ANNEX C

Evolution of Past Lending and Performance of the Urban Development Portfolio

The Bank's portfolio of urban development projects is characterized by its focus on urban affairs as a development arena whose key dimensions are *urban place*—a spatial location where economic and social relations occur—and *urban governance and the management and financing of urban public services*, which are the primary responsibility of municipalities in partnership with central government, private enterprises, and community organizations.

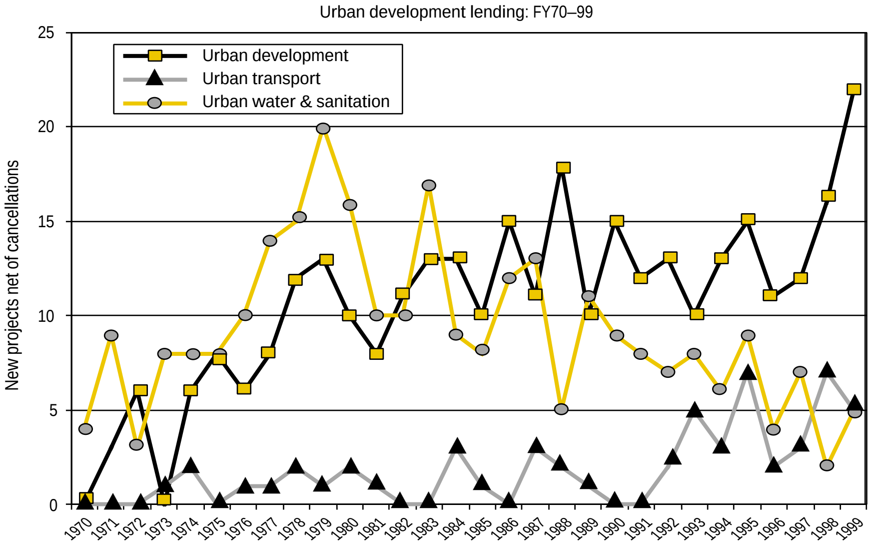
The Bank's urban assistance has evolved since the 1970s

Urban development projects accounted for about 3 percent of World Bank and International Development Association (IDA) lending throughout the 1970s and 1980s, rising to 5–6 percent in the early 1990s. The 10–15 urban development projects a year at present average about $1 billion in annual commitments. In parallel with urban transport and urban water and sanitation (which together account for another 5–6 percent of Bank lending), urban development lending dipped around fiscal 1996, in absolute amounts and a share of total Bank commitments. But the pipeline indicates a resurgence of demand, especially for urban development assistance (figures C.1 and C.2). For a description of the breakdown of the current urban development portfolio by lines of business and examples of completed and new projects by subcategory, see attachment 4.

The Bank's approach to urban development has changed in response to experience. Urban assistance in the first decade focused on poverty alleviation through investment in basic infrastructure and housing for low-income residents. The aim was to test the feasibility of providing low-cost improvements that could be replicated to reach large numbers of unserved residents.

The slum upgrading projects or project components generally met this objective, sometimes with dramatic results, as in the Kampung Improvement Program in Indonesia (see box B.1). But the first generation of slum upgrading projects was less successful in bringing about even indirect cost recovery through property taxation. Although the projects incorporated extensive community participation before it became the norm in other sectors, local counterpart institutions (both municipal and

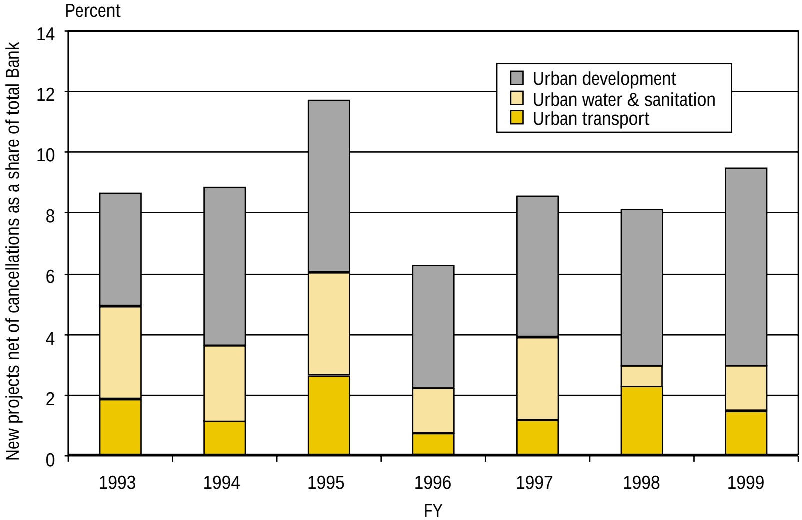
Figure C.1 The demand for urban development projects is increasing



Source: OIS as of May 3, 1999.

Figure C.2 Urban development lending is recovering as a share of total Bank lending

Lending comparison: urban development, urban transport, urban water, and sanitation as a share of total Bank lending



Source: OIS as of May 3, 1999.

Table C.1 Urban development projects by region, May 1999

Regions	Number of active projects	Share of active projects (percent)	Commitments outstanding (US$ millions)	Share of commit-ments (percent)
East Asia and Pacific	19	21	2,191	32
Europe and Central Asia	18	20	1,464	21
Latin America and the Caribbean	13	14	1,214	17
Middle East and North Africa	13	14	996	14
South Asia	2	2	61	1
Sub-Saharan Africa	27	29	1,078	15
Total	92	100	7,004	100

Note: Outstanding portfolio as of May 3, 1999.
Source: OIS.

nongovernmental) were insufficiently developed to sustain and expand the projects. Consequently, the efforts were rarely replicated to broader service areas except in a few countries (Indonesia, Jordan, and Tunisia) where there was significant central government leadership and financial support.

Many of the multisectoral urban projects that had a less clear focus than urban upgrading acquired poorly integrated and ill-prepared components that suffered from weak borrower ownership and implementation capacity. The need for a better enabling policy environment for all urban activities, based on supportive intergovernmental relations, became very clear.

During the 1980s urban development projects were therefore reoriented toward strengthening the policy, financial, and institutional frameworks. Housing assistance, for example, shifted from shelter investment to the reform of housing finance policies and restructuring or dismantling of housing banks and public housing agencies. The Bank began devoting a much larger share of lending to municipal development projects that aimed to effect broad capacity building and financial reforms within municipal government, coupled with credit lines to support investments and help municipalities establish credit records. Single-sector projects in urban areas, notably urban transport, water, and sanitation, also became popular in some country programs.

The solid base of urban policy analysis that was developed during the late 1980s and early 1990s—building in part on Bank-supported research—remains a sound guide for the Bank's assistance activities.[21] This policy work substantiated, for example, the effects of the regulatory regime for land and housing on the costs and demand-responsiveness of these markets, particularly for the poor; the necessary

[21] *Bank policy papers issued in this period include* Urban Policy and Economic Development: An Agenda for the 1990s *(1991);* Housing: Enabling Markets to Work *(1993a); and* Better Urban Services: Finding the Right Incentives *(1995). And an unpublished sector review, "An Agenda for Infrastructure Reform and Development," (1993b) served as an input to the Bank's* World Development Report 1994: Infrastructure for Development.

conditions for sustainable municipal credit and housing finance markets; the critical role of intergovernmental frameworks in defining incentives for effective municipalities; and the growing importance of urban environmental and poverty issues in sustainable urban development. These findings were increasingly reflected in the projects funded in the mid-1990s, which have taken on an ambitious agenda of municipal policy, institutional change, and market reform.

The performance of the urban development portfolio

The performance of the urban development portfolio has been strong in most respects over the years and has shown further improvement recently in response to increased attention by sector managers and staff. On the whole, urban development assistance has a solid record that is valued by clients and serves as a good launching point for the renewed strategy.

The first two decades—a strong record despite tough challenges

Urban development projects received relatively high performance ratings from the Operations Evaluation Department (OED) in the first 20-year retrospective (World Bank 1994). Of those completed between 1972 and 1992, 80 percent were judged to have a satisfactory outcome, compared with 74 percent Bankwide. The institutional development impact was rated substantial for 32 percent of urban development projects, compared with 28 percent Bankwide. Urban development projects fell below the Bankwide average only in likelihood of sustainability, with less than half—47 percent—deemed likely to be sustained, compared with 55 percent for the total Bank portfolio.

This first generation of urban development projects demonstrated that the Bank had sound ideas (demonstrating low-cost investments, introducing channels for municipal credit, reducing regulatory constraints) that were well executed in individual projects. But the innovations and reforms were too seldom replicated within a country or sustained after the project period. One of the reasons for this was that the larger political and economic context was often not conducive to such outcomes. Local governments had little say in many of the early urban projects, which were designed and implemented by special agencies answering mainly to the central government. The municipalities' lack of autonomy reduced their commitment and ability to maintain or extend the project activities. Decentralization and rationalization of intergovernmental fiscal relations can create a more positive environment for sustainability, although political conflicts between central and local governments remain a potential complicating factor in any urban work.

As urban development projects became more focused on policy and institutional reform, they needed a firm grounding in country sector work and macroeconomic dialogue to ensure understanding and commitment among the national and local counterpart agencies and among the Bank staff and managers. The financial conditionalities of urban projects needed to be consistent with the macroeconomic realities and other incentives facing clients. Bank assistance in related areas (such as investments in rural communities or in social sectors) has not always had consistent financing conditions, which has sometimes reduced demand for disbursement under the urban projects. Where the Bank has sustained a strong national urban dialogue, integrated it with the country strategy, and maintained support to responsive clients, urban development assistance has led to significant policy and institutional reforms even under difficult macroeconomic conditions—as in Brazil, Ghana, Mexico, and the Philippines.

The early lending experience also taught that the intersectoral nature of urban issues and the multiplicity of stakeholders can lead to a temptation to make urban development projects overly expansive in design. Complexity in terms of the number of components or implementing agencies is not necessarily associated with poor performance; however, urban projects in many countries have worked well with fairly complex structures—as long as the counterparts fully accept the objectives, are committed to working together, and have the means to do so. Where these conditions do not exist, experience suggests that it is better to work with simpler designs.

While not entirely unique to urban work, these issues create challenging standards for performance in institutional development and sustainability. The first generation of urban projects met these standards better than, or almost as well as, other types of Bank projects. It was clear from the OED's review of the first 20 years, and from the body of sector work and research preceding that review, that the Bank had acquired the knowledge and experience to reach a consistently higher level of performance—but that this would require even closer coordination of urban analysis with the macroeconomic dialogue, more careful preparation and supervision of projects, and tighter management of the portfolio.

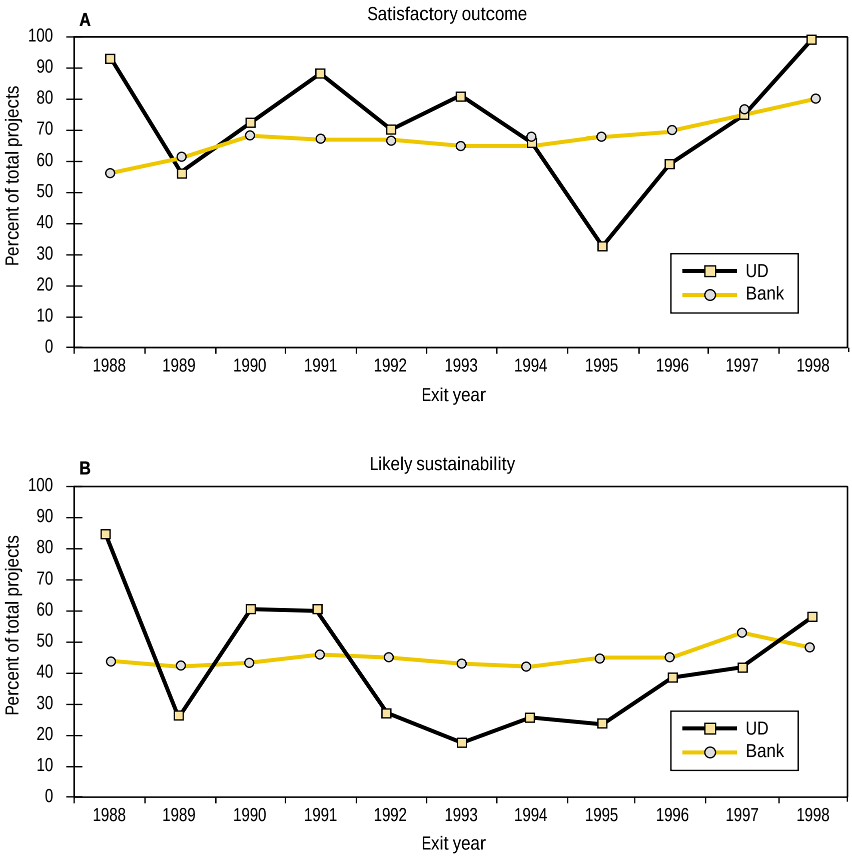
Lending in the 1990s—a brief slip and then steady recovery

Rather than advancing from a position of strength, the Bank's urban work retrenched in the early 1990s for a number of reasons. With the 1987 reorganization, the central cadre of experienced urban project staff dispersed and many left the field. Urban assistance requires a wide range of disciplines and subsectoral knowledge, but many Regional sector units had difficulty building a critical mass of such expertise. More seriously, relatively few Regional project managers after that time had experience with or understanding of the urban agenda. In addition, the Bank's emphasis on structural adjustment in the 1980s meant that activities seen as not directly contributing to the external sector were downplayed, and so urban issues, which suffered mistakenly from this connotation, tended to fall aside in macroeconomic dialogue and country strategy work. At the same time, there were few organized external pressures (such as from international NGOs, which have a predominantly rural base) to keep urban issues prominent in the Bank's country assistance. Urban development lending, sector work, and new research have therefore been relatively neglected since the early 1990s. The policy papers issued in this period summarized past work clearly linking urban issues to the Bank's broader development agenda, but these paths were not actively pursued by the Bank in most countries.

Completed projects. The legacy of this period is apparent in the deterioration of the performance ratings of urban projects that exited the portfolio from about fiscal 1992 to 1995. The evaluations by project staff of institutional development impact and likely sustainability worsened in that period, while outcome took a dip only in fiscal 1995 (Figure C.3a–e).[22] The pattern occurred to some extent in all regions and all project subcategories. The preparation and implementation of exiting projects in this period suffered from the loss of experienced project leaders

Figure C.3.a–e A brief slip and then steady recovery in the performance of completed urban development projects

Performance by exit year according to Operations Evaluation Department evaluation criteria, fiscal 1988–98



[22] *As a result of this pattern in the data, the fiscal 1993–97 ratings fell far below those for the fiscal 1988–92 cohort in OED's reporting of period averages.*

Figure C.3 A brief slip and then steady recovery in the performance of completed urban development projects *(continued)*

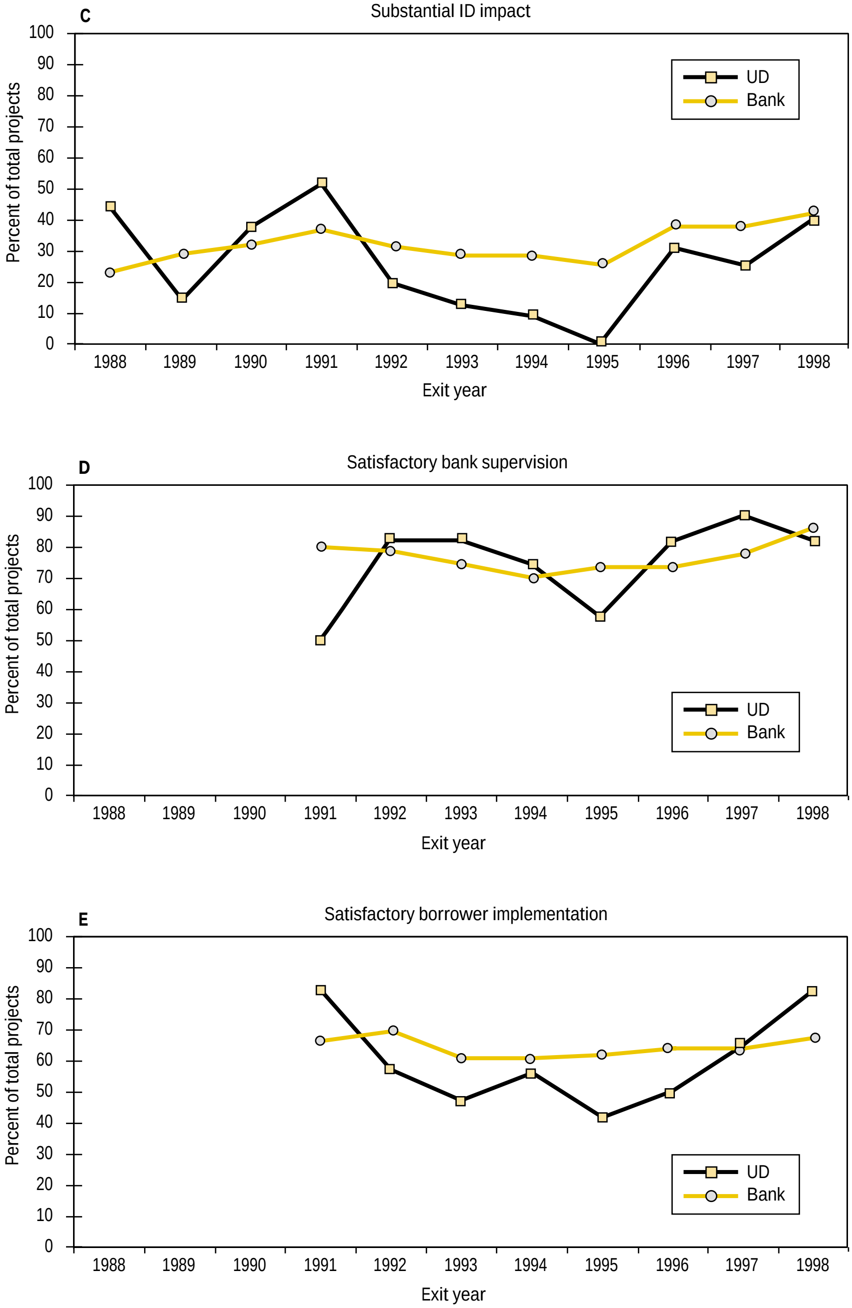
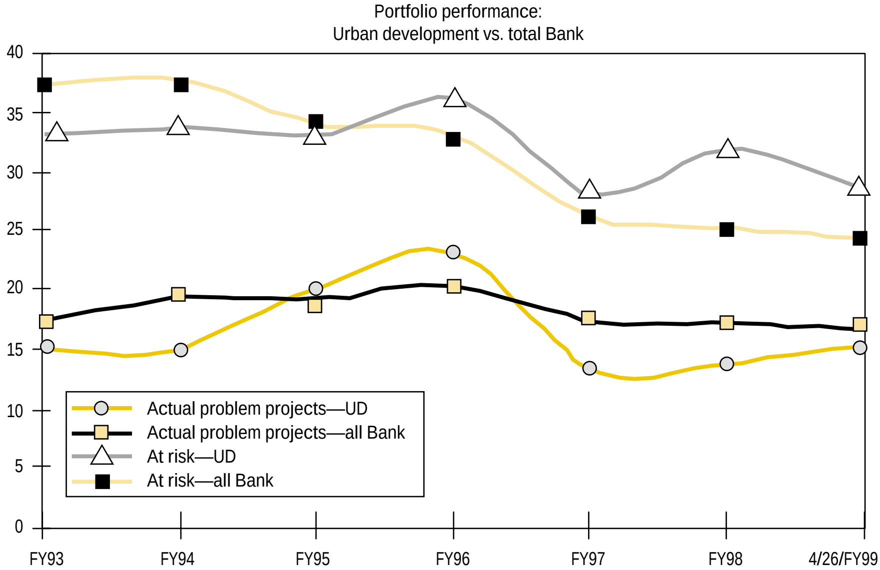


Figure C.4 The performance of the active urban development portfolio based on QAG criteria compares well with the Bank average



Source: OPR ratings as of April 26, 1999.

and weak management attention after 1987; the fiscal 1995 low also reflected a cleaning out of particularly problematic projects. The share of new Bank commitments to urban development also fell off sharply after fiscal 1995, reflecting discouragement and the low priority of urban lending in the view of many managers.

The most recent performance ratings show a much different and more positive trend, however. By all OED evaluation criteria—outcome, institutional development impact, sustainability, borrower implementation, and supervision quality—*the performance of exiting urban projects rebounded from the mid-decade lows to a level around or above the Bankwide averages in the fiscal 1997–98, to points above the fiscal 1972–92 averages*. This recovery attests to the more active management of the portfolio under the strengthened sector leadership in the Regions.

Ongoing projects. The performance of the active urban development portfolio as monitored by the Quality Assurance Group (QAG) compares favorably with the Bankwide average in share of problem projects (figure C.4).[23] Urban de-

[23] *QAG defines "problem" projects as those having unsatisfactory supervision ratings for fulfillment of development objectives or implementation progress. Potential problem projects are those having three or more risk factors from a list of 12, even if ratings on development objectives and implementation progress are satisfactory. The 12 risk factors are long effectiveness delays, poor compliance with legal covenants, project management problems, shortage of counterpart funds, procurement problems, poor financial performance, environmental or resettlement problems, significant disbursement delays, long history of past problems, project in risky country, project in risky subsector, and poor macroeconomic setting. The sum of actual and potential problem projects is the total of "at risk" projects.*

velopment projects continue to be rated as higher risk than the Bank average, due in part to the above recent history. The main performance issues of the present urban development portfolio according to QAG are problems with counterpart funding, financial performance, disbursement delays, and macroeconomic context. These problems indicate underlying weaknesses in borrower readiness, ownership, and the financial frameworks of municipalities. The problems are most frequent in the urban management subcategory (projects with multiple institutional, policy, and investment objectives), which has grown as a share of the urban portfolio in the 1990s and has been tagged a "risky subsector" by QAG.[24]

Some of the urban management and other operations have been found to have ill-defined or excessive objectives relative to components and to borrower capacity.[25] But the strengths in the urban development program have also been identified. The 1997 and 1998 quality at entry and rapid supervision assessments by QAG have found urban development projects to be among the very best surveyed.

[24] *The "risky subsector" flag is expected to be removed by QAG in early fiscal 2000 because of performance improvement.*

[25] *This issue has been noted in OED and QAG reviews and illustrated in depth for a sample of recent projects by Boyer 1998. See also Costa 1998. The urban management subcategory also includes the municipal development fund projects, some of which have been given very high marks by OED.*