



UNITED  
NATIONS

# HSP



UN-HABITAT

## Governing Council of the United Nations Human Settlements Programme

Distr.  
GENERAL

HSP/GC/19/2/Add.4  
21 March 2003

ORIGINAL: ENGLISH

---

### **Nineteenth session\***

Nairobi, 5-9 May 2003

Item 6 of the provisional agenda\*\*

### **Activities of the United Nations Human Settlements Programme: progress report**

## **ACTIVITIES OF THE UNITED NATIONS HUMAN SETTLEMENTS PROGRAMME, UN-HABITAT: PROGRESS REPORT OF THE EXECUTIVE DIRECTOR**

### Addendum

### **Strengthening the United Nations Habitat and Human Settlements Foundation**

### **Report of the Executive Director**

### Summary

1. In its resolution 56/206 of 21 December 2001, the General Assembly devoted a full section to the issue of financing human settlements and called upon the Executive Director to strengthen the United Nations Habitat and Human Settlements Foundation in order to achieve its primary operative objective, as set out in resolution 3327 (XXIX) of 16 December 1974, of supporting the implementation of the Habitat Agenda, including supporting shelter, related infrastructure development programmes and housing finance institutions and mechanisms, particularly in developing countries.

2. The present report sets out the progress made in this regard, and provides a short introduction to the Foundation. It summarizes the results of two recent reviews (one still ongoing) of options for strengthening the Foundation and its contribution to the implementation of the Habitat Agenda and the millennium development goals – and particularly target 11, of delivering a significant improvement in the lives of 100 million slum dwellers by the year 2020. It provides information about two suggested financial

---

\* In its resolution 56/206 of 21 December 2001, the General Assembly transformed the Commission on Human Settlements into the Governing Council of the United Nations Human Settlements Programme (UN-HABITAT), a subsidiary organ of the General Assembly. This session has been designated as the nineteenth instead of the first session of the Governing Council to signify the continuity and relationship between the Governing Council and the Commission on Human Settlements.

\*\* HSP/GC/19/1.

K0360851 250403

instruments. One is a domestic currency loan guarantee facility (Global Shelter Facility) with a proposed initial capitalization of \$200 million, to play a catalytic role in mobilizing public and private sector domestic resources to meet the housing and infrastructure needs of the urban poor. The other is a complementary fund (Shelter Assistance Fund) to finance technical assistance and to provide seed capital, capacity-building grants and challenge funds to help put in place the necessary preconditions for successful slum upgrading, and for successful Global Shelter Facility interventions. A funding target of \$100 million over five years is proposed for the Shelter Assistance Fund.

3. These financial instruments are being developed in the context of the establishment of the United Nations Human Settlements Programme (UN-HABITAT) as a fully-fledged United Nations programme and of preparations for subprogramme four on human settlements financing, which was introduced as part of the follow-up to General Assembly resolution 56/206. The present report also provides an update on other progress in preparing for subprogramme four, in particular with respect to enhancing the capacity of UN-HABITAT, and strengthening cooperation with the World Bank and the regional development banks.

4. The report concludes with a number of recommendations for consideration by the Governing Council, including the proposed establishment of an Executive Board for the Foundation.

### Introduction

5. One of the three operative sections of General Assembly resolution 56/206 of 21 December 2001, on strengthening the mandate and status of the Commission on Human Settlements and the status, role and functions of the United Nations Centre for Human Settlements (Habitat), was devoted to financing human settlements. In it the General Assembly called on the Executive Director to strengthen the United Nations Habitat and Human Settlements Foundation (the Foundation) in order to achieve its primary operative objective as set out in resolution 3327 (XXIX). The first section of the present report provides an introduction to the Foundation and subsequent sections detail the progress made since resolution 56/206 was adopted by the General Assembly. The report concludes with a number of recommendations.

6. The Foundation was born out of recommendation 17 of the Action Plan for the Human Environment,<sup>1</sup> developed by the United Nations Conference on the Human Environment, held in Stockholm in June 1972. That recommendation called for the establishment of an international fund or financial institution to facilitate effective mobilization of domestic resources for improvements in housing and human settlements. The recommendation was subsequently developed by the United Nations Environment Programme (UNEP), following its own creation at the end of 1972, into a proposal for the establishment of the United Nations Habitat and Human Settlements Foundation. That proposal was adopted by the General Assembly in its resolution 3327 (XXIX), and the Foundation was established with effect from 1 January 1975 under the auspices of UNEP.

7. Resolution 3327 (XXIX) sets out the mandate of the Foundation, and states that "the primary operative objective of the Foundation will be to assist in strengthening national environmental programmes relating to human settlements, particularly in the developing countries, through the provision of seed capital and the extension of the necessary technical and financial assistance to permit an effective mobilization of domestic resources for human habitat and environmental design and improvement of human settlements."

8. The core mandate of the Foundation is thus to leverage domestic resources for making improvements in human settlements. While this role was set out for the Foundation nearly 30 years ago, the need for and relevance of this mandate remain as pertinent today. Not only does it respond to the requirements of supporting the implementation of the Habitat Agenda, the two global campaigns on secure tenure and urban governance, and the millennium development goals, but it also responds directly to the emphasis given in the Monterrey Consensus<sup>2</sup> on mobilizing domestic financial resources for development. The typically high capital cost of interventions in the human settlements sector, and the predominantly domestic nature of the resources required – particularly labour – make access to domestic capital, including private-sector domestic capital, an essential element in sustainable human settlements development.

9. In December 1977 the General Assembly adopted resolution 32/162 establishing the United Nations Centre for Human Settlements (UNCHS) (Habitat), and transferring the Foundation from UNEP to the administration of the Executive Director of UNCHS (Habitat). In the same month, by decision 32/451, the General Assembly also established United Nations Financial Regulations 5.10 and 9.4 giving the Foundation, uniquely in the United Nations system, the authority to raise capital and provide loans in support of its mandate – enabling legislation that was reconfirmed by the General Assembly at its fifty-seventh session.

10. In the years that followed, however, the mandate of the Foundation was forgotten and it became instead an account only for receipt of voluntary contributions to support the core staff and work of UNCHS (Habitat), as the organization struggled to secure adequate and predictable funding for its own operations. Yet, since the creation of UNCHS (Habitat), with modest contributions from the donor community, the Foundation has been able to support only the implementation of its work programme. It has not contributed directly and significantly to the improvement of shelter and human settlements conditions in developing countries. Operational activities of UNCHS (Habitat) have generally not been funded by the Foundation but through technical cooperation resources mobilized at country level, on a case-by-case basis, from funding partners such as the United Nations Development Programme (UNDP), other external support agencies and the recipient Governments themselves.

11. It was against this background, of an organization struggling for adequate resources coupled with an essentially dormant financial institution, that two senior consultants were commissioned, in late 2001 with financial support from the United Kingdom of Great Britain and Northern Ireland, to review the structural weaknesses in the financing of UN-HABITAT and to make practical, innovative proposals for improving its financial stability. The next section summarizes the findings and recommendations of that report, which was finalized in March 2002.

#### I. UN-HABITAT FINANCIAL STUDY – MARCH 2002

12. Following a comprehensive review of the historical framework and institutional problems besetting UN-HABITAT – which have now in large part been addressed by the General Assembly in resolution 56/206 – the report analysed the financial structure and dependencies of the organization. It highlighted in particular:

- (a) The failure of the Foundation to develop as the financial and catalytic institution originally envisaged;
- (b) The downward spiral of donor confidence during the 1990s whereby donors shifted funding from non-earmarked core support to earmarked project activities, thereby weakening the Foundation's core staffing, stability and competencies, and eroding confidence;
- (c) The potentially short-term nature of the recent increases in non-earmarked core funding and their vulnerability to political shifts among key donors;
- (d) The dependence of the core staffing and structures of the regional offices on technical cooperation overhead income, and hence on securing projects for implementation, making the offices vulnerable and weakening the framework for effective integration of normative and operational activities;
- (e) The decline in UNDP funding to technical cooperation activities;
- (f) The strong experience of UN-HABITAT in the field of post-disaster and post-conflict recovery programmes.

13. The further analysis and proposals then built around a number of key themes, including a fundamental link to the millennium development goals – particularly target 11, of delivering a significant improvement in the lives of 100 million slum dwellers by 2020 – and a perception that urban issues are marginalized in development thinking and financing, just as UN-HABITAT has also been marginalized. The consultants'

report recommended that, instead of focusing initially on funding for the organization itself, UN-HABITAT should focus first on the larger issues of the lack of targeted funding for the implementation of the Habitat Agenda, and the existence of market failures in pro-poor urban financing. The report went on to propose four options for increasing the scale and stability of funding to pro-poor urban needs, which in turn would be expected to facilitate the work and impact of UN-HABITAT and increase the visibility and credibility both of the organization and of its mandate.

14. The options formed a continuum from a broadly status quo option, through an "incremental" option which essentially envisaged more substantial and stable core funding for UN-HABITAT by means of an endowment fund built around the millennium development goals, to two options described as "transformational" which include an additional step-change dynamic of a revitalized Foundation as a full financial institution.

15. The review by UN-HABITAT itself of the proposed options favoured one of the transformational options – the so-called "transformational-retain" option whereby the Foundation would be modernized and given fresh capital with a mix of loan/equity/grant/guarantee funds. It would participate in targeted projects and programmes at the operational level and seek to leverage other public and private partners and co-finance sources, particularly at city and subnational levels. The revitalized Foundation would provide a distinct financing window for investments in pro-poor urban housing and slum upgrading to address in parallel but simultaneously the problem of sustainable funding for UN-HABITAT and the housing finance market gap in developing countries.

16. Building on the above analysis, in response to General Assembly resolution 56/206, and in order to give appropriate priority and significance to the fundamental issue of human settlements financing, UN-HABITAT proposed revisions to the human settlements section of the United Nations medium-term plan for 2002-2005. In particular, it was proposed to introduce a new subprogramme on human settlements financing, under the responsibility of the Foundation. The next chapter outlines the present situation with regard to that subprogramme.

## II. SUBPROGRAMME FOUR — HUMAN SETTLEMENTS FINANCING

17. The human settlements section of the United Nations's revised medium-term plan for 2002-2005 that was approved by the General Assembly in December 2002, following review by the Committee of Permanent Representatives in Nairobi and by the Committee for Programme and Coordination in New York, includes a new subprogramme on human settlements financing. This responds particularly to the section of General Assembly resolution 56/206 on this subject, including the call to UN-HABITAT to strengthen the United Nations Habitat and Human Settlements Foundation.

18. The same section of resolution 56/206 calls for the active collaboration of financial organizations and bodies within and outside the United Nations system, including the World Bank and the regional development banks, in the activities of UN-HABITAT, in particular with regard to the provisions of seed capital and the financing of programmes and projects, as well as the development of innovative financing approaches. Subprogramme four will focus on the identification and promotion of such approaches with a particular emphasis on supporting the millennium development target on slum upgrading.

19. This subprogramme represents a core component in enabling UN-HABITAT to operate as a fully-fledged United Nations programme in its work to improve the human settlements conditions of the poor in developing countries and in countries with economies in transition. Whilst the other subprogrammes focus on other instruments that support the implementation of the Habitat Agenda and the millennium development goals, such as advocacy and policy development, subprogramme four focuses on the financial instruments that can support and deliver these goals. Responsibility for the subprogramme is vested in the Foundation.

20. There are two main aspects to the work planned under subprogramme four:

(a) Enhancing the capacity of UN-HABITAT to support the implementation of the Habitat Agenda and the millennium development goals;

(b) Directly facilitating the mobilization of domestic resources in developing countries and in economies in transition, including from the private sector, for human settlements development, and promoting and facilitating the mobilization of resources from international sources, including from the private sector. Further details on the subprogramme are provided in the proposed budget and work programme for 2004-2005 (HSP/GC/19/8 and 19/9). The remainder of this chapter of the present report provides an update on progress, particularly from the perspective of strengthening the Foundation.

#### A. Enhancing the capacity of UN-HABITAT

21. Over the past two years there has been a significant increase both in the Foundation's general purpose funding (a total of \$13 million over the past two years compared to \$7 million in the previous two years) and special purpose funding (\$28 million compared to \$15 million). The increase in general purpose funds in particular has enabled the organization to strengthen its core capacity, especially its staffing.

22. Also important has been the move by several major donors – Belgium, the Netherlands and the United Kingdom – towards multi-year commitments to finance core programmes of UN-HABITAT. It is hoped that in the next biennium there will be further progress in that regard, in terms of an increase in both the number of donors providing multi-year commitments and the number of years covered by such commitments.

23. Another development has been the introduction of thematic trust funds under the umbrella of the Foundation. The first such fund is the Water and Sanitation Trust Fund that was established at the end of 2002, and it is planned to apply this approach also in some other subject areas. It is anticipated that a limited number of thematic trust funds will enable donors to support their priority areas, where these also form part of UN-HABITAT priorities, instead of operating on a more restrictive single-donor, earmarked project basis.

#### B. Mobilizing domestic and international resources

24. There have been limited resources available for working on this aspect of the subprogramme in the run-up to its implementation from 2004. However, particular progress has been made on two fronts. First, UN-HABITAT has been developing its collaboration with multilateral financing institutions in line with resolution 56/206, and this is covered in the paragraphs that follow. Second, following on from the UN-HABITAT Financial Study of March 2002 and with financial support from the Governments of Sweden and the United Kingdom, UN-HABITAT has commissioned a study on the scope for a pro-poor urban financing facility to leverage domestic resources. Details of this study and its findings so far are given in the next chapter.

25. The Cities Alliance partnership between the World Bank and UN-HABITAT, which has been joined by a number of bilateral donors and also recently by the Asian Development Bank, continues to provide an important forum for policy coordination and development, as well as providing support for the preparation of pro-poor city development strategies and slum upgrading programmes.

26. In addition, UN-HABITAT has been expanding its collaboration with other parts of the World Bank group. For example, building on the experience of the Water for African Cities programme, a wider framework of collaboration is being developed with the World Bank for expanded support to African cities, addressing the millennium development goal in the area of water and sanitation. Furthermore, with the support of the President of the World Bank, UN-HABITAT is entering discussions with the International Finance Corporation, particularly in the context of the development of the proposed Global Shelter Facility.

27. With regard to the regional development banks, UN-HABITAT has recently concluded a memorandum of understanding with the Asian Development Bank under which the bank will provide \$500 million in loans to Asian countries for pro-poor investments in water and sanitation. UN-HABITAT has also recently concluded a memorandum of understanding with the Inter-American Development Bank that is expected to form the basis for enhanced future cooperation.

28. The further development of these partnerships and the formation of additional partnerships and alliances are an important component of the proposed work for subprogramme four in 2004-2005.

### III. FEASIBILITY STUDY FOR AN INTERNATIONAL MUNICIPAL DEVELOPMENT AND HOUSING INVESTMENT FACILITY

29. The UN-HABITAT financial study of March 2002 concluded that the so-called "transformational" option referred to in chapter I above would provide an innovative flexible housing finance instrument that could operate at the subnational level. It would also be the first dedicated to addressing market failures in pro-poor housing finance over the required medium to longer term and at a scale – an initial capitalization of \$200 million to \$250 million is suggested in the report – sufficient to make a real difference. In doing so it would also serve to deepen and widen capital markets by expanding municipal and household creditworthiness, convert wealth from informal to formal and boost the real productivity effect of savings. Leverage would be at both the fund and project level. It would also provide a specific delivery vehicle for the slum improvement commitments in the Millennium Declaration.

30. The report recommended also that a feasibility study should be undertaken to review the scope for such a pro-poor urban financing facility that could support municipalities and community-based organizations to leverage their resources. Sweden and the United Kingdom agreed to finance this second study and in September 2002 UN-HABITAT contracted PM Global, a Washington-based firm with considerable experience of development financing and of infrastructure and urban development. This work is continuing, but the remainder of this chapter provides an overview of the findings of PM Global. It should be stressed that these are preliminary findings, and are presented here to form a basis for discussion.

#### A. Existing international initiatives

31. Apart from UN-HABITAT – the lead United Nations agency for coordinating activities in the field of human settlements – several other United Nations organizations, such as UNDP, the United Nations Educational, Scientific and Cultural Organization (UNESCO) and the World Health Organization (WHO), have technical assistance or development projects focused on urban slum areas, although they remain quite modest compared to the programmes of the development banks.

32. The World Bank and most of the regional development banks have major lending programmes supporting slum upgrading, trunk infrastructure construction, and housing finance institutions, and also policy reforms and institutional strengthening. On aggregate, their urban sector lending ranges between \$2.5 billion and \$3 billion annually. However, their charters which mandate them to lend only to Governments or to other entities, such as municipalities and utility companies or private organizations which have government guarantees, and the size of their lending operations have made it difficult for them to support non-governmental organizations, community-based organizations and private enterprises directly. Similarly, in their housing finance operations they have generally supported mortgage-lending institutions rather than microlending organizations.

33. The Cities Alliance, operating under the tutelage of the World Bank and UN-HABITAT, focuses its activities, mostly in the form of technical assistance on two areas: city-wide and nation-wide slum upgrading and city development strategies.

34. The International Finance Corporation (IFC) and, to some extent, the private sector arms of the regional development banks support private sector infrastructure investments and formal mortgage lending institutions. Most of this assistance takes the form of loans and equity investments. However, IFC recently provided a guarantee that would help mobilize international financing for a municipal water project in Mexico. The Inter-American Development Bank has a guarantee programme that supports domestic borrowing by private infrastructure enterprises.

35. A number of the bilateral donors have urban assistance programmes that tend to be well suited for supporting community and non-governmental organization schemes as well as micro-finance institutions. For over three decades, USAID used its Housing Guaranty Programme to support housing and municipal investments. This programme typically guaranteed dollar-denominated loans made by United States banks to developing country Governments, or were backstopped by them. The programme became defunct when too many countries defaulted on their foreign loans and their external official debt was rescheduled. Under a new instrument, the Development Credit Authority, USAID can guarantee loans made by domestic financial institutions to municipalities, microfinance organizations and other entities engaged in development activities.

36. The Private Infrastructure Development Group, comprising several European bilateral aid agencies, has funded the Emerging Africa Infrastructure Fund (EAIF) that finances private infrastructure projects in sub-Saharan Africa. The Group is also presently developing GuarantCo, a facility that would provide guarantees for mobilization of local funding for large-scale infrastructure projects.

37. The bilateral development finance corporations operate in a similar fashion to IFC, supporting private infrastructure investments. Several, like the Finance Company for Developing Countries (FMO) of the Netherlands, have recently increased their support for mortgage lending institutions.

38. The non-profit organizations active in the urban development field tend to have fairly small programmes and a strong poverty focus. However, of special note is the growing network of organizations that support micro-finance institutions in the developing world. International organizations like ACCION provide technical assistance, equity and loan guarantees to local micro-finance organizations. Housing associations in the United Kingdom of Great Britain and Northern Ireland and the Netherlands are supporting low-income housing and slum upgrading in developing countries through loan guarantees.

39. On aggregate, multilateral and bilateral assistance for housing and urban infrastructure appears to be less than \$5 billion annually, while overall investments in housing and related infrastructure in developing countries are estimated to amount to approximately \$300 billion annually.

40. While it is apparent from the above that there are a range of international initiatives relevant to shelter and slum upgrading, it is noteworthy that the United Nations is making only a relatively weak contribution, in part reflecting the former marginal status of UN-HABITAT. This contrasts to sectors covering other basic human needs such as health, education and nutrition, where United Nations programmes complement the work of the bi-laterals and the international financial institutions, and make an important contribution through the provision of catalytic and programme finance – in addition to their roles in policy, advocacy and technical assistance.

#### B. Financing housing and infrastructure for the urban poor

41. Housing finance has largely focused on mortgage-based lending through formal housing finance institutions. In developing countries, the effectiveness of this approach is frequently limited by the inadequacy of institutional and/or market conditions for an effective mortgage lending environment. The widespread perception that lending to low-income households involves higher risks and lower profit margins has contributed to their lack of access to finance. The unstable incomes of many poor urban households have made them reluctant to commit to long-term financial obligations. With the growing recognition that the traditional mortgage approach has benefited mainly upper and middle-income groups, recent initiatives are attempting to reach lower income households. In this process, the barrier between formal and informal

institutions is becoming less pronounced, as elements of both kinds of arrangements have tended to come into play in most recent schemes.

42. The consultants have reviewed experiences of various types of financial and other institutions involved in housing and infrastructure finance. For instance, the Housing Development Finance Corporation in India is an example of a formal sector institution which has had some success in reaching poor urban households and in scaling-up its operations, and which relies on intermediary agencies familiar with households' repayment capacities. The National Urban Reconstruction and Housing Agency in South Africa, is a new agency created specifically to support housing projects to benefit the urban poor – not by lending directly, but by filling gaps (e.g., guaranteeing institutions making bridge loans to developers). Its financing scheme makes use of government housing subsidies available to its target households.

43. Microfinance for housing, which grew out of micro-enterprise lending, is expanding in developing countries, offering households the opportunity to improve their housing incrementally. Several micro-finance institutions have grown into banks operating on commercial terms and offering a variety of loan types, including for housing; examples include Mibanco in Peru, SEWA Bank in India, and Banco Sol in Bolivia. As housing micro loans have longer terms than those for micro-enterprise, micro-finance institutions typically face a term mismatch between their assets and liabilities, and availability of medium-term capital is an important constraint.

44. There are some promising new approaches by local authorities in extending infrastructure to poor urban areas, as well as some interesting private sector schemes. In many areas poor urban communities have taken the initiative in improving infrastructure, and these community-based initiatives also offer promise for future financing schemes - although it should be noted that experience shows that community mobilization can take a long time, and is likely to require financial and/or technical advisory support.

45. Community-based initiatives focusing on improvements in shelter and related infrastructure and services come in a wide variety of forms. Many involve savings and credit schemes, which foster community organization and mobilization within low-income settlements. Of particular interest are initiatives involving working with appropriate local authorities for extension of infrastructure and municipal services. Some successful schemes have already been "scaled up." For example, the Karachi based Orangi Pilot Project, a community-based organization focusing on slum upgrading, is providing advice to organizations in other parts of Pakistan. An Indian non-governmental organizations, the Society for Promotion of Area Resource Centres has formed an alliance with two large organizations of slum dwellers and pavement dwellers, and now has successful community-based schemes in several Indian cities.

46. The Community Led Infrastructure Financing Facility, under the auspices of the Cities Alliance and with initial funding from the United Kingdom, is still in its early stages. But it combines many of the elements that appear relevant for success - it features local currency guarantees, repayment on commercial terms for financial sustainability, and local participation to ensure that the investment is the highest priority of the community.

47. At the municipal level, given the difficulties faced by municipalities in accessing funds on the commercial market, more than 50 countries have established municipal development banks for lending to local governments. The experience of most municipal development banks highlights the importance of collateral - especially in the form of a right to intercept transfers from central to local governments – for successful lending to municipalities. Although some municipal development banks were established almost three decades ago, they have largely remained vehicles for channelling funds from international institutions and central governments, with few evolving into market-oriented credit suppliers capable of mobilizing private sector savings, or facilitating private sector participation in the municipal credit market. This has limited their capacity to raise the kind of capital necessary to finance the large urban investment needs.

48. Although municipal bond markets have already emerged in a wide variety of countries – typically "upper middle-income" countries with well developed capital markets - most low and lower middle income countries are still putting in place the fundamentals needed for a functioning bond market.



49. Subsidies from central government - or other sources - may also have a role to play in financing housing and infrastructure. Many well prepared and deserving projects may not be commercially viable without subsidies funded by multi- and bilateral donors, government, local authorities, and/or others. However, where subsidies are deemed necessary, they should be known and committed in advance, and preferably in the form of direct demand subsidies (i.e., capital subsidies) delivered up front to households - Chile as a successful example. There is a risk with simple interest rate subsidies that they discourage sustainable commercial lending and the mobilization of domestic savings for housing construction and improvements.

50. Approaches to financing housing and infrastructure in developing countries are evolving rapidly. Experience to date yields general agreement in several areas:

(a) Success in financing shelter improvements for larger numbers of low-income urban households will depend on the committed participation of local communities, but will need to incorporate elements of formal finance to achieve sustainability, replicability and scale, i.e., should combine elements of both formal and informal finance systems;

(b) Eligibility for, and amounts of, housing subsidy are a matter of government policy; but any grant elements should be separate, quantified and committed up front, particularly if they are structured into repayments of commercial banks;

(c) Housing finance proposals should not be limited to mortgage-based loans for the full cost of house and land. Building on the growing success of small loans for shelter improvements, a new facility should also consider schemes to support the scaling-up of housing improvement lending programmes, and schemes to increase the availability of affordable rental housing.

#### C. Global Shelter Facility (Proposed title)

51. By the Monterrey Consensus<sup>2</sup> of March 2002, heads of State and Government resolved to address the challenges of financing for development, and to mobilize and increase the effective use of financial resources needed to fulfil internationally agreed development goals. Noting the estimated shortfalls in resources required to achieve these goals, they committed, inter alia, to mobilizing domestic resources and to increasing international financial and technical cooperation for development, acknowledging the complementary nature of these two sources of finance.

52. For housing and urban infrastructure the assistance from the international community falls far short of the needs. In terms of amount, this is inevitable given the high cost of fully funding interventions in this sector, and domestic (including private sector) resources are essential if scale and sustainability are to be achieved. Nevertheless, it is clear that the international community has an important role to play in facilitating the effective mobilization of domestic and private sector resources.

53. Neither the amount nor the type of international support available fully meets the needs. Bilateral and multilateral assistance is almost exclusively in the form of foreign currency or special drawing right grants or loans, and thus the beneficiaries take the foreign exchange rate risk. In the case of shelter projects in particular, domestic currency loans are to be preferred since not only are nearly all of the expenditures in local currency, but also the payments from project beneficiaries are in local currency.

54. The consultants conclude that there is a need for a new international facility whose principal objective should be to play a catalytic role in mobilizing domestic resources at all levels, from both public and private sectors, to meet the housing and infrastructure needs of the urban poor, especially those living in slum areas. They propose that the facility be termed as the "Global Shelter Facility". This title will be used throughout the present report but, as this work is further developed, it is recommended that other titles should also be considered.

55. The consultants recommend that the main product of the facility should be local currency guarantees for domestic bank loans and bonds, rather than direct provision of loans, equity investments or grants – grants would be provided by the proposed other window outlined in the next section. A guarantee is generally a more flexible instrument than a loan, and the provision of loans, especially in local currencies, would create a major administrative burden. Experience has shown that guarantees can have a major "demonstration effect" or "learning" impact on local lending institutions and encourage them to gradually assume more, and ultimately all, of the risk. A guarantee instrument can also be tailored to allow increased leverage as risk perceptions improve over time. Furthermore, the availability of secure and attractive guaranteed debt instruments would provide investors with more choice, encourage local savings, reduce capital flight and, thus, strengthen the local capital market. From the potential donors' point of view, a guarantee facility offers the scope of getting much greater leverage (and development impact) than a loan facility.

56. The consultants conclude that, operating in this manner, the Global Shelter Facility would fill an important need not presently adequately met by the donor community.

57. The intention is that the Global Shelter Facility would leverage a limited amount of donor financing with resources coming from individual households, communities, municipalities, regional/state and national governments and, especially, from domestic financial markets. It is suggested that by pooling donor resources and, thus, lowering transaction costs, the Global Shelter Facility would be able to reach a broader set of countries, cities and schemes with greater impact than if different donors proceeded separately. An additional benefit to the donors would be risk sharing by spreading the cost of potential calls on the guarantees over a larger portfolio.

58. It is envisaged that the Global Shelter Facility initially would receive capital through the provision of funds from a group of interested bilateral donors, but the possibility of obtaining funds from charitable foundations should also be explored at an early stage. A possible target for initial capitalization would be \$200 million. It may also be possible to attract private equity into the Global Shelter Facility once a track record has been established.

59. It is suggested that initially the value of guarantees would be limited to the amount of paid in capital; but over time the gearing ratio might be increased to say 3.5:1 (the ratio adopted by the Multilateral Investment Guarantee Agency). If it is further assumed that 30 per cent of the portfolio is reinsured, that commercial lenders are required to assume 50 per cent of the total risk, and that approximately 25 per cent of project costs are met by down payments from project sponsors or beneficiaries, the value of investments supported by a \$200 million donor contribution could be as high as \$2.7 billion.

60. The consultants propose that, in order to ensure sustainability, the Global Shelter Facility should be managed on a commercial basis, but not for profit to its subscribers, with the day-to-day operations handled by a professional finance firm or consortium acting as facility manager. Any surplus on operations would be reinvested and not distributed as dividend.

#### D. Shelter Assistance Fund (proposed title)

61. The proposed guarantee facility would need to be complemented by a second window, and it is proposed that a Shelter Assistance Fund be created to complement the operations of the Global Shelter Facility. As a minimum this would be needed to finance enhanced technical assistance to help non-governmental organizations, community-based organizations and other potential beneficiary institutions, structure projects and programmes that could qualify for support from the Global Shelter Facility.

62. But the Shelter Assistance Fund could also play a more strategic role in providing seed capital, and finance in the form of grants and challenge funds for capacity-building as well as for creation of policy and institutional frameworks and for facilitating the other pre-conditions needed for successful slum upgrading.

63. In addition the fund could finance preparation of bankable slum upgrading schemes in general, and not only those being developed for the Global Shelter Facility support. By making resources available, the fund, could play an instrumental role in developing effective partnerships that go on to deliver scale and sustainability in slum upgrading, making real progress towards meeting the millennium development goal on slum upgrading.

64. Unlike the Global Shelter Facility, which would be a capital facility, the Shelter Assistance Fund would be expected to require routine replenishment from official development assistance or other funds

#### E. Next step

65. A draft report is currently being finalized by PM Global, along the lines set out above. Expert review of the draft report will then be followed by issuance of a final report.

66. An essential next step would be to promote the above concepts with a group of donors, both to seek commitments in principle to help finance the proposed facilities, and also to secure finance for the next phase of this work as outlined above.

67. However, because of the policy implications and magnitude of the proposals relating to the Global Shelter Facility, it is recommended that the immediate next step should be to seek guidance from Member States, and request the endorsement of the UN-HABITAT Governing Council to continue work in the broad direction set out above, and to the approach being adopted in the revitalization of the Foundation.

68. It is further recommended that the Governing Council, in the event that it endorses the approach being adopted, should also consider endorsing specific targets for the financing of both the Global Shelter Facility and the Shelter Assistance Fund. As indicated above, it is suggested that an initial capitalization target of \$200 million should be set for the Global Shelter Facility. With respect to the Shelter Assistance Fund, it is proposed that a target of \$100 million over five years should be set; this would represent an average of \$20 million per annum - that is annual grant making activities of approximately 10 per cent of the level at which the Global Shelter Facility is capitalized.

69. In taking forward and developing these proposals, experience from similar donor initiatives shows that the start-up of operations generally is slow and can take several years. To begin with, a core team of staff from UN-HABITAT and potential partners, augmented by consultants as needed, could be established to: coordinate with potential donors/equity investors; supervise studies and other activities needed for the Global Shelter Facility/the Shelter Assistance Fund establishment; coordinate with other organizations with related objectives; and, identify a pipeline of potential projects and, possibly, process a small number of pilot projects. In summary, the core team would coordinate all activities necessary for the establishment and financing of the Global Shelter Facility and the Shelter Assistance Fund as well as preparing for the subsequent start-up of operations.

#### IV. GOVERNANCE OF THE FOUNDATION

70. It is clear, particularly from the above sections on the proposed Global Shelter Facility and Shelter Assistance Fund that there will be a number of important and detailed decisions to be made between the nineteenth and twentieth sessions of the Governing Council. While the Executive Director is seeking a general endorsement from the Governing Council to proceed as outlined in this report, it is also recommended that the Governing Council consider establishing an Executive Board for the Foundation to assist in the development of the Foundation over the next critical period.

71. It is proposed that this Executive Board be chaired by the Executive Director, on an ex-officio basis, in her capacity as Administrator of the Foundation, pursuant to General Assembly resolution 3327 (XXIX). The Board would report through the Executive Director to the Governing Council and to the Committee of Permanent Representatives.

72. A study of other relevant financial institutions and facilities, for example International Fund for Agricultural Development, the Global Environment Facility and the Global Fund, reveal general use of Executive Boards that seek to balance the representation from donor and non-donor Member States. In addition, in the case of the most recent of these models - the Global Fund - there is representation from other important stakeholders, a principle which, it is suggested, is also appropriate for the Foundation.

73. It is therefore proposed that an Executive Board be established for the Foundation with a broad balance in the representation between donor and non-donor States, and with representation from Habitat Agenda partners such as local authorities, non-governmental organizations and the private sector.

## V. RECOMMENDATIONS

74. In conclusion, the recommendations set out below are submitted for consideration by the Governing Council.

75. It is recommended that the Governing Council consider providing endorsement to the general principles presented above to establish a loan guarantee facility, and also consider endorsing the Executive Director to continue work in the broad direction set out above, and to use the approach being adopted in strengthening the Foundation so as to provide finance for, inter alia:

- (a) Supporting the core staff and programmes of UN-HABITAT;
- (b) Seed capital, challenge funds and grants to encourage the mobilization of domestic resources for shelter and related infrastructure with due priority to the needs of low-income households;
- (c) Technical support services to foster and improve effectiveness in developing countries for the mobilization and utilization of domestic resources for the improvement of human settlements and to assist countries at both national and local levels in the preparation and implementation of projects;
- (d) Local currency guarantees for domestic loans through a global facility focusing on slum upgrading and the eradication of urban poverty.

76. It is recommended that the Governing Council also consider endorsing specific targets for the financing of both the Global Shelter Facility and the Shelter Assistance Fund. For the Global Shelter Facility it is suggested that an initial capitalization target of \$200 million should be set. With respect to the Shelter Assistance Fund, it is proposed that a target of \$100 million over five years should be set.

77. It is also recommended that the Governing Council should consider establishing an Executive Board for the Foundation which, with due regard to the policy directives of the Governing Council, would oversee the Foundation's operations, particularly the establishment of financial instruments and facilities, as well as the approval and evaluation of loans, guarantees and grants, and report thereon to the Committee of Permanent Representatives and the Governing Council. It is recommended that consideration be given to the following general composition, although further elaboration would be required:

- (a) Five representatives nominated by donor country Governments with due regard to their support to the Foundation;
- (b) Five representatives from the regional groups — one representative nominated by each of the five regional groups;
- (c) Four representatives of other Habitat Agenda partners, including local authorities, non-governmental organizations, multilateral financial institutions and the private sector;
- (d) The Executive Director of UN-HABITAT as the ex-officio Chair, in her capacity as the Administrator of the Foundation and without voting rights, save for a casting (deciding) vote.

78. It is further recommended that the appointment of the members of the Executive Board, and the rules of procedure for the Executive Board, be subject to the approval of the Governing Councilor, during the inter-sessional period, to that of the Committee of Permanent Representatives.

---

<sup>1</sup> *Report of the United Nations Conference on the Human Environment* (United Nations publication, Sales No. E.73.II.A.14 and corrigendum), chap. II. Sect. B.

<sup>2</sup> *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.O2.II.A.7), chap. I, resolution 1, annex.

-----