

# Money where it matters

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Event report

# Money where it matters

Financing the Sustainable Development Goals and Paris Agreement through local finance



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## About the event

For more information about this report visit [www.iied.org/money-where-it-matters-local-finance-implement-sustainable-development-goals-paris-agreement](http://www.iied.org/money-where-it-matters-local-finance-implement-sustainable-development-goals-paris-agreement), or contact: Paul Steele, [paul.steele@iied.org](mailto:paul.steele@iied.org)

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# Summary

## Benefits of local finance

Fulfilling the Sustainable Development Goals (SDGs) and the Paris Agreement on climate change will require strong action at all levels, particularly at local level. Because local people — local governments, community organisations, local nongovernmental organisations (NGOs), small businesses and others — have a critical role to play in delivering sustainable development. Here we define local finance as the devolution of resources to sub-national governments, local enterprises and to communities — where there is community engagement and voices in prioritising investments.

Local finance is effective because of the relevance, accountability, efficiency and institutional sustainability of the investment:

- It is relevant as local people know what issues are at stake and what interventions are most likely to reduce poverty and improve resilience, whether that be an improved water supply, a microcredit scheme or access to clean energy
- It is more accountable as citizens can have more oversight at local levels
- Local finance can be more efficient and cost effective — building on collective action and communities' own resources
- And it can be more institutionally sustainable — supporting local solutions that tackle the underlying challenges with greater local ownership.

National finance and policies will still play an important role as communities also need support through national policy and investments — and national governments need oversight of finance to local levels to ensure effective coordination with other investments. But despite the multiple benefits, local action is relatively poorly financed by national and global channels.

The problem is that citizens too often lack the finance, authority and voice to act effectively. Most of the barriers lie upstream. So only a small proportion of development and climate finance and public and private resources reach local governments. An even smaller share is channelled to community organisations or small businesses. In cases where money is invested in low-income and marginalised communities, these citizens tend to have little or no say in how the funds are spent.

If vulnerable communities are to become more resilient and prosperous, and if limited finance is to be used effectively, more must reach the local level, and local people must have more influence over how that money is used.

## Common challenges and shared solutions for local finance

IIED has spent the past ten months researching local finance issues in urban and rural settings, in the context of climate, energy and natural resources. On 7–8 December 2016, we hosted an event to reflect on our insights and explore how financing mechanisms can more effectively channel resources to the local level. The 'Money where it matters' event featured speakers from finance, research, policy and practice. By sharing their experience and expertise, participants began to shape an agenda for better supporting poor women and men to have a greater voice in allocating climate and development finance.

Together, they reviewed the evidence generated by IIED, shared insights on the value of channelling finance to local governments, communities and small businesses, identified the opportunities available for increasing the flow of local finance in new geographies and contexts, and pointed to the 'next frontiers' — areas for future work that will enable funds for climate resilient sustainable development to be most effective and be managed efficiently. This document highlights the evidence and insights discussed at that workshop.

Throughout the two days of the 'Money where it matters' event, participants were asked to point to the most significant challenges to getting finance to the local level, and to describe their approaches to overcoming those barriers. As speakers and participants shared their experiences, it became apparent that many of the hurdles to local finance are the same, regardless of sector or region. So too are the solutions. The table below summarises the challenges and solutions that were raised again and again by participants working in both urban and rural settings in the context of climate change, energy access, natural resource management and urban services. The five key solutions and frontiers for further work on local finance include:

- Risk: building a shared understanding
- Aggregation: reaching the right scale
- Complementarity: structuring public and private roles and finance
- Capabilities: growing technical and financial skills
- Bridges and brokers: dialogue across scales and through trusted intermediaries.

Common challenges	Shared solutions
<p><b>High risk: real and perceived</b></p> <p>Investors, financial institutions and many development agencies see local finance as risky and so either avoid it or make it prohibitively expensive. This view may be accurate — due to limited capacity issues (see below), concerns about fiduciary standards or policy stability — or it may be perceived, based on sometimes unfair assumptions that grassroots organisations are more prone to corruption and inefficiency than larger organisations.</p> <p>The perceived risks mean that many private financiers lend at interest rates that are too high for local organisations or small businesses. Even microfinance loans can have prohibitive interest rates. Banks tend to lend to ‘safer’ investments that offer a better or faster return on their money. Some local banks do have appropriate financial instruments for local groups, but often do not promote them because they are less profitable.</p> <p>Despite rhetoric about community participation, donors can place due diligence procedures on access to finance that are too onerous for local organisations who are engaging communities. Many donors are becoming more risk averse and with limited staff, prefer dealing with larger organisations.</p>	<p><b>Risk: building a shared understanding</b></p> <p>Finance providers and recipients recognise risk as a challenge, but understand it in different ways. Recipients tend to think of risks from disease, natural disasters, climate change, inadequate or unsafe infrastructure etc, which threaten successful outcomes, or the risk of the financier stopping their investment before outcomes can be effectively sustained. Providers tend to focus on fiduciary risk — the risk that their money will not be used for its intended purpose, or that it will not be properly recorded and accounted for.</p> <p>Both are essential. So a first step for those working in local finance is to build a shared understanding of what risk means, as well as understanding the risks of the project not happening, and to innovate in how these risks can be mitigated and tracked to both parties’ satisfaction.</p>
<p><b>Many small projects</b></p> <p>Small projects result in what financiers call ‘high transaction costs’ — the costs of interacting with many smaller units. Similarly, the costs of due diligence are multiplied if a lot of organisations are involved. The more dispersed geographical spread and remoteness required by local finance also increases costs. Large scale financiers tend to be remote — located in the capital city or even in another country.</p>	<p><b>Aggregation: reaching the right scale</b></p> <p>Joining up investments, or aggregating, creates financing opportunities at the right scale for public and private investors. This can be done effectively on both demand and supply sides, for example by communities joining up in cooperatives, federations or community-owned enterprises. This can also give the poor a voice in informing policy and negotiating services. Brokers can also be valuable, ensuring projects are ‘investor ready’. Donors can ask consortia to form or can invest through intermediaries such as local governments or banks. Community and city/district level funds also avoid this problem.</p>

Common challenges	Shared solutions
<p><b>Unsupportive public and private policy and procedures</b></p> <p>Public and private finance procedures and policy often do not support local finance — or do not effectively complement each other — sometimes explicitly favouring large investments. Our approximate estimate is that less than ten per cent of international public climate finance is targeted at the local level or intended to be implemented with local ownership and engagement. And less than four per cent of international public finance for renewables is for off-grid energy. Even in a country with supportive policies, such as Tanzania, just two per cent of government energy spending and 11 per cent of energy finance from development partners is invested in decentralised energy access. Even when finance is available, it is often offered in ways that local businesses and groups find expensive or hard to access. Public finance can also have unintended impacts, ‘crowding out’ private finance for local businesses — as has happened with some renewable energy entrepreneurs.</p>	<p><b>Complementarity: structuring public and private roles and finance</b></p> <p>Public policy can help tip the balance in favour of local projects. For example, policies securing communities’ land and resource rights give private investors more confidence in investing in their enterprises. Local collective action can also help. For example, investments designed by communities can reassure investors of their social acceptability — and communities can reduce the costs of the investment by offering in kind investment, such as labour or by investing their own savings. Regulatory reform or standards can make it easier for investors to invest in community action or local enterprise. Blending finance between public and private actors — with concessional funding or guarantees — can de-risk investment for both sides by building trust. And public finance can be important to pump prime; new enterprises need start-up finance to prove their business model before attracting private investment. The use of public finance gives investors confidence in policy stability, and private finance scales up the impact of public investment.</p>
<p><b>Limited knowhow</b></p> <p>A lack of technical, business and financial management skills can be a major barrier to effective local finance. In many cases, small businesses and local groups are also looking for support to develop the skills to manage the money, and it’s hard to get finance for that. Even where local groups have built skills in planning and financial management, as seen with the federations of the urban poor, local authorities may have too few staff with the skills to technically appraise proposals.</p>	<p><b>Capabilities: growing technical and financial skills</b></p> <p>More funding is needed to support local organisations to build the technical and financial skills needed to access finance. That includes supporting initiatives that offer ways to aggregate small producers. But it also means channelling support to institutions, such as local governments or local banks, to help them improve their capacity to engage communities and provide local communities with appropriate products and services.</p>
<p><b>Lack of trust or knowledge</b></p> <p>Even with aggregation, investors and investees are failing to reach each other — with communities saying there are lots of needs but where is the money, while investors say we have the money but where are the projects? Investors with an interest in social impacts can be concerned about the quality of outcomes, or that they cannot assess cost effectively given the dispersed investments required to support local action. In practice, there are very few opportunities for dialogue between grassroots organisations and public and private financiers.</p>	<p><b>Bridges and brokers: dialogue across scales and through trusted intermediaries</b></p> <p>Building bridges through dialogue between local organisations and investors — both public and private — would help create a shared language and understanding. Building shared solutions, learning across contexts and finding success stories would all help increase scale and reach new contexts. Brokers, trusted by both sides, could also increase scale, as they can assure investors that the finance is being used well and that impacts meet their standards. They can also help community organisations and small- and medium-sized enterprises (SMEs) to develop the financial and technical skills to meet these standards.</p>

# Money where it matters: future frontiers

The five solutions are explored further below in terms of frontiers for future research, drawing on the insights from IIED's research and the discussions at the 'Money where it matters' event.

## Risk: building a shared understanding

Risk is a central challenge for finance providers and recipients, but can be understood as very different things by both parties. Risks to delivery — fiduciary or technical — and risks to delivering real impact are important to both sides, but not always understood in the same way.

So those working in local finance need to **build a shared understanding of what risk means** between investors and investees.

*“If you are lending, you need assurances you’ll get your money back”*

A sustainability advisor to institutional investors

Part of this shared understanding of risk is to build awareness among financiers that community-owned initiatives have greater transparency through **'social oversight'** that enhances accountability and reduces corruption. Social budgets and social audits can be used to ensure communities know how investments will be used and what impact should be expected from them. This is easier to do with local finance than with national investments, suggesting local finance is more

accountable. Stronger evidence is needed to demonstrate the effectiveness of social oversight in challenging mismanagement, and this should be widely communicated.

Investors in new geographies and technologies need to be confident of a return on their money and **local finance is perceived to be risky** in this regard. That means investors either tend to avoid it altogether, or make it unaffordable.

Reducing the cost of finance is fundamentally about reducing risk. A number of ways of reducing risk, with the potential for supporting local finance, were highlighted at the workshop (see below). These will need to be tested in a range of contexts to better understand their relative value:

- **First loss finance, guarantees and insurance mechanisms** underwrite an agreed level of risk giving confidence to private investors, but have yet to be tested for local finance
- **Creating a track record** with credible assurance of impact can build confidence in local finance — as is happening with off-grid energy business models
- **Building relationships** to change perceptions through mutual trust, although this is a long-term process
- **Tackling delivery risk** through working with local organisations to better understand the genuine risks. There is potential for digital technology to create better real time monitoring of risks for distant investors
- **Building understanding of the benefits of community involvement** in setting relevant priorities, gathering, monitoring and evaluating data, and in providing social oversight. The urban poor federations, forest community cooperatives and local adaptation funds all offer evidence of these benefits.

As well as thinking about strategies for reducing risk to encourage investment, we must also build understanding of the **risks of not investing** at all: the social and environmental damage of not investing may be greater than that of making the so-called risky investments.

## Aggregation: reaching the right scale

The power of aggregation to attract finance was highlighted by both the research and the workshop discussions. By joining forces, local activities or projects can together make an investment opportunity at the right size for the investor. This could include programmatic approaches (bundling small projects into a larger set to reduce transaction costs) or working through intermediaries or partners who reach local level (governments, banks, civil society actors).

Success stories were highlighted from both the supply and demand side. On the supply side, finance institutions such as SunFunder are successfully putting together finance vehicles to provide finance to many small energy entrepreneurs. On the demand side, cooperatives such as FEDECOVERA (the Federation of Cooperatives of the Verapaces) in Guatemala are aggregating individual producers to be able to access larger funds.

The role of **local intermediaries** in aggregation on the demand side were identified as critical to attracting private investment. The 'Money where it matters' event agreed that 'good' local intermediaries are ones that:

- Are able to **challenge power relations**, for example the urban poor federations
- Have accountable **business models**
- Are **accountable and transparent**
- Are **close to the ultimate beneficiaries**, and build their support
- Are able to **measure impact** credibly.

“ *[To be a successful intermediary] first of all you have to be able to understand local peoples' needs. And to do that you need cultural and geographical proximity* ”

Aurora Malene, Gapi, Mozambique

**Effective aggregation builds community commitment and contributions.** Davide Ceretti, from Fondazione ACRA working in Tanzania, said they used three models to do this: local ownership through a community-based social enterprise, a consumer association as one of the shareholders, and splitting ownership according to the purpose of the project (for example, energy production owned by the private sector with energy distribution owned by the community). By organising the aggregation in this way, the intermediaries can provide members with loans to better benefit from improved infrastructure through new enterprises. In the past 20 years, the federations of the urban poor have proved that aggregation by the poor themselves works: more than 35,000 households have been supported to get housing and around 200,000 households have been helped to access basic services.

**Aggregation can influence policy** in both urban and rural settings. Anastasia Maina, from the Akiba Mashinani Trust in Kenya, described how the federation of informal settlement dwellers that she represents negotiates directly with municipal authorities in Nairobi. Anna Bolin from IIED explained how a national alliance of forest communities in Guatemala has become an important player in shaping national government programmes.

From the investor's perspective, perhaps the biggest advantage of grouping local people together **is to make them more 'investor ready'**. Participants showed through a range of examples how, through aggregation, local groups have:

- Reduced **transaction costs**
- Improved **financial literacy**
- **Prioritised** effectively
- Tracked and expressed **impact**
- **Blended** their own money with resources leveraged from external sources.

“One of the big challenges we face is getting projects to the place where they become ‘bankable’ and attractive to private investments”

Frode Neergaard, Global Green Growth Institute

## Complementarity: structuring public and private roles and finance

Public finance won't be enough to reduce poverty in the hardest to reach locations, or to set economies and societies onto low carbon and climate resilient pathways. We need to understand how to engage private investors internationally and domestically, and support home grown innovation and entrepreneurship to develop climate positive solutions.

Private financiers and public partners need to develop a variety of instruments — including low interest rates, seed funds, guarantees, long repayment periods and grace periods — to address different barriers for SMEs and local groups to access finance.

But participants all agreed that local finance cannot simply be private. It needs to be a complementary approach to blend public and private money. The question is **what sort of blend?** What is the most effective role that public finance could and should play in getting funds to the local level?

Some speakers argued that the public sector should be pump priming investments in areas **where the private sector won't tread**. For example, when it comes to improving decentralised energy access, it is the smallest distributors that have the toughest time accessing finance to achieve greater scale. Nico Tyabji from SunFunder argued that filling that gap is a good example of how public finance could be really powerful in delivering social and environmental benefits.

“The blend depends on what you put into it; it can taste sweet or it can taste bitter”

David Jackson, UNCDF

The second key role that the public sector could play lies in **creating enabling policy** for private investment. For example:

- **Providing secure use and tenure rights** to communities improves investor confidence in backing enterprises based on these resources
- **Reforming regulation** can influence investor decisions and increase the ease of investing in local enterprise and community action
- **Enabling local bodies to develop innovative blended finance tools** could increase the ability of local government and local banks to broker investors' access to communities and SMEs and provide business models for investors to scale up
- **Endorsing verification mechanisms and standards** can give investors confidence in the social and environmental value of investments, tipping the balance in favour of local climate resilient development projects.

A further role for the public sector in promoting local finance was identified as providing knowhow and capacity building (see below).

Whatever shape public finance takes, participants were keen to understand further **where public finance serves to de-risk private investments and where it might distort markets.**

For example, Nico Tyabji from SunFunder talked about how his organisation can be priced out of loans by well-intentioned more concessional funding from donors.

In Ethiopia, donors working to protect forests are similarly distorting markets by focusing their money on export crops such as coffee — at the expense of crops for domestic markets that would support local food markets and the forest landscape.

Market distortion isn't necessarily a bad thing — if it works to promote public interests. David Jackson from UNCDF argued that there's no such thing as an undistorted market and that health standards in milk, for example, may distort markets but they ensure people remain healthy.

Participants pointed to reforms to the procedures and design of international public finance — particularly climate finance — that would increase flows to the local level, including:

- **Think local — setting a target for local level finance:** a target requires a common understanding of what 'local finance' means. Few donors provide information about the flows of finance from their programmes to the local level, which undermines accountability to national and local partners, and therefore ownership and potentially impact too. A definition will need to capture how far local actors are empowered with voice and choice over deciding the use of finance, and the level at which these decisions are made (national, local government or community). USAID is the lead donor in this area, having set itself a goal for 30 per cent of its finance to go to local organisations. Although USAID has yet to reach its goal, having the goal has promoted policy reforms to enable increased support to local organisations.
- **Simplifying procedures:** to make applying for funding, undertaking the due diligence and reporting easier for smaller organisations — rather than using the same procedures for a small grant as is needed for a large multi-million investment.

*“We see ourselves as building a financing ecosystem around the sector, which is important to get long-term sustainability... There is a strong role for public finance but we are trying to demonstrate that [off-grid energy] is a market that can stand on its own feet and we should be orienting it towards that”*

Nico Tyabji, SunFunder, UK

*“Markets should not be sacrosanct... In Kenya we have a private housing market that provides a shack with no toilet, without anything, at an exorbitant price. That is an imperfect market”*

Jane Weru, Akiba Mashinani Trust, Kenya

*“If we want to distort the market we must ask ourselves are we distorting the market in a way that finance flows to local level”*

Sarah Colenbrander, IIED, UK

- **Smaller grants or financing for brokers to aggregate opportunities:** by providing dedicated finance for local organisations or for brokers and intermediaries that can bring together local investment opportunities, donors can enable finance to get to local levels. This can also support capacity development, with brokers able to support the community in developing skills.
- **Multi-stakeholder platforms for accountability:** donors could set the standard for improving accountability on finance by sharing information about their finance flows with local and national governments and wider stakeholders. This would improve decision making by ensuring effective coordination with other work as well as enabling local contexts and priorities to be fed into decisions. It would also enable domestic private investors to work with donors and governments to ensure policy and public finance enable greater private investment to the local levels.

## Capabilities: growing technical and financial skills

The public sector has a central role in promoting local finance through supporting **knowhow and capabilities at the local level**. The research and partners at the event identified improving technical and business skills, as well as local organisations' and businesses' financial systems as a central challenge to increasing investment flows. Local governments also need support in these areas and the capability to create a pipeline of 'bankable' projects.

“*Nobody wants to fund the capacity-building gap*”

Anna Bolin, IIED, UK

Some local organisations — including urban poor federations and some municipalities — have proven skills in financial and business management. But for many others — including many SMEs and local authorities — this remains a major challenge. Using brokers to enable local energy finance is not just about investing hard cash but also about providing domestic financial institutions and companies with technical and business advice. Finding a sustainable way to pay for that advice is a major challenge.

But some investors are managing it. The Global Climate Partnership Fund, which is a structured fund with donors and private investors, makes credit lines available to local banks for energy efficiency investments. It also provides technical assistance to help local financial institutions identify projects and do the due diligence, needed to build their confidence in making these investments.

SunFunder is another investor that works to build capacity, providing business coaching to small and micro enterprises to support them to take on loans. It would be able to reach greater scale with support from public finance for building business skills.

Gapi in Mozambique spends 30–40 per cent of its budget on capacity building because it recognises that without technical and business skills, SMEs cannot succeed. But Gapi is the exception, rather than the rule. For example, in Mozambique's Zambezia province, there are around 100,000 registered SMEs. The government has just three employees assigned to support them.

Federations of the urban poor have built up impressive skills in planning and financial management over a number of years. But there remains a capacity gap when it comes to working with local authorities, who themselves have limited staff with technical planning skills.

Local municipal governments also face limited knowhow in revenue raising, which is critical if they are to be given devolved power to plan and invest in inclusive, sustainable infrastructure.

Kampala, Uganda, shows how targeted assistance to improve municipal governments' ability to identify and raise revenue has enabled them to borrow in capital markets and invest in urban infrastructure.

## Bridges and brokers: dialogue across scales and through trusted intermediaries

Building a bridge for dialogue between investors and those with investment opportunities at the local level was identified as critical to create **mutual understanding and share experience and expertise**.

Even with aggregation on both sides, investors and investees are failing to reach each other — with communities saying there are lots of needs but where is the money, while investors often say we have the money but where are the bankable projects?

In practice, there are very few opportunities for dialogue between grassroots organisations and public and private financiers.

So how do we build bridges? In some ways, it is about **networking**. For example, supporting platforms that try to match financial products with local organisations or businesses looking for funds. But it is also about enabling a more sophisticated and common understanding between the two sides through capacity building or co-developing financial instruments.

Improving communication is not just about getting investors and investees talking. It's also about **supporting cross-sector learning**. At the 'Money where it matters' event, participants began to identify some key opportunities to share learning, for example between rural SMEs, who are huge 'invisible investors' using their own labour and savings, and urban informal settlement dwellers, who are successfully using savings groups to regularly collect small amounts to create their own social financing to leverage loans.

*“It is only when you engage with the urban poor and see for yourself what they do and how that you understand it's a good investment”*

David Satterthwaite, IIED, UK

Beyond thinking about who needs to talk to who, participants also looked at topics for discussion, and came up with two critical areas where improved communication would deliver for local finance:

1. **Where does the money go?** In part this is about tracking and measuring finance — getting data on where the money goes so that we can establish a target on local level finance. That is essentially the next step in advocacy. But it's also about breaking down **assumptions and mindsets** that local finance is more at risk of corruption. We must do that by turning a critical eye on what enables local accountability, building the evidence of how local finance can be effectively managed and deliver high standards of transparency.

2. **What does 'good' local finance look like?**

There's a need to understand success stories and to share them widely so we can all learn from them and replicate them elsewhere. That includes using new technologies such as mobile phones, GPS and other digital innovations that can give investors insight into the value of their investments.

*“The next step is all about how we pick up our successes and run with them to upscale”*

Victor Orindi, Adaptation Consortium, Kenya

# 1. Climate finance

*Insights from 'Money where it matters'*

## 1.1 Overview

### The issue

Climate finance — international, national and local sources of funding for mitigation and adaptation — is critical in enabling developing countries to respond to climate change. The finance levels available are fast increasing. Over US\$10 billion has been pledged to the Green Climate Fund (GCF). And individual countries are spending greater sums than this from their own climate-related domestic budgets.

But getting available funds to the poorest citizens who need it most remains a challenge. It is the world's poorest communities that are hardest hit by the impacts of climate change. This makes it essential that poor people sit centre stage in the debate about how to finance mitigation and adaptation initiatives.

### What are the challenges in getting climate finance to the local level?

#### Perceived risk

- A lot of capital is available but it is not getting to the local level because investors and investees alike lack the confidence or capacity to send or receive it
- There may be sound arguments for complying with fiduciary standards but these in themselves pose a risk if they fail to lift people out of poverty.

*“It's also risky to fail people: business as usual has left a billion people in poverty”*

Sarah Colenbrander, IIED, UK

#### Tracking

- There is a lack of data on how much climate finance reaches the local level
- Reporting frameworks that satisfy donors' high standards on accountability are difficult to work with because it's hard to identify the right key performance indicators and because the logistics of tracking finance at the local level are cumbersome.

*“Devolved climate spending is fussier and resource-intensive, and fundamentally a political challenge”*

Tracy Carty, Oxfam, UK

#### Opportunity

- On one side there are climate funds and on the other there are local groups that need those funds to secure climate resilience. Bridging the divide remains a major challenge — one that requires local knowledge and connections.

## What are the solutions: how can we improve the flow of local climate finance?

### Use decentralised channels

- The Adaptation Fund in Kenya is a good example of how decentralised channels can deliver effective local finance. Some of the design features underpinning the Adaptation Fund's success include:
  - » agreement on how the money will be split between wards and counties
  - » a commitment to give the lion's share (70 per cent) of funds directly to communities (through ward planning committees)
  - » a financial contribution (up to ten per cent) towards administration costs
  - » acknowledgement that the county-level committee is there to provide oversight and technical support
- The Local Climate Adaptive Living Facility (LoCAL), run by the UN Capital Development Fund, is another example of decentralised finance at work. It combines performance-based climate resilience grants with technical and capacity building support. The grants are disbursed as part of a local government's regular budget and provide a financial 'top-up' for local governments to integrate adaptation to climate change into their development plans.

*“Communities know what they want; county committees may know how best to achieve that... The 'higher' level strengthens, rather than vetoes”*

Victor Orindi, Adaptation Consortium, Kenya

### Encourage networking and matchmaking

- One way of matching those with funds to those who need funds is to build a marketplace for climate-related capital; one that involves financial institutions as well as small businesses or cooperatives that can show viability as investable entities
- Another approach is to use online platforms, such as the Global Impact Investment Network (for investors) or Allied Crowds (for investees)
- A third approach is to encourage donors' direct engagement with local groups. This can showcase not only the needs on the ground but also the existing capacities for how they can be addressed.

### Provide concessionary finance

- Offering concessionary finance for initiatives and infrastructure that build climate resilience could be one way of getting more money to the local level.

### Set standards

- Verification mechanisms or standards can serve to tip the 'investment scales' in favour of local finance for climate resilient development
  - » For example, Bhutan is starting to reorganise itself to use local government systems more effectively, with local governments embedding nationally determined contributions (NDCs) into their plans. By doing so, they simultaneously open the door to verification mechanisms and to finance through the GCF
- Any such standards must be easily accessed and shared among stakeholders.

*“Standards = a green light for finance”*

David Jackson, UNDCF

## 1.2 Six steps to local climate finance



According to initial estimates, less than ten per cent of international public climate finance from international climate funds reaches the local level. In reality, we do not know the true figure. Evidence from community-focused initiatives suggests that climate and development funds can improve the delivery of local finance by adopting six key structural changes.

### Six steps

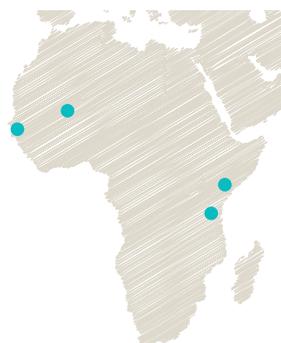
- 1 Identify how much financing reaches the local level and involves communities.
- 2 Use that baseline to set an ambitious yet achievable goal.
- 3 Earmark flexible grant funding for local programmes.
- 4 Increase the appetite of international funds for supporting innovative financial instruments and local co-financing, and for prioritising results that are locally relevant.
- 5 Tailor support to strengthen local capacity to manage climate funds.
- 6 Build national and local platforms for overseeing and strengthening climate finance flows to the local level.



The Forest Investment Program, an investment fund with simplified funding frameworks, has invested US\$10 million in a US\$24 million project with the African Development Bank to restore Ghana's degrading forests. (Photo: Greg Neate, Creative Commons, via Flickr)

Contact: Marek Soanes, researcher, IIED, UK. [marek.soanes@iied.org](mailto:marek.soanes@iied.org)

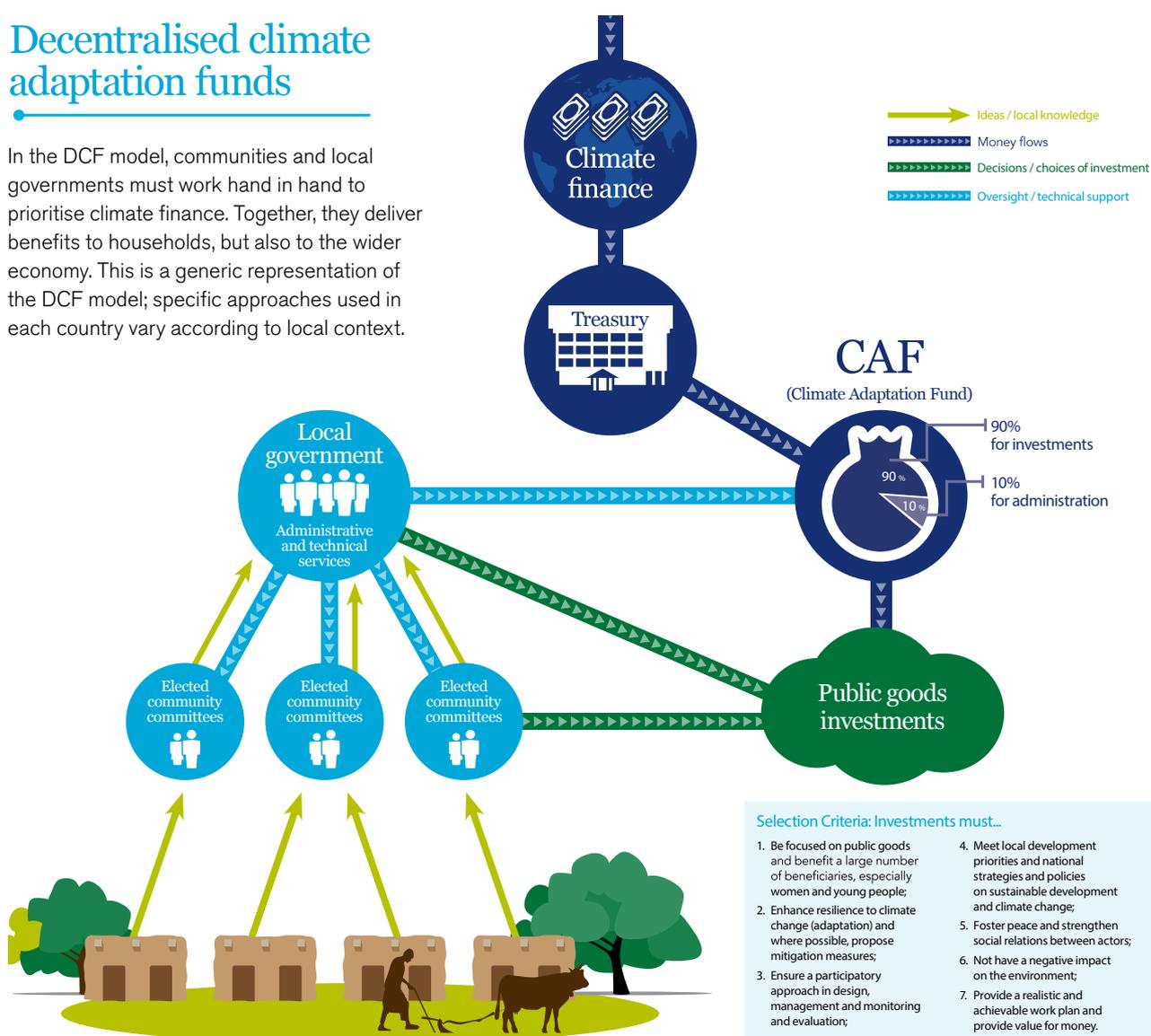
## 1.3 Decentralising climate funds



Decentralising climate funds (DCF) is an initiative through which local governments in Kenya, Mali, Senegal and Tanzania are establishing devolved climate adaptation funds. Communities decide how this money is allocated to fund public good investments, which they prioritise through inclusive planning processes.

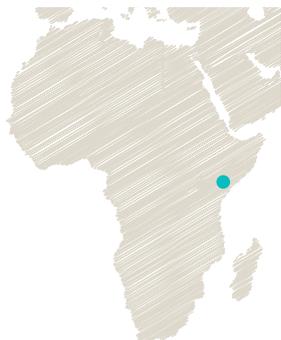
### Decentralised climate adaptation funds

In the DCF model, communities and local governments must work hand in hand to prioritise climate finance. Together, they deliver benefits to households, but also to the wider economy. This is a generic representation of the DCF model; specific approaches used in each country vary according to local context.



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## 1.4 Community-led climate finance



Kenya's Adaptation Consortium (ADA) was set up to design and test a mechanism to allow local people to identify investments that build their resilience to climate change, and then finance those investments through a County Climate Change Fund. What began as a pilot project in Isiolo County has been such a success that in 2014 it began to be replicated in four more counties.

Pastoralists fetch water (top) and give their livestock a drink (bottom) at rehabilitated boreholes. (Photos: Jane Kiiru/ADA)



### £1 million

has been allocated to communities in Isiolo County since 2012. The money has been used to fund a livestock disease laboratory, sand dams to store water and a community radio, among other things.

### 110,000

people have directly benefited from the fund's investments



**ADA partners:** National Drought Management Authority, Kenya Meteorological Department, Christian Aid, UK Met, IIED

Contact: Victor Orindi, ADA Consortium Kenya. [vorindi@adaconsortium.org](mailto:vorindi@adaconsortium.org)

## 2. Energy finance

*Insights from 'Money where it matters'*

### 2.1 Overview

#### The issue

Across the world, more than a billion people lack access to electricity and nearly three billion lack access to modern cooking fuels. Most of these people live in rural areas of sub-Saharan Africa and South Asia. The International Energy Agency (IEA) estimates that it will take nearly US\$50 billion a year between now and 2030 to achieve universal access to energy. There is nowhere near this amount available: according to the IEA, if we are to reach the energy poor, we need an extra US\$23 billion every year for decentralised energy systems, such as solar home systems or mini-grids.

It's not just about paying for technology hardware. It's about financing the many different people and groups that are critical to expanding decentralised, renewable energy access, including energy users, energy providers — particularly SMEs — and governments, as well as financial intermediaries such as local banks.

There are lots of potential sources of finance available for the task: seed investors, impact investors, private foundations, venture capitalists, development finance institutions, carbon finance providers, national or local banks, private foundations, bilateral donors, host country governments and national power utilities, and international climate finance.

But getting the many sources of finance to flow to the many energy enterprises and local groups that need it to improve energy access remains a challenge. For example, of the US\$14.1 billion in approved international public climate finance between 2003 and 2015, only US\$475 million (3.5 per cent) was earmarked for decentralised energy.

#### What are the challenges in getting climate and development finance to small enterprises and local groups for decentralised energy access?

##### Politics

- At national and international levels of energy finance, there is a political preference for large-scale, on-grid projects.

##### Transaction costs

- Channelling energy finance to the local level and decentralised solutions means working with a large number of small groups and businesses. The transaction costs can simply be too high for banks and other investors to cope with
- In many cases, donors' rigid reporting frameworks add to the cost: the more layers you put down in terms of tracking outcomes, the higher the transaction costs, and the lower the likelihood of delivering.

*“Smaller distributors have the toughest time accessing finance to scale”*

Nico Tyabji, SunFunder, UK

## High Risk

- When it comes to channelling energy finance to the local level, the perceived and actual risks for investors remain high.

## Low initial returns

All investors look for a solid return on their money. When it comes to funding decentralised energy access, the bottom line is that banks often have other investment options with better return.

- The upfront costs associated with developing higher power technologies such as mini-grids (generation and distribution) — including feasibility studies, environmental impact assessments and regulatory approvals — can affect returns and make investments unattractive
- Even if you succeed in delivering electricity services, communities and local businesses may need support to use it effectively and make it worth their while to pay for — eg by using energy in productive activities such as food processing or irrigation.

*“Electricity itself doesn’t create business opportunities”*

Davide Ceretti, Fondazione ACRA

## Knowhow

- The financial, business and technical skills of SMEs — particularly domestic enterprises that supply and use energy — all need building up and there’s a lack of finance to do that.

## What are the solutions: how can we improve the flow of local finance for decentralised energy access?

### Enable aggregation

- Aggregating end users is essential to channel energy finance towards decentralised energy and the local level. Development financial institutions would prefer to work with intermediary aggregators. Even domestic banks need some form of aggregation
- Records of customers’ payments can act as a mechanism for aggregating end users
- New technologies are emerging that can similarly help aggregate consumers. For example, remote monitoring technology built into modern solar panels and lanterns provide excellent information about consumers and their credit performance
- As well as aggregating end users, investors can also aggregate portfolios as a means of scaling up systems. And you can also aggregate projects: for example, using energy access as an umbrella project to connect sectors and other development work in a given area.

*“Even for domestic banks to be interested, there must be some form of aggregation”*

Ben Garside, IIED, UK

## Build capacity

- Enabling local energy finance is not just about giving out hard cash but also about providing domestic financial institutions and companies with technical and business advice. Finding a sustainable way to pay for that advice is a major challenge
- Some investors are managing it. For example, the Global Climate Partnership Fund is a structured fund with donors and private investors that makes credit lines available to local banks. It has a technical assistance branch that is key in helping local financial institutions to invest in energy projects
- SunFunder is another example of an investor working to build capacity. This debt provider provides business coaching to SMEs to support them to take on debt financing.

## Blend public and private money

- Companies such as SunFunder are trying to demonstrate that decentralised energy access can stand on its own two feet in the market. But at the same time, it recognises that there are some market failures — for example the poorest of the poor — where public finance needs to step in
- There are other reasons that energy access cannot be solved by private money alone. Off-grid projects often come with upfront costs for infrastructure, impact assessments, etc that can only be paid for by public money.

*“What type of money — grants, equity, loans — is best to enable the commercial sector to have enough money to grow and serve the rural poor?”*

Paolo Mele, Practical Action

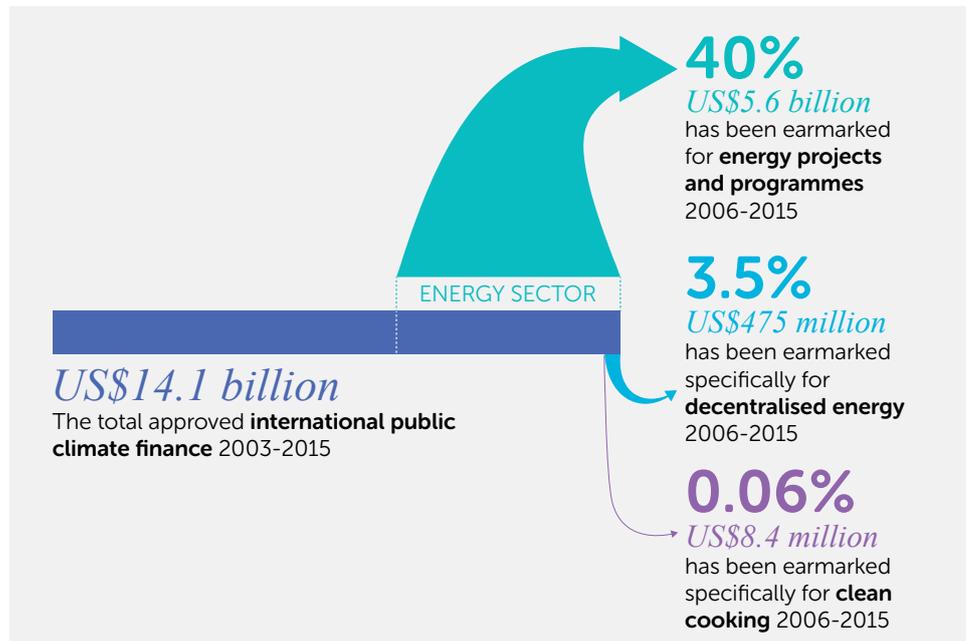
*“Public money needs to lift that next generation of entrepreneurs”*

Nico Tyabji, SunFunder, UK

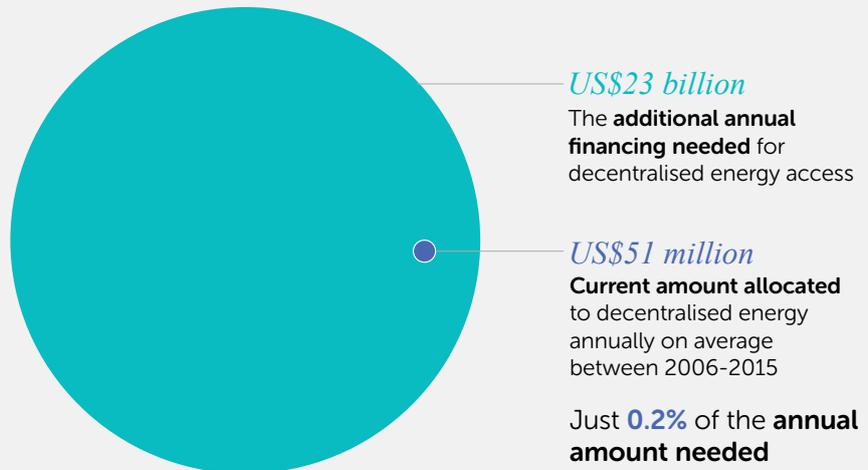
## 2.2 Energy finance does not reach the poor



A report by IIED and HIVOS — which crunches more than a decade’s worth of data — suggests that when it comes to spending international public climate funds in the energy access sector, policy and investment prioritises ‘business as usual’ large-scale grid extension over newer, smaller, decentralised solutions that better suit poor communities.

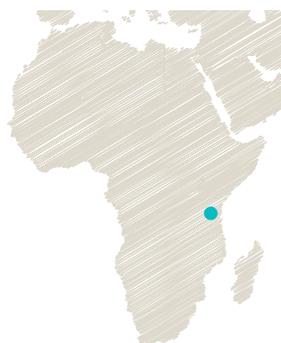


### Decentralised energy access — finance needed and current allocation from climate funds



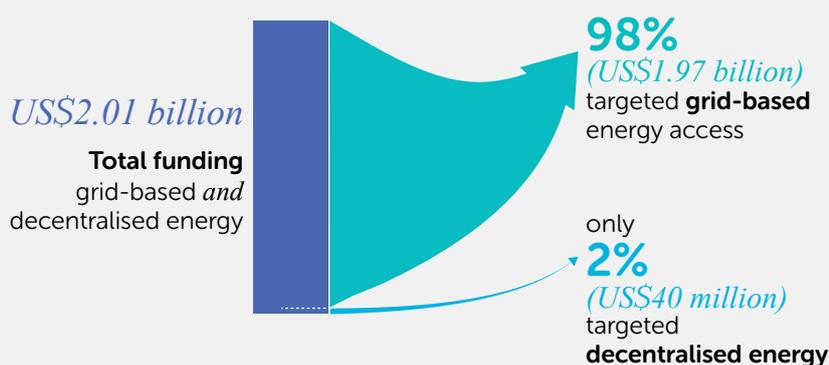
Contact: Sarah Best, senior researcher, IIED, UK. [sarah.best@iied.org](mailto:sarah.best@iied.org)

## 2.3 Mind the gap: energy spending in Tanzania

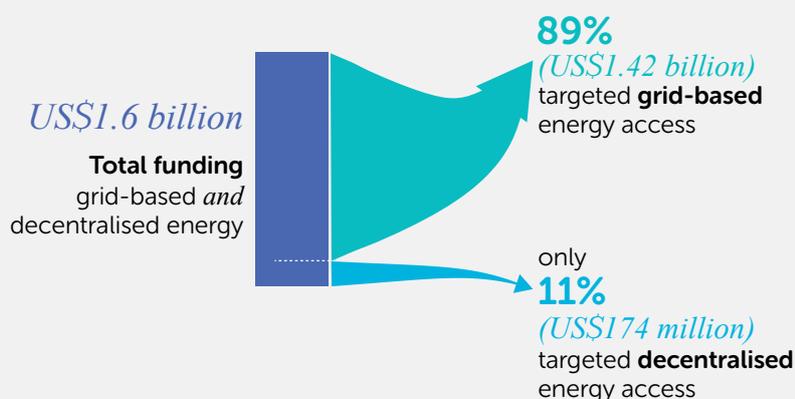


An IIED-led report on energy spending in Tanzania shows that the lion's share of both government and development partner funds goes to big infrastructure projects designed to serve or extend the grid. Just two per cent of the US\$40 million allocated to energy access by the Tanzanian government (2009/10–2016/17), and 11 per cent of the US\$1.6 billion committed by development partners for energy, went to decentralised energy projects. The World Bank estimates that US\$425 million is needed each year to 2030 to give all Tanzanians basic access to energy. These needs could be met by funding for decentralised energy.

Total Spending (US\$) by Government on Energy Access in Tanzania Mainland 2009/10–2016/17



Total Spending (US\$) by Development Partners on Energy Access in Tanzania Mainland 2008–2021



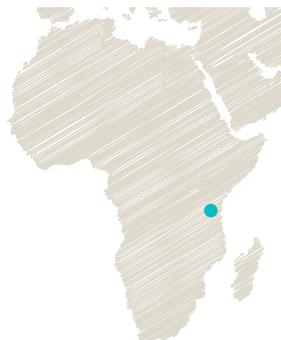
### High hopes

In 2012, just 20 per cent of people had grid access.

But by 2033, the government aims to turn the situation around and achieve 75 per cent electrification. Achieving this ambition will require a step change in public finance for decentralised energy access.

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## 2.4 Mini-grids that benefit local people



Since 2006, in Ludewa, Tanzania, Fondazione ACRA and Njombe Development Office have worked to improve access to clean and affordable energy through mini-hydropower. Their approach puts communities front and centre: after securing funds and building generation and distribution facilities, the NGO hands over full or part ownership of the new hydroelectric plants to local communities and provides them with business planning and technical support. Combined, the Ludewa projects benefit more than 70,000 people. They connect schools, health centres and homes to a mini-grid. They help SMEs add value to their products. And they protect watersheds through income-generating opportunities such as pine farming and beekeeping.

### Lessons

- Off-grid projects need subsidies to cope with high upfront costs.

### Customers

- Tariffs must be affordable, with connection costs close to zero
- Locals need support to improve productive use of energy.

### Environment

- Extra financing is needed to conserve and sustainably manage natural resources.

### Social

- Local authorities must play a key decision-making role.

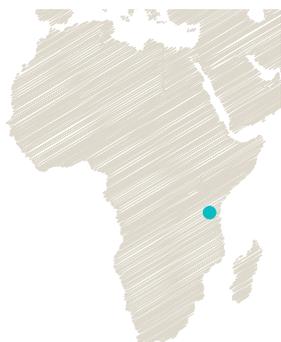


Top: Communities in Ludewa are owners or shareholders of mini-hydroelectric power plants. (Photo: Fondazione ACRA)

Bottom: The projects in Ludewa support SMEs, such as workshops, carpentries and grain mills to buy electrical equipment so they can use energy to earn money. (Photo: Sarah Best, IIED)

Contact: Davide Ceretti, energy programme manager — Tanzania, Fondazione ACRA, Italy. [davideceretti@blu.it](mailto:davideceretti@blu.it)

## 2.5 Financing off-grid solar for local communities



SunFunder is a solar finance business based in the United States and Tanzania that unlocks capital to drive the growth of solar power where grid access is limited or not available. It raises and aggregates capital through private debt funds, offering investors a diversified portfolio of solar companies and projects. SunFunder uses this capital to tailor loans for the sector to scale, from working capital and inventory finance to specialised structured finance vehicles. It works with pico-solar, residential solar, mini-grid and SME solar businesses in Africa, Asia and other emerging markets.

### US\$36m

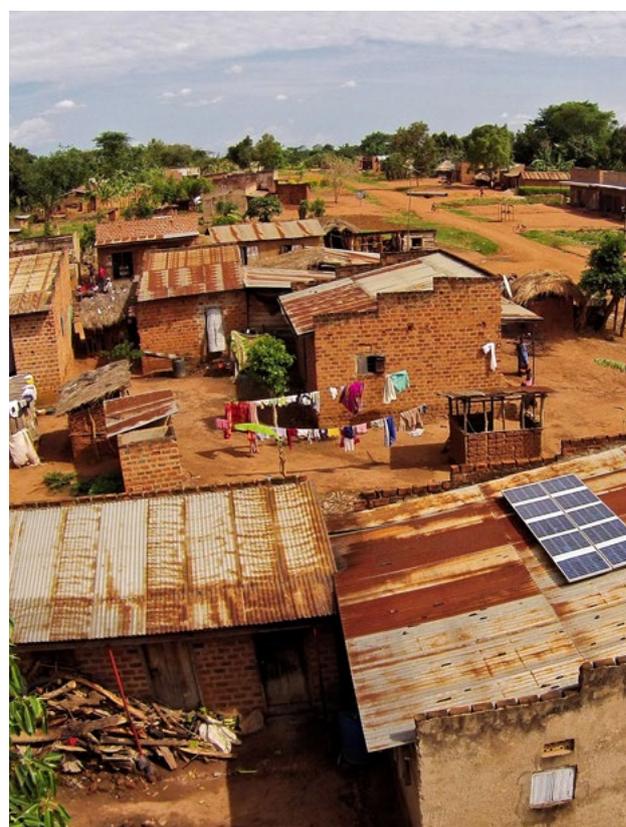
debt funds raised by SunFunder so far to invest in solar companies increasing decentralised energy access

### 80 loans

made to solar companies for working capital, inventory, construction and structured finance

### 2.5 million

people have gained energy access as a direct result of SunFunder lending



A residential solar system in Uganda deployed by SolarNow, one of SunFunder's customers. (Photo: SunFunder)

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# 3. Forestry finance

*Insights from 'Money where it matters'*

## 3.1 Overview

### The issue

The forestry sector in developing countries is dominated by SMEs. The diverse range of these enterprises makes data on them hard to collect, but rough estimates suggest that in many countries between 80 and 90 per cent of all forestry enterprises are SMEs and that these businesses employ more than half of all forest sector workers. Worldwide, more than 20 million people work in forest-linked SMEs.

The sector is often informal, dispersed and insecure. But its sheer size and scale means it has enormous potential to create jobs, generate tax revenue and meet domestic and international demand for sustainably-produced forest products and services.

Appropriate investment, capacity building and management could have a multiplier effect on the sector, significantly increasing its outputs and benefits. So how do we get it there?

### What are the challenges in getting public and private finance to local forest-linked SMEs?

#### Risk and high cost of finance

- For both investors and investees, the biggest barrier to supporting forest- and agriculture-linked SMEs is risk
- Creditors and investors view these SMEs as high-risk borrowers due to informality, insufficient assets, low capitalisation and a history of low repayment rates in developing countries
- Only 25 per cent of people living in Mozambique have savings accounts. This means that there isn't a lot of 'investable' money available in the banking sector — so banks tend to lend to 'safer' investments.

*“Banks see SMEs as risky investments and ask for a lot of collateral — not just land but high-value, unmortgaged housing, tax payment records, proof of registration...”*

Xiaoting Hou Jones, IIED, UK

#### Knowhow

- Most forest-linked SMEs are not just looking for money but also for the capacity to manage that money
- Many SMEs are looking to strengthen their business and technical skills too, and also want to learn how to position themselves to be more environmentally responsible
- There is a lack of creditors and service providers who understand SMEs' needs and it is hard to find the money or people-power to deliver capacity building
- For example, in the Zambezia province of Mozambique, there are around 100,000 registered SMEs, but the government has just three employees assigned to support them

- And even where there are initiatives that aim to deliver finance or capacity, they do not necessarily enable finance to trickle down to the local level. The bottom line is that for forest-linked SMEs, the failure to deliver business, technical, environmental and financial management capacity is often the biggest bottleneck for local finance.

### Short repayment terms

- Repayment periods are a key challenge for SMEs in the forest sector, where sustainable forest management relies on long rotation periods (for example, up to 50 years for most species of rosewood) and so it takes businesses a long time to repay debts and become viable
- The required repayment period for commercial bank or public financed loans extended to SMEs are often too short to pay off any sizeable investment
- The ability of commercial banks in developing countries to offer long-term loans is constrained by limited capital (for example, only 21 per cent of people in sub-Saharan Africa have a savings account) and consumers' preference for liquidity (short-term deposits of less than a year).

### High interest rates

- SMEs are often seen as risky investments and so are offered loans with higher interest rates than other businesses
- In Mozambique, where macro-economic conditions are currently unstable, base interest rates tend to be both high (around 25 per cent) and volatile, making loans from commercial banks prohibitively expensive for SMEs
- The interest rate offered by commercial banks also depends heavily on what business you are in. For example, a mahogany exporter in Guatemala — with guaranteed lucrative returns — has no problem accessing low-interest loans. But a pine grower for the domestic market has much lower profits and returns and will find it very hard to access financial services of any kind, let alone low-interest ones
- Interviews with SMEs in Mozambique show that for interest rates to be acceptable, they must not rise above 10–15 per cent.

*“We help the SMEs on training for managing their business and organising their companies... There is more demand for this support and, because of our limited funds, we are not able to cover. But finding new partners to increase our funds and expand the programme remains a great challenge”*

Mario Macheca, IPEME, Mozambique

*“[In Guatemala], even if local banks do have appropriate financial instruments for SMEs, they tend not to promote them because they are less profitable”*

Anna Bolin, IIED, UK

## What are the solutions: how can we improve the flow of local finance for forest-linked SMEs?

### Build capacity and knowhow

- We need a shift change in the level of finance provided for capacity building
- Finance should go first to supporting existing initiatives that already build social capital and business capacity and have a continued presence in the country, such as Gapi in Mozambique or Intecap in Guatemala
- We also need a change in our approach to capacity building to ensure more comprehensive support. For example, some NGOs work to strengthen sustainability skills but will not tackle business skills, while other NGOs promote business management but ignore sustainability. We need to link the two.

*“We need finance to support those intermediaries that are critical in transforming SMEs and digesting available financing”*

Xiaoting Hou Jones, IIED, UK

### Enable aggregation

- Individually, SMEs don't account for much. But combined, they're the biggest private sector in many developing countries
- Guatemala's National Alliance of Community Forestry Organisations is a good example of what can be achieved with aggregation. Established in the early 2000s, it has grown to represent 388,000 small-scale foresters and is now an important voice in policy, with a large role in shaping new programmes
- FEDECOVERA is another example from Guatemala's highly organised forest SME sector that illustrates how aggregation into a cooperative can take on the role of financial provider in addition to offering a range of social services.

*“Because of the employment [SMEs] provide, the potential increase in tax collection – both from employees and from corporate income tax and value-added tax – is huge”*

Isilda Nhantumbo, IIED, UK

### Blend public and private money

- The public sector plays a key role in bridging the gap between what the SME world needs and what the banks can supply
- If you consider that SMEs in Mozambique are the biggest private sector, then public money used to support them is equivalent to public money being used to leverage private money. Mozambican SMEs themselves invest a huge amount of money into their businesses, using part of their own income as well as that of their families' to invest in the landscape around them.

## Support value addition

- For forest-linked SMEs, being able to diversify and add value through, for example, processing, agroforestry, restoration or bioenergy is an important step in growing and developing a business to be viable and profitable in the long term
- Public funds are often subject to restrictions and will rarely cover the value addition and business consolidation phase of projects.

*“The idea of helping SMEs make a profit doesn’t sit well with donors interested in helping the poorest of the poor”*

Anna Bolin, IIED, UK

## Structure finance around SME needs

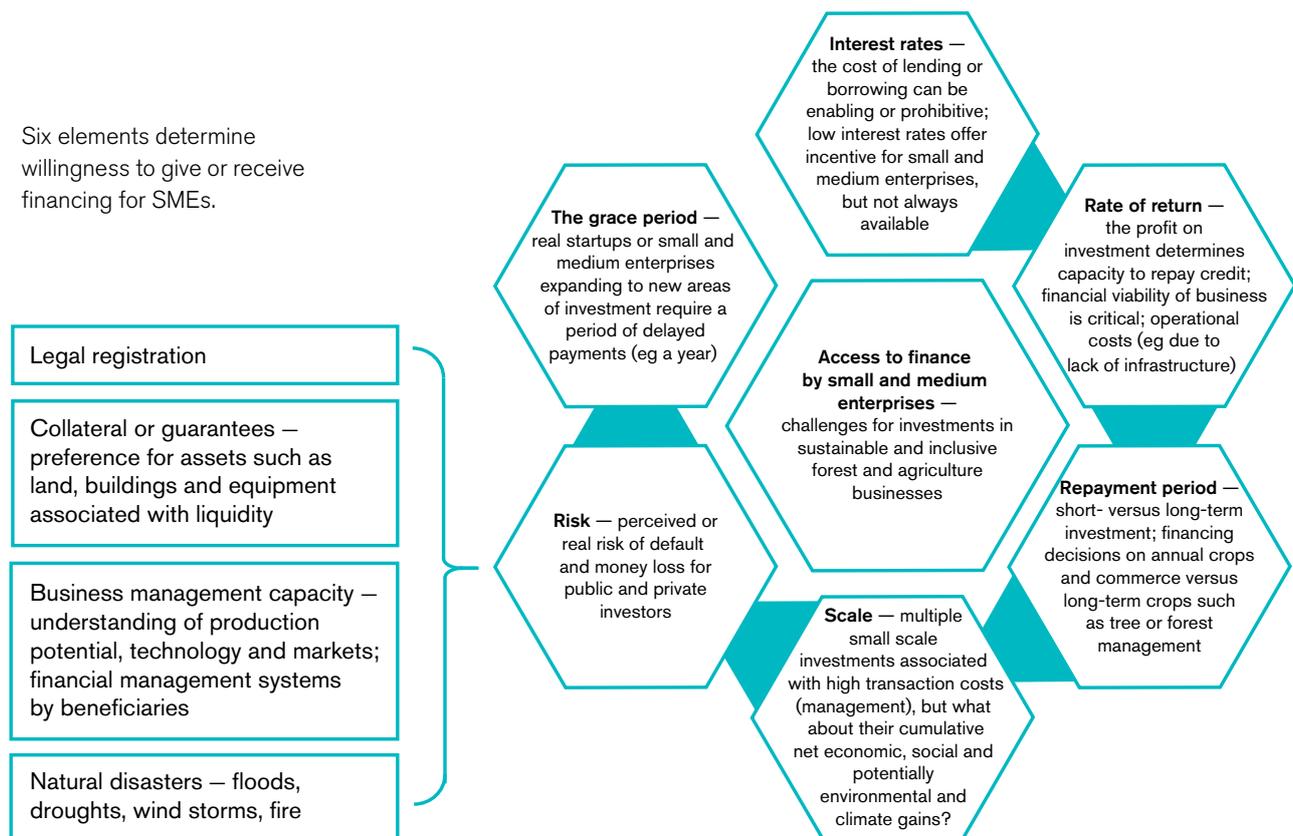
- Tailoring financial services to include longer repayment and grace periods would better suit the needs of forest-linked SMEs. For example, in Guatemala the bank Financera Occidente offers rubber growers a loan with a grace period of six years, which acknowledges the time needed to grow and harvest the wood before generating any income from it (although that is an exceptional case, based on more than 50 years of specialising in a particular sector, rubber)
- Another example from Guatemala, from the public sector, is the forest incentives programme PROBOSQUE. This is the latest of the government’s forest incentives programmes and has been specifically structured to meet the needs of very small-scale farmers (of less than 0.1 hectares) and the fact that they need to spend a year preparing the land before it will give them any sort of income.

*“We have set up ‘round business tables’ to introduce producers and buyers to each other and help eliminate the middlemen, or ‘coyotes’ as we call some of them. This year we had our first regional round business table for Central America and South America, where we supported negotiations for around US\$2.9 million (Q.22 million)”*

Edwin Ariel Pereira, National Forestry Institute (INAB), Guatemala

## 3.2 Unlocking barriers to forestry finance

Using desk research, semi-structured interviews and discussions in high-level forums, IIED is examining the challenges and opportunities of securing finance for forest-linked SMEs. Our study suggests that SME development is not only hampered by lack of potential investment funding, but especially by barriers such as ‘fear of risk’ by both financing institutions and SMEs.



### Risk is key

Risk is the overarching decision-making factor for both the investor in offering, and the SMEs in accepting, finance. SMEs must be supported to develop their capacity in all areas of business planning and in monitoring and managing environmental and social impacts so they can reduce risks (actual or perceived) and feel confident to engage with credit institutions.

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## Insights from Guatemala and Mozambique

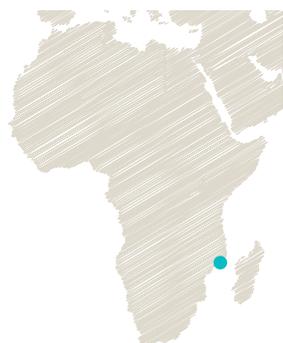
<b>Interest rates</b>	Lending conditions could include incremental interest rates to help SMEs take up loans and strengthen their businesses.
<b>Rate of return</b>	By investing in better infrastructure such as roads, governments could reduce SMEs' operational costs and improve conditions for business development.
<b>Repayment period</b>	Introducing longer repayment periods would help SMEs access more finance in both Guatemala and Mozambique.
<b>Scale of investment</b>	In Mozambique, some institutions will only provide some of the capital needed by SMEs (up to 70 per cent). Banks similarly only provide partial lending. Supporting SMEs to secure co-funding would help increase the uptake of loans.
<b>Grace period</b>	On both sides of the Atlantic, SMEs need at least a year grace period to get their business going.



Boys polish chairs for sale in the furniture market, Nampula, Mozambique. (Photo: Mike Goldwater)

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### 3.3 Towards strong SMEs and inclusive finance



In Mozambique, the public-private partnership Gapi combines finance with support for business and institutional development to provide a more inclusive financial system and strengthen the SMEs that make up more than 98 per cent of the country's registered companies. Over 25 years, Gapi has lent more than US\$90 million across 100 districts and helped more than 2,500 SMEs each year to develop their businesses by helping them to formalise, build technical and financial management skills, and access new markets.

#### Recipe for success

##### 1. Good governance

A public-private partnership, Gapi is jointly governed by Mozambican shareholders from government, business and civil society. This multi-stakeholder structure ensures transparency and solvency.

##### 2. Capacity building and credit

30–40 per cent of Gapi's funds go to building SMEs' business, technical and financial capacities. That includes providing training, building savings groups and creating micro-enterprises.

##### 3. Diverse loans

A variety of instruments — including low interest rates, seed funds, guarantees, long repayment periods and grace periods — work to address different barriers for SMEs to access finance.



Gapi supports communities to establish savings and credit groups. (Photo: Gapi)

#### Highlights (2012–2015)

**600** savings and credit groups created

**200** women's associations in the Beira corridor financed

**12** Farmer Field Schools created

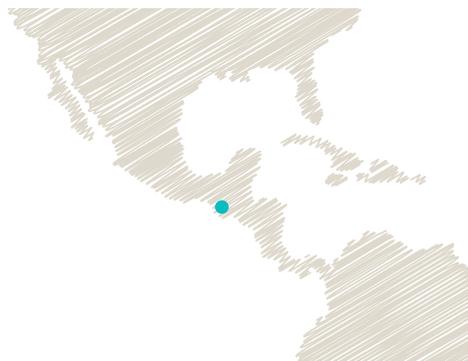
**169** agricultural centres created in Niassa

**225** young people attended entrepreneurship seminars

**86** women-owned micro-enterprises for agro-processing created

Contact: Aurora Malene, director of credit and investments, Gapi, Mozambique.  
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## 3.4 Progressive forest governance for SMEs



Guatemala has been developing policies to protect both its forests and forestry businesses since 1989. In 1996, the government introduced a forest incentive programme (PINFOR) to reward community and industrial forest concession holders and decentralised forest and protected area managers. A decade later, it reached out to small-scale and community forestry through a new programme, PINPEP. From 2017, this programme will be replaced by PROBOSQUE, which will run for 30 years and expects to invest more than US\$625 million in 7.5 million farmers (one third of whom are women).

### US\$308m

has been invested by PINFOR and PINPEP since 1996

### 430,000ha

of natural forest and plantations have been established or managed through PINFOR and PINPEP



The legal framework governing Guatemala's forestry sector is one of the most progressive in the world. (Photo: Anna Bolin, IIED)

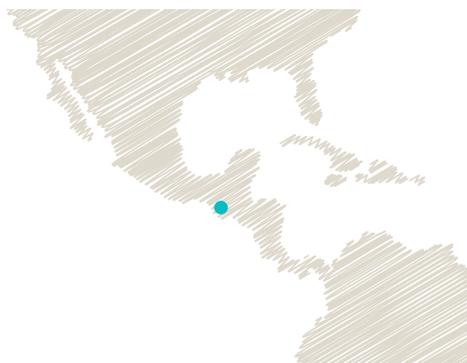
### Forest alliance

The National Alliance of Community Forestry Organisations is the main beneficiary network for PINPEP. It comprises ten second-level organisations and 400 community-level organisations, representing 388,000 forest producers.

Together, the alliance members sustainably manage 750,000 hectares of forest, or 17.5 per cent of Guatemala's forest.

Contact: Edwin Ariel Pereira, National Forestry Institute (INAB), Guatemala.  
edwin.pereira@inab.gob.gt

## 3.5 FEDECOVERA: financing local cooperatives



The Guatemalan Federation of Cooperatives of the Verapaces (FEDECOVERA) is made up of 43 cooperatives, representing 25,000 of the country's poorest producing families. The organisation accesses public finance from the government's incentives programme and combines these funds with its own capital to provide technical and financial services for cooperative members and more than 100 non-member group enterprises. It also offers environmental, legal and social services, including health and education, that build social capital and support sustainable natural resource management.



At FEDECOVERA'S tree nursery, 75 per cent of activities are done by women. (Photo: SOCODEVI, Creative Commons via Flickr)

### 90–97%

of FEDECOVERA loans are recovered, thanks in part to regular monitoring, financial management support and individual repayment plans

### 14

lines of services are provided by FEDECOVERA, including social, economic, financial and legal services

### 300

young members of FEDECOVERA benefit from training programmes that aim to employ at least 30 per cent within the cooperative network

Contact: Anna Bolin, researcher, IIED, UK. [anna.bolin@iied.org](mailto:anna.bolin@iied.org)

# 4. Urban finance

*Insights from 'Money where it matters'*

## 4.1 Overview

### The issue

Nearly a billion people live in informal settlements across the world — a figure that is set to double by 2030. Most live with inadequate or no provision for water, sanitation, drainage, electricity, health care or other needs. In cities and in villages, low-income communities are vulnerable to natural disasters and climate change, both of which can exacerbate the root causes of poverty and inequality.

All this means there is an urgent need for investment finance. Indeed, the Global Commission on the Economy and Climate's *New Climate Economy*<sup>1</sup> cites the amount required to simply meet the basic needs of urban residents at US\$4–5 trillion each year for the next 15 years. Current finance is only supplying about half of that, so there is a big gap in terms of amount of money needed for urban finance. Of the public finance that is available, most is highly centralised, flowing internationally from donors to recipient governments and then through various intermediaries until a small fraction of the original sum reaches the intended beneficiaries — poor communities.

In the absence of adequate support from both development assistance and national government, organised groups of the urban poor have developed an alternative finance system based on local savings schemes. These schemes come together to pool funds at the district, city and national levels. Most of the savers are women, so too are the fund managers. They manage the community finance but also carry out activities such as upgrading, or carrying out surveys and enumerations to get detailed profiles.

These community-led funds have been established at the international scale. Many have built financial systems that can draw in external funding and blend it with their own savings and loans to enable more sizeable investments. They have a proven track record in providing affordable housing and infrastructure, and in ensuring strong community oversight and accountability and transparency for all funds.

The funds have the power to increase their impact 20-fold, if given adequate external finance. But this finance has not been forthcoming. Despite the proven benefits, the urban poor federations have failed to get the level of support they need from international agencies.

### What are the challenges in getting urban finance to local groups?

#### Risk

- Lending to informal settlement dwellers is seen as risky, so there are few financial services available from the banking sector or other investors
- Where such services do exist, investors ask for unrealistic guarantees to combat the high perceived risk, for example demanding not only a cash collateral but also a corporate guarantee as well as charter land

*“Banks won't accept slum dwellers' land as collateral—the reputational risk is too high...”*

Jane Weru, Akiba Mashinani Trust, Kenya

<sup>1</sup> <http://newclimateeconomy.net/>

- Commercial banks lend at interest rates that are too high for informal settlement dwellers
- Microfinance loans can also carry prohibitive interest rates (more than 20 per cent in some cases) and entail burdensome bureaucracy
- And even impact investors can lose sight of their social mission in the search for a good return on their investment in countries such as Kenya, where base interest rates are high.

*“We found microfinance systems to be a bit tedious and heavy. Interest rates were very high and there were lots of hidden costs – application fees, loan insurance fees, guarantors etc...”*

Jane Weru, Akiba Mashinani Trust, Kenya

## Knowhow

- Federations of the urban poor have themselves built up impressive skills in planning and financial management. But there remains a capacity gap when it comes to working with local authorities, who tend to have very low technical planning skills
- Local municipal governments also face limited knowhow in revenue raising, which is critical if they are to be given devolved power to plan and invest in inclusive, sustainable infrastructure.

## Upfront costs

- For municipal governments trying to invest in sustainable urban infrastructure, upfront costs are a major challenge
- Urban poor federations face similar problems: the capital required to plan just 23 acres in Nairobi is high because technical support is expensive and difficult
- Informal settlement dwellers can help reduce some aspects of upfront planning costs for municipal governments, providing data collection for example. For local authorities, collecting data on informal settlements is prohibitively expensive and a logistical nightmare. Not so for the organised federations that live and work there. Combined, these federations have completed detailed surveys and maps for 8,512 informal settlements in more than 500 cities.

*“We’ve done the enumeration and profiling and have the information that the government want... [Our data are] good and reliable and the government are using it to subdivide the land and give us certificates of ownership so we can build our own houses”*

Anastasia Maina, Akiba Mashinani Trust, Kenya

## Limited municipal coffers

- A significant barrier to scaling up inclusive, sustainable urban infrastructure is the fact that local authorities have had a devolution of responsibilities, without a devolution of money.

## What are the solutions: how can we improve the flow of urban finance to local groups?

### Support aggregation

- Specifically, support saving groups (and their federations), which are organised around how poor people earn incomes so that they can save and accumulate funds to invest in livelihoods, services and infrastructure
- By organising and aggregating in this way, the groups can provide members with loans to improve infrastructure and livelihoods. In the past 20 years, the federations of the urban poor have proved that aggregation works: more than 35,000 households have been supported to get housing, and around 200,000 households have been helped to access basic services
- Organised urban poor groups have much stronger bargaining power to negotiate with the state to secure the resources they need or to change constraining regulations
- Aggregation allows the federation members to provide other services too, such as social support, security and counselling
- Many federations have built the financial systems to draw in external funding to blend with their savings and loans and resources leveraged from local government.

*“We looked at the rich and saw that the middle class are rich because they’re well organised – so we became organised too ...”*

Jane Weru, Akiba Mashinani Trust, Kenya

*“We know external funders can’t support hundreds of little projects. But they can support the national and local funders that can ...”*

David Satterthwaite, IIED, UK

### Build capacity

- Building capacity is about strengthening the planning and technical skills of local governments and their ability to work with community groups
- It is also about sharing learning and resources across organised groups
- And it should also include supporting local governments to enhance their credit worthiness so that they can invest in inclusive, sustainable infrastructure. Kampala, Uganda is an example of how targeted assistance to improve the municipal governments' ability to identify and raise revenue has enabled them to borrow in capital markets and invest in urban infrastructure.

## Demonstrate success

- The power of example is important. We need to find examples of how blending community and external finance has been successfully used to improve livelihoods and wellbeing — and then communicate those widely to help to make the argument
- Demonstrating success includes taking people out to the field on learning journeys, and bringing stakeholders together face-to-face in different environments
- It includes bringing out ‘stories of impact’ about how cities are being shaped from the bottom up
- The beauty of the federations is their ability to innovate and demonstrate success and set precedents for scaling up.

*“Many of the partners we work with are not familiar with what community finance means and can achieve... Real examples make all the difference”*

Nick Godfrey, New Climate Economy, UK

## Build bridges

- Getting finance to flow from national and international sources to local groups relies on stakeholders on both sides knowing and trusting each other and being able to have good quality conversations. That makes building bridges — creating links between the two sides — critical
- How can we help match the interest of investors with those of investees? In theory, a housing trust such as the Kenyan federation’s Akiba Mashinani Trust in Nairobi — with its steady, long-term returns — is just the type of investment that pension funds should be interested in. So how can we bring them together?

*“A lot of the links and channels for conversations are weak or non-existent. We need to better understand how to link financial numbers into the impact on the people-centred approach we all want to see”*

Jane Clark, DFID, UK

## 4.2 Community funds for urban development



The Shack/Slum Dwellers International (SDI) network supports savings groups in informal settlements and the city-wide and national federations they have formed in more than 30 nations. These groups enable savers (mostly women) to accumulate daily savings, provide loans to members and contribute to financial local

initiatives. This also enables communities to partner with local governments, donors and banks to implement development programmes. Such community finance, and the local institutions set up to provide it, help realise the potential of urbanisation and contribute directly to inclusive cities.



Community toilet blocks like these in Ghana (left) and Malawi (below) have been built using community savings, in partnership with local authorities. (Photos: Diana Mitlin/IIED; SDI)



**900m**  
people live in informal settlements across the world — a figure that is set to rise to two billion by 2030

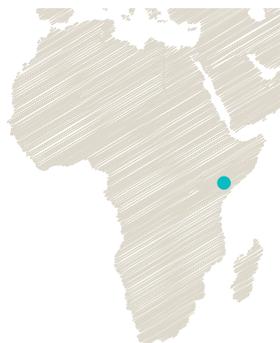
**8,455**  
savings groups across towns and cities in the global South are supported by the SDI network

“*We do the savings to improve our lives. To improve our homes where we raise our children. To improve our businesses*”

Janet Abu, informal settlement resident from Ghana

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## 4.3 Urban poor funds for affordable shelter



In 2007, the Akiba Mashinani Trust (AMT) was set up to support Kenyan informal settlement dwellers to develop financial and technical solutions to community challenges. Combining donor funds with community savings, the AMT supports the construction of affordable housing and infrastructure, and provides a line of credit for enterprise projects.

### 6,822

informal settlement dwellers financed and supported to access land and housing

### 3,500

informal settlement dwellers financed and supported to access water

### 300

different groups of informal settlement dwellers have been financed to improve general livelihoods

### 70%

of clients served by AMT are women



↓ transformation ↓



### Impacts

- Higher incomes
- More start-ups
- Business growth
- More secure livelihoods
- Decent permanent housing
- Clean water
- Adequate sanitation
- Community savings leverage additional resources.

The AMT loans for housing development have transformed slums in Kenya. (Photos: AMT)

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## 4.4 An alliance for finance in India's slums



Since the mid-1980s, an alliance of three organisations in India — SPARC, Mahila Milan and the National Slum Dwellers Federation — has capacitated the urban poor to define and address their priorities. The alliance works through neighbourhood savings groups, mostly formed and managed by women. These savings groups provide loans and also develop their capacity to improve housing and infrastructure in informal settlements, working with local governments.

### £1.6m

in loans was disbursed by the alliance's savings groups between 1996 and 2016

### 63,672

families have directly benefited from public and private investments in housing and sanitation owing to alliance support

### What's so special?

- The alliance is building informal settlement dwellers' capacity to identify and prioritise their needs, and to design and implement solutions
- This collective action builds social and political capital in informal settlements
- In this way, the alliance empowers communities living in informal settlements to negotiate with the state for land rights, housing and infrastructure, creating new community-led development.



The alliance supports low-income communities to build and manage toilet blocks such as this one. (Photo: Indian Alliance)

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IIED has been researching local finance issues in urban and rural settings, in the context of climate, energy and natural resources. On 7–8 December 2016, we hosted an event to reflect on our insights and explore how financing mechanisms can more effectively channel resources to the local level. The ‘Money where it matters’ event featured speakers from finance, research, policy and practice. By sharing their experience and expertise, participants began to shape an agenda for better supporting poor women and men to have a greater voice in allocating climate and development finance. This document highlights the evidence and insights discussed at that workshop.



## Event Materials

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### Climate change, sustainable markets

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*Keywords:*

Climate finance, financing for development, decentralising climate funds, local level finance, local ownership, climate change governance



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