

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

## **HONDURAS**

### **MUNICIPAL DEVELOPMENT PROGRAM FOR THE CENTRAL DISTRICT – PHASE II**

**(HO-L1001)**

### **LOAN PROPOSAL**

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## Proposed resolution

Electronic Links and References	
Abbreviations	<a href="http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=418483">http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=418483</a>
Basic Socioeconomic Data	<a href="http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata">http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata</a>
Loans in execution	<a href="http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=418481">http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=418481</a>
Information available in the RE2 technical files	<a href="http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=418486">http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=418486</a>
Executive Summary, Phase I	<a href="http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=387990">http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=387990</a>
Logical Framework	<a href="http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=418484">http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=418484</a>
Procurement table / Means of verification	<a href="http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=418485">http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=418485</a>

## PROJECT SUMMARY

### HONDURAS MUNICIPAL DEVELOPMENT PROGRAM FOR THE CENTRAL DISTRICT – PHASE II (HO-L1001)

Financial Terms and Conditions			
Borrower: Republic of Honduras		Amortization period:	40 years
Executing agency: Secretaría de Estado en el Despacho de Finanzas [Office of the Minister of Finance], and the Office of the Mayor of the Central District Municipio (AMDC)		Disbursement period:	Minimum 3 years; maximum 4 years
Source	Amount %	Interest rate:	1% first 10 years; 2% thereafter
IDB (FSO)	US\$22,500,000	Inspection and supervision fee:	1%
Local	US\$2,500,000	Credit fee:	0.5% on undisbursed balances
Other financing:			
Total	US\$25,000,000	Currency:	United States dollars
Project at a glance			
<p><b>Project objective:</b></p> <p>The Municipal Development Program was designed to attain sustainable improvements of urban services in the Central District and San Pedro Sula, primarily by: (i) restructuring financial management; and (ii) modernizing service delivery arrangements. The aim of the financial restructuring is to improve transparency and efficiency, and to instill more rigorous discipline. The program supports implementation of a strategy to improve the delivery of urban services, especially water supply and sanitation, road transportation, solid waste management, and slum improvements. It will involve greater private enterprise participation in service delivery, as well as institutional reorganization and the strengthening of the municipio's capacity to supervise the delivery of services by the private sector.</p> <p>The objective of Phase II is to continue to modernize the administration and delivery of services by the Municipality of Tegucigalpa, emphasizing sustainability of the reforms. The activities proposed for Phase II will further modernization efforts, building on and consolidating the progress achieved during Phase I. Phase II activities also include strategic planning and institutional and economic development actions in the Central District Metropolitan Area, with the aim of fostering more orderly and coordinated metropolitan development.</p> <p><b>Special contractual conditions:</b> See paragraphs: 3.1, 3.3, 3.6, 3.7, and 1.6, 2.11, 2.16, 2.26.</p> <p>As a condition precedent to the disbursement of the Phase II resources, the borrower must submit evidence to the Bank that: (i) the commercial bank has been commissioned to operate the Municipal Development Trust Fund (MDTF); (ii) the individual consultants making up the Technical Unit and the chief technical advisor have been hired; (iii) an agreement has been signed with the National Housing and Production Fund (FONAPROVI) on terms satisfactory to the Bank; (iv) a contract for the transfer of resources has been entered into among the borrower, the Central Bank of Honduras, and the commercial bank that will operate the MDTF; (v) the program's Operating Regulations have been approved, and the borrower and Office of the Mayor of the Central District Municipio (AMDC) have put them into effect; and (vi) an agreement has been entered into between the borrower and the AMDC specifying the terms and conditions by which the loan proceeds will be transferred to the AMDC.</p> <p>The loan contract will specify that the AMDC has delivered to the Bank: (i) a collection plan for the developing neighborhoods sector; (ii) the charter of the Municipal Infrastructure and Road Transportation Fund (FMITV) and the terms under which it is to operate; (iii) a list of corrective measures to address the auditors' observations on accounting and financial management; and (iv) an agreement among the AMDC, the National Autonomous Water Supply and Sewerage Service (SANAA), and the Ministry of Finance (SEFIN) for transfer of the Central District water supply and sanitation systems. In addition, subloans awarded to the AMDC will be subject to fulfillment, by the AMDC, of the conditions set out in the eligibility matrix that will form part of the Operating Regulations (see paragraphs 3.5 and 3.6).</p>			

**Exceptions to Bank policies:** None.

Project consistent with country strategy: Yes ☒ No ☐  
Project qualifies as: SEQ ☒ PTI ☐ Sector ☐ Geographic ☐ % of Beneficiaries ☐

Verified by CESI on: 22 October 2004 (see paragraphs 4.8 and 4.10.)

Procurement: See paragraph 3.9.

## **I. FRAME OF REFERENCE**

### **A. Background**

- 1.1 On 18 November 1998 the Bank's Board of Executive Directors approved the Central District and San Pedro Sula Municipal Development Program in Honduras (1024-SF/HO). The objective of Phase I of the program is to attain sustainable improvements in the urban services of San Pedro Sula and the Central District, specifically drinking water, solid waste management, urban roads, and slum improvements. The program also seeks to improve municipal management and financial sustainability. The borrower is the Republic of Honduras, which transfers the resources to the two executing municipalities in Phase I. The resources are reimbursable through the Municipal Development Trust Fund (MDTF).
- 1.2 Although the program was designed and reviewed by the Bank as a single operation with two phases, Phase I actually comprised two independent programs, one for each municipality. The Bank financed Phase I with a US\$63 million loan, of which US\$36 million were earmarked for the Alcaldía Municipal del Distrito Central [Office of Mayor of the Central District Municipio] (AMDC or Tegucigalpa). The cost of Phase II in Tegucigalpa is US\$25 million, of which US\$22.5 million comes from the Bank loan. Phase II was approved for San Pedro Sula in June 2002; the cost is US\$11 million, of which US\$9 million comes from the Bank's loan.
- 1.3 The purposes of this report are to: (i) demonstrate that the condition for submitting Phase II for Tegucigalpa has been met; (ii) assess the outcomes achieved to date in Tegucigalpa under Phase I; and (iii) deliver to the Board of Executive Directors, for its consideration, the project for Phase II of the Municipal Development Program for the Central District.

### **B. Fulfillment of the condition for Phase II**

- 1.4 The condition to be fulfilled before submitting a loan for Phase II in the Central District to the Board of Executive Directors was the transfer of ownership of water supply and sanitation services from the central government to the AMDC, through the signing of an agreement acceptable to the Bank, which was to provide for the effective transfer of assets and contain a commitment from the AMDC to contract an experienced operator to manage the system. Until ownership of water supply and sanitation systems was clearly defined, it was not considered prudent for the AMDC to conduct activities in the sector; for that reason, it was not included in Phase I.
- 1.5 During Phase I, a committee was established to study the implications of awarding a concession for the system. The Bank supported the committee by providing nonreimbursable funds to conduct several studies: (i) a financial analysis on rates and needed investments; (ii) a database of technical, commercial, and financial information on the systems to be transferred; and (iii) an evaluation of the strategic

measures that needed to be taken prior to the concession process. The preliminary conclusion was that a concession could be viable but would require substantial cofinancing by the public sector.

- 1.6 At the same time, the Central Government was promoting a new framework law for the water supply and sanitation sector. The law, passed by Congress in October 2003, stipulates that responsibility for water supply and sanitation services lies with the municipios and that the National Autonomous Water and Sewerage Service (SANAA) should transfer the systems to the municipios within a period not to exceed five years (2003-2008). The law's implementing regulations established a series of steps for the transfer. The National Autonomous Water Supply and Sewerage Service (SANAA) and the AMDC have entered into a transfer agreement that includes a workplan to prepare for and effect transfer of the systems. The loan contract will specify that such an agreement has been signed. Additionally, the Central District Municipio Corporation has issued a resolution establishing the Municipal Water Supply and Sanitation Maintenance Unit (UGASAM) to manage the services through outside contracts.
- 1.7 Therefore, the project team concludes that the condition set by the Bank's Board of Executive Directors has been met by the approval of the framework law for water supply and sanitation services, signature of the transfer agreement between SANAA and the AMDC, and the resolution establishing UGASAM.
- 1.8 Phase I was prepared before the Bank had made the procedures for preparing multiphase operations official, and did not include triggers to measure accomplishments and progress in the sectors targeted by the financing. This was because at the time the operation was approved a Phase II was planned that was to finance technical assistance and investments exclusively in the water supply and sanitation sector. Even so, given the fact that no investments should be made in the water supply and sanitation sector until an institutional and contractual model for service delivery has been established, the scope of Phase II has been changed to finance technical assistance activities and investments in all the phase I sectors, in addition to technical assistance activities in the water supply and sanitation sector. This report therefore includes an evaluation of what has been achieved and tasks still outstanding, which explains the inclusion of activities in such sectors.

#### **C. The Municipal Development Program for the Central District – Phase I**

- 1.9 Phase I was designed to attain sustainable improvements in the urban services of Tegucigalpa, primarily by: (i) restructuring the financial management of the AMDC, and (ii) modernizing service delivery arrangements. The aim of the financial restructuring is to improve transparency and efficiency, and to instill more rigorous discipline. Along with the financial reform, Phase I supports implementation of a strategy to improve the delivery of urban services, especially roads and road transportation and solid waste disposal, and slum improvements.

This involves greater private sector participation in service delivery, as well as institutional reorganization, and the strengthening the AMDC's capacity to supervise delivery of these services.

- 1.10 In support of the aforementioned objectives, Phase I finances the following: (i) technical assistance to improve the financial management of the AMDC and its capacity to manage or supervise services; (ii) execution of action plans to restructure municipal services, using service, rental, or concession contracts, whenever possible, to transfer operating and investment responsibilities, to the degree possible, to private enterprises; and (iii) if services are not transferred to the private sector, municipal investments consistent with modernization plans.
- 1.11 The resources of Phase I have been transferred to the municipalities in the form of credits or subloans that are to be repaid in accordance with the economic life of the investments. AMDC's access to the resources of Phase I is controlled by means of an eligibility matrix that establishes conditions for: (i) the overall performance of AMDC; (ii) the performance of each sector eligible for financing; and (iii) the specific projects. The MDTF Technical Unit (TU), run by a private bank (see paragraph 1.57 for a detailed explanation of the MDTF), reviews the funding requests for specific projects. After analyzing the technical feasibility of a project and confirming that the indicators have been met, the specific project is submitted to the Bank for consideration. In this way, the TU—a team of professionals with expertise in finance and engineering—helps underwrite municipal projects.
- 1.12 The interest rate for the subloans to the AMDC is variable and adjusted every six months to 85% of the weighted average of the deposit rates in the local banking system. Maturity is established according to the economic life of project assets. In particular, the maturity of the subloan may never exceed the IDB loan period so as not to create a negative imbalance between the amortization of the subloan and the debt service to the IDB. Borrowing rates are currently low in Honduras; in 2004, the average rate being applied to subloans is 7.22%, in 1998 the average rate was 12.25%.
- 1.13 A periodic rating system drawing on the same eligibility matrix is used to monitor the global performance of the AMDC. This system rates each condition according to the commitments acquired and to the following parameters resulting from the review to be conducted semiannually during the program's administrative missions.



**Table I-1**  
**Level of Compliance with Program Indicators**

<b>Level of Compliance (Rating)</b>	<b>Description</b>
A	Fully met.
B	Fulfillment in process of being reached; shows significant progress.
C	Some noncompliance; delay in fulfillment, but no structural obstacles.
D	Serious noncompliance; significant problems exist.
P	Pending fulfillment; fulfillment has been deferred or depends on the fulfillment of a precedent condition.
NA	Not applicable; fulfillment no longer relevant.

- 1.14 For purposes of the periodic Bank review, a rating of between A and B means that the AMDC “acceptably fulfills” the conditions set out in the eligibility matrix. Should fulfillment fall below those levels, corrective actions are agreed upon.
- 1.15 The financial resources approved for Phase I were distributed among five sectors; larger amounts were allocated to the urban transportation and developing neighborhoods sectors. A summary of current allocations and the state of execution to date follow in Table I-2.

**Table I-2**  
**Allocation of IDB Funds by Component – Phase I**  
**(in thousands of US\$)**

<b>CATEGORY</b>	<b>Current allocation</b>	<b>Executed to Sept.-04</b>	<b>To be executed Phase I</b>
Subloans	33,909	19,196	14,713
Solid waste	1,559	1,195	0.364
Urban transportation	12,844	8,970	3,874
Developing neighborhoods	16,000	7,014	8,986
Environment	2,036	1,423	0.613
Institution-strengthening	1,470	0.593	0.877
<b>Administrative costs</b>	<b>0.851</b>	<b>0.823</b>	<b>0.028</b>
<b>Financial costs</b>	<b>1,240</b>	<b>0.749</b>	<b>0.491</b>
Interest	0.880	0.389	0.491
Credit fee	0.000	0.000	0.000
Inspection fee	0.360	0.360	0.000
<b>TOTAL</b>	<b>36,000</b>	<b>20,768</b>	<b>15,232</b>

- 1.16 By September 2004, Phase I had disbursed US\$20.8 million, or 58% of the total of Phase I resources. All Phase I resources have been programmed and the awarding and contracting processes are well under way, which suggests that the AMDC may have disbursed all the Phase I resources by the first half of 2006. This means that

the AMDC needs additional financing to continue implementing the investment plan for the program sectors.

1.17 In accordance with the last performance review of Phase I (January 2004), the Bank updated the AMDC's performance rating. Its performance has been satisfactory, in the administrative areas of finance and transparency, and in the various service sectors. The solid waste sector received a lower rating, due to delays in the process to contract a private manager and to resolve the collection issue in the shantytowns. The land regularization and land-markets area also received a lower rating, which reflects the AMDC's difficulty from the outset to establish an institutional structure to coordinate this sector. The roads and transportation sector also received a lower rating, due to the complexity of the process to establish the Municipal Infrastructure and Road Transportation Fund (FMITV). Technical assistance is being provided to address these situations.

1.18 A summary of the AMDC's performance is presented in Table I-3:

**Table I-3**  
**Rating by Municipal Area<sup>a</sup> of Tegucigalpa – Semiannual Review**

<b>Sector</b>	<b>January 2004 Level</b>	<b>July 2003 Level</b>
<b>Finance</b>	<b>B</b>	<b>A</b>
<b>Transparency</b>	<b>A</b>	<b>A</b>
<b>Environment</b>	<b>A</b>	<b>A</b>
<b>Roads and transportation</b>	<b>B+</b>	<b>B+</b>
<b>Solid waste</b>	<b>B-</b>	<b>B+</b>
<b>Developing neighborhoods</b>	<b>A-</b>	<b>A-</b>
<b>Land regularization/ land market</b>	<b>B+</b>	<b>B-</b>

<sup>a</sup>The areas rated do not exactly match program components.

## **1. Evaluation of Phase I sector activities**

1.19 This section summarizes, by sector, the original objectives of Phase I and assesses the outcomes to date. A midterm assessment of the program was conducted this year by an international firm. Given the complexity of the program, the assessment was designed to cover the performance of the two municipalities and to review the program's overall structure and its administration by the MDTF, the Ministry of Finance (SEFIN), and the Bank. The firm is presently concluding the assessment by updating the project's monitoring and evaluation instruments, including the respective eligibility matrix for each municipio. The recommendations of the evaluation were taken into account in preparing Phase II.

**a. Component 1. Solid waste**

**(i) Modernization strategy**

- 1.20 In 1998, 420 tons of domestic waste and 60 tons of industrial waste were generated every day in the AMDC Metropolitan Area. One hundred tons of garbage went uncollected each day, mostly in remote areas, especially shantytowns. All the services in this sector were provided directly by the municipality. The sector's original objectives were to bring about comprehensive improvements in solid waste disposal services, seeking sustainability by involving the private sector in garbage collection and in the management of the municipal dump.
- 1.21 More specifically, the goals were to award a concession for the collection services concession; provide service coverage to 40% of the population in shantytowns (both by the end of year two); rehabilitation of the dump so that it can operate as sanitary land fill; award a concession for managing the landfill; and achieve 90% coverage (by the end of year three).

**(ii) Targets met and targets pending**

- 1.22 During Phase I, US\$1.6 million were allocated to this sector. By late August, US\$1.2 million (77% of the allotment for the sector) had been disbursed.
- 1.23 Given the public health crisis existing at the outset of the program as a result of the poor management of solid waste in the AMDC, all program funds were conditioned to progress being made in this sector.
- 1.24 With program support, the AMDC prepared a strategic sector plan that has been guiding the reforms; it is now preparing the financial plan. Although it has been difficult to meet the plan's original schedule, the AMDC has made significant progress in managing the sector.
- 1.25 In the shantytowns, the neighborhood associations have been involved in the collection of solid waste, which is deposited in certain sites for collection by AMDC trucks. This has helped improve services and increase collection coverage to up to 93% of the settlements. The neighborhood collection model will continue to be applied and will therefore be included in the contract with the new operator. In addition, the AMDC set up an Oversight Unit responsible for monitoring the private collection contracts; improved street cleaning in the city by contracting microenterprises; constructed small environmental works in the municipal dump (drains, chimneys, fences); and completed the environmental audit and other studies required for closing it in the future. The administration has also identified and issued the expropriation agreement for the site of the new sanitary landfill, and an assessment has been commissioned to determine the price the AMDC should pay for the land, with own resources already identified. The AMDC also received approval of the environmental audit to close the current dump and the

environmental license for the new sanitary landfill. Finally, it has prepared a social plan for the trash pickers who earn their living in the dump. Some Phase I funds were used for street cleaning after Hurricane Mitch.

- 1.26 By the end of Phase I, it is expected that: (i) 100% of the collection and transportation services in currently served areas<sup>1</sup> will have been transferred to the private sector; (ii) the site for the new sanitary landfill will have been acquired, the design of the facility finalized, and a concession awarded for its operation; (iii) the present dump and the adjacent site will have been closed in accordance with the environmental audit; and (iv) the social plan and the pilot recycling project with the trash pickers will have been implemented.

## **b. Component 2. Roads and road transportation**

### **(i) Modernization strategy**

- 1.27 In this sector, the principal objective of Phase I was to improve the efficiency, continuity, connectivity, and condition of the municipal road network, and at the same time to establish a financial and technical mechanism to ensure long-term maintenance of the municipal road network. An independent fund (the FMITV and its Transportation Technical Unit) was designed to ensure proper management of the sector, channel sector revenues to the maintenance of the existing road network, and finance key investments for resurfacing and road network connectivity.
- 1.28 The targets of Phase I are associated with creating the FMITV, conducting the road inventory, and implementing a series of physical works.

### **(ii) Targets met and targets still pending**

- 1.29 During Phase I, US\$12.9 million were allocated to this sector. Of this amount US\$9 million (70% of the allocation to the sector) had been disbursed by late August.
- 1.30 To date, the AMDC has completed approximately 80% of the activities of Phase I. The road network inventory of the Central District was completed and will be used by the FMITV to achieve its objectives and to consolidate the actions to be taken in the sector. According to the inventory, the AMDC road network does not have a sustainable source of funds for maintenance. Of the total 1,091 km of roadways (541 km paved, 550 km unpaved), 54% of the paved and 74% of the unpaved roads are in fair or poor condition.
- 1.31 The AMDC has the organizational chart of the FMITV, the job descriptions, proposed funding sources, and the institutional transition plan for implementation.

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<sup>1</sup> The contract to transfer 100% of the AMDC's coverage to private collection services was awarded in October 2004 by the Central District Municipio Corporation.

A series of physical works has been completed to improve the coverage and efficiency of the Central District's road system, including the paving of approximately 100 km of public bus routes. Still pending is the step to ensure maintenance of the municipal road network (that is, full implementation of the FMITV). The Central District Municipio Corporation is in the process of implementing the structure and the financing arrangement.

### **c. Component 3. Developing neighborhoods**

#### **(i) Modernization strategy**

- 1.32 As a result of the heavy flow of rural-urban migration, the widespread damages and poverty in the country, and the consequences of Hurricane Mitch, more than half the population of Tegucigalpa (some 75,000 families) lives illegally in shantytowns. Because of the uncertainty of property ownership, improvised dwellings have persisted over the years and there has been a reluctance to invest in infrastructure and social services in these areas. The AMDC lacked methodologies for prioritizing and selecting social investments that promote the sustainability of investments through community participation, encourage savings and foster community organization.
- 1.33 The proposed strategy is to address actions to regulate property and title lands, improve infrastructure and urban services, enhance the land market, and plan for future urban growth, encouraging regularization of family assets, and emphasizing benefits for women heads of household.

#### **(ii) Targets met and targets pending**

- 1.34 During Phase I, US\$16 million were allocated to this sector. Of this amount, US\$7 million (44% of the allocation to the sector) had been disbursed by end August.
- 1.35 The original targets of this component included: (i) adoption of an implementing mechanism for the selection, preparation, financing, contracting, and payment of the community works to be carried out, as well as formal establishment of the repayment mechanisms; (ii) design and adoption of methodologies for outsourcing the land regularization programs, taking into account considerations for protecting women's rights in titling arrangements as well as dedicated mechanisms for registering properties by neighborhood; (iii) training and institution-strengthening, especially for social outreach workers; and (iv) establishment of viable financial arrangements for the purchase/sale of properties, channeling the gains from these arrangements to an improvement fund for each beneficiary neighborhood in the program.
- 1.36 Although this component suffered delays in consolidating the necessary methodological and instrumental framework, during Phase I the AMDC was able to

systematize and implement, with remarkable success, a methodology for selecting and prioritizing projects in low-income communities, which includes an innovative system to collect premiums that rewards savings and community organization as a project eligibility requirement. The methodology also includes an arrangement that combines municipal subsidies and betterment levies for repaying the subloans to the MDTF. In addition to community organization during the project design stage, this requires a concentrated collection effort in communities that, as a whole, have not been subject to taxation. To this end, the AMDC is creating a collection trust system with a private bank that will launch operations this year.

- 1.37 The AMDC has taken action to provide technical assistance and investments for: (i) strengthening the operating capacity of the Social and Community Development Office to prepare the post-Mitch emergency program; (ii) conducting studies for prioritizing and designing pavement works for bus routes in shantytowns, to add 26 km to the primary road network; (iii) designing, systematizing, and validating the social engineering methodology, including production of all the manuals and the training program; (iv) implementing projects to pave bus routes in shantytowns, for a total of 13.9 kilometers and benefiting a total of 24,577 families; (v) implementing sewerage projects in 23 neighborhoods; (vi) designing and implementing a pilot land regularization project in the informal settlements for duly legalizing and registering lots; and (vii) designing, systematizing, and adopting a single land regularization and land-titling methodology in the municipio.
- 1.38 By the end of Phase I, the AMDC will also have concluded: (i) the paving of bus routes in 48 neighborhoods, directly benefiting 10,847 low-income families; and (ii) a program to title 10,374 lots, directly benefiting 62,244 beneficiaries in five shantytowns. It is worth noting that the land regularization program includes city planning actions in the settlements (subdivisions, identifying social services, road network, right of way, parks, etc.) as well as inclusion of the legalized lots in the municipal cadastral base.
- 1.39 In addition, in executing this component, the AMDC has taken action to reposition, restructure, and strengthen the organization of the functions of land titling and land regularization, and of betterment levies, responsibility for which has been assigned to the Municipal Finance and Administration Division.

#### **d. Component 4. Environment**

##### **(i) Modernization strategy**

- 1.40 In this sector, the strategy of Phase I was to support two complementary environmental objectives: (i) to correct institutional weakness in environmental control; and (ii) to design and implement a mechanism for identifying and mitigating the program's environmental and social impact. The specific institutional objective was to strengthen the Municipal Environmental Management Unit

(UGAM), equipping it to assume responsibility for environmental planning and regulation and transferring operating responsibilities (such as cemetery maintenance) to the Urban Services Division.

- 1.41 Sector indicators were designed to encourage the definition of environmental indicators, establish the benchmark, implement the measurement system, and strengthen the UGAM. In addition, the UGAM is required to disseminate the information compiled on a regular basis, as part of the efforts to foster transparent municipal management.

**(ii) Targets met and targets still pending**

- 1.42 During Phase I, US\$2 million were allocated to this sector. Of this amount, US\$1.4 million (70% of the sector's allocation) had been disbursed by the end of August.
- 1.43 Financing for this component sought to create two specific capacities: (i) environmental planning, and (ii) environmental project review. To this end, financing was provided for an environmental information system and for creating the capacity for municipal environmental planning. In addition, delegation of responsibility for reviewing project environmental impact was negotiated and consolidated with the Ministry of Natural Resources and Environment (SERNA).
- 1.44 The results are remarkable, placing the AMDC at the forefront of the municipalities of the region with regard to environmental management. Results can be examined on the AMDC's web page ([www.alcaldiadetegucigalpa.com](http://www.alcaldiadetegucigalpa.com)), which contains information and data on its municipal environmental management efforts. The AMDC laid the foundations for good environmental management by conducting a municipal environmental assessment and strengthening the UGAM, which included purchasing measurement equipment and placing the unit under general management within the municipal structure. Noteworthy achievements to date include the establishment of a benchmark of environmental variables for air and water, and the launching of efforts to measure sound pollution. In 2004, fixed air quality meters were installed in the municipio and work is under way to establish a vehicle emissions control program.
- 1.45 The UGAM is implementing the ISO 14001 Environmental Management System (pending final certification), which includes procedures for environmental authorization, certification and complaint; environmental audits; and issuance of logging permits. Moreover, with support under an agreement with the SERNA, procedures have been established for reviewing the environmental impact of municipal projects, including projects financed by the program. To strengthen the environmental legal framework, the AMDC has approved ordinances to control sound pollution, control mosquito breeding sites so as to prevent dengue, and clear empty lots. It has modified the municipal tax plan to include economic instruments

that support environmental sustainability, such as the environmental tax and a tax for environmental services.

- 1.46 This component has been so successful in Phase I that its resources will be increased from the US\$250,000 originally programmed to nearly US\$2 million by the end of the phase. The additional allocation will enable the AMDC to achieve ISO 14001 certification by the end of the Phase I, and to plan the comprehensive natural resources management project and the environmental education program. Finally, by then the environmental management program for the municipal meat processing plant will be under way and the AMDC will have designed and be implementing an environmental guide for construction works and a guide for forest protection and reforestation in the Central District.

#### **e. Component 5. Institution-strengthening**

##### **(i) Modernization strategy**

- 1.47 For this component, the two main focuses of the institution-building strategy in Phase I are to modernize municipal management (organization and operations) and strengthen the finances of the AMDC. Activities supporting these goals were financed both by this component (the focus of which is municipal administration in general and financial management in particular), and by the various sectors (for the reforms directly related to the management of the particular services). Following are some of the specific activities completed to date: reorganization of the municipality, including redefinition of functions and responsibilities; a human resources plan; and the first stage of efforts to design and implement a municipal integrated financial management system (MIFMS). With a view to improving transparency in the AMDC, this component promoted the following actions: private external audit of the AMDC, new practices for disseminating program information, and creation of a web site to facilitate access to program information.
- 1.48 For this area, the eligibility matrix of Phase I includes targets for financial performance (including control of expenses and debt); the disclosure of financial information (specifically financial statements and information on procurements and contracts financed by the program); and the reengineering of financial management.

##### **(ii) Targets met and targets still pending**

- 1.49 During Phase I, US\$1.5 million were allocated to this sector. Of this amount, US\$600,000 (40% of the allocation to the sector) had been disbursed by the end of August.
- 1.50 The sector discussions describe the progress made in strengthening sector management. With regard to modernization of municipal and financial administration, during the past two years the AMDC has fulfilled, to satisfaction, its targets in the areas of finance, administration, and transparency.



- 1.51 Financial management has been strengthened by organizing and systematizing processes, and financial information has been improved, given the constraints of the present administrative system. The units responsible for collecting the betterment levies and for land regularization (in fact, the sale of community lands or “ejidos”) have been relocated to improve financial management efficiency. External audits of the AMDC were conducted for 2002 and 2003, the findings of which have been addressed or can be resolved. The program audit contained no major reservations.
- 1.52 As part of efforts to implement the MIFMS, the AMDC reviewed, systematized, and documented all the administrative processes of the Municipal Finance and Administration Division. This reengineering was validated by the firm commissioned to implement the MIFMS and, when implementation concludes in 2005, it will have been automated and integrated.
- 1.53 The absence of suitable financial management and budgetary controls systems has affected the AMDC’s capacity to meet several of its financial strengthening objectives for Phase I. There has been a substantial increase in municipal tax revenues over the last two years (from 391 million lempiras in 2001 to 612 million lempiras in 2003). Nonetheless, the midterm evaluation identifies important shortcomings in the AMDC’s financial management and points out that the increases are due mainly to rate increases for road infrastructure and the garbage train), and very little to increased efficiency through reductions in tax evasion and arrearages. Moreover, this increase has not enabled the municipality to accumulate a current balance because of similar increases in operating expenses.
- 1.54 The evaluation points out significant delays in implementing the system for recovering Phase I investments and underscores the need for the AMDC to be more proactive in developing direct repayment mechanisms for the investments, given the small size of the current surplus with which the AMDC is to repay nonrecoverable investments. The evaluation also points out shortcomings in the national accounting and legal frameworks for municipal finances, which allow for flexible interpretations of the few existing municipal financial rules, do not require presentation of contingent obligations, and do not require controls on municipal debt.
- 1.55 As the AMDC is responsible for repaying the loan to the MDTF, the program emphasizes financial recovery of the investments, to the degree that works are categorized by the recovery instrument to be used for each subloan. The Credit Regulations set out the rules that govern the submission of funding requests and requires assurance that specific financing strategies exist for each. These rules have not been duly observed. Nor did the program assign clear responsibility for monitoring implementation of the strategies. As a result, the midterm evaluation identified the need to strengthen the conditions for accessing sector resources, improve monitoring of strategies, and consolidate the AMDC’s capacity for

collection so that it can maintain financial equilibrium during the loan payback period.

- 1.56 Human resources management in the municipio continues to be a challenge for the AMDC and will continue to receive support in Phase II. The AMDC has documented all the jobs on the modified organization chart and is in the process of adjusting the organizational units and the staff roster to bring them into line with the new institutional arrangement. The absence of municipal civil service legislation in the country and a somewhat rigid labor structure has led the AMDC to create technical and professional capabilities outside the municipal structure, to the point of converting the unit that supports program execution into an executing entity. Phase II will focus on reintroducing and stabilizing these capabilities within the permanent municipal structure.

## **2. Operation and performance of the Municipal Development Trust Fund (MDTF)**

- 1.57 The MDTF is in full operation. Its functions include: (i) reviewing municipal projects and requests for subloans in accordance with the procedures established in the Credit Regulations; (ii) reviewing requests for disbursement; (iii) supervising the reserve accounts system for repayment of the loans; (iv) administering loans and repayment; and (v) collecting the debt service from the two municipalities and repaying the Ministry of Finance (SEFIN). In addition, the MDTF is implementing its treasury strategy to invest the financial surpluses that are building up through the recovery of subloans and their returns, and rules are being drawn up for reinvesting this surplus in new municipal projects.
- 1.58 Given the lack of experience with the trust model proposed for the program, extensive collaboration has been needed among participating institutions to implement all the functions of the MDTF. It has been necessary to refine and, in some cases, modify the original concept, particularly with respect to the coordination of functions within the MDTF. For example, the technical services provided by the MDTF's Technical Unit were originally outsourced to a private consulting firm in accordance with the program design, but now the Technical Unit is made up of individual professionals contracted by the trust bank.

## **3. Portfolio management and creation of the municipal fund**

- 1.59 The lending and repayment arrangement offered to the municipalities by the program is such that SEFIN must ensure recovery of the initial portfolio of subloans for up to 20 years. Additionally, terms that differ from the FSO terms of the Bank loan with the borrower mean that the MDTF, while making half-yearly payments to the Bank, is accumulating a surplus of funds to be used to finance new municipal projects.

- 1.60 The following table summarizes the cash flow of the MDTF and shows that the SEFIN is receiving the resources needed to make the payments on the Bank loan and also has a surplus of US\$5.2 million to reinvest in municipal projects.

**Table I-4**  
**Summary of MDTF Cash Flow**  
**(in thousands of US\$)**

	<b>AMDC</b>	<b>MSPS</b>	<b>Total</b>
Total repayments to MDTF	2,571,707	3,731,559	<b>6,303,266</b>
( - ) Transfers to SEFIN	658,036	711,733	<b>1,369,769</b>
<b>Subtotal</b>	<b>1,913,671</b>	<b>3,019,826</b>	<b>4,933,497</b>
(+) Returns on investments	109,258	184,899	<b>294,157</b>
<b>Amount available</b>	<b>2,022,929</b>	<b>3,204,725</b>	<b>5,227,654</b>

- 1.61 The loan agreement for Phase I required that in year three of execution, the SEFIN commission a consulting assignment to design a strategy for managing the MDTF portfolio after year five.<sup>2</sup> Additionally, the best institutional option needs to be identified for investing and administering the surplus funds being accumulated in the MDTF. The contract recommended analyzing the following options, among others: (i) sale of part of or the entire MDTF portfolio; (ii) transfer of responsibility for portfolio management from the Trust to a chartered bank; and (iii) that responsibility for management be assumed by the SEFIN. In 2004 SEFIN commissioned a study to analyze and model the current portfolio and its reflows, and recommend guidelines for the MDTF's future structure. One study conclusion was that macroeconomic conditions are undermining the MDTF's long-term sustainability. Still pending is an agreement between SEFIN and the Bank on possible adjustments to the terms of the subloans, to ensure that the MDTF is sustainable. As far as identifying an institutional option for managing reflow investment into new loans to municipios, SEFIN has proposed naming the fund where the reflows accumulate the Municipal Development Fund (FOMUNDE), and designating the National Housing and Production Fund (FONAPROVI) as the institution responsible for managing the reflows (see paragraph 3.2). In keeping with the program contracts, SEFIN will make this proposal formally and reach agreement with the Bank.

#### **D. Coordination with other development finance organizations**

- 1.62 The Bank has worked in coordination with other financial organizations supporting the AMDC during the execution of Phase I and the preparation of Phase II, directly and through the country's Decentralization Committee with international cooperation. This has included working with the Swedish International

<sup>2</sup> Disbursements for the two phases are expected to conclude in year six.

Development Authority (SIDA) to define the solid waste strategy and to harmonize land regularization activities, and with the World Bank, in the area of risk management.

## E. Lessons learned from Phase I

- 1.63 The project team's extensive involvement in the administration of this operation, the ongoing monitoring and evaluation system, and the formal evaluation of Phase I have made it possible to compile an exhaustive list of lessons learned from this program. The midterm evaluation has provided new perspectives as well as very useful and extensive recommendations for participating institutions. Lessons learned have been drawn from each aspect of the operation and can be categorized as follows: administration of the operation, municipal considerations, and national context. The table below briefly summarizes some of the important lessons learned from Phase I and considerations that are being taken into account in Phase II.

Lesson Learned	Response
<p>1. <b>Recognize and compensate for the impact of the "Mitch factor."</b> Hurricane Mitch hit immediately before the program was approved, and the Bank responded by adjusting the lending terms in order to make it possible to finance urgent needs caused by the hurricane in the two municipalities. However, the financing and repayment scheme, and the targets of the eligibility matrix, were not suitably modified (even though many of the post-Mitch expenditures were unrecoverable).</p>	<ul style="list-style-type: none"> <li>When programs are approved for given purposes and later used to finance post-disaster needs, it is important to reevaluate expected program results and ensure that the logical framework and other execution and monitoring instruments are duly modified.</li> <li>Taking into account the recommendations of the midterm evaluation, in early 2005, the Bank and the SEFIN will begin to jointly reevaluate post-Mitch expenses financed by the program.</li> </ul>
<p>2. <b>Improve the effectiveness of institutional reform activities within the program.</b> In a project that combines both physical works and institutional reforms, there is a temptation to focus on the works while neglecting the reforms, or allowing them to be carried out in tandem.</p>	<ul style="list-style-type: none"> <li>Detailed planning of the reforms during preparation and careful monitoring thereafter.</li> <li>A municipal executive officer has been appointed to coordinate institutional reforms in Phase II.</li> <li>Condition disbursements on progress made in institutional reforms.</li> <li>Make sure that the reforms reflect and support the municipio's strategic objectives and that commitments to implement them are renewed after elections.</li> <li>Consolidate the reforms with manuals, systems, and other operating instruments.</li> </ul>
<p>3. <b>Require and implement reforms in accordance with well-formulated sector strategies.</b> There is a tendency in municipalities to work in ad hoc fashion, particularly at the beginning of new administrations, without devoting time to strategic and operational planning, the</p>	<ul style="list-style-type: none"> <li>Require executors to devise sector strategies and goals before investing in reforms or works, update them periodically, and monitor them.</li> <li>Ensure that strategies are both operational and financial so as to ensure that resources are available for implementing them.</li> </ul>

Lesson Learned	Response
establishment of standardized processes, and the measurement of results.	<ul style="list-style-type: none"> <li>▪ Earmark technical-assistance funds in Phase II for formulating financial plans related to sector strategies.</li> </ul>
<p>4. <b>First of all, establish collection capabilities.</b> Creating a culture of payment for services to ensure recovery of investments is a complex process that requires political determination and a disciplined administrative effort by the municipality. The program should require that the municipalities put more of the resources into recoverable investments and hold back investments until collection mechanisms become effective.</p>	<p>Phase II is:</p> <ul style="list-style-type: none"> <li>▪ strengthening the TU's capacity to conduct financial feasibility analyses at the subloan level;</li> <li>▪ financing technical assistance in the area of cost recovery;</li> <li>▪ establishing a financial management system that presents financial data in accordance with cost centers; and</li> <li>▪ earmarking resources for mass communicating information on payment of services, particularly for the water sector.</li> </ul>
<p>5. <b>Effectively deal with the complexity of the process to outsource municipal services.</b> The convergence of factors including negative pressure by economic interests, fear of the economic impact on society, and lack of experience and understanding of the models have made municipal outsourcing more difficult to carry out and maintain in good working order.</p>	<ul style="list-style-type: none"> <li>▪ Finance mass communication activities as part of the outsourcing process and promote transparent decision making.</li> <li>▪ Require entities in charge of the concessions to have a communication plan.</li> <li>▪ Provide training to municipal staff to familiarize them with the models and their pros and cons.</li> <li>▪ Conduct full and high-quality comparative financial analyses and disseminate the results in understandable terms; maintain and disseminate reliable data on outcomes and impact.</li> <li>▪ Establish an effective and independent regulatory body to support and provide advice during the process.</li> </ul>
<p>6. <b>Consider creating new entities or eliminating ineffective ones instead of restructuring them.</b> The new entities established under the program have proven to be more effective, efficient and innovative than existing entities that have undergone reform (i.e., the UGAM for environmental management).</p>	<ul style="list-style-type: none"> <li>▪ Teach and/or apply new Bank measures for objectively assessing institutional effectiveness: Institutional Capacity Assessment System (ICAS).</li> <li>▪ Analyze innovative options for conducting effective institutional reforms, including the restructuring or complete elimination of agencies.</li> </ul>

## **II. PHASE II OF THE MUNICIPAL DEVELOPMENT PROGRAM FOR THE CENTRAL DISTRICT**

### **A. Objective**

- 2.1 The objective of program Phase II is to continue the modernization of management and delivery of municipal public services by the Office of the Mayor of the Central District Municipio (AMDC) with an emphasis on sustainability of reforms. The program also seeks to foster more orderly and coordinated metropolitan development through strategic planning, as well as institutional and economic development in the Central District Metropolitan Area (ZMDC). The new phase includes investments and activities for administrative modernization and reforms in the sectors financed under Phase I; it will also include the water supply and sanitation sector.

### **B. Description**

- 2.2 A description of the components of Phase II and its principal actions follows:

#### **1. Component 1. Water supply and sanitation (US\$2.5 million)**

- 2.3 This component seeks to design and institute an institutional and contractual model for the management and delivery of water and sanitation services with private-sector participation. The resources allocated to this component will fund the following technical assistance activities: (i) a study of the assets and liabilities of the Central District Municipio's water supply and sanitation system; (ii) an immediate action plan and a master plan for the metropolitan water supply and sanitation system; (iii) the strengthening of the capabilities of the new Municipal Water Supply and Sanitation Management Unit (UGASAM) as an oversight agency for the consulting services that will be commissioned to structure private sector involvement in service management; and (iv) the structuring of the definitive operating model.
- 2.4 The original design of Phase I considered that Phase II would finance investments only in the water sector. However, for the reasons stated earlier, the proposed Phase II includes the water supply and sanitation sector as one component of a program of several municipal public services. Activities in this sector will seek to facilitate an orderly transfer of services from the National Autonomous Water and Sewerage Service (SANAA) to the AMDC, as provided for under the new sector regulations. Phase II will finance activities to establish a management system that provides efficient, quality services and encourage urgently needed investments in the system.
- 2.5 By the end of Phase II, it is expected that: (i) UGASAM will have contracted with the private sector to manage the services, and developed sufficient capacity to

supervise these contracts; (ii) the assets of the SANAA systems to be transferred to the municipality have been inventoried; and (iii) a contract has been awarded to update the water supply and sanitation services master plan for the Central District. All the proposed studies will be done in accordance with applicable Bank policies.

## **2. Component 2. Solid waste (US\$0.52 million)**

- 2.6 The objective for this sector under Phase II is to attain quality services and total coverage for the collection and final disposal of solid waste, and for street cleaning. The services will be provided through the involvement of the private sector in a competitive bidding process among service providers to ensure reasonable prices and environmentally sound operations; the municipio will be responsible for supervising the services.
- 2.7 Sector financing will be used to outsource the operations of the sanitary landfill, specifically, to commission the coordination and preparation of the bidding forms for a contract for comprehensive management of the landfill. This will include institution-building activities, such as monitoring the sector financing strategy; strengthening and equipping the unit that will provide training to and involve the trash pickers; and the Solid Waste Supervision Unit. The latter will include drawing up service regulations and training to improve oversight efficiency of the solid waste collection contracts in the municipio. The financing arrangement for the new sanitary landfill will consider, as part of the feasibility analysis, a component to sell carbon credits under the Clean Development Mechanism, and the potential of generating energy through the capture and combustion of methane gas. The AMDC has asked the Bank for technical support and contacts with organizations with experience in these fields for developing this aspect of the project.

## **3. Component 3. Roads and urban transportation (US\$5.6 million)**

- 2.8 The principal objective for this sector under Phase II is to improve the operation of the Central District's road network through strategic road works, and to ensure full implementation of the Municipal Infrastructure and Road Transportation Fund (FMITV) as a financial and institutional mechanism that ensures sustainable, long-term maintenance of and investment in the municipal road network. Initiatives to improve the urban public transportation system will also receive support.
- 2.9 The specific objectives of Phase II are to: (i) upgrade the efficiency of the existing network through physical works to improve road connectivity and efficiency in order to reduce the duration of travel, pollution and the operating costs of the vehicle fleet; (ii) consolidate the FMITV's operations to ensure policy definition for the sector, investment planning, and maintenance of the AMDC's road network; and (iii) improve access for pedestrians within the road infrastructure.

- 2.10 To meet the institutional objectives, the AMDC will conduct a technical-assistance program. A series of strategic projects will be implemented in critical points of the road network: (i) expansion and comprehensive resurfacing of the Boulevard Centroamérica to include a third lane, in indirect support to public transportation; (ii) construction of the El Estadio connector road, in order to improve access to and from downtown Tegucigalpa and Comayaguela (this project supplements the roadway solution in the National Stadium sector that began with the construction of the new Estocolmo bridge); (iii) improvement of three difficult intersections located in La Granja, Humuya, and BAMER, to facilitate the flow of traffic in the Central District, where serious traffic problems have been attributed to the circulation of public transportation and high levels of environmental pollution; and (iv) in order to improve pedestrian safety, all proposed projects include the necessary pedestrian facilities for the new road infrastructure, in accordance with concept of “universal design.”
- 2.11 The loan contract will specify that the Central District Municipio Corporation has chartered the Municipal Infrastructure and Road Transportation Fund (FMITV) and established the terms under which it is to operate, in accordance with the implementing system agreed upon with the Bank.

#### **4. Component 4. Developing neighborhoods (US\$9.5 million)**

- 2.12 Under Phase II, the specific objective for this component is to improve the living standards of the beneficiary population by consolidating participatory methodologies for promoting and executing physical works and land regularization efforts, and to strengthen the AMDC’s institutional capabilities for applying them and recovering sector investments.
- 2.13 During Phase II this component will provide investment funds and technical assistance for: (i) community works (paving bus routes, social infrastructure, and sewerage works); (ii) expanding the land regularization program to include new informal settlements in both urban and rural sections of the municipio; and (iii) institutional strengthening of the technical units in charge of community works, social outreach, and land regularization. This component focuses entirely on the low-income residents of shantytowns. The social engineering methodology consolidated during Phase I ensures that all eligible community works projects will be widely consulted and prioritized directly with the target groups.
- 2.14 Specifically, the component will finance investments and technical assistance for: (i) five additional projects to pave bus routes in shantytowns (US\$2.4 million); (ii) approximately 20 new initiatives for community works prioritized in city’s shantytowns using the social engineering methodology (US\$5 million); (iii) expansion of the land regularization program to some 15 additional informal settlements, to include implementing pilot regularization projects in rural



settlements (villages) of the Central District (US\$2 million); and (iv) institution-strengthening (US\$0.11 million).

- 2.15 Technical assistance for institution-strengthening will focus on the procurement of goods and consulting services for strengthening the capabilities of the Social and Community Services Office in the following areas: (i) training and appraisal of social projects; (ii) systematization, implementation, and dissemination of the Municipal Social Plan; (iii) support for formulating the regulations of the municipal neighborhood associations system; and (iv) upgrading of the municipal socioeconomic statistics system administered by the Municipal Development Institute. In addition, the Municipal Lands Division will receive support for: (i) upgrading administrative capacities in order to consolidate the land regularization methodology adopted in Phase I, including cost recovery; (ii) improving capabilities to resolve land disputes; (iii) modernizing and systematizing the electronic registry of data, including online linkages with the Department of Investment Recovery and the Taxpayers' Registry; and (iv) project control and supervision. In Component 6, resources have been earmarked for implementing this sector's collection system, through the Administration and Finance Division.
- 2.16 The loan contract will specify that the AMDC has delivered to the Bank a collection plan with a strategy for recovering investments in the developing neighborhoods sector and for setting up and funding the special account for such resources.

## **5. Component 5. Environmental management (US\$1.4 million)**

- 2.17 The objective for this sector under Phase II is to further Phase I efforts to strengthen municipal environmental management. To determine which activities would be financed under Phase II, the AMDC updated its environmental assessment, examined the results of the application of the ISO 14001 system, and surveyed 2,500 residents of the municipio in order to identify social priorities. On this basis, the AMDC selected seven priority areas for environmental management: clean air, natural resources, reduction of the vulnerability of the Choluteca river, dangerous solid wastes, sound and visual pollution, improvement of environmental culture, and strengthening of institutional environmental management capabilities. In addition, 16 priority projects were identified.
- 2.18 Phase II proposes to finance projects that will supplement the Phase I program to strengthen the Municipal Environmental Management Unit (UGAM). The strategic areas<sup>3</sup> to be addressed in Phase II are: (i) strengthening the institutional, legal, and

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<sup>3</sup> The strategic underpinnings and orientation of the activities to be financed under this component were developed by the program in an exercise conducted during the preparation stage to update the environment strategy.

organizational framework; (ii) diversifying and supplementing the environmental management tools used by the municipio; (iii) upgrading activities to monitor, evaluate, and manage information on environmental impact; and (iv) fulfilling the certification and sustainability objectives of the environmental management systems.

- 2.19 Phase II of the program will support the UGAM by providing technical assistance and equipment for the following programs: (i) natural resource management; (ii) strengthening of metropolitan environmental management; (iii) air quality improvement; (iv) clean production; (v) economic instruments for municipal environmental management; and (vi) strengthening of the environmental monitoring and information system. The environmental information system financed under this component will collect and analyze information on socio-environmental indicators that impact on neighborhood programs, including beneficiary populations, environmental health, urban infrastructure, and air, water and soil pollution.

## **6. Component 6. Municipal planning and management (US\$3.3 million)**

- 2.20 In Phase II this component seeks to: (i) strengthen the AMDC's planning capacity in priority areas; (ii) support the implementation of general institutional reforms in specific sectors including capacity-building to better plan and manage municipal human resources; and (iii) strengthen municipal financial management, especially in the development and implementation of a municipal financial strategy, the financial management of services, and service cost recovery. Phase II will support the AMDC with technical assistance activities in each of these areas, including final implementation of the municipal integrated financial management system (MIFMS), safety enhancements, and improvements to the physical facilities associated with the system.

### **a. Strategic planning**

- 2.21 This component aims to improve planning processes and instruments, and the management of urban and rural growth and development in the municipio. This will be accomplished primarily by updating and implementing the Metr poli 2029 strategic development plan for the Central District metropolitan area, which includes instruments for urban and rural land-use planning and control. The purposes are to: establish better planning processes, strengthen public participation in municipal strategic planning, and promote private sector involvement in the delivery of services linked to land-use control. It will also promote reengineering in the operating units responsible for directing and conducting municipal land-use planning; strengthen inter-municipal coordination within the Plan by consolidating the municipalities making up the metropolitan area; and reinforce joint planning processes and the resulting structures for coordination and service delivery.

- 2.22 Specifically, this subcomponent will finance technical assistance for: (i) formulating the specific plans<sup>4</sup> included in the Metrópoli 2029 Plan and their instruments; (ii) supporting institutional reorganization and operational consolidation of the technical unit responsible for arranging and monitoring the municipio's urban and rural development planning; and (iii) developing a municipal e-government strategy.

#### **b. Institutional reform**

- 2.23 This subcomponent aims to consolidate the progress made during Phase I in the reengineering and institutional reorganization activities with a view to attaining, by the end of Phase II, a stable and efficient municipal structure, well adjusted to the municipio's financial capabilities and professional needs, and with transparent and standardized selection, contracting, and evaluation processes. It will also develop a management model that promotes ongoing improvements in municipal administration and the capacity to adjust continually to technical criteria, emphasizing results measurement and closer monitoring of the program's institutional reforms. One of the component's targets is to design and implement an administrative transition process that will serve as a model of efficiency and transparency for other municipalities in the country. Resources have been earmarked to finance a transition program between the current and the next administration; it will be supervised by a transition committee that will be appointed by the AMDC before the resources for this activity can be used.

#### **c. Municipal finance**

- 2.24 During 2002 and 2003 there was a substantial increase in the municipio's tax and non-tax-related revenues, resulting from technical and administrative restructuring and efforts to improve the effectiveness of tax collection. However, reforms in many areas need to be furthered: in the units that participate in generating revenues, to improve municipal financial planning and define methodologies for strengthening financial management and cost recovery in the sector; and in client services, including for the more than 40,000 new taxpayers in shantytowns.
- 2.25 This financial strengthening project will provide resources for the following consulting services to: (i) prepare a medium-term municipal financial plan for the AMDC and sector financing strategies; (ii) increase tax collection; (iii) strengthen the audit and inspection units; (iv) extend tax collection coverage and rates (in collaboration with the borrower's Executive Office of the Revenue); (v) prepare manuals on administrative and accounting policies and procedures; (vi) taxpayer

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<sup>4</sup> The AMDC's priority plans under the strategic municipal development plan are: (i) the urban development and land management plan; (ii) the risk management and environmental management plan; (iii) the land regularization, land titling and community development plan; (iv) the rural development plan; (v) the comprehensive solid waste management plan; (vi) the tax decentralization and government coordination plan; and (vii) the consolidated municipal development plan.

services as part of the e-government strategy; (vii) finalize implementation of the municipal integrated financial management system (MIFMS); and (viii) enhance safety and improve the physical facilities associated with the system.

- 2.26 The loan contract will specify that the AMDC has delivered to the Bank a list of corrective measures to address the auditors' observations on accounting and financial management and its 2003 audited financial statements, which it will implement according to a plan agreed upon with the Bank, as stated in the eligibility matrix.

### C. Cost

- 2.27 The total cost of Phase II will be US\$25 million, and will be allocated as follows, by category of investment and source of funding:

**Table II-1. Program Cost**  
(in thousands of US\$)

Category	IDB	Phase II Local Contribution <sup>a</sup>	Total
	21,005	1,985	22,990
<b>Water supply and sanitation</b>	2,434	126	2,560
Solid waste	495	25	520
<b>Roads and urban transportation</b>	5,349	276	5,625
<b>Developing neighborhoods</b>	8,224	1,326	9,550
<b>Environmental management</b>	1,341	69	1,410
<b>Municipal planning and management</b>	3,162	163	3,325
<b>Administrative costs</b>	545	315	860
MDTF and TU <sup>b</sup>	350	-	350
Audit	195	15	210
Executing Unit expenses	-	300	300
<b>Evaluations</b>	175		175
<b>Financial costs</b>	775	200	975
Interest	550	-	550
Credit fee	-	200	200
Inspection fee	225		225
<b>TOTAL</b>	<b>22,500</b>	<b>2,500</b>	<b>25,000</b>

<sup>a</sup> The local contribution to be paid by the borrower will come from the AMDC's contributions. However, should the AMDC not make the payment, the borrower will still be under obligation to the Bank to cover it.

<sup>b</sup> SEFIN will finance the program chief technical advisor (CTA) with recovered resources that have been recorded as local counterpart. The expected value of the contract is US\$250,000.

### III. EXECUTION OF PHASE II

#### A. Execution structure

- 3.1 The structure for Phase II execution and the financial terms of the subloans will be as established and operating for Phase I, with certain modifications introduced in the San Pedro Sula Phase II and others to incorporate lessons learned. The borrower will be the Republic of Honduras. The loan proceeds will be transferred to the Office of the Mayor of the Central District Municipio (AMDC) through subloans from the Municipal Development Trust Fund (MDTF), which will be the borrower pursuant to a trust contract signed between the Ministry of Finance (SEFIN) and a private bank (see project loan proposal 1024/OC-HO). Because the trust contract signed with the FICOHSA Financial Group for Phase I will conclude in April 2005, the SEFIN will initiate a bidding process for contracting a trust to manage the resources of both phases.<sup>5</sup> **The signing of the trust contract in terms satisfactory to the Bank is a condition precedent to the first disbursement. Another condition precedent to the first disbursement is the signing of a transfer agreement between the borrower, the Central Bank, and the private bank that will operate the MDTF.**
- 3.2 The borrower will also enter into an interagency agreement with the National Housing and Production Fund (FONAPROVI), under which FONAPROVI will be responsible for contracting and supervising the Technical Unit and coordinating its operations with the borrower.<sup>6</sup> FONAPROVI is a deconcentrated institution under SEFIN, set up by the Government of Honduras as a second-tier financial institution with its own separate legal status and assets, to finance productive projects and medium- and long-term social investment. It is currently transforming into a second-tier bank as part of the national financial sector reforms.
- 3.3 FONAPROVI will select and hire at least two individual consultants to form the Technical Unit (TU), using the loan proceeds or funds recovered from subloans. One will be a municipal finance specialist, and the other a specialist in municipal investment project engineering. The TU may have one other consultant specializing in an area to be determined by the program's needs. The TU will be responsible for technical and financial review and supervision of projects. The borrower will also undertake to facilitate coordination between the TU and MDTF with support from a legal/financial advisor ("chief technical advisor" or CTA), to be selected and hired using resources from program reflows. The CTA will keep SEFIN informed of

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<sup>5</sup> The trust contract will include responsibility for administering the fund's surpluses obtained from the recovery of the subloans.

<sup>6</sup> In the event that FONAPROVI becomes a second-tier bank (see paragraph 3.2), the resulting bank would assume FONAPROVI's program execution obligations.

progress and problems arising in program execution. Selection of the TU members and the CTA under terms of reference previously agreed upon with the Bank, and their hiring under terms satisfactory to the Bank, will be a condition precedent to the first disbursement. **Evidence that the agreement with FONPROVI has been entered into on terms satisfactory to the Bank will be a condition precedent to the first disbursement.**

- 3.4 The funds recovered from subloans to the AMDC from program resources will flow into the MDTF, to be transferred by the borrower to the Municipal Development Fund (FOMUNDE) that the borrower proposes to establish at FONAPROVI. During the term of the loan contract, FOMUNDE will use these funds recovered from subloans to: (i) transfer to the borrower the amounts needed to service the debt with the Bank; (ii) capitalize the reserve account that will be maintained for servicing the debt, pursuant to the Credit Regulations; (iii) fund the hiring of the TU, the CTA, and other program administrative expenses agreed upon with the Bank; (iv) finance new projects in keeping with the municipal development objective and procedures to be agreed upon by the borrower and the Bank; and (v) in order to maintain its value over time and provided no other financial commitments exist, invest in low-risk, high liquidity instruments, pursuant to the investment program agreed to earlier among the borrower, FONAPROVI, and the Bank. Until such time as the borrower establishes the FOMUNDE, the trustee will use the resources for the same purposes, except for financing new projects.
- 3.5 The AMDC will make the investments and implement the technical assistance financed by the program. To coordinate activities, the AMDC will continue to maintain a program coordination unit (PCU) with technical personnel specialized in program areas. The PCU may be the program executing unit from Phase I. The costs of the PCU (up to 1.2% of disbursements) will qualify as municipal counterpart. For Phase II, the AMDC will appoint a coordinator for the program's institutional reforms and a technical specialist to manage the technical assistance with the PCU. The AMDC will formulate projects valued at no less than US\$75,000 and will submit them to the Technical Unit (TU), which will rate them for program financing in accordance with the eligibility matrix set out in the Operating Regulations.<sup>7</sup> The AMDC is to provide a counterpart which, for the entire project, will amount to 10% of the program cost and which, for each year, should amount to 10% of the financing resources.<sup>8</sup> The AMDC's local contribution will be transferred to the MDTF before the loan proceeds are disbursed. The MDTF will administer the local contribution in separate accounts. The counter part will not be financed with resources from loans. Each financed project will be shielded,

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<sup>7</sup> Some conditions from the Phase I eligibility are acknowledged not to have been met. These will be carried over to create an integrated matrix for the two phases of the program.

<sup>8</sup> The payments by the communities in the developing neighborhoods sector will be accredited as part of the overall 10% counterpart.

individually or collectively, by a credit document that specifies the AMDC's debt to the MDTF, and will meet all the Program's conditions, including those related to the terms and conditions of financing, the provision of the guarantees, and the maintenance of earmarked accounts, pursuant to the Credit Regulations. The grace period will be the same as the disbursement period for the subloan plus up to one year. The Bank's policy on subloan interest rates will be taken into account in determining the interest rate. The borrower will use its best efforts to ensure that the terms of the subloans are such that the MDTF and FOMUNDE will be sustainable in terms of their ability to repay the Bank loan and finance municipal development projects.

- 3.6 **Operating Regulations.** As a condition precedent to the first disbursement, the Bank will agree to the program's final Operating Regulations (OR). The **OR** will consist of the following components: **Regulations on General Matters (RGM)**, **Credit Regulations (CR)**, which will govern the rules for granting and repaying subloans; and **Municipal Regulations (MR)**, for activities to be executed by the AMDC. The **RGM** will include terms of reference and work plans for the MDTF, the TUs and the chief technical advisor (CTA); the eligibility matrix; procedures for program monitoring and evaluation, and procedures for the transfer of recovered resources to FOMUNDE. The **CR** will include, among other things, guidelines for project submission; criteria for reviewing the feasibility of subloans; and procedures for disbursement, fund control, and subloan recovery. The **MR** will include, among other things, the municipal financial plan and its targets; procedures for supervising program-funded technical assistance, guidelines for maintenance plans for the physical works; the specifications of the earmarked accounts; the work plans for the sectors covered by the program; profiles of key positions, by sector; and guidelines for preparing and submitting periodic reports and disseminating information on the website. Under the MR, the AMDC will be required to collaborate in conducting the program audits (see paragraph 3.12); deliver the reports to the Bank on a timely basis; and disseminate information on its web page.
- 3.7 In addition, the AMDC and the SEFIN will sign an agreement whereby the AMDC pledges to comply with the OR and which will establish the terms and conditions under which the SEFIN will transfer resources to the AMDC through the MDTF. **The signing of this agreement to the satisfaction of the Bank is a condition precedent to the first disbursement.**

## **B. Procurement**

- 3.8 **Management of funds.** The SEFIN maintains an earmarked account in the Central Bank for the project and transfers from this account to the MDTF are automatic. Disbursements from the MDTF to the AMDC follow the procedures established in the Credit Regulations, which include: (i) approval of the specific project; (ii) signing of the credit document; and (iii) management of payments from the MDTF to the AMDC's contractors and suppliers, on the TU's recommendation.

- 3.9 **Contracting.** All contracting will be done in accordance with Bank policies and procedures. International competitive bidding will be used for physical works valued at US\$1 million or more, and for the procurement of goods and services valued at US\$250,000 or more. Local legislation will apply for lower amounts, provided it does not contradict Bank policy. International competitive bidding will be required for consulting services valued at more than US\$200,000.
- 3.10 **Contracting of trust services and the TU.** All documents, data, and regulations developed by the MDTF and TU during Phase I, including the Credit Regulations, are the intellectual property of the State and will be placed at the disposal of bidders during the contracting process.

## C. Disbursement schedule and supervision

### 1. Disbursement of funds

- 3.11 Phase II will be executed over a period of three years and the disbursement period will be 4 years. The AMDC will use funds for the two phases at the same time, in each case pursuant to the provisions of the corresponding loan agreement.

**Table III-1.**  
**Tentative Disbursement Schedule**  
**(in millions of US\$)**

Source	Year 1	Year 2	Years 3/4	Subtotal
Local	0.6	1.0	0.8	2.5
IDB/FSO	6.0	8.5	8.0	22.5
Total	6.6	9.5	8.8	25.0
%	26.5%	38%	35.5%	100%

### 2. External audit

- 3.12 The external audit (financial and performance) will be conducted by an independent auditing firm acceptable to the Bank. It will follow Bank policies and procedures, taking into account the guidelines established in the terms of reference previously accepted by the Bank. The auditing firm will be contracted in accordance with the procedures established in the External Audit Tender Document (AF-200). The following reports will be required during program execution: annual audited financial statements of the AMDC; annual audited financial statements and a final audited financial statement of the program; annual audited financial statements and a final audited financial statement of the MDTF.
- 3.13 The borrower, through the AMDC, will deliver the audit reports within the following time frames: (i) the annual reports on the financial statements of the program, the AMDC, and the MDTF, no later than 120 days after the end of the corresponding fiscal year; and (ii) the final reports on the financial statements of the



closing of the program and the MDTF, no later than 120 days after the last disbursement. The cost of the audits is considered a program cost and will be financed with the Bank's loan proceeds, through the mechanism of subloans to the AMDC.

### **3. Monitoring and supervision**

- 3.14 Supplementing the supervision commissioned for each physical work, the TU will conduct onsite inspections every three months during the construction period in order to ensure that construction is carried out as planned. The AMDC will provide the TU with: (i) a pre-inspection report before each inspection; and (ii) a project conclusion report no later than two months after the last disbursement for the given activity.

### **4. Supervision and evaluation of Phase II**

- 3.15 Phase I of the program has been supervised at three levels on an ongoing basis, a practice that will continue during Phase II.
- 3.16 **Semiannual program evaluation.** The Bank's Country Office will conduct the semiannual evaluation of Phase II with the normal project performance monitoring report (PPMR), based on the performance indicators included in the program's logical framework and eligibility matrix. The Municipal Regulations that form part of the Operating Regulations will require that the AMDC collaborate in this evaluation by presenting semiannual reports, among other things.
- 3.17 **Semiannual review of the eligibility matrix.** Semiannually during execution, the Bank will conduct an administrative mission to assess the AMDC's performance, based on the eligibility matrix and the logical framework. As mentioned earlier, the matrix establishes three levels of conditions related to: (i) the municipio's overall performance; (ii) the performance of the sectors; and (iii) eligibility for specific projects. The MDTF will be responsible for providing the relevant financial and progress reports. Should problems be detected in sector performance, the Bank will reach agreement with the AMDC on specific actions to be taken and on the deadlines for resolving them.
- 3.18 The program's technical files contain the preliminary eligibility matrix for Phase II, identifying the areas of the AMDC targeted for performance assessment. The final matrix will be included in and be approved with the program's Operating Regulations.
- 3.19 **Project rating by the TU.** The AMDC's access to the program's investment resources is governed by the technical and financial conditions set out in the Credit Regulations, certification of compliance with the Municipal Financial Plan, and the eligibility matrix mentioned above. The TU checks fulfillment of the indicators and related agreements, and will present its assessment when it submits a specific

municipal project for the no objection of the Bank. Semiannually, the TU will certify the creditworthiness of the AMDC and compliance with the Financial Plan.

- 3.20 **Supervision of the MDTF and the TU.** In Phase II, and as part of the semiannual evaluation, a matrix of performance indicators will be applied to the MDTF and the TU. Areas to be evaluated include: fulfillment of contractual obligations; timeliness, efficiency, and quality of work; and financial management of the fund. The preliminary matrix for supervising the MDTF and TU can be found in the program's technical files; the final matrixes will be included in the program's Operating Regulations.
- 3.21 **Reports.** The Government and the AMDC will submit an inception report, in keeping with Bank requirements and standards. Semiannually, both the AMDC and the borrower will deliver to the Bank reports on the progress and outcomes of the program, for their areas of responsibility, using as a framework the performance indicators and work plans set out in the Operating Regulations. The AMDC's semiannual report is to include the unaudited financial statements; this requirement will be set out in the Municipal Regulations which form part of the Operating Regulations.
- 3.22 **Periodic program evaluation.** The borrower will commission consulting firms to conduct two evaluations of the program: one midterm evaluation, when 50% of the Bank loan proceeds have been disbursed, or when two years have elapsed after the date the loan agreement went into effect, whichever occurs first. The other will be conducted at the conclusion of the program, when 90% of the Bank loan proceeds have been disbursed. The borrower will deliver the report to the Bank. The evaluations will make use of the performance indicators and sector benchmarks set out in the Municipal Regulations, and the environmental and social indicators to be developed with Phase II resources; the purpose will be to measure the program's outcomes and impact. The midterm evaluation will have an additional focus: to analyze the effectiveness and efficiency of program's implementing structure. In order to evaluate program's impact on the public, surveys of the users and beneficiaries of sector activities will be conducted as part of both evaluations, which will be financed with loan proceeds through the mechanism of subloans to the AMDC. The Municipal Regulations that form part of the Operating Regulations will contain the provisions that govern the preparation of these evaluations and the delivery of the reports.

## IV. VIABILITY, BENEFITS, AND RISKS

### A. Financial viability

- 4.1 The program's financial viability depends on three factors: the profitability of the individual projects, the creditworthiness of the municipality, and the financial sustainability of the Municipal Development Trust Fund (MDTF). When the loan was being prepared, a financial feasibility analysis was conducted of Phase II and measures were agreed to for maintaining financial viability during that phase.
- 4.2 **Project profitability.** The Office of the Mayor of the Central District Municipio (AMDC) submitted a preliminary financial analysis and cost-recovery strategy for each project and/or sector of Phase II. The strategies describe the collection mechanism and administrative programming needed for implementation. A condition was established that each new project has to be recovered by new municipal revenues, because the AMDC's cash flow limits its ability to repay the subloans with current net municipal revenues. The MDTF will modify its project review procedures to condition approval of Phase II projects to the acceptance and implementation of the project-recovery strategy. In addition, implementation of strategies and financial results will be monitored periodically and the new financial management system will play a key role in implementing these measures.
- 4.3 **Financial management and municipal debt.** Financial management (in terms of control, transparency, and quality of information) in the AMDC has improved substantially during the current administration. However, due to the extension of and improvement in municipal services, new expenses and credit obligations have been acquired which have continued to restrict the generation of financial surpluses. The eligibility matrix of Phase I contains indicators for debt control but they have been difficult to evaluate. Accordingly, the midterm evaluation proposes that a new system of financial indicators be included in the Phase II matrix. The MDTF has developed a methodology for analyzing municipal creditworthiness, based on the risk analysis system used with private clients, and a similar methodology will be applied in Phase II. The AMDC must submit and update a financial plan that meets established indicators of municipal creditworthiness before it disburses resources during Phase II (this includes cash flow coverage). The TU will periodically monitor compliance with the plan and the repayment capacity to ensure the necessary cash flow for repaying the loan.
- 4.4 **Financial sustainability of the MDTF.** In 2004, the MDTF hired an expert to update its financial projections and determine if the lending terms of the MDTF and macroeconomic policies were enabling its sustainability during the loan repayment period (40 years). This analysis (program technical files) identified low interest rates on the local market and the planned displacement of the lempira vis-à-vis the dollar as risk factors that will require adjustments in the near future. The loan

agreement for Phase II will allow for future adjustments in the interest rate and other terms of the subloan if they are necessary to maintain the long-term sustainability of the MDTF.

**B. Technical and economic viability**

- 4.5 The selection process for projects to be financed in each sector has been adjusted to take into account the economic, social, and environmental criteria established during Phase I, and validated in accordance with the characteristics of the sector. For example, in the roads and transportation sector, projects have been selected within the context of a sector strategic planning process. The projects in shantytowns are selected (and supported financially) by the communities through a participatory process of community organization. The technical viability of the subloans is reviewed by the TU, in accordance with the Credit Regulations established for the Program. The TU will apply technical, financial, environmental, and social criteria to each project, which are designed to meet Bank requirements, using the framework of national legislation for environmental considerations and the criteria of equity and financial sustainability in service management.

**C. Institutional viability**

- 4.6 Certain aspects of the institutional arrangements of Phase II have been adjusted to reflect the experience gained in Phase I and the recommendations of the midterm evaluation, specifically modification of the arrangements for project reviews and monitoring of financing strategies (see paragraph 3.1). The Bank, the Ministry of Finance (SEFIN), the National Housing and Production Fund (FONAPROVI), the MDTF, the TU, and the municipality will carry out the functions set out in the program's Operating Regulations (see paragraph 3.6). With the adjustments made by the AMDC during Phase I to expand the role of its Executing Unit, the municipality's support for the program has demonstrated high technical capabilities and administrative flexibility.

**D. Environmental and social viability**

- 4.7 During preparation of Phase II, the operation's environmental strategy was updated with a view to identifying critical strategic and operating aspects of the program's environmental performance. Using strategic environmental assessment (SEA) tools, specific strategic areas of action were devised for Phase II, as follows: institutional and regulatory capacities; effective use of environmental management tools; environmental monitoring and performance audit; transparency and communication; and long-term sustainability of environmental management systems. In addition, actions were defined for sustaining the environmental aspect of the operation as a whole, including: preventive measures and cumulative impact of multiple works; key factors for the technical review of projects; coordination of roles and intersector capabilities; development of benchmarks for participating

sectors and for the city; and performance monitoring of the proposed activities as a whole.

- 4.8 The environment strategy has contributed to improving the design of Phase II, including the proposals to strengthen the capacities of the Municipal Environmental Management Unit (UGAM) in overall municipal environmental management and, more specifically, in its activities to support environmental management in other program sectors. It also facilitated organization of a coherent sequence of activities in the environment component, thus ensuring the effectiveness of the work and its sustainability within the UGAM. It provided criteria on environmental sustainability for the program as a whole, connecting targets with information on environmental performance in the rest of the program's sectors. The environment strategy update was used as an important reference in the design of this operation, providing criteria for shaping activities and a series of performance indicators and targets for the program's eligibility matrix, logical framework and Operating Regulations.
- 4.9 Risk management is addressed in several program components and is being expanded in Phase II. In Phase I, the program helped the AMDC map risk areas for the environment sector (see the AMDC's web page), which are being used in efforts to control and clean up the land occupied in risk areas of the municipio. In Phase II, the work agenda of the watershed agency to be established includes risk management, reforestation, and fire control. For the developing neighborhoods sector, the program does not allow investments for physical works or regularization efforts in risk areas. Sewerage and pavement works in this sector and in the roads and urban transportation sector are improving rain drainage in the shantytowns and reducing erosion and floods in the rainy season. Finally, the social engineering applied in the shantytowns promotes social unity, which will help bring together the neighborhoods in times of emergency.
- 4.10 With regard to the environmental impact of investments, the National Environmental Impact Assessment System (SINEIA) found that all the currently proposed projects are of priority for financing under the program and determined that none would require an environmental impact assessment (EIA). Nevertheless, because of the program's transparency, its executive projects should meet national EIA standards as well as Bank policies and procedures concerning the mitigation of socio-environmental impact by Bank-financed actions.
- 4.11 The AMDC has maintained a strategy to involve the beneficiary population in the design and execution of Phase I, and will continue to do so in Phase II. This participation has been framed by a well-developed social engineering methodology that was tested and adjusted during Phase I, and adopted for defining priorities for physical works and target groups in the subcomponents of the developing neighborhoods sector. For the planning subcomponent, representatives of the private sector, organized civil society, and academia will participate actively in the

formulation of the Metrópoli 2029 Plan, during the consensus-building and public consultation stages. Participation was also taken into account in defining the logical framework indicators to ensure a smooth transition between administrations when the change of government scheduled for January 2006 takes place. By law, the AMDC must conduct public consultations for all projects to be financed with the betterment levy mechanism, and in the required stages of its environmental assessment (during the design stage and before executing these works). The UGAM has adopted participatory methods for the development of plans and programs; for example, the lines of action of the natural resources management plan were defined with public participation.

- 4.12 All recommendations and suggestions included in the minutes of the 16 April 2004 meeting of the Committee on Environment and Social Impact (CESI) have been included in this document.

#### **E. Benefits and rationale**

- 4.13 The activities financed by the program will produce four important benefits: (i) improved quality and coverage of municipal services, particularly in areas inhabited by the low-income population, and greater equity in service delivery through service planning, the simplification of rates, and administrative efficiency; (ii) improved discipline in financial management, financial planning and in the transparency of the AMDC's management of expenses and revenues, which will increase confidence in the AMDC's financial management, improve its capacity to allocate costs equitably, and increase the availability of local resources in the future; (iii) improved management of urbanization and the settlement process, and greater possibilities for legalizing land ownership in the municipio; and (iv) a stronger lending relationship between the private sector and the municipalities, including the creation of instruments and mechanisms for measuring municipal performance and municipal creditworthiness.

#### **F. Risks**

- 4.14 The project involves economic risk because one of its approaches involves payment for public services in a sector where family incomes are seriously limited. In 2003, although the growth rate of the Honduran economy was 3.2% of GDP, which reflected improved international conditions, growth was weak in the areas of job creation and per capita incomes. In order to mitigate risk, program design ensures that the municipality will analyze the financial impact of each project and identify the source of repayment before proceeding to invest and, in the projects in shantytowns, it must obtain ex ante approval of the projects by residents. The program also includes a series of activities for improving the AMDC's collection system.

- 4.15 With 2005 being an election year, the political will to make decisions may be affected, particularly regarding institutional reforms, and pressure may be brought to bear to accelerate physical investments. The program mitigates these risks by conditioning certain investments to sector reforms, and by continuing with the objective and technical subloan approval process by the TU and the MDTF. Moreover, in the planning and municipal management sector, the program will support formulation of a specific project to facilitate the transition between municipal administrations in order to minimize loss of know-how, strategic approaches, and goods during the change of administration scheduled for January 2006.
- 4.16 The program depends on the municipality making a very disciplined effort to balance the financial performance not only of the municipality itself, but also of the municipal sectors or services. This will require spending control in the sectors and an effort to improve and maintain suitable collection of service fees. In Phase I, this system has shown certain shortcomings due, among other things, to poor financial information at the sector level. The following will be required: (i) a municipal financial plan and financial strategies in several sectors; (ii) fully operational cost-recovery mechanisms in the program's most important sectors (the FMITV for transportation; the collection system through a trust for projects in the shantytowns) for Phase I projects, before Phase II resources can be disbursed in those sectors; (iii) strengthened procedures for project financial analysis; and (iv) TU implementation of a system for monitoring recovery strategies and the AMDC's overall creditworthiness. In Phase II, once the municipal integrated financial management system (MIFMS) and cost-center accounting have been implemented, sector-level financial results will be required for periodic evaluations. The program is also financing a series of consulting services that seek specifically to improve collection and financial management. This administration has effectively used public campaigns and the Internet to communicate information on a variety of topics, but not on tax issues. The awareness exists that communication must be improved to ensure the success of the new program to collect the betterment levy through private banks. The eligibility matrix will include indicators for monitoring the use and effectiveness of communication on tax matters.
- 4.17 There is a risk of overindebtedness in the AMDC. The program will address this risk with a system of safeguards, including the periodic evaluation of municipal creditworthiness, the evaluation and monitoring of economic and financial profitability of individual projects, and the annual external audits.

**G. Social equity and poverty targeting classification**

- 4.18 This operation qualifies as a social equity enhancing project as described in the indicative targets for Bank activities mandated in the Eighth Replenishment report (document AB-1704), inasmuch as it extends services to low-income citizens as a

result of modernization efforts and the targeted investments to improve the quality of life of these citizens in certain sectors.

- 4.19 This operation does not qualify as a poverty targeted investment (PTI).