Urban transport project
Summary of the Operation Performance Evaluation Review
March 2006

THE PROJECT

Public transport is the responsibility of the municipality in most cities. It is typically a high priority in municipal budgets. Since 1996, the City has consistently improved the quality of its services for citizens and visitors. During the late 1990s the City approached the Bank for assistance. A project emerged as the result of a protracted process. With Bank-funded technical cooperation (TC), a multi-year investment programme was developed that covered several municipal sub-sectors and amounted to more than €130 million. Through further TC assistance, a €40 million urban transport investment programme was identified. This was eventually scaled back to a non-sovereign loan to the City of €12 million for the improvement of urban public transport, including: (i) tram track modernisation; (ii) supply and operation of an electronic ticketing system; (iii) upgrade of part of the tram fleet and (iv) restructuring and commercialisation of municipal transport operator. A non-sovereign loan of €5 million was also extended to another City. for the implementation of a traffic circulation plan, including: (i) traffic signal and junction improvements on a main traffic route, and (ii) measures favouring pedestrians and cyclists.

There was a further late change requested by the City, whilst loan negotiations were in its final stages. The tram track modernisation programme was reduced from € 12 million to € 6.1 million, and the remaining €5.9 million was re-allocated to a bus fleet renewal component (€ 4.7 million), which constituted a new project component within the original overall scope of the project. The tram refurbishment component was also reduced (€ 1.2 million) and its funding provided by the Bank rather than the city.

The focus of this evaluation is on the preparation and implementation of the investment operation. It includes observations regarding the effectiveness of the TC operations involved. In this context, note should be taken that whilst the investment appraisal contained two investments, for two cities, which were processed in parallel, they concern different borrowers, different components, and were subjected to separate implementation and monitoring processes. EvD decided that this evaluation will attend to the former City only.

PROJECT RATIONALE

Reminiscent of the central command economy era, urban transport infrastructure facilities were generally dilapidated, lacked maintenance and required significant investment. Increasing economic activities, greater traffic and transportation needs (including those of tourists), and a general call for improving citizens' living conditions, were among the motivators for the project. Backed by its experiences from municipal lending and TC operations in the country, the EBRD was well positioned to respond to the urban transport needs of the City. This prior experience in municipal lending was essential for enabling the Bank to structure this project. Besides the Bank's preparedness for the financing of municipal transport infrastructure facilities, it was possibly more importantly, the Bank's experience record in providing TC support for establishing and enhancing a municipality's credit worthiness, that determined its added value.

ACHIEVEMENT OF OBJECTIVES

The project aimed at enabling the cities to improve their urban transport systems by investing in trams, tram track refurbishment and buses. TC also helped improve the creditworthiness of the public transport company. The achievements under the urban transport project were rated *Good* overall. The city conveyed to EvD that it was very satisfied with the EBRD investment, TC operations and the cooperation with the Bank. As a result, the Bank extended two more loans to the City; one to the municipal transport operator, without municipal-guarantee, and one to the City's water infrastructure company.

OVERALL ASSESSMENT

This project was rated *Successful*. The achievement of objectives was rated *Good*. The project was in full compliance with the pertinent country strategy and with the transport sector policy of the Bank. The Bank's additionality was *Verified at large* because of the "design and functioning" elements included in the project. The environmental performance of the Bank and the city was assessed as *Good* with there being *Some* extent of environmental change. It should be noted that the project, after the change of scope, was environmentally less positive.

Bank handling and the financial performances of the city and the current transport company, were rated *Good*. The project's profitability for the Bank was regarded as *Marginal*. This is mostly because there was a long preparation period with costs incurred on the project before disbursement started: costs were incurred from 1998, while the first disbursement was in 2002. The transition impact achieved was *Good* for short-term materialised effects and *Good* for future effects still to materialise, associated with a *Low* risk.

Through the investment and associated grant-funded technical cooperation work, know-how, technology transfer and skills transfer were achieved. The project was instrumental in outsourcing and corporatising the transport services

Amongst the TC inputs, the creditworthiness enhancement programme deserves a mention. It helped the city improve its financial management. As a result, the City ranks amongst the best managed city managements in Poland and enjoys an investment grade credit rating

BANK HANDLING

Overall, EvD assigned a rating of *Good*. The appraisal for the investment operation and the terms of reference for the TC operations were prepared diligently, covering all relevant aspects. These documents did not give space for misinterpretation of objectives and tasks at stake. The City was appropriately consulted and involved at all stages. The Bank's technical due diligence work was based on sound expertise. From a financial point of view, the Bank's due diligence work was in compliance with the required sound banking principles. A number of key loan covenants and conditions prior to effectiveness of the loan have been set, and a clear performance monitoring regime has been established. Thus, the appraisal quality was good but time consuming and lengthy in order to prioritise the components of the project.

MAIN ISSUES AND LESSONS LEARNED

Change of project scope

The project is a good example of the importance of thorough pre-investment due diligence. Starting with a "wish-list" of €130 million, scaling it down to a €40 million investment programme, and ending-up with a project of €12 million demonstrates progress. The subsequent change of scope relating to 50 per cent of the loan was understandable (owing to municipal budget constraints) but the related Bank-internal process is regarded as deficient. Whilst the appraisal report justifies the project design, based on a feasibility study that discusses the rationale of the tram track rehabilitation and the tram refurbishment, such rationale is not underpinning the change of scope. In EvD's opinion, the change of scope was material and would have required the formal involvement of all parties, notably the Environment Department and possibly the Office of the Chief Economist, which was not the case. The Environment Department confirmed that, although it was not involved formally, it had received information informally from the operation team about the proposed changes, and that it had commented on this issue. However, it was only in 2004 that the consultant, as part of the diligence process, for the subsequent second loan, undertook detailed feasibility work on buses as a mode of transport and provided detailed information about the environmental impact.

<u>Lesson learned</u>**: Bank-internal processing of post-approval changes of project scope and design require more rigour.** The Bank-internal approval process of subsequent project scope and design should involve all erstwhile approval parties, if such change is considered material. In this regard changes have been made in the Bank's Operations Manual in 2003.

Loan size, project gestation process and Bank administrative costs

The evolution of this project from a multi-year programme to a one-year project resulted in the original investment volume being scaled down from more than €130 million to €12 million. The pre-approval gestation process was protracted over 18 months. As a consequence, project profitability for the Bank is marginal. Obviously, the lack of profitability is of concern and raises the question anew about break-even parameters and draws attention regarding the effectiveness of the administrative concept clearance process, or more generally, the pre-approval scrutiny process.

<u>Lesson learned</u>**: Monitoring of administrative cost evolvement versus Bank profitability prospects needs more attention.** The project clearance process, an important process element targeting avoidance of misallocation of scarce Bank resources, may need reconsideration and refinement. For investment areas where projects are known to enter the Bank's management cycle with high loan volume potential, but also with a high risk that this volume may need to be scaled-down substantially in the course of project gestation, and also where gestation processes typically are protracted, the Bank should consider identifying alternative delivery mechanisms that are more cost-effective. Enhancing the project feasibility process and/or financing it through a loan may be an alternative route to secure project profitability for the Bank.