

Sustainable Cities Strategy (Draft): Financing Solutions for Cities in Asia to Achieve GREAT

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Introduction

1. Asia has been urbanizing at an unprecedented scale and speed, and this trend is expected to continue. By 2050, an additional 1.2 billion people are projected to live in Asian cities, and Asia's urban population will account for more than half of the world's urban population¹. The Asian region is also increasingly affected by climate change and natural disasters. A third of the world's natural disasters that occurred in the last three decades took place in Asia, and many of Asia's coastal cities are expected to be among the worst affected by rising sea levels due to global warming².
2. Infrastructure investment to support the rapid growth of Asian cities under climate change is urgent. As more Asian cities become engines of economic growth and hubs of trade, infrastructure will be a key contributor for ensuring the connectivity, productivity, efficiency and overall competitiveness of these cities. As Asia's urban population grows, not only will new cities and new urban districts need to be developed, but existing cities will also need to be re-tooled to improve livability and people's quality of life. The residents of many Asian cities today experience inadequate access to water and sanitation, unreliable power supply, traffic congestion, air and water pollution, inefficient land use, and a lack of decent shelters especially for the low-income group, amongst others. The lack of adequate infrastructure in Asian cities can be attributed, in part, to the small fiscal revenue base, poor access to finance, and weak planning and management capacity of local administrations.
3. In view of Asia's urgent need for infrastructure investments in cities and its strong alignment to AIIB's mandate³, AIIB has identified financing infrastructure for the sustainable development of cities in Asia as a key priority. AIIB views infrastructure investments in cities to be distinctive from sectoral infrastructure investments, as they are often multi-sectoral in nature, require spatial integration, and have strong area impacts. These distinctive characteristics also create possibilities to utilize more innovative financing approaches, such as financing by land value capture⁴, for infrastructure investments in cities. Nevertheless, AIIB also recognizes that infrastructure investments in cities have inter-linkages with sectoral infrastructure investments, such as energy and inter-city transport. AIIB has thus developed, and will implement, its Sustainable Cities Strategy in close coordination with its other sector and thematic strategies⁵.

¹ United Nations, 2014, "World Urbanization Prospects".

² Asian Cities Climate Change Resilience Network of the Rockefeller Foundation, and United Nations.

³ AIIB's Articles of Agreement states that "The purpose of AIIB is to foster sustainable economic development, create wealth and improve infrastructure connectivity in Asia by investing in infrastructure and other productive sectors ...".

⁴ Financing by land value capture is premised on the principle that the benefits of infrastructure projects are capitalized into land values, and refers to tapping into the increments in land values to fund the respective infrastructure projects.

⁵ Notably, urban transport is covered under AIIB's Sustainable Cities Strategy, rather than AIIB's Transport Sector Strategy. Notwithstanding this, AIIB will encourage the urban transport projects that the Bank finances to be integrated with both the urban transport network and the national/inter-city transport network where possible.

Vision, Comparative Advantages and Guiding Principles

4. Consistent with many Asian cities' aspirations and the broader global goals, such as the Sustainable Development Goals, New Urban Agenda, Paris Agreement on Climate Change, and Sendai Framework for Disaster Risk Reduction, AIIB's long-term vision is to support cities in Asia to be economically, environmentally and socially sustainable, by being green, resilient, efficient, accessible and thriving (GREAT).
5. AIIB is well-positioned to support the sustainable development of cities given its ability to directly finance not only national governments, but also sub-national entities, including provincial and city governments and agencies, as well as state-owned and municipal-owned enterprises. In addition, AIIB's considerable financial resources, ability to provide sovereign-backed and non-sovereign-backed financing within the same balance sheet, and thematic priority to mobilize private capital into infrastructure development will enable the Bank to support urban public-private partnerships (PPP) and commercially-financed solutions.
6. Taking into consideration AIIB's primary role as a multilateral development bank (MDB) with focus on infrastructure financing and the Bank's comparative advantages, AIIB's long-term aspiration is to be a **trusted banker in providing financing solutions for cities in Asia to achieve their GREAT objectives, with distinct capabilities to support sub-national entities in addition to national governments, and to mobilize private capital.**
7. AIIB will be guided by three principles in its infrastructure investments in cities. They are: client-driven; outcome-driven; and financial viability-driven.
8. **Client-driven:** AIIB recognizes that sub-national governments are increasingly responsible for providing urban infrastructure and services. Their in-depth knowledge of local conditions can also facilitate the testing and refinement of the implementation of innovative solutions locally. Nevertheless, AIIB is also cognizant that urban governance structures vary considerably across countries in Asia, and that national governments continue to play an important role in urban development, including in coordinating the overall national development agenda. In addition, while some sub-national governments have relatively strong creditworthiness and are able to tap into domestic financial markets, many sub-national governments continue to have a small own-source revenue base and are supplemented by inter-governmental transfers and grants. In view of these considerations, AIIB will proactively seek to build trusted client relationships with sub-national governments, while maintaining the flexibility to work with national governments, sub-national entities and private sponsors for financing infrastructure investments in cities.
9. **Outcome-driven:** AIIB's infrastructure investments in cities will be delivered mainly within the geographical boundaries of metropolitan areas to largely benefit urban populations⁶. Given the importance of spatial integration in cities, AIIB will proactively seek to support infrastructure projects that adopt a more holistic/integrated approach, such as by being part of a city masterplan and/or by considering strategic/efficient land-use. In addition, while AIIB recognizes that the sustainable development of cities requires a balanced integration of many economic, environmental and social dimensions, the Bank will proactively seek to invest in infrastructure projects that promote elements of green development, resilience, efficiency, accessibility and/or economic growth, so as to support cities towards becoming GREAT.

⁶ For operational purposes, a city is defined as a metropolitan area with a projected residential population exceeding 150,000 at the appropriate time horizon of the project.

10. As set out in AIIB's Environmental and Social Framework and Policy, AIIB will seek to ensure environmental and social soundness and sustainability in all of its projects, including its infrastructure investments in cities. During the identification, preparation and implementation of AIIB's projects, the Bank will aim to address environmental and social risks and impacts. In addition, through its projects, AIIB will be supportive of social development and inclusion that are critical for sound development in a manner consistent with AIIB's Articles of Agreement. AIIB recognizes that selected urban infrastructures (such as urban transport) can have significant potential to improve economic inclusion and social outcomes, and will encourage the infrastructure projects that it finances in cities to build in such considerations where possible.
11. **Financial viability-driven:** In line with AIIB's mandate to adopt sound banking principles⁷, the Bank will prioritize infrastructure investments in cities that are financially sound and viable. This will also support AIIB's thematic priority to mobilize more private capital into infrastructure development, including in cities. Notwithstanding this, to the extent that AIIB's financial sustainability is preserved, the Bank will maintain the flexibility to selectively support infrastructure investments in cities that do not initially offer sufficient financial returns to attract standalone private financing but present significant economic benefits with high social value.

Implementation Approach and Priorities

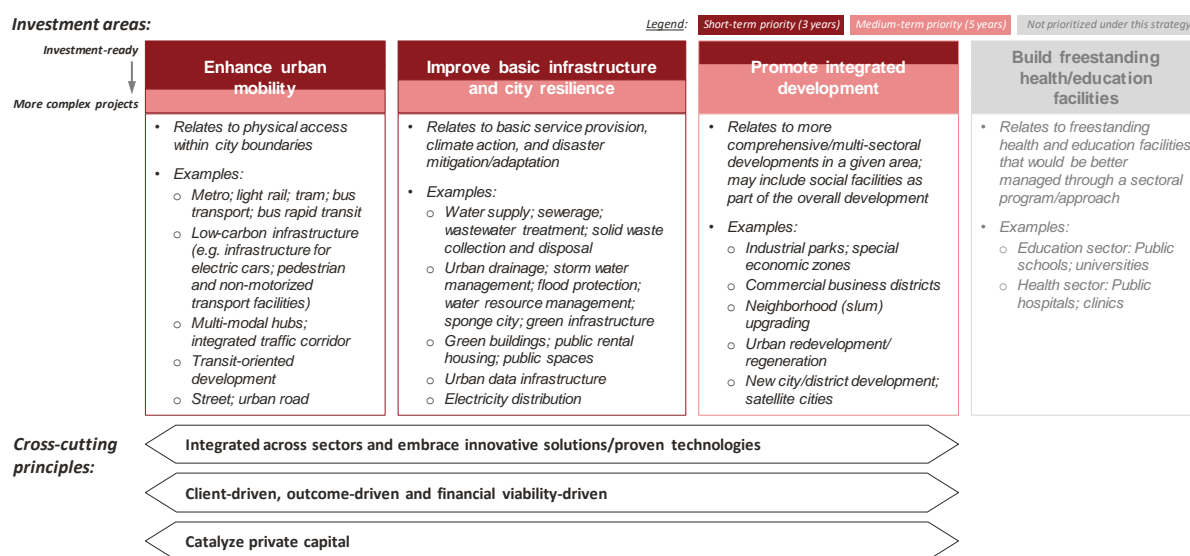
12. Given that AIIB is still a relatively young institution, the Bank will need time to build trusted client relationships and partnerships, strengthen its institutional capacities, and proactively learn from its growing operational experiences. As such, AIIB will adopt a gradual and focused approach in its infrastructure investments in cities.
13. **Cities:** AIIB is open to working with cities of all sizes, from small cities to megacities. Notwithstanding this, in the short term (3 years), AIIB will seek to invest in a selected group of cities with higher implementation capacity, particularly where there are established city masterplans and where project sponsors have sound financial positions and robust governance. Over the medium term (5 years), the Bank will gradually widen its investments across a larger group of cities, including those with more challenging circumstances.
14. **Investment areas:** Infrastructure investments in cities can be broadly categorized into four areas based on their objectives:
 - a) Enhancing urban mobility: These projects generally contribute to better access and more efficient connectivity between residential, commercial and industrial areas, which in turn support trade, economic development and potentially poverty reduction, within urban boundaries. They may also promote green outcomes by incorporating low-carbon elements where possible. Examples include: metro systems; bus rapid transit systems; infrastructure supporting electric vehicles; pedestrian and non-motorized transport facilities; multi-modal hubs; transit-oriented developments; and urban roads.
 - b) Improving basic infrastructure and city resilience: These projects generally aim to:
 - (i) provide better access to and improve the efficiency of basic infrastructure and services;
 - (ii) promote green outcomes by reducing pollution challenges and incorporating low-carbon elements where possible; and
 - (iii) enhance resilience against climate change and natural disasters, including through nature-based solutions where feasible, within urban boundaries. Examples include: electricity distribution; water supply; sewerage; solid waste management; urban drainage; flood protection; and green buildings.

⁷ AIIB's Articles of Agreement states that "The resources and facilities of the Bank shall be used exclusively to implement the purpose and functions set forth, respectively, in Articles 1 and 2, and in accordance with sound banking principles."

- c) Promoting integrated development: These projects generally relate to more comprehensive and multi-sectoral development initiatives in a given urban area or sub-area, where social facilities such as public housing, hospitals and schools may also be part of an overall development initiative. They encourage more efficient land use, which in turn supports trade and economic development, and provide better access to livable areas, thereby improving people's quality of life. Examples include: industrial parks; special economic zones; commercial business districts; neighborhood (slum) upgrading; urban redevelopment/regeneration; new city/district developments; and satellite cities.
 - d) Building freestanding health and education facilities: These projects relate to the development and improvement of freestanding health and education facilities within urban boundaries. Examples include freestanding public: schools; universities; hospitals; and clinics.
15. AIIB will prioritize investments in three of the abovementioned areas under this strategy (Figure 1). They are: (a) enhancing urban mobility; (b) improving basic infrastructure and city resilience; and (c) promoting integrated development. While AIIB recognizes that health and education facilities are important for the sustainable development of cities, it is viewed that such facilities are better managed through a sectoral program/approach given the high degree of specialized expertise and policy dialogue required in these sectors. Nevertheless, where health and education facilities are part of a more comprehensive/multi-sectoral integrated development that the Bank is considering to finance, AIIB will support the building of such facilities under this strategy, as part of the broader integrated development.
 16. AIIB recognizes that the nature of urban growth (e.g. rural-urban migration, natural growth) and changing economic structures have long-term implications on the spatial transformation of cities. Once built, the physical forms and land-use patterns of cities will likely be locked in for several decades. Taking this into account, AIIB will consider investing in urban real estate developments to the extent that they clearly: contribute to achieving one or more of the GREAT outcomes; present significant public benefits beyond private benefits; and are part of the city's integrated masterplan. In particular, given the large and growing need for more sustainable and more affordable housing in Asia, AIIB will support the development of residential housing with significant social value, such as public rental housing and affordable housing. This is especially where the housing developments require investments in basic infrastructure and/or are part of a broader integrated development (e.g. new city/district development). AIIB will, however, not prioritize investments in residential housing and commercial developments that have largely private benefits and little social value, such as luxury villas.
 17. AIIB will gradually progress from financing relatively investment-ready projects to financing more complex projects across the three priority investment areas. Taking into consideration AIIB's prevailing client demand and institutional capacity during its early years of operation, in the short term (3 years), AIIB expects its infrastructure investments in cities to be largely focused on investment-ready projects that: (a) enhance urban mobility (such as metro systems); and (b) improve basic infrastructure and city resilience (such as water supply, sewerage, waste water treatment, and flood management). As AIIB learns from more experienced project partners and its growing operations, over the medium term (5 years), AIIB expects that its projects within each investment area of cities will increase in complexity, and that its portfolio of infrastructure investments in cities will broaden across the three priority investment areas and their respective sub-sectors.

18. In addition, there is an increasing number of initiatives to adopt innovation and digitization to help improve economic, financial, environmental and social outcomes in cities, such as smart cities. These innovations and technologies may be applied across the three priority investment areas that AIIB has identified, such as: intelligent traffic and transit; e-road pricing; smart outdoor lighting; environmental monitoring; and smart grid and metering. Where they have shown to be beneficial for the sustainable development of cities and are scalable in Asian cities, AIIB will also support investments in such innovations and technologies.

Figure 1: AIIB's priority areas for infrastructure investments in cities



19. **Financing instruments:** AIIB will aim to offer a variety of financing instruments, including government financing, private financing and PPPs, to deliver the best development outcomes for cities. With regard to government finance, in addition to providing sovereign-backed financing, AIIB will seek to support sub-national entities with higher implementation capacity through sub-national finance without sovereign guarantee. Over time, AIIB will seek to widen its range of non-sovereign-backed financing instruments and develop scalability in its more innovative financing instruments, such as local currency financing, credit enhancements for municipal bonds and green finance. As appropriate, financing to sub-national entities will be conducted in consultation with relevant national authorities. On private financing, AIIB will coordinate with its efforts and priorities as set out in AIIB's Strategy on Mobilizing Private Capital for Infrastructure. AIIB will also use its Special Fund to support project preparation for its investments in cities, especially where there is clear potential to improve project bankability and catalyze private investments.

20. **Strategic partnerships:** AIIB will continue to work closely with its existing partners and build new strategic partnerships. In addition to the other MDBs, AIIB will seek to collaborate with international and regional urban initiatives, such as 100 Resilient Cities, Cities Development Initiative for Asia (CDIA) and Local Governments for Sustainability (ICLEI), to identify projects in the early stage and complement the Bank's lean business model where possible. AIIB's partnerships with private financiers will also be particularly relevant and important for the Bank's infrastructure investments in cities. AIIB will build on these partnerships to develop a more granular understanding of and deepen its expertise in areas that are within the Bank's mandate and where the Bank has the potential to add significant value.

Results Monitoring Framework

21. All of AIIB's investments, including those in cities, will be prepared and implemented with the aim to ensure robust quality and a focus on delivering results, without compromising on the Bank's lean business model. Each project will be required to identify its expected results from the start of project preparation, and will be monitored for its achievement of the expected results during project implementation. As AIIB's infrastructure investments in cities will be targeted towards promoting elements of green development, resilience, efficiency, accessibility and/or economic growth, each project may consider demonstrating its contribution towards achieving one or more of the GREAT outcomes. Notwithstanding this, AIIB will need time to build the necessary capacity for project implementation and results monitoring. While the Bank will largely monitor project implementation and output in the short term (3 years), AIIB will also seek to learn from other MDBs and project sponsors' experiences and good practices, and where feasible, include relevant outcome measures in its monitoring framework. Some examples of project-level outcome measures that are being used by other institutions are provided in Annex A.
22. At the portfolio level, AIIB has identified a set of high-level indicators to monitor progress in implementing its Sustainable Cities Strategy (Table 1). The multi-sectoral nature of cities and challenges arising from cross-sectoral aggregation reinforce that input (i.e. investment amounts) and qualitative measures will be more feasible to monitor in the short term (3 years). Consistent with AIIB's approach to project-level monitoring, over time, AIIB will seek to learn from other institutions' experiences and good practices, and include aggregable outcome measures in its portfolio-level monitoring framework where feasible. In addition, where possible and available, the monitoring of infrastructure investments in cities will be aligned with the results monitoring frameworks set out in AIIB's other sector strategies, such as energy and transport.

Table 1: Portfolio-level monitoring indicators for the Sustainable Cities Strategy

Objectives	Portfolio-Level Output/ Outcome Indicators	Investment Amounts
Enhancing urban mobility	<ul style="list-style-type: none"> Number of cities where AIIB has invested in projects towards achieving one or more of the GREAT outcomes 	<ul style="list-style-type: none"> USD and percent of financing for enhancing urban mobility
Improving basic infrastructure and city resilience	<ul style="list-style-type: none"> Where possible and available, align with AIIB's individual sectors' results monitoring frameworks as set out in the individual sector strategies (e.g. energy, transport) 	<ul style="list-style-type: none"> USD and percent of financing for improving basic infrastructure and city resilience
Promoting integrated development		<ul style="list-style-type: none"> USD and percent of financing for promoting integrated development

23. As AIIB gains more operational experience and builds deeper institutional capacity, the Bank will periodically review and refine the portfolio-level monitoring indicators, as well as the Sustainable Cities Strategy, as appropriate. The timing of such reviews will be agreed with the Board of Directors in the context of the annual Business Plans.

**Annex A:
Examples of project-level outcome measures**

Project objectives	Description	Illustrative project-level outcome measures (unit)
Green	Protect and enhance environmental sustainability (e.g. pollution reduction, climate mitigation, biodiversity protection)	<ul style="list-style-type: none"> • Greenhouse gas emission reduced (tons of CO₂ equivalent per year) • CO₂, NO_x, SO₂ and/or particulate matter reduced (tons per year)
Resilient	Develop the ability to withstand both sudden shocks (e.g. natural disasters) and slow-onset impacts (e.g. through climate adaptation)	<ul style="list-style-type: none"> • People benefitting from disaster and/or climate resilient projects (number)
Efficient	Deliver the best possible outputs with the least possible inputs (e.g. reduce congestion) and minimize waste generated during the process (e.g. heat)	<ul style="list-style-type: none"> • Cost savings generated from utilization of less inputs (USD) • Industrial or municipal waste reduced or recycled (tons per year)
Accessible	Provide people (especially the low-income group) and trade with easier access to infrastructure and services	<ul style="list-style-type: none"> • People provided with improved urban living conditions, such as improved water supply, improved sanitation, regular solid waste collection, all-season roads, electricity (number and percent)
Thriving	Contribute to sustained economic growth and job creation	<ul style="list-style-type: none"> • Private capital mobilized⁸ (USD) • Direct employment generated during construction and during operation (number)

⁸ Cross-reference to indicators as set out in AIIB's Strategy on Mobilizing Private Capital for Infrastructure.