

# Sector Guidelines

## for Pre-Feasibility Studies on

### URBAN RENEWAL



#### A. Introduction

##### 1. Context

Cities Development Initiative of Asia (CDIA) Sector Guidelines describes the approach to pre-feasibility studies in the sectors most commonly encountered in CDIA support to cities. These guidelines are a sector-specific appendix to the overarching *CDIA Pre-Feasibility Study Guidelines* (CDIA 2011) that sets out the format, process, and output requirements in general.

The Sector Guidelines are not meant to replace terms of reference or to provide detailed technical input for consultants, who are assumed to be qualified and experienced professionals in their field and thus technically capable. These apply to the conduct of a pre-feasibility study (PFS) for a project or group of projects (hereinafter referred to as “the project”) identified and prioritized in the plan and by the relevant authority for implementation.

These guidelines apply in the context of existing policies, visions, plans, and studies pertaining to urban renewal and other related issues. These address the approach expected of consultants engaged at the PFS stage as regards urban renewal.

##### 2. Objective

CDIA support to the formulation of any urban renewal project aims to enhance the sustainability and inclusiveness of the project. This means that the project should

1. Comprise a viable component of an *integrated urban renewal program* including consideration of housing, economic activity, transport issues, infrastructure provision, and social services (see section B);
2. Be *inclusive* in the sense that affordable and accessible housing and employment options are available to different income groups comprising the area's existing inhabitants and potential



new inhabitants, *and* that persons negatively affected by the project should be minimized and adequately compensated for any adverse impacts (see section C);

3. Be *economically viable* and *financially sustainable* in that the economic rate of return on a project must be acceptable *and* that revenues, subsidies, taxes or levies, concession/lease revenue, microfinancing, grants/loans, community service obligation payments, carbon credits, or any combination of these must be capable of funding capital and operational costs of various components of the project, including long-term maintenance and capacity building (see section D);
4. Be *environmentally sustainable* in that the proposed investments should contribute to improvements to the urban environment through reduction in environmental hazards resulting from poor solid and liquid waste management, sanitation, air pollution (including green house gas emissions), and contamination of water bodies and land (see section E); *and* that adequate measures will be taken to mitigate any potential adverse environmental impacts of the project (see section E); and
5. Have *sound, transparent governance* arrangements enabling efficient financing, design and construction, commissioning, and operation of the project (see section F).

### **B. Developing an Integrated Urban Renewal Project**

The vision for any city in Asia must include an environment-friendly, energy-efficient, low-carbon, integrated, and inclusive development. To achieve this vision, urban renewal programs should aim to enhance the viability and livability of subject areas, utilizing and enhancing the potential of the existing environment and local economy, where possible, to retain the character of the area, and introducing new development. Such planning should be balanced and integrated across residential and commercial activities. The investment project should be based on a sound planning framework. The consultant should review this framework and the role of the urban renewal project within it. If it is not adequate in terms of its providing strategic guidance to the project as regards its social, economic, and environmental contribution to the city's development, the consultant should, within the limits of resources provided under the contract, set out proposed objectives based on available data and consultations.

The project design should describe the key subcomponents of housing, commercial development, and infrastructure investments and show how these will achieve the strategic goals discussed above. The documentation of the project design should also demonstrate how land development patterns and investments will contribute to sustainable transport and energy efficiency goals (see Sector Guidelines on these topics). Mechanisms to achieve such goals, for example, promoting pedestrian areas in respect of transport goals and refurbishment to provide better insulation in respect of energy efficiency, will normally need resources that must be funded and managed. Such issues are addressed in sections D and F respectively.

#### **Summary**

- ▶ Review planning framework to identify investment components and priorities
  - ➔ Fill "gaps" with rapid analysis of strategic goals.
- ▶ Demonstrate how the proposed design fosters economic development, particularly in respect of the poor.
- ▶ Demonstrate how the proposed design furthers sustainable transport and energy efficiency goals.



### **C. Developing an Inclusive Urban Renewal Project**

The baseline for developing an inclusive urban renewal project is understanding the needs of existing residents, particularly the poor. This includes an analysis of the following:

- (i) Capacity for employment and constraints to expansion of economic activity. This includes a holistic view of the economy that takes into account informal economic activity involving, for example, cleaners, shopkeepers, street vendors, food stalls, informal transport systems, etc., which will invariably be affected positively or negatively by the project.
- (ii) The need for services such as health care and willingness to pay for these (by different income and other groups such as single-parent households)
- (iii) Safety and security is an important aspect, especially from a gender perspective.

The first major task for the consultant is to undertake a rapid screening of the proposed route(s) and facilities to determine the following:

- (i) The potential benefits to income and other groups and their employment opportunities; ("potential" should be gauged not just by likely cost of conventional delivery but also include potential for cost-reduced delivery and cross-subsidy possibilities); and
- (ii) Likely disruption to communities in terms of relocation, division, noise, disruption of the visual context of important historic or scenic sites. The scale and cost of relocation should be estimated along with options for near-site<sup>1</sup> resettlement (to minimize disruption to employment).

Changes to the design should be considered where (i) significant employment opportunities could be easily accessed, particularly by low-income groups, or (ii) significant disruption could be reduced. Costs associated with the social impact mitigation measures should be included in the financial assessment (section D) and the associated management systems should be incorporated into governance arrangements (section F).

#### **Summary**

- ▶ Document the design by subcomponent, segmenting the market for housing, services, and access to infrastructure, and assessing outcomes for each group (segment the market by identifying key potential user and/or beneficiary groups by income and other characteristics e.g. gender).
- ▶ For the proposed design, estimate benefits by group.
- ▶ Consider alternative design options to maximize employment and other benefits, particularly for the poor, and to minimize disruption.

### **D. Ensuring Financial and Economic Viability**

#### **1. Financial Assessment**

Crucial to the viability of the project will be a realistic assessment of revenue streams for each investment with a direct cost recovery component, such as health, water supply, housing, and others. Often, assumptions are "over optimistic," to say the least. The assessment of affordability and willingness to pay on the part of each market segment in each investment should be rigorous and well documented. If the assessment of existing preliminary estimates suggests they are

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<sup>1</sup> Off-site resettlement is to be avoided wherever possible. Potentials for urban renewal in parallel to the transit development should be assessed to provide additional units for resettlement.



unrealistic, cheaper, more appropriate alternatives, or increase in the density of development should not only be considered but also strongly suggested. Costs should be benchmarked against average construction costs in country (preferably) or in like country. The latter is available on the web. Costs should explicitly include social (e.g., relocation) and environmental mitigation measures.

Subsidies, cross-subsidies from leasing of property, community service obligation payments, and others should be assessed for their sustainability and legal enforceability. Clean Development Mechanism for energy efficiency investments and other credit/subsidies from international agencies should be assessed based on prior experience with similar projects and, if necessary, on engagement of specialist expertise<sup>2</sup> to provide advice where such funding is crucial to the viability of the project.

The financial assessment should include cash flow, income statement, and balance sheet projections of any corporate or special purpose vehicle (SPV) entities involved in the financing and standard financial cost benefit analysis (CBA). The hurdle rate adopted for this latter should be the relevant weighted average cost of capital (WACC) for the sector and country, but where private investors are involved market rates for return in equity and debt should be the benchmark for viability.

In particular, the assessment must include an analysis of the cash flow of local government(s) with project capital expenses and subsidies included to determine the sustainability of the project in relation to the likely revenue streams for the local government(s). Such an analysis should be the basis for discussions about alternate organizational structures for implementation (see section F). For example, public–private partnership (PPP) models can be used on unbundled, commercially viable components of projects. Thus, such analysis should be done in a preliminary form at the start of the consultant engagement.

### **Summary**

- ▶ Rigorously assess revenue assumptions and costing and strongly advocate alternatives where such assessments make viability suspect.
- ▶ Adopt realistic return hurdle rates.
- ▶ Assess impact of project on (local governments) budget and use as basis for developing implementation options.
- ▶ Provide financial analysis for all relevant organization participants and adopt realistic return hurdle rates.

## **2. Economic Assessment**

Economic assessment techniques for urban renewal projects—basically involving property development and infrastructure investments—are well understood by professionals. These normally involve estimates of health improvement, employment (income increase or decrease), property value increase (due to improved accessibility), and externalities among others. Avoidance or generation of congestion and safety benefits are less commonly taken into account. The economist/financial analyst should be aware that these are potentially significant and make all efforts to estimate them, adopting proxy values such as land value increase where necessary as set out in ADB's Guidelines for the Economic Analysis of Projects.<sup>3</sup> Care should be taken to avoid double counting such as health and employment productivity increases. Shadow pricing of costs is standard and follows an established process in each country. Hurdle rates for economic assessment are

<sup>2</sup> ADB Clean Energy Facility can provide resources for assessments of Clean Development Mechanism.

<sup>3</sup> ADB. 1997. *Guidelines for the Economic Analysis of Projects*.



routinely set by ADB and other agencies in each country. ADB standards should be adopted where available.

### **Summary**

- ▶ Estimate all benefits of proposed project across all involved sectors (see other Sector Guidelines)
- ▶ Undertake economic assessment using established processes and hurdle rates in the country concerned using ADB standards where possible.

## **E. Ensuring Environmental Sustainability**

Urban renewal projects may have both environmental benefits and environmental impacts. The objective of the PFS is to maximize the former while minimizing the latter. The project should include measures to minimize GHG and maximize energy savings through (i) higher density development, (ii) energy efficiency of buildings and services such as water supply and wastewater treatment, (iii) distributed (e.g., solar) energy generation, (iv) and fostering nonmotorized transport (e.g., walking) and public transport. Options for these measures should be explicitly examined by the PFS. The revenues and cost implications of these measures, and their governance implications should be included in the financial (section D) and governance analysis (see section F).

Most infrastructure projects would eventually require the preparation of an environmental impact assessment (EIA) as a basis for an environmental or similar permit. At the PFS stage, a rapid environmental assessment (REA) or a rapid environmental impact assessment (REIA) may be required.<sup>4</sup> It is also vital that the requirements and the time frame for a full-blown EIA are identified already during the PFS stage to avoid delays in downstream work as well as unexpected investment costs for environmental protection measures.

In terms of reducing possible adverse environmental impacts, the process is similar to that adopted for social assessment. The proposed investments and facilities should be screened to determine (i) potential environmental impacts in terms of noise and pollution to communities, and (ii) potential impacts on water resources, forest resources, biodiversity, etc. as set out in ADB's environmental checklist.<sup>5</sup> Mitigation measures should be formulated and costed. The implications of these measures should be included in the financial assessment (see section D) and governance arrangements (section F) of the project.

### **Summary**

- ▶ Document and cost proposed environmental benefits measures.
- ▶ Document and cost proposed environmental mitigation measures.

## **F. Ensuring Good Governance**

The institutional arrangements for implementing the project must be clearly described and agreed with the city government.<sup>6</sup> The ability to successfully implement urban renewal investments—achieving social and environmental benefits, mitigating adverse impacts, and achieving financial sustainability—depends on a sound governance structure.

<sup>4</sup> ADB. 2003. *Environmental Assessment Guidelines, REA Checklists for categorization of the project*

<sup>5</sup> ADB. 2003. *Environmental Assessment Guidelines*.

<sup>6</sup> CDIA. 2011. *Guidelines for Urban Governance and Institutional Development*





The PFS must include the following:

- (i) Discussion of organizational options for design, construction/commissioning and operation, including the possibility of PPP options. Where such options are pursued, the organization structure for transparent oversight and/or regulation of private operations needs to be considered. In terms of services integration, the arrangements for coordination across sectors and facility providers need to be described. Finally, arrangements for stakeholder participation (in particular, any affected persons as described in sections C and E) must be proposed.
- (ii) Consideration of how, and with what incentives, will the existing institutions and stakeholders change to the proposed arrangements. For example, will existing landowners be shareholders in a redevelopment company? Will informal vendors be included in revamped retail facilities?
- (iii) Consideration of the legal basis of each involved organization, its sources of revenue and responsibilities for expenditures (the two must match), and the hierarchy of authority across organizations (the legal basis of coordination).

Governance elements for urban renewal projects should reflect funding arrangements. Components of such developments, e.g., public markets, can be "unbundled" and will have their own SPV. Consultants must consider such requirements and design the governance structure accordingly. For example, what authority regulates the SPV, and on what legal basis? The organization design under construction may vary from that under operation. These should be described together with arrangements for the required transition.

### ***Summary***

- ▶ Design of institutional arrangements must be thoroughly documented, encompassing the legal and financial bases of sustainable operation.
- ▶ A clear description of how we get from where we are now to the proposed arrangements is required.

## **G. Institutional Strengthening**

Since most Asian cities have various agencies working on different parts of the urban renewal problem, initial priorities for a PFS team should focus on ensuring all concerned agencies participate in the PFS process. The team should design a structure of participation to engage these agencies throughout the whole PFS period. Such a process will improve institutional capacity by fostering dialogue, setting joint priorities, and coordinating approaches to investment.

## **H. Capacity Development**

It is clear that capacity development is an essential foundation for sustainable urban renewal in any given city. The PFS must identify all stakeholders, define their respective responsibilities, and suggest a capacity development program that will match proposed projects and measures. Coordination between the local government, the private sector and international or national nongovernment organizations (NGO) can give synergies and a better impact. The overarching goal is to create a safe and sustainable system and ensure that investments in the sector are properly handled.



The PFS team should explicitly plan activities for capacity development and training, designed and conducted to address the local situation and needs, during the PFS as well as part of a future capacity development program.

### I. Conclusion

Although a PFS financed by CDIA will not support urban planning studies, it will help a city to concretize its city development vision, examine alternatives to solve its urban renewal problems, and recommend investments for further feasibility study and/or implementation.

The criteria for a successful CDIA PFS, derived from the above, can be summarized as follows:

- *Technical effectiveness*—the extent to which proposed investments solve the stated urban renewal goals of a city;
- *Impact*—the extent to which the investments impact, positively or negatively, the livability of the area, efficiency of land use, the local economy, nearby natural resources, air quality, energy, the urban transport network and access to services, etc.;
- *Cost effectiveness*—the extent to which the costs of the investments are commensurate with their benefits;
- *Financial sustainability*—the extent that funds required to build and operate the preferred options are likely to be available and affordable; and
- *Equity*—the costs and benefits of the alternatives are distributed fairly across different population groups.