeking to reduce public expenditure, governments have sought to encourage the market to address needs where possible.

As noted earlier, affordability is not just about access to and the cost of housing finance, it is also critically about the price of housing. One of the most important trends in housing finance in Western Europe has been the widening 'gap' between incomes and house prices. House prices have risen since 1997, notably in Australia, Ireland, Spain, and the UK. In 2003, the European Mortgage Federation noted strong price increases in Latvia, Portugal, Spain, the UK, and Ireland.

In a number of countries, housing supply appears to be inelastic, responding only slowly to increases in housing demand expressed through rising prices. Research has shown that local regulations that prevent housing construction are a significant cause of high house prices in the US and UK, as well as in Malaysia, Republic of Korea, Tanzania, and New Zealand.

In a context of rising house prices, housing finance systems have a greater job to do in bridging the gap between incomes and prices. Young people have particular difficulties in purchasing dwellings as they have had less time to save for a down payment (deposit) and earnings are lower for those who have recently entered the labor market.

Turning to more general problems of affordability, US data for 2004 indicates that there are some 6 million households living in owner-occupied dwellings that fall below the poverty line. This is not that much less than the 7.9 million households below the poverty line who are living in rental accommodation. In the transition countries, there are real problems with affordability due to generally low levels of income. For example, only 10 to 20 percent of the population in Estonia and Latvia are considered to be eligible for housing loans. In the South, the numbers of people able to afford formal housing with the associated financing costs are limited. As indicated earlier, the clear emerging trend in a number of countries is that of the extension of mortgage finance. However, it is very difficult to assess how successful this has been.

Chapter 5 – Financing for Rental and Social Housing

While a narrow definition of housing finance may focus only on the provision of credit, the scale and significance of housing finance subsidies primarily through rental housing, subsidized loan finance, and direct-demand (capital) subsidies makes this component difficult to ignore. An understanding of how the financing of social housing can fit within a broader system of housing financing is needed. This chapter looks specifically at some strategies that have recently been used to provide financial subsidies.

Financial subsidies seek to provide incentives to enable and persuade a certain class of producers or consumers to do something they would not otherwise do by lowering the opportunity cost or otherwise increasing the potential benefit of doing so. Some argue that such financial subsidies are best avoided and should be a policy of last resort. Such concerns focus on the potential distortion of markets and are often accomplished by recommendations on institutional and regulatory reforms. In addition, subsidies, especially those offered on interest rates, may have a huge hidden cost.

While subsidies tend to be criticized by economists seeking to encourage a greater realization of the potential effectiveness of markets, they remain popular with governments. The interest in subsidies has resulted in multiple approaches to their delivery, which notably includes direct interest rates reductions; allowing mortgage interest to be deducted from income taxes; support for housing savings; support for insurance in the primary market; support for insurance in secondary markets; and direct grants. However, concerns remain, notably that such subsidies rarely reach the poor. Governments in the North and the South have primarily used two financing strategies to assist families to obtain housing: assistance for ownership and/or the assistance to afford adequate rental accommodation.

Three specific trends are well established in a number of countries:

1. Governments have shifted away from the direct construction and management of public housing. They have used several strategies to reduce their stocks, with large-scale transfers to occupiers in some cases.
2. There is increasing assistance for homeownership through direct-demand (capital) subsidies.
3. Consistent with the two trends above is the greater use of housing allowances (rather than direct provision) to assist low-income families renting accommodation in the private or non-profit sectors.

Despite their focus on lower income households, funding for direct subsidies is often smaller in scale than interest rate subsidies when the full costs of the latter over the life of the loan are considered.

Rental housing in the North

Although in the North the state is generally playing a less direct role in economic intervention, this is not necessarily the case in housing. Despite the shift to income-related support, the social rented sector (defined as housing let at below-market prices and allocated administratively on the basis of housing need, rather than on the ability to pay) remains a significant tenure in several states. However, there have been significant changes in policy and the nature of housing support has shifted in Western Europe. Support systems with large, general interest subsidies for new construction and rehabilitation have been phased out. Targeted income-related subsidies have become relatively more important, as have subsidies to depressed housing areas.

There has been a general marked decline in the levels of new housing units in this sector. As the numbers of designated social housing and/or public properties fall, there are concerns that the scale of social disadvantages associated with such accommodation will rise. It is feared that this will result in a high concentration of social disadvantage, thereby exacerbating social exclusion, reducing mobility, and creating greater marginalization for tenants. One further concern is that the growth of means-tested housing allowances (also encouraged by the use of private finance) has resulted in higher rents.

However, means-tested housing allowances are considered to offer better incentives in terms of labor mobility and to enable more effective targeting.

One of the most significant developments in social rented housing has been the increased use of private finance for rented housing in much of Western Europe. Despite this use, there has been limited private equity investment. Another key trend during recent years has been the emergence of surpluses in the social rented sector, as a whole, in many countries. Declining debt burdens arising from lower levels of construction and the repayment of older debt have coincided with rising rents to create these surpluses. Several countries have attempted to establish 'revolving-door' systems of finance whereby surpluses are reinvested in the sector. However, it seems that revolving-door finance alone does not stimulate increased construction, either because funds are inadequate or incentives are absent.

Rental housing in transition countries

Prior to transition, in most Eastern European countries housing was provided by state institutions (workplace, local government, and/or housing co-operatives). Essentially, the system was one in which state-provided social rental systems dominated, with low rents and administrative allocation systems.

The transition phase included the transfer of some of these dwellings to their occupants under privatization programs. In some countries, more than 90 percent of the stock was sold, while in others the percentage was as low as 6 percent. However, housing markets were very limited. Even where people own their dwellings, it appears to have been difficult to trade them.

By the end of the 1990s, there was some interest in reinvestment in rental housing — for example in Poland, Slovakia, the Czech Republic, and Hungary. A significant scale is planned — between 10 and 30 percent of new construction in Poland, Romania, and Hungary. However, a considerable problem remains, which is that the institutional strategies for addressing the housing needs of the poorest have collapsed, with no alternative being developed.

Rental housing in the South

Large-scale public housing has not been that significant in the South despite exceptions such as Hong Kong. While many countries have experimented on a minor scale, in general the scale of provision reflects the limited funds available to invest in public housing initiatives and the high standards that are required. In general, public rental housing has not been allocated to the poor, nor would it necessarily have been affordable even if it had been allocated. In some cases, these properties have now been privatized following the increased emphasis on market provision. As with the transition countries in Europe, China has relatively recently begun a policy to transfer to homeownership dwellings that had previously been rented from state-owned enterprises and from other state housing providers.

Despite a general trend against direct provision in the South as well as the North, there is some continuing support for rental housing in a number of countries. In Hong Kong, the Housing Authority actually increased its stock by 18,000 units between 1991 and 2001. In the Republic of Korea, there has been (since 1989) a growing interest in a permanent rental dwelling program for those on low incomes. In South Africa, there has also been a policy (albeit as a secondary strategy subsidiary to the main emphasis on homeownership) to support the development of a social housing sector and, more specifically, to encourage the development of housing associations to manage low-income estates and rental accommodation.

Social housing and homeownership

In practice, the high costs of construction of rental public housing and the ongoing costs of maintenance, often in a context in which rents remain very low and national housing budgets very limited, has resulted in large-scale rental programs being considered impossible in many Southern countries. Despite these

problems, there are some governments that have sought to introduce subsidy programs of a significant scale.

In a number of cases, they have chosen to use limited funds to support small loan programs that enhance the process of incremental housing development. In other cases, governments have chosen to subsidize a minimum complete dwelling. In yet other cases, effective capital subsidies have been given through low-interest loans. The limited resources that exist for housing finance mean that allocations may be made as political favors rather than as universal entitlements.

Despite the initial political commitment, the Chilean, Colombian, and South African governments have not put large-scale funding into capital subsidies. The percentage of state expenditure for these three countries does not exceed 1.25 percent, while 2 percent has been considered typical in the South.

Chapter 6 – Small Loans: Shelter Microfinance

For individuals or households with limited incomes, the only possibility of homeownership (even in an illegal settlement) is through shelter investment made in several stages. Land purchase; service installation and upgrading; and housing construction, consolidation, and expansion are all made at separate times. An estimated 70 percent of housing investment in developing countries occurs through such progressive building. Such incremental shelters, often initially built of temporary materials, frequently require repairs because of damage (for example, from natural forces).

In the vast majority of cases these households are ineligible for commercial mortgage finance. Households seeking to invest in their shelter (land, infrastructure, and housing) have been forced to use their own limited income, seek additional resources from family and friends, and borrow on informal credit markets or, in some cases, from groups like credit unions. There have been several institutional efforts to assist these households secure access to some kind of loan finance. In particular, shelter microfinance and community finance mechanisms have grown considerably during recent decades. This chapter discusses the use of microfinance approaches to shelter lending. The loans are almost universally to individuals, generally those with some security of tenure, for investment (construction, improvement and extension) in housing.

The growth of microfinance for shelter

The growth of microfinance agencies since their inception during the 1980s has been considerable and there are now many such organizations. To exemplify the situation in one country, in India the number of such grassroots-level organizations engaged in mobilizing savings and providing micro-loan services to the poor is estimated to be in the range of 400 to 500 organizations. Evaluations of microfinance organizations have demonstrated that, whatever the loans were taken for, a proportion as large as 25 percent could be diverted for shelter investments. Findings such as these have encouraged the exploration of microfinance lending specifically for shelter.

There are a considerable number of NGOs who have been working with housing issues, generally for lower income groups, and who have been drawn into loan financing in order to scale up their activities and/or to provide assistance to residents who have been successful in acquiring land. Shelter NGOs looked to the examples of microfinance agencies seeking to bring financial markets to those who traditionally had been excluded from opportunities for savings and credit. There are two distinct groups of such NGOs working in housing finance. The first group is professional urban development NGOs who have primarily been drawn into finance programs to influence state policies and the demands of low-income communities. The second group consists of humanitarian agencies who have worked to improve housing conditions in low-income areas. Recognizing that families are able and willing to invest in their own dwellings, they have directly developed small loan programs at scale.

In addition to NGO initiatives, there has been considerable interest in housing lending shown by the microfinance sector. Microfinance agencies appear to be diversifying rapidly into housing micro-credit in at least some regions. One study funded by the International Finance Corporation (IFC) identifies 141 institutions providing shelter-finance loan products to the poor. The speed with which housing loans have been integrated within such agencies appears to have been facilitated by the similarity of lending practice.

One reason for the diversification of microfinance agencies into housing is commercial advantages. Such diversification may increase the financial stability of their loan portfolio and enable them to take advantage of opportunities for growth, as well as avoid losing clients to other microfinance agencies that provide housing loans. A further notable advantage is that the longer repayment period associated with housing loans helps to draw the borrowers into a longer-term relationship with the lending agency and increases the likelihood that further loans will be taken.

Neighborhood improvement (slum upgrading)

A further potential role for shelter microfinance is within more comprehensive slum upgrading programs. There appears to be a growing interest in using microfinance agencies to provide specialist financial services within more comprehensive neighborhood improvement and poverty reduction programs. Within this strategy, the development agency, central government, and/or municipality finance a process to upgrade the low-income area with components to regularize tenure and provide and/or upgrade infrastructure and services. The upgrading program then contracts with an organization to offer small-scale housing loans for those who wish to upgrade their homes.

A good example is the Local Development Program (PRODEL) in Nicaragua that was set up to enhance development in smaller towns and cities with a number of components, including infrastructure improvements, housing loans, and loans for micro-enterprises. A more focused (and smaller-scale approach) is illustrated in Ahmedabad, India, where the Slum Networking Project (undertaken within the municipality) wished to include a credit component to help households afford to contribute to infrastructure improvements.

While most slum upgrading initiatives have been led by the state, an alternative approach is that developed from an Indian alliance of the Society for the Promotion of Area Resource Centers (SPARC) — an NGO — the National Slum Dwellers Federation and Mahila Milan (a network of women's collectives). Their strategy is to develop the capacity of local communities to manage a comprehensive upgrading and redevelopment process that is financed primarily by the state (through subsidies), with additional monies through loans taken by communities and repaid by individual members. Through a not-for-profit company, Samudhaya Nirman Sahayak, communities draw down the funds they need to pre-finance land, infrastructure, and housing development. The scale of activities has resulted in additional donor finance being drawn into the process through the Community-led Infrastructure Financing Facility (CLIFF).

A further model offering a more comprehensive development strategy than shelter microfinance is the strategy of combining small loans for housing improvement with land development. One illustration is the case of El Salvador where low-cost subdivision regulations established during the early 1990s have helped to stimulate a low-income land development industry of 200 firms. After developing the area and selling the household a serviced plot, many of these developers offer a small loan (often around US \$1000) to build an initial core unit. It appears that this strategy has resulted in affordable secure tenure over the last decade and — with greater supply — has lowered real estate prices in real terms.

The neighborhood development (slum upgrading), together with the servicing of greenfield sites, approaches suggest a number of distinct neighborhood and housing strategies that include a role for small-scale housing loans:

- improvements of existing housing units (this is the dominant approach today within shelter microfinance);

- linked land purchase and housing loan developments;
- linked land development and/or upgrading paid for with a capital subsidy and housing loan developments; and
- linked settlement upgrading and housing loan.

Sources of capital finance

How do microfinance agencies secure capital for their lending? Some providers draw on their own capital, notably the private sector and, for the most part, the small-scale voluntary organizations such as credit unions.

In general, microfinance agencies have four sources of capital finance: deposits, development assistance, governments, and the private sector. The problem of lack of capital remains even in countries with a well-developed microfinance sector.

There is a difference of opinion between microfinance agencies about the need for housing subsidies. On the one hand, there is a belief that subsidies are needed both because of the traditional association between subsidies and low-income housing and because of the larger size of housing loans. On the other hand, it is widely accepted that microfinance needs to perform without subsidy finance in order to be able to expand as market conditions permit.

In situations in which there is no state support, there appears to be an effective cross-subsidy from enterprise to shelter lending, as the interest rates are lower in the latter. In some countries, particularly in Asia, subsidies are available through reduced interest rates, and microfinance agencies have become a conduit to deliver state support to the poor. In some cases, the subsidy is provided in the form of an interest rate reduction. Grameen Bank in Bangladesh and the Self-employed Women's Association (SEWA) in India have both accessed low-interest sources of funds and pass on this subsidy.

Savings and collateral

The link between housing investment and savings extends well beyond the microfinance sector. In the North, families have traditionally saved for several years simply to access conventional mortgage finance. Similarly, many microfinance programs for housing, particularly in Asia and Africa, have savings requirements. Savings has a place in microfinance for many reasons. It is a strategy to assist with repayments in which borrowers have to demonstrate a capacity to make regular payments and accumulate sufficient funds for the required down payment or deposit.

Collateral is an asset pledged to a lender until the borrower pays back the debt. Its major role is in reducing lender risk and it is widely recognized that a key challenge for shelter microfinance is that of loan security. Many microfinance agencies seek to minimize the need for collateral by using existing client history (enterprise lending). A further strategy used for lending for income generation is small repeat loans as a way of building up repayment skills and capacities and providing an incentive for repayment. However, the larger size of shelter microfinance makes this strategy more difficult to follow.

Another strategy used by micro-enterprise lenders is that of group guarantees. However, this strategy has been found to be problematic for housing loans, again because of the bigger loans and longer loan period. In the absence of such strategies, a wide range of collaterals are used, including mortgages, personal guarantees, group guarantees, fixed assets and/or pension/provident fund guarantees. Pension fund collateral is used particularly in South Africa and Bangladesh and, more recently, in Namibia, but is not significant elsewhere.

Foreseen challenges

While shelter microfinance might not be effective in every context, there is now widespread experience and understanding of the process and considerable appreciation of the approach in many countries. There are two notable challenges facing the shelter microfinance sector. The first is the nature of the beneficiary group and the difficulties faced by very poor households due to problems of affordability and lack of secure tenure. The second is sources of funding.

Shelter microfinance programs appear, in general, to reach the income groups served by microfinance agencies lending for enterprise development and families with similar incomes in the formal sector. Many shelter microfinance programs appear to be targeted at the higher income urban poor, sometimes those with formal employment (at least one member of the family) and often those with diversified household livelihood strategies. This bias reflects the need of the agencies to secure high levels of repayments and give out larger loans (with the administration costs therefore being a smaller proportion of the loan).

Lack of capital emerges as being a very significant constraint on expansion. Banco ADEMI (in the Dominican Republic) cited lack of capital as the principal challenge that the organization faces in providing housing credit, for which there has been substantial demand. These difficulties reflect a general constraint on the microfinance sector and, in general, do not appear to be specifically related to housing lending. In addition, microfinance agencies face an issue of scale. To be profitable they have to increase the quantity of lending. There is evidence that this is driving their expansion into shelter microfinance; but for the smaller agencies, lack of capital to expand operations appears to be a significant constraint. Longer-term loan repayment periods are also common in shelter microfinance agencies despite the small size of the loans. Raising funds for shelter microfinance may be more complicated than for enterprise lending because of these longer loan periods. Donor support has placed emphasis on building the institutional capacity of lending agencies and assisting in the accumulation of their capital base. There has been a resistance to providing concessional funds for on-lending.

Chapter 7 – Community Funds

Community funds are of growing significance in assisting the poor to address their shelter needs. As the role of the state has diminished, increased emphasis has been placed on alternative strategies to support secure tenure, access to basic services, and improved dwellings. Community funds offer small loans to households but route these loans through community organizations. The emphasis on collective loans is for many reasons, but one is that the loans support investments in land and infrastructure which are necessarily made by a group working together. This chapter describes community funds, identifying their key characteristics, and discusses trends within this sector. It looks specifically at a number of key challenges, notably the affordability of their strategies and sources of funds.

Community funds are financial mechanisms that encourage savings through establishing and strengthening local savings groups that provide collective finance for shelter improvement. This may include any one or more of the following activities: land purchase; land preparation; infrastructure installation; service provision and housing construction; and extension and improvement. Their most distinguishing characteristic is the way in which funding is perceived — rather than the mechanisms of the financing process. Community funds use savings and loans to trigger a development process — not simply to increase the access of the poor to financial markets. They seek to strengthen the social bonds between community members (building social capital) so that existing finance within the community can be used more effectively and external finance can be integrated within community development strategies. Community funds are targeted at group borrowing and therefore may include those with lower incomes.

Generally, there has been increasing interest in community funds during the last decade. The growth is supported by a general acknowledgement that small-scale lending has been somewhat successful and that urban poverty is growing. Two further current trends related to the development of such funds are

worth noting: first, the growing interest by local government in these approaches, in part related to the use of such funds to extend essential infrastructure; and, second, the expansion of Shack or Slum Dwellers International (SDI), a community/NGO network whose strategies incorporate savings and lending activities for shelter improvements.

With respect to the latter trend, over the last 15 years, SDI has evolved into an international movement with affiliates in more than 12 countries. SDI groups have spawned a host of local community-owned and NGO-administered funds. In Cambodia, the Philippines, South Africa, Nepal, Sri Lanka, Zimbabwe, and Kenya, federation groups have established their own funds, which they lend to savings schemes. State contributions have been obtained in South Africa, Namibia, and, more recently, Nepal. A further area of interest is the use of community funds for utility investment for which the local authority may be formally responsible.

Funding sources

The importance of mixed funding sources is evident. In some cases, funds have been established by government and located within a state agency with access to subsidies. In other cases, the fund has been set up by civil society organizations and financed through a combination of state funds, NGO monies, community contributions, and, generally, international development assistance agencies. In both cases, the communities may make direct contributions to the fund through deposits to secure loans.

An important and common characteristic of community funds is that some subsidy is provided — either through state funds or international development assistance. This is a further significant difference from conventional microfinance and its individualized housing loans. While conventional microfinance programs may offer a subsidy, in general there is an understanding that this should be avoided. Within community funds, greater priority is placed on achieving poverty reduction goals and neighborhood improvement. Subsidies may be needed for institutional survival if interest rates are below the level required to maintain the real value of the fund. Equally or alternatively, subsidies may be required to reach everyone in a community or to reach very low-income communities.

There are several routes through which subsidies are delivered. The primary routes are direct subsidies, interest rate subsidies, additional support (for example, community development and technical assistance), and unintended subsidies when delayed payment and/or default occurs.

A further source of finance is that of commercial financial institutions. A number of groups managing community funds have sought to draw in commercial banks. At a minimal level, loan funds are released through banks, thereby encouraging the poor to see such institutions as something that they might use. In CLIFF, a donor-financed program working with SPARC, the National Slum Dwellers Federation and Mahila Milan in India, there is an expectation that the urban poor groups will become strong enough to be able to borrow from the banks.

Terms and conditions

Savings plays a central role in community funds. However, the programs may differ in the speed and the intensity of savings. This difference reflects both the orientation of the program itself and the possibilities within different countries. For example, in a large number of countries (including those with experience of informal savings and loan mechanisms), communities have been skeptical about the value of savings for shelter investment, and loan finance has been provided rapidly once the savings commitment was fulfilled. This is particularly true of countries that have experienced rapid inflation and/or where the state has confiscated or temporarily frozen savings.

Interest rates are generally subsidized, especially for land purchase and infrastructure, but often also for housing investment. Three major reasons emerge for this policy: practical, political, and social. On the practical side, many of these early programs evolved with an interest rate subsidy because the relatively

large size of the loan made affordability difficult if market rates were used. Politically, the policies may have been influenced by communities who were familiar with state support for housing through a reduced interest rate. This appears to be particularly strong in Asia where, for example, the Bangladeshi, Indian, Thai, and Philippine governments all have programs with interest rate subsidies for low- (and low-medium) income households. From a social development perspective, inclusion of the poorest and affordability are critical.

There are two distinctive characteristics of the collateral strategies used by community funds. First, there is reliance on community systems and community collateral rather than claims over the individual borrowers. Second, in cases of land purchase, legal title deeds may be used. However, the difficulties of loan security are considerable because of the different attitude towards non-repayment.

Loan periods appear to be longer than those used for shelter microfinance with, for example, rates of 25 years in the Philippines and 10 years in Thailand. To a certain extent, this is because of the large size of the loan relative to family incomes. It is also an acknowledgement of the fact that land purchase, for example, may be only a part of the investments that the family needs to make. NGO loan periods are lower and are generally less than five years. While some appear longer, such as those of the uTshani Fund in South Africa, the design reflects the fact that funds are primarily released as bridge finance for the state subsidy.

Challenges

Community funds face challenges that are very similar to those faced by agencies supporting shelter microfinance initiatives. How can they secure the funding they need for long-term viability and how can they be effective in reaching out to those in need of shelter investment?

A particularly different challenge faces community funds as they develop — what should their strategy be with respect to the state? Fundamentally, this is about strategies that maximize possibilities for scaling up funds while retaining a process that can be controlled by local communities. Links to the state are almost certainly essential if funding on the required scale is to be available. However, there is a concern that funds will be bureaucratized.

Community fund programs are designed for relatively stable communities who are in need of finance to secure land tenure and to upgrade their neighborhood. With regard to the challenge of inclusion, community funds may struggle to include all residents living within the settlement. They may also find it difficult to assist those who do not live permanently in areas of the city.

Throughout Asia, Latin America, and Africa, conventional development processes have failed to deal with many groups of poor people. In some cases, these are the poorest; but this is not always the case. There are particular groups who are vulnerable, such as illegal migrants. For example, Nicaraguans living in Costa Rica, Peruvians in Ecuador, or West Africans in South Africa are often treated as non-citizens. The practice of daily saving in India helps to ensure that even the poorest can participate. The livelihoods of the poor are generally managed daily (or in three- to five-day cycles), not monthly. Groups who save monthly exclude the poor. At the same time, richer households may not be interested in a process that requires them to save daily.

A group who may also face exclusion is tenants. It may be difficult to ensure that tenants are granted equal rights as tenure is secured and development takes place. A further aspect of inclusion is that of gender. There is a widespread understanding that the centrality of women is important. In part, this is because women are concerned about their neighbors, about who is sick and who needs what; it is also related to the level of poverty and vulnerability experienced by women. Women's community role means that if women are central to managing the savings process, then it is likely that there will be fewer problems with exclusion within the community. However, this requires that the process is orientated

towards women taking up a leadership role. While this seems prevalent in the case of savings and loans, in some contexts, the shift to construction encourages higher levels of involvement by men.

PART III: TOWARDS SUSTAINABLE SHELTER FINANCE SYSTEMS

Chapter 8 – Assessing Shelter Finance Systems

The analysis in Chapters 7 highlights a number of specific issues that have policy implications with regard to the value of shelter finance in addressing urban shelter needs. This chapter discusses these issues across the different approaches to shelter finance addressed in the Global Report. The issues considered are affordability and the difficulties of reaching the poor; access to capital and the lack of loan finance; the move to markets and what the market cannot manage — including the issues of maintaining financial viability; connections and diversity within globalization; and risk management within the market.

Affordability and the difficulties of reaching the poor

Rising house prices have made affordability more difficult in the North, as well as in the South. There have been very considerable attempts supported by government to extend homeownership to lower income groups — for example, through the more extensive use of mortgage insurance. There are some indications of success (higher homeownership rates) and some areas of concern as households may find it difficult to manage the associated risks.

In the South, the percentage of those who cannot afford mortgage loans is significantly higher in many countries, reflecting high levels of poverty. The estimates suggest that these numbers may be over 70 percent in sub-Saharan Africa and the lower income countries of Asia, and at or above 40 percent in the higher income countries of Asia and Latin America.

Opportunities to acquire small loans for land acquisition, infrastructure and housing do appear to have grown significantly during the last two decades, particularly during the last 10 years. However, provision still appears very small given potential demand (and in the context of estimated housing deficits).

The growth of microfinance agencies for enterprise development pre-dates the specific rise of shelter microfinance. These agencies have been encouraged to move into this sector due, in part, to the scale of enterprise loans that were 'misdirected' at housing investment. In other cases, they have extended their loan services to respond to explicit needs and requests, and because of their own commercial needs to expand their markets. The major problem faced by these agencies appears to be a lack of capital for expansion.

The tradition of community funds has grown up to respond to the needs of urban poor groups to invest in land purchase and to develop infrastructure on such land. While many loans are for secure tenure and infrastructure, the financial systems are also used for more individualized lending, both for housing and income generation.

However, once more, there are indications that the poorest find it difficult to participate. Such problems are evident in assessments of the Community Mortgage Program (CMP), a group-lending scheme in the Philippines that has provided almost 150,000 households with secure tenure, but which finds it difficult to include the poorest households. However, it has to be recognized that the use of loans carries inherent risks for those who are too poor to manage repayment risk, and greater emphasis may need to be placed on savings and grant combinations. Although there have been some attempts to develop micro-insurance schemes with microfinance initiatives, relatively little attention has been given to such strategies in the context of shelter microfinance.

The role of mortgage finance: Access to capital and the lack of loan finance

Mortgage finance is unaffordable for many of those living in the South and a significant minority in the North. Despite this, great emphasis has been placed by both governments and development agencies on mortgage finance, and state subsidies for mortgage finance still appear to be at a considerable scale in more than a few countries.

Different housing markets are not necessarily distinct, and if no other arrangements are made the higher income groups could take up those opportunities that are being offered to the poor.

In both Latin America and Asia, there have been initiatives at the government and multilateral agency level to support the development of secondary markets to increase wholesale finance to mortgage lenders. While it is possible that it is a shortage of capital that is preventing the expansion of mortgage finance, many other reasons have been identified in this report. What appears to be of most significance is the scale of informality in property and labor markets. It seems that much emphasis has been placed on formalizing land titles; but, as seen in Peru, this has not necessarily increased the take-up of either mortgages or enterprise loans. This suggests that access to loans may be limited in ways that cannot be addressed by reforms to property titles, increasing the ease of foreclosure or the scale of finance and competition in the sector.

Despite these problems, mortgage lending does appear to have expanded in a number of countries. This appears to be associated with economic growth and with increasing affluence. Competition has intensified and the market for mortgage finance is moving beyond a small number of lenders in several countries.

There are risks for individual households in taking on mortgage loans, and some of these risks have been evident when housing prices have fallen, notably in the UK and Japan. While mortgage insurance has been extended, it appears that much emphasis has been placed on protecting the lender rather than the borrower. Mortgage finance has survived difficult circumstances in Asia and Latin America during the last decade.

The bigger picture and what the market cannot manage

Despite a general emphasis on the expansion of market-orientated mortgage finance and housing support, more generally, the analysis in this report does point to a number of areas in which markets alone appear to be struggling, including institutional failings related to necessarily collective rather than individual investments in shelter, and issues related to urban planning and land-use management.

The housing finance market is strongly orientated towards providing loans to individual households. In two of the situations discussed in this report, there is a need for collective investment: to maintain multi-family dwellings in transition countries and to invest in land and infrastructure for those without tenure in the South. In both cases, it appears that the market is unable to make an adequate response, in part due to reasons of affordability, but also because local institutions that can manage the finance are missing. While the suggestion proposed by government agencies is often the establishment of formal management committees, care needs to be given that these do not discriminate against the poor. To address the housing needs of the poor, housing finance systems need to provide for loans for such collective purposes, and appropriate local structures must be in place for this to happen.

The market also seems to struggle with ensuring the quality of the urban environment (in a physical and social sense). The greater emphasis on targeting and reduced social provision in the North appears to have resulted in a greater concentration of low-income households in specific areas. This applies both in the case of the transition countries and for the richer countries of Western Europe.

Another important issue is the nature of the developments that are being supported by the direct-demand subsidies — for example, in South Africa and Chile. A consequence in both countries is that low-income housing has been located on low-cost sites, often a considerable distance from jobs, services and other facilities, with little consideration of the social cost that results from such physical exclusion. This suggests that the market is unable to respond to the needs of the poor without greater interventions from the state — either the funding agency and/or the local authority. This further suggests that a key task for government is to ensure adequate supplies of well-located and well-served land.

Connections and diversity within globalization

The broad context within which the analysis in this report is situated is one in which financial markets are deregulating and the state is withdrawing from direct involvement in the economy. Despite this financial deregulation, there is relatively little evidence that financial globalization is taking place in the housing sector. Markets for housing finance have internationalized rather than globalized. Hence, at present, while money can flow across borders and assets are sold offshore as well as domestically, there is no globalized market in which there is a continuous flow of funds into assets whose risks and returns are independent of national regulatory and banking structures, and where prices are identical across national borders (for areas with similar risks).

Internationalization has occurred in place of globalization because, although the state has withdrawn to some extent, it remains involved and housing finance markets are still particular, depending upon their specific historical and structural contexts. As a result, rather than there being a single market, many national markets exist.

Chapter 9 – Policy Directions Towards Sustainable Urban Shelter Finance Systems

Chapter 9 discusses the ways in which shelter finance systems could be strengthened, in terms of both performance and sustainability, on the basis of the experiences reviewed in the preceding chapters. Its main purpose is to point the way forward, highlighting best policies and practices. The chapter starts by identifying policy directions in improving urban development finance, which is necessary for citywide infrastructure development. It then proceeds to identify policy directions in shelter finance.

The essential basis of the municipal side of the compact between households and the public realm is a system of financing public goods so that they can be provided across the city, in appropriate quality and quantity, and at affordable cost, and so that the city can be managed effectively. Unless urban areas can produce more income at the same rate that they absorb more people, the resources to develop infrastructure and build shelter will not be available.

It is vital that powers, duties and revenues are congruent. If the municipal authority is responsible for social housing, it should have the power to take policy decisions on how it will act and receive the required revenue, or be able to raise the finance.

Towards inclusive urban infrastructure and services

Municipalities should be able to raise at least part of their revenue from local taxation, at levels which reflect local conditions. As a consequence, municipalities and governments need to build the institutional capacity to levy and collect these taxes, and to spend them responsibly. Indeed, legislation may be necessary to guide the responsible use of municipal revenues.

It is vital that there is some source of loans for capital projects to which municipalities can apply in order to allow them to develop major projects that cannot be financed out of annual budgets. There are many models. Funds may be made available through loans from central government or an agency thereof, a mortgage bank, a finance company, a provincial-level institution, or a group of municipalities working cooperatively.

Just as protecting endangered environments can be funded through debt swaps, so such exercises can be used to fund housing and urban services, as shown in the case of Bolivia (described in Chapter 3). As in many other financing arrangements, having a poverty reduction strategy paper (PRSP) in place which influences urban policy enables debt swapping in that it gives the parties confidence that the money will be spent within a strategy for poverty reduction rather than ad hoc.

The rising value of urban land is a significant potential source of finance for cities. Extracting public value out of the development process has been practiced in many countries, some with great success. The US linkage process, in which city authorities leverage funds from the profits derived by developers of real estate to fund social projects, might be effective in cities in the South.

The level of accuracy required in land records for the collection of property taxes is lower than that for avoidance or resolution of land disputes. Thus, such systems as half cadastres and the use of regular low-resolution aerial photography can provide a level of accuracy well able to support property taxation systems at relatively low cost, compared with an expensive, high-resolution land survey.

It is also important that municipalities are paid economic charges for their services. Thus, functions such as land registry, building regulation, and planning control should be subject to a charge that covers the cost. Similarly, user fees for municipal services (markets, abattoirs, car parks, transport interchanges, bus services, assembly halls, etc.) should cover life-cycle costs and, where appropriate, generate revenue.

In many cities, there is a culture of replacing regular maintenance with irregular capital projects. It is better practice to cost infrastructure over its whole life (life-cycle costing) and put aside money for periodic maintenance over a long life. The savings are considerable compared with rebuilding at the end of a short life.

The ability of the small-scale private sector to run local supplies of water, waste collection, and other services in partnership with the public authorities is well documented and should be explored by municipalities not already using such partnerships.

Wherever it occurs, corruption saps the ability of central and municipal governments to meet the needs of their constituents through diverting money away from the development and maintenance of services. Only when real progress is made on making corruption simply unacceptable in business and government, and involving people in eradicating it wherever it is found, will cities function efficiently and with trust from all partners.

It is likely that government funding can have the greatest effect if it is directed towards infrastructure and services for low-income neighborhoods and welfare services for the poorest. In the provision of land, basic infrastructure, and social services to the poor and poorest, subsidy is likely to be required unless the cost of services is low indeed.

Unless urban areas can produce more income at the same rate that they absorb more people, per capita incomes will fall and urban poverty will deepen. Thus, employment and income are central to the financing of urban development. The potential of shelter provision to generate employment for low-income workers should be utilized to generate income to improve people's ability to pay for housing. The income multipliers are very high for construction and even higher for low-technology, labor-intensive construction. In parallel, the provision of efficient infrastructure and appropriate shelter is critical in ensuring the economic productivity of the work force in urban areas and countries as a whole.

Local governments should reduce the costs of economic activity by streamlining land allocation, development control, and other regulatory activities, while retaining appropriate ability to act in the public good. One-stop shops allowing planning and building control to be streamlined are capable of radically

reducing the transaction costs of development and encourage more people to take the formal development route.

Strengthening the sustainability and performance of the shelter finance system

Turning to housing finance, there is both a need and a demand for layers of finance for different sectors of the housing supply process. Mortgage finance, for relatively large sums over a long period of repayment, is essential for those well off enough to buy a complete formal dwelling. However, small loans, taken out over short terms of between one and eight years, loaned at market rates, are growing in importance in the housing sector.

The problem in many developing (and even in some developed) countries is not that housing is too expensive, but that incomes are too low. The locus of attention should not be on the minimum quality and cost of housing, but on the level of payment received by workers. This demand-side focus is in line with current trends in subsidies and concentrates attention on the systemic problem of poverty, which generates poor housing consequences.

In many countries in the South, the cost of urban housing is increased significantly by the high standards to which it must comply. The introduction of lower standards that are more appropriate to the local context could potentially make housing more affordable to a far greater proportion of the urban population. Lower standards would still, however, have to safeguard the health and safety of the occupants and protect the public interest.

Most policies behind official development assistance and national policies are based on the provision of independently serviced single-household dwellings, owned by their occupants. However, this is by no means the main form of occupation by households living in poverty. Instead, large numbers of households live in buildings occupied by many households. There is much to be gained from encouraging multi-occupied housing development where it fits in with local norms.

Small-scale landlords in informal settlements are a major source of affordable housing for a growing majority of households living in poverty in the urban South; but there are few initiatives to assist them. It is imperative, therefore, to understand how best to assist the informal rental sector and, at the same time, to preserve affordability in order to preclude gentrification.

In the spirit of the Habitat Agenda, and if the housing backlog is to be cleared at all, it is vital that all actors in the housing process are involved in the role in which they are most efficient. The most important suppliers of the dwellings themselves, and their ancillary services, are the millions of small-scale building contractors, the single artisans or small groups of skilled people and the laborers who service their needs. However much demand there is for housing, it can only be supplied as quickly as the construction industry can build it. Finance to provide healthy liquidity among small-scale contractors and single artisans is an essential prerequisite to effective housing supply to scale.

In countries where the housing supply system is efficient and speculative of what the market demands, developers are often an important part of the process. Some mechanism for recognizing their contribution with financial assistance, especially for bridging loans, may be very beneficial for the housing supply process and could institute the efficient speculative building of housing, which is common in industrialized economies.

Recent research into regulatory frameworks for urban upgrading and new housing development has recommended the removal of constraints that prevent the poor from borrowing from financial institutions or accessing credit through other formal channels. In particular, administrative procedures that delay investments and/or increase risks should be reviewed as they add to the cost and deter the poor from conforming.

The countries in which most of the urban growth will take place during the next 25 years have very low domestic savings measured as both per capita and as a percentage of GDP. As savings are the foundations for investment, this does not auger well for urban development. It is important that developing countries maintain as much as possible the investment and savings arising from local economic activity within their borders, or benefit from net inflows from investments overseas. It is difficult to overstress the importance of reliable banks and low inflation in discouraging capital flight.

It is in governments' interests to extend mortgage markets down the income scale, as homeownership is seen to be beneficial economically and politically. Measures that could be adopted include reducing the cost of lending, especially through reducing interest rates; supporting the system of mortgage financing, especially through extending secondary markets and reducing risks; and providing direct capital grants to reduce the size of a household's mortgage in comparison with the dwelling cost.

Well-run mortgage facilities are undoubtedly important to the health of the housing supply system in the North and may be a major contributor to housing improvement in transitional countries. They are also important in providing upper- and middle-income groups with housing finance, without which they would claim the shelter opportunities provided for those lower down the income scale.

As mortgage finance is unlikely to assist the majority of the people, it must not be allowed to divert attention from financing that is helpful to lower income groups or to drain resources away from low-income households towards those in the middle- or upper-income groups.

Loan periods and loan-to-value ratios (LTVs) are vital components of mortgage loans, which are determined by the lender rather than the global macro-economic environment. Decisions about them can be the difference between the success and failure of the mortgage company and can determine who can afford to borrow, at least at the margins. Low LTVs (and, therefore, high initial deposits) reduce risk but increase the need for upfront capital. The level of repayments can be varied in order to help households meet their obligations. Variable-interest loans allow low payments at the beginning, increasing as income improves to repay the loan on time.

There is a well-documented link between finance for income generation and improvements in housing. Many homeowners operate one or more home-based enterprises from the structure on which they raise housing finance. The same goes for rental income. One of the most important sources of low-cost rental property, which is becoming more important as the years pass, is the extra room built on to a home and rented out to a stranger for rent, or to a co-villager or relative for no rent but some other benefit (if only to satisfy family obligations).

It is obvious that improvements in housing can benefit home-based income generation, including room rentals. Thus, lenders should take account of the likelihood of income improvements in the application procedure through a process which factors in future income generated by the housing goods, to be provided under the loan. It is also important that financiers recognize that the poor are more concerned about access to credit than its cost. Experience shows that there is great demand for microfinance even if interest rates are high.

Subsidies come in many guises, including direct interest-rate reductions; allowing mortgage interest payments to be deducted from income tax; supporting housing-related savings; supporting insurance of mortgages; supporting the secondary mortgage markets; and direct grants for shelter.

If appropriate housing finance is in place, the proportion of households requiring subsidy should be minimized to only those too poor to afford the real cost of the shelter available. The need for subsidy can, thus, be reduced by adopting effective financing systems. The work of some NGOs to provide funding to assist individuals in accessing subsidies is very helpful to many households. In Ecuador, a revolving fund provides the down payment necessary to obtain a national housing subsidy grant.

Social housing is, almost by definition, subsidized housing. The subsidy element is a financial credit to the occupier and, thus, often constitutes an important element in a nation's housing finance system. Although social housing is becoming residual in Europe and transitional countries, the need to provide more housing that is affordable to the low-income households is still present. Those who cannot afford homeownership or market rents in the private market need shelter through public rental housing. In the South, however, few countries have been successful in large-scale public rental housing.

Small housing loans, disbursed through housing microfinance institutions (HMFIs), are some of the most promising developments in housing finance during the last decade. They are suitable for extending existing dwellings, building on already serviced land, adding rooms (often for renting out), adding services such as toilets, and housing improvements within in situ neighborhood upgrading. They tend to reach much further down the income scale than mortgage financing, but not to the households close to or below poverty lines.

In the context of large numbers of new low-income households in cities over the next two decades, it is important to increase the number of lenders in the housing microfinance sector, rather than to concentrate only on mortgage finance which, inevitably, serves the middle- and upper-income groups.

There is a serious issue of funding for on-lending by HMFIs. Many have received concessionary funds, and their lending reflects the low price of the capital. If they are to expand their operations, they will need to cope with borrowing at international market rates and reflect this in their loans.

In comparison to enterprise microfinance, shelter microfinance lending involves long-term and large loans and generates a need for group security or some security of tenure backed by documentation. In the context of group lending, mandatory savings periods before loans not only build up an understanding of finance, but also strengthen community ties among savers through regular group meetings. Then the group becomes the collateral, as the members will support each other in times of difficulty and take away from the lender the complication of following up defaulters.

Throughout the days of sites-and-services projects and other aided self-help, efforts have been made to reduce the financial burden of low-income homeowners by allowing materials to be drawn from dedicated warehouses or to be supplied on credit through local commercial suppliers. Recent experience in Mexico and elsewhere has shown how there may be great potential for this to expand alongside housing microfinance and the downscaling of mortgages to lower income households using the longstanding credit culture operated by furniture and household goods retailers.

Remittances from overseas residents of local nationality are an important part of housing finance in many countries. Many people can remit enough to build a house in a few years overseas in quite lowly employment that would be impossible if they stayed at home in higher-level employment. But there is a danger that tastes, standards and ability to pay from a different context may take over the local markets and drive other residents into poorer housing than they would otherwise have.

Many charities give large amounts of money towards housing improvement and shelter for the poorest. There is a place in funding shelter for the poor for that which arises from altruistic humanitarian support.

Community-based financing of housing and services has been used for both settlement upgrading and for building on greenfield sites. In a context where small loans are evidently successful, and where there is an increase in poverty, it has many advantages for low-income and otherwise disempowered households. The experience of the affiliates of the Shack or Slum Dwellers' Federation has demonstrated that there is great potential for community-based organizations to manage development finance to the benefit of large numbers of relatively poor households. The evident success of community funds has attracted some governments to take part in their financing.

Epilogue

The shelter issue has become one of a global nature after the concept of 'human settlements' found its place in the international development agenda. Until recently, the classical response to the shelter problems of the urban poor was social housing, both in developed and developing countries. However, the massive demand for affordable housing in developing countries, coupled with the limited resources of the public sector, would have made this solution inapplicable, even in the presence of a well-organized and transparent public-housing delivery sector. Notable exceptions are states such as Singapore, which implemented huge and very successful public housing programs, as well as successful policies in other larger countries such as Tunisia and isolated exemplary projects in many others.

The notion of 'financing shelter for the poor' corresponds, in a way, to the abandonment of the traditional concept of public responsibility embedded in the 'social role of the state'. With the commodification of the economy, where housing is but another good to be produced, sold, and bought, the solution to the shelter dilemma is based on the notion that 'the poor' will always exist, and that their access to a fundamental human need —adequate shelter — will always require special measures and special solutions.

This Epilogue starts from the premise that 'special approaches' and ad hoc solutions, however ingenious, will never work at the scale required. Three points are made. First, the percentage of the urban poor in the cities of the developing world is far too high to be considered a residual issue. Second, the demand for affordable shelter is increasing at an extremely fast pace, notably in the rapidly growing cities of the developing world. Third, the standards and costs that city life requires are high and complex. Shelter is only one, albeit the central, requirement of all citizens. Given the rapid spatial growth of cities in the developing countries, transport, for example, becomes a crucial necessity for survival. The living, working and spatial circumstances of city life require standards and services for all that are far superior in quality and sophistication to those usually associated with minimal shelter — a roof over one's head.

Given these considerations, the issue is not simply financing shelter for the poor. The issue is making adequate shelter affordable to the poor. This approach may be called 'sustainable shelter': shelter that is environmentally, socially, and economically sustainable because it satisfies the Habitat Agenda requirements of adequacy. Its acquisition, retention, and maintenance are affordable by those who enjoy it. It does not overburden the community with unaffordable costs. Finally, it is located in areas that do not constitute a threat to people or to the environment.

There is no single magic formula to achieve this. Individual self-help can only produce solutions that are admirably suited to the harsh circumstances of urban migration, but are also the most fragile of all. Community-based funding has proven a valuable and indispensable asset, particularly for improving services and, in some cases, infrastructure in informal settlements; but it is not likely to reach the scale required, at least in the short term. It must also be noted that the admirable solidarity mechanisms found in poor urban communities stem from the common will to stave off a common threat, often rooted in a state of illegality and a risk of eviction. They also depend upon the cultural and ethnic composition of the informal settlement. Strongly desirable and supported outcomes such as regularization, infrastructure upgrading, and the improvement of economic circumstances can also bring the attenuation of community solidarity and mutual self-help mechanisms. Therefore, they cannot be assumed to work in all cases and for indefinite periods of time.

Abating housing costs

Housing is becoming an increasingly expensive commodity in all countries. Between 1997 and 2004, according to a very recent survey, average housing prices grew by 131 percent in Spain, 147 percent in the UK, 179 percent in Ireland, 113 percent in Australia, 90 percent in France, and 65 percent in the US. The only developing country listed in the survey is South Africa, which registered the highest growth in the sampled countries: 195 percent.

Of course, these sharp increases in housing prices can, in many cases, be due mainly to speculative bubbles. But there is little that policies can do to prevent or control these phenomena. On the other hand, while average housing prices are lower in the developing countries, they are also influenced by steeply rising costs of land, building materials, and other cost components.

Affordability, therefore, rests to a large extent upon policies capable of bringing down housing production costs. Housing production cost components are known: capital, land, infrastructure, building materials, standards, design, location, and modes of production. To be affordable, all of these elements will require a substantive element of subsidy; but in some cases they will only need intelligent policy changes.

Increasing purchasing power

In the developed world, a household with two sources of income, wife and husband, however humble the occupation or the source of income may be, normally can gain access to decent shelter on the market, however modest. In the developing world, this is virtually impossible — hence, the virtual necessity of finding affordable inadequate shelter in a slum. People who live in slums are known as 'slum dwellers'. In reality, they are 'working poor': people who work for a living, but whose income cannot guarantee them access to the basic needs that everybody in developed countries take for granted — adequate shelter, proper nourishment, health, education, and decent and non-threatening living environments.

There is something terribly wrong about the inability of vast numbers of the working poor in developing countries to gain access to adequate housing. Part of the problem is the rising costs of conventional housing addressed above; but an equally important issue is the extremely low wages in the formal sector and income from other income-earning activities, particularly in the informal sector. This is why making shelter affordable to the poor also depends upon increasing the poor's income.

The issue, of course, is not simply that of wages. A regular income is also a standard prerequisite for accessing mortgage or shelter microfinance markets. Continuity in income earning is important once one enters a mortgage agreement in order to avoid the risk of losing all of one's investment through the painful process of repossession. But a decent income is the minimum basis for accessing decent shelter, particularly in the situations of virtually all developing countries where workers' benefits and pensions are virtually non-existent and where the prices of basic necessities rise as rapidly as those of housing.

Lower housing prices and higher incomes

Increasing both wages and income opportunities for the working poor augments the saving potential of the same earning group. The urban poor show a marked propensity and ability to pool part of their incomes into community funds and other forms of saving arrangements. This triggers virtuous circles: the more capital is saved, the more is available for improving shelter conditions, productivity, skills formation, and income-earning activities. With upgrading and adequate shelter solutions, more disposable income can become available to contribute to basic infrastructure and services, thus making public capital investment in this area more sustainable.

Financing shelter is only a component of the broader goal of securing solutions that can make shelter truly sustainable and that can fill the gap between the two extreme outcomes which are being witnessed today: affordable shelter that is inadequate and adequate shelter that is unaffordable. One starting point is to look at the inhabitants of informal settlements not simply as 'slum dwellers', but as 'working poor'. Important opportunities exist for addressing the affordability gap by acting on both ends of the sustainable shelter equation — reducing housing production costs and increasing the incomes of the working poor.

Given the urgency and growing significance of the 'urbanization of poverty' challenge, it is difficult to think of other areas of development that deserve more attention and investment on the part of the local, national, and international institutions committed to reaching the Millennium Development Goals (MDGs), including the target of improving the lives of at least 100 million slum dwellers by 2020 and, more

generally, to find practical and sustainable solutions to the global fight against poverty. Cities can lead the way, and the MDG targets within them — the urban poor — can become the protagonists, leading actors, and living examples of a brighter future for all of humanity.

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