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RE-332

FIRST INDEPENDENT EVALUATION OF THE EXPANDED PROJECT SUPERVISION REPORT EXERCISE

Office of Evaluation and Oversight

Inter-American Development Bank
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ACRONYMS

ECG:	Evaluation Cooperation Group
EMS:	Environmental Management System
ERR:	Economic Rate of Return
ESHS:	Environmental, Social, Health and Safety
FRR:	Financial Rate of Return
IDB:	Inter-American Development Bank
IRR:	Internal Rate of Return
MDBs:	Multilateral Development Banks
OVE	Office of Evaluation and Oversight
PRI:	Private Sector Department
PPA	Power Purchase Agreement
SAR:	Semi-Annual Report
XPSR:	Expanded Project Supervision Report

EXECUTIVE SUMMARY

This document evaluates the first exercise of the Expanded Project Supervision Reports (XPSR) elaborated by PRI in 2006. The XPSR exercise was done in order to comply with the Good Practice Standards (GPS) of the Evaluation Cooperation Group of the Multilateral Development Banks (ECG-MDB). This document also reports on OVE's validation of the project performance ratings, findings and lessons learned that were identified in the XPSR exercise conducted by PRI.

The first finding of OVE is that PRI did not comply with the ECG requeriments because the number of projects evaluated by PRI (five) is lower than the minimum number of projects necessary to comply with the ECG requirements. All of the ten projects that achieved early operational maturity should have been evaluated. The small quantity of projects self-evaluated by PRI limited the possibility of extraction and generalization of in depth lessons learned from project implementation.

XPRS rate projects in three dimensions of performance: project development outcome, investment profitability to the IDB and operational effectiveness. In general terms, OVE concurred with the performance ratings defined by PRI. The analysis of XPSR's findings shows that the projects performed better both in development outcome and investment profitability (40% of highly satisfactory) than in their IDB's Operational Effectiveness standards, in which the projects presented the lowest overall performance (none of them highly satisfactory).However, OVE downgraded 13 % of the ratings rated by PRI, three of them in the development outcome performance and four of them in the IDB's Operational Effectiveness performance.

Most of the lessons learned from the XPSRs addressed the IDB's operational effectiveness, in particular, it stressed the importance of local knowledge to improve the appraisal work, closer monitoring to permit the adoption of promptly corrective actions during the project implementation, and the need to reduce legal costs.

Based on the findings and lessons learned from the XPSRs, OVE recommends the following: (i) PRI should comply with the ECG Guidelines in the exercise of 2007 by evaluating a representative sampling of projects that achieved early operational maturity; (ii) This exercise should be based on a predictable schedule agreed between OVE and PRI in order to permit a better feedback process; (iii) PRI should implement a systematic effort to fill the data gap presented by the XPSRs, especially those related to the IDB's operational effectiveness performance such as the reasons for client's prepayments, the client's survey links and project's fee analysis, which should also be available in the XPSRs; (iv) PRI should increase its efforts to identify lessons learned from all project dimensions, by stimulating the staff to exercise lesson identification from the project implementation experience; (v) PRI should stress whether some of the recommendations raised from the staff have been implemented and what their results have been, and finally, (vi) PRI should identify how other similar financial institutions are dealing with the following issues raised from the project reviews such as (a) the reduction of risk on loan prepayments and (b) the reduction of legal costs.

I. INTRODUCTION

1.1. In September 2005, after OVE had defined the guidelines for the implementation of the ECG Standards for the Private Sector (PS-125),[1] PRI committed itself to initiate the first self-evaluation of its projects in 2006. In accordance with the ECG, all projects that are completed or have reached early operational maturity – i.e. have generated at least 18 months of operating revenues after the their last loan disbursement or have elapsed 5 years from their approval date – are eligible to be self-evaluated. Based on this, ten PRI projects that had achieved early operating maturity from 2000 to 2005 (see Annex 1) should have been self-evaluated by PRI in order to comply with the ECG Guidelines referring to the exercise of the year 2006. [2]

1.2. This document evaluates the Expanded Project Supervision Reports (XPSR) prepared by the Private Sector Department (PRI). These reports are PRI's first attempt to comply with the ECG-GPS, which also require OVE to inform the Board of Executive Directors about the results derived from its validation of the XPSR's performance ratings, as well as about the findings and lessons learned from the XPSRs.

1.3. The XPSRs rated the projects based on three evaluative performance indicators defined by the ECG-MDB Guidelines as: (i) development outcome, (ii) investment profitability to IDB and (iii) IDB operational effectiveness (Table 1).

Table 1. Performance Dimension and Standards Indicators.

Performace Dimension	Standards Indicators (Std. # 27)
Project Development Outcome (Std. #26)	Project Contribution to Company Business Success (Std. 31)
	Project Contribution to Private Sector Development (Std. #31)
	Project Economic Viability (Std. #33)
	Project Contribution to the Country Living Standards (Std. #34)
	Project ESHS Impact and Sustainability (Std. 35)
	*Project Expected Outcome and Ouput Analysis (PCR Compliance)**
Project Investment Profitability for IDB (Std. #26)	Project Gross Profit Contribution to IDB (Std. #36)
IDB's Operational Effectiveness (Std. #26)	Screening, Appraisal and Structuring Work (Std. #37)
	Monitoring and Supervision Quality (std. #38)
	Role, Contribution and Additionality (Std. #39)

* This is only for projects that have logical framework and PPMRs from 2004 on. This rating will not be counted towards Project Development Outcome overall rating.

[1] See http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=584817. OVE recommended that PRI adopted ECG-GPS in RE-303 "Evaluation of the Bank's Direct Private Sector Lending Program 1995-2003", Annex IV. Otherwise, IIC has already prepared four annual reports until now and MIF is in the preparation phase of its first report for reimbursable operations.

[2] The ECG-Guidelines states that the sample of projects to be self-evaluated should be in a confidence interval of 95%. It means that for the universe of ten eligible projects, all of them should be self-evaluated.

1.4. The first finding of OVE is that the number of projects evaluated by PRI – five – is lower than the minimum necessary to comply with the ECG requirements – ten. However, based on the experience and lessons learned during the exercise, PRI can comply with the Guidlenes this current year by evaluating a representative sample of projects.

1.5. PRI concluded the preparation of the XPSRs in December of 2006 and sent them to OVE for validation with some supporting documentation. OVE revised all XPSRs and did not find evidence to support some XPSR's ratings, and found that some supporting information was missing as well. Then, OVE sent its consolidated comments on the XPSR's to PRI on January 2007. Finally, PRI incorporated most of OVE's suggestions and sent the final version of its XPSR's to OVE in February 2007.

1.6. This document is organized in three sections. The first, reviews and validates the PRI's ratings on the project performance indicators, checks the quality of the rating justification and verifies the completeness of the supporting information necessary to support the ratings. The second section focuses on the main findings of the XPSR analysis. The third section displays the lessons learned from the XPSRs and, finally, the document brings some conclusions and recommendations to Management.

II. OVE REVIEW AND VALIDATION OF SELF-EVALUATION

2.1. This section summarizes OVE's review of the 5 XPSR's prepared by PRI during 2006. This section briefly describes the projects selected by PRI and presents OVE's comments on performance ratings, rating justification, and the supporting information to the rating justification.

A. The Projects

2.2. PRI selected five of ten projects that reached maturity from 2000 to 2005 with the objective of reflecting the profile of the universe of eligible projects to be self-evaluated (Annex 1). It shows more loans (80%) than guarantees (20%) and a large concentration of loans in the energy sector (90% of the total). Brazil (40%) and Mexico (30%) had the largest number of operations in this universe of projects.

2.3. The projects selected by PRI consist of 4 loans to the energy sector - Energia Norte (*BR0316*), Bajio Gas-Fired Project (*ME0225*), Vitro CO-generation Plan (*ME0228*) and Redesur Transmission Line (*PE0210*) and one guarantee to concession roads - Santiago-Valparaiso-Vina del Mar Toll Road Project (*CH0167*).

Table 2. The group of projects self-evaluated by PRI

Project Number	Project Name	Type	Project Description	Total Project Cost (US$ million)	Total IDB Lending/Bond Guarantee Issue (US$ million)
BR0316	Energia Norte	Loan	Construction of a Thermo Power Generation in Isolated Areas	94,7	60,9
CH0167	Santiago-Val Paraiso- Vina del Mar Toll Road	Guarantee	Construction, Rehabilitation, Maintenance and Operation of Road	416,5	305,7
ME0225	Bajio Gas-Fired	Loan	Construction of a Thermo Power Generation	485,0	136,0
ME0228	Vitro Cogeneration Plan	Loan	Construction of Cogeneration Power	184,1	136,5
PE0210	Redesur Transmission Line	Loan	Construction of a Electrical Transmission Line	80,37	40,85

B. The Ratings

2.4. The XPSRs rated the projects based on three evaluative performances defined by the ECG-MDB Guidelines: (i) development outcome; (ii) investment profitability to IDB and (iii) IDB operational effectiveness.

2.5. Each of the performance dimensions and each of the standard indicators are assigned a rating based on a matrix that uses a standard four-point scale for each indicator rating. The scale ranges are (i) Highly Unsatisfactory, (ii) Unsatisfactory, (iii) Satisfactory, (iv) Highly Satisfactory.

2.6. In general terms, OVE concurred with the ratings defined by PRI. However, OVE downgraded 13 % (seven) of the ratings rated by PRI, three of them in the development outcome performance and four of them in the IDB's Operational Effectiveness (Table 3).

Table 3. OVE's Validation of the XPSR's Ratings

Ratings	a. Total	b. Adequate		c. Inadequate	
		Number	% (b/a)	Number	% (c/a)
Development Outcome	25	22	88	3	12
Investment Profitability	10	10	100	0	0
IDB Operational Effectiveness	20	16	80	4	20
Total	55	48	87	7	13

2.7. Regarding the development outcome performance, specifically in terms of private sector development, OVE downgraded three projects because they did not fulfill all the requirements established by the ECG Guidelines. Instead of rating them as highly satisfactory, OVE considers they should be rated as satisfactory. OVE downgraded the performance of both Mexican projects in terms of their contribution to private sector development because PRI did not provide the necessary information in order to justify that they supported a sustainable model of intervention in the sector, despite the fact that they contributed to introduce private participation in the sector and mobilized new actors for the country. Indeed, these projects support a contracting model with the state-owned CFE that has produced an increase in CFE's off-balance sheet liabilities to guarantee Power Purchase Agreement (PPA) payments that could be unsustainable in the long run.[3]

2.8. OVE also downgraded the rating of the *ME0225* project regarding ESHS impacts, from highly satisfactory to satisfactory, because PRI did not provide the necessary information in order to justify that the project also positively affected the environment or the social conditions in the local area, beyond the fact that the project did comply with all the environmental and social requirements of IDB safeguard policies.

2.9. Regarding IDB's Operational Effectiveness, OVE downgraded the ratings of both Mexican projects in IDB's Operational Effectiveness performance – the XPSRs have rated them as highly satisfactory *(ME 0225)* and satisfactory *(ME 0228)*. OVE judged that the *ME0225* performed only satisfactorily and the *ME0228* even did unsatisfactorily in monitoring and supervising quality standard.[4]

2.10. OVE downgraded the performance of *CH0167* in the same indicator – from highly satisfactory to satisfactory because the project had problems regarding affirmative convenants in the monitoring and supervision works that affected its rating. Likewise, OVE downgraded the performance of the Peruvian project *PE0210* on screening, appraisal, and structuring work from satisfactory to unsatisfactory because the project took a relatively long time to prepare compared to other similar projects. In addition, there is no evidence that the clients were satisfied with the quality and/or efficiency of the Bank's work on this subject.

C. Rating Justification

2.11. OVE found problems with 31 % of the rating justifications (see Table 4 below). Out of 45 justifications, four were considered inadequate (all of them referred to the Mexican projects) and ten were classified as incomplete.

2.12. Regarding to the development outcome justifications, the inadequacies reffered to fact that they incorrectly attributed to the Bank a positive contribution "to the development of regulatory framework of Mexican energy sector through its continued engagement in such sector, including the introduction of the self-generation scheme for IPP, and the opening of the market through making the out-of-area self generation process" (*ME0225*) and that "the project was consistent

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[3] OVE have already underscored this aspect in the Evaluation of the Private Sector Operations (RE-303). See also "Electricity in Mexico: When doing the right thing is not enough" by Luis Guzman, Severo Arana and Mariano Lopez in the 23rd IAEE North American Conference of the VI Annual Congress of AMEE in 21 of October of 2003 in Mexico City and "Power to Converge", Morgan Stanley, Equity Research Latin America, January, 2003.

[4] The reasons for the downgrade of these ratings will be analyzed in the paragraph 2.13.

with the Bank's energy policy" (*ME0228*), whereas the projects did not support a sustainable model of intervention in the sector, as explained in the paragraph 2.7 above.

2.13. Regarding to the operational effectiveness justifications, the inadequacies reffered to the fact that they neither reported the problems verified in the screening, appraisal and structuring works (*ME0225*) nor did they report the problems that occurred in the monitoring and supervision quality work (*ME0228*).

Table 4. OVE's Validation of the XPSR's Rating Justification

Ratings	Total	Adequate		Inadequate		Incomplete	
		Number	%	Number	%	Number	%
Development Outcome	25	22	88	2	8	1	4
Investment Profitability	5	0	0	0	0	5	100
IDB Operational Effectiveness	15	9	60	2	13	4	27
Total*	45	31	69	4	9	10	22

(*) The number of justifications is smaller than the number of ratings because the XPSR does not require justification to overall ratings.

2.14. Regarding the problems with incomplete justification found in the XPSRs, most referred to the Bank's investment profitability (50% of the total) and IDB operational effectiveness performance (40% of total). On the former, the XPSRs missed information about fees received during project execution; and regarding the latter, the XPSR missed either information about the average Bank's times or detailed client's opinion about the Bank's screen, appraisal and structuring work.

D. Supporting Information

2.15. OVE verified that 31% of the supporting information of the ratings was incomplete (see Table 5 below), mainly in the investment profitability dimension (100% of them) and IDB's operational effectiveness (40% of them).

2.16. The lack of supporting information in the XPSR jeopardized the rating justifications analyzed before. For instance, in some cases like in *BR0316*, the absence of information regarding Client's Surveys or fees impacted the completeness of the justification of the Bank's investment profitability and IDB's operational effectiveness.

2.17. However, OVE also verified a significant absence of supporting information in terms of the role, contribution and additionality of the IDB, mainly referring to the questions about coherence with Bank strategies, policies and programs. Finally, the lack of information about project projections vis a vis actual-to-date ones was also noticed by OVE.

Table 5. OVE's Validation of the XPSR's Supporting Information

Ratings	Total	Complete		Incomplete	
		Number	%	Number	%
Development Outcome	25	22	88	3	12
Investment Profitability	5	0	0	5	100
IDB Operational Effectiveness	15	9	60	6	40
Total	45	31	69	14	31

(*) The number of requirements of supporting information is smaller than the number of ratings because the XPSR does not require supporting information for overall ratings.

E . Internal Peer Review

2.18. Internal Peer Review Meetings were a positive aspect of the experience of the XPSR exercise. In particular, the Peer Reviews underscored suggestions for the improvement of the XPSRs, which will be taken into account by OVE for the next exercise. However, benefiting from the previous exercise, the next Peer Reviews could improve their capacity to identify possible lessons learned, as well as deficiencies in the XPSR that need to be corrected.

III. THE MAIN FINDINGS OF THE XPR ANALYSIS

3.1. This section has the objective to present the results from the analysis of the 5 XPSRs. Table 6 shows that all projects performed highly satisfactory and satisfactory in the development outcome and investment profitability indicators. However, two projects performed unsatisfactorily regarding IDB Operational Effectiveness: *ME 228* and *PE210*.

Table 6. – OVE's Validation of the PRI Projects

Performance Indicators/XPSRs	***BR0316***	***CH0167***	***ME0225***	***ME0228***	***PE0210***
III. Development Outcome Rating	Satisf	High Satisf	Satisf	Satisf	High Satisf
III.A. Company Business Success	Unsatisf	Satisf	Satisf	High Satisf	High Satisf
III.B. Private Sector Development	Satisf	High Satisf	Satisf*	Satisf*	High Satisf
III.C. Project Economic Viability	High Satisf	High Satisf	Satisf	Satisf	High Satisf
III.D. Country Living Standards	High Satisf	High Satisf	Satisf	Satisf	High Satisf
III.E. ESHS Impacts and Sustainability	Satisf	Satisf	Satisf*	High Satisf	High Satisf
III.F. Expected Outcomes and Outputs**	na	na	na	na	na
IV. Investment Profitability	Satisf	High Satisf	Satisf	High Satisf	Satisf
IV.A. Gross Profit Contribution	Satisf	High Satisf	Satisf	High Satisf	Satisf
V. IDB Operational Effectiveness	Satisf	Satisf	Satisf	Unsatisf	Unsatisf
V.A. Screening, Appraisal and Structuring Work	Satisf	High Satisf	Satisf	High Satisf	Unsatisf*
V.B. Monitoring and Supervision Quality	Satisf	Satisf*	Satisf*	Unsatisf*	Satisf
V.C. Role, Contribution and Additionality of IDB	High Satisf	High Satisf	High Satisf	High Satisf	High Satisf

(*) Ratings Downgraded by OVE;
(**)This section is only applicable for the projects that have Logical Framework and PPMR.

3.2. The analysis of Table 7 below also shows that the projects performed better in both development outcome and investment profitability (40% highly satisfactory) than in their IDB's Operational Effectiveness ratings, which present the lowest overall performance (none highly satisfactory).

Table 7. General Performance of the Group of Projects Self-evaluated by PRI*

Ratings /General Performance (%)	Highly Satisf	Satisfactory	Unsatisfactory	Highly Unsatisf
III. Development Outcome	40	60	0	0
III.A. Company Business Success	40	40	20	0
III.B. Private Sector Development	40	60	0	0
III.C. Project Economic Viability	60	40	0	0
III.D. Contribution to Country Living Standards	60	40	0	0
III.E. Project ESHS Impacts and Sustainability	40	60	0	0
*III.F. Expected Outcomes and Outputs***	na	na	na	na
IV. Investment Profitability	40	60	0	0
IV.A. Gross Profit Contribution	40	60	0	0
V. IDB Operational Effectiveness	00	80	20	0
V.A. Screening, Appraisal and Structuring Work	40	40	20	0
V.B. Monitoring and Supervision Quality	00	80	20	0
V.C. Role, Contribution and Additionality of IDB	100	0	0	0

(*) Based on the OVE's validated ratings of the XPSRs.;
(**)This section is only applicable for the projects that have Logical Framework and PPMR.

A. Project Development Outcome

3.3. For the Project Development Outcome dimension, the overall rating is constructed by measuring five standard indicators: 1. Project Contribution to Company Business Success (Std. #31), 2. Project Contribution to Private Sector Development (Std. # 32), 3. Project Economic Viability (std. #33), 4. Project Contribution to the Country Living Standards (std. #34) and 5. Project ESHS Impact and Sustainability (std. #35 and #30). Each standard indicator was rated following specific benchmarks.

3.4. The project economic viability and contribution to country living standards had the best ratings among the development outcome indicators (60% of highly satisfactory). In contrast, the project contribution to company business success, to private sector development, and to ESHS impacts and sustainability achieved relatively lower performances (40% of highly satisfactory).

3.5. Both project economic viability and contribution to country living standard ratings are confirmed by ex-post economic evaluation that found ERR above 20% in the cases of Brazil, Chile, and Peru and slightly above 10% in the case of Mexico. They reflected a wide range of project benefits regarding the boost of productive activities and the expected positive impacts on improving overall local living conditions by enhancing a reliable supply of energy in remote areas (*BR0316*) [5] and

[5] For instance, the XPSR documents that the *BR0316* project contributed to reduce the duration of service interruption in the market supplied by the company by 70% from 2000 to 2004.

increasing the electrification coefficient (*PE0210*).[6] Other projects estimated increasing in the GDP from the delivering of the infrastructure (*CH0167*).[7]

3.6. Regarding the project contribution to company success, two out of the five projects performed highly satisfactorily (*CH0167* and *PE0210*) - achieving FRR higher than expected, both Mexican projects did satisfactorily - achieving FRR as expected – and, finally, the BR0316 project reached a FRR lower than expected in the appraisal phase.

3.7. Therefore, the ratings for the project contribution to private sector development ranged from highly satisfactory (*CH0167* and *PE0210* projects), i.e. projects that have already achieved clearly evidenced demonstration effects, to satisfactory (*BR0316*, *ME0225* and *ME0228* projects), i.e. projects which demonstration effects are yet to be observed. In the first case, the projects contributed either to increase the confidence of the market in infrastructure local bonds (*CH0167*) or to consolidate the private model in the industry (*PE0210*). Otherwise, all projects contributed to the business climate by either enhancing of energy supply or improving the logistic corridor to exportation.

3.8. Finally, all projects fully comply with all environmental and social requirements of the IDB project legal agreement. They also apply the Bank's safeguard policies and environmental and social impacts and risks procedures. In particular, the *ME0228* and *PE0210* projects show evidence to have positive environmental effects by either substituting pollutant plants by environmentally-friend equipments (*ME0228*) or by achieving ISO certification on quality, environment and on occupational health and safety (*PE0210*).

B. Project Investment Profitability for IDB

3.9. The rating for Project Investment Profitability for IDB is based on its Gross Profit Contribution to IDB (std#36), by comparing the project achieved performance and a minimal satisfactory expected performance at the time of project approval.

3.10. From the analysis of the XPSRs it is possible to note that 40% of the projects performed highly satisfactory regarding the dimension of project investment profitability for IDB. In general, the projects have received their payment obligation since their inception and their "risk classification" has been "satisfactory" through project execution. The main finding of this dimension was the importance of the project's security package to mitigate borrowers' financial limitations (*BR0316*). The borrower of this project, as well as the borrowers of the *ME0225* and *PE0210*, prepaid their loans.

[6] The *PE0210*'s XPSR reports that from 1998 until 2002, the electrification coefficient increased from 88% to 94.5% in Arequipa, from 79% to 85.8% in Moquegua, from 35% to 49% in Puno and from 88% to 97.2% in Tacna.
[7] The *CH0167*'s XPSR's states that the project is expected to increase GDP of the regions linked to the projects by 0.12% and 0.16% respectively for the period of 2005-2010.

C. IDB Operational Effectiveness

3.11. For the IDB/PRI Operational Effectiveness dimension, the rating is constructed by the measuring of three standard indicators: (1) Screening Appraisal and Structuring work (std. #38). (2) Monitoring and Supervision Quality (std. #38). (3) Role, Contribution and IDB Additionality (std. #39).

3.12. The analysis of the overall performance of the projects on operational effectiveness undercores that 80 % of the projects were rated satisfactory. This overall performance hides distinct performances of the projects in the specific indicators that compound the "operational effectiveness" indicator. Indeed, while all projects were highly satisfactory in the IDB additionality, none of them achieved high performance in monitoring and supervision quality works, in which 20% of the projects performed unsatisfactorily. At the same time, while 40% of the projects performed highly satisfactory in the screening, appraisal, and structuring work standard, 20% of them performed only unsatisfactorily.

3.13. Regarding IDB's additionality, the main contribution of the projects are the following:

(i) *financial additionality* by providing longer term than the available commercial financing average term at the time of the loan approval (*BR0316*, *CH0167*, *ME0225* and *ME0228*) and catalytic effect, by helping the company to mobilize other financial resources (*BR0316*, *CH0167*, *ME0225*, *ME0228* and *PE0210*) and by contributing to improve the credit rating on the bond issued by the company (*CH0167*).

(ii) *environmental additionality* by requiring compliance with higher environmental and social standards than prevailing at the time of the project approval (*BR0316* and *PE0210*) and by ensuring the project's compliance with the international and World Bank's standards (*CH0167*, *ME0225* and *ME0228*);

(iii) *corporate governance* by introducing obligations on share transfer as well as labor and ethics norms (*BR0316*, *ME0225* and *ME0228*), by mitigating legal problems among sponsors (*CH0167*), by including minimum equity requirements, covenants on share transfers and contributing to improvement of borrowers/sponsors internal control and external audits (*ME0225* and *ME0228*);

(iv) *regulatory additionally* by supporting private investments on a innovative scheme of present value of the revenue was utilized as variables for the adjustment of the concession (*CH0167*) and by mitigating the regulatory risk for the sponsor (*PE0210*)

3.14. Based on the XPSRs, the reasons that explain a lower performance on screening, appraisal and structuring indicator, are the following: (i) construction and installation risks due to the political factors that were not fully identified at the time of loan preparation (*BR0316*); (ii) client perception that Bank requested additional guarantees for the revenues associated to the excess capacity over the PPA contracted capacity, carrying expensive legal costs associated to this structure (*ME0225*); (iii) longer processing time for the project (*PE0210*); and (iv) evidence that the client was not satisfied with the quality and/or efficiency of the Bank's work (*PE0210*).[8]

3.15. Therefore, the XPSRs explained the lower performance rating for monitoring and supervision quality on the following terms (i) when the project was rated as satisfactory, the XPSRs identified several non-compliance on the reporting requirements even though the project team's repeatedly requested to the company's sponsors the compliance with financial statements, construction progress and consultant's insurance reports on time (*BR0316*), historical debt service coverage ratio (*PE0210*) or affirmative covenants (*CH0167* and *ME0225*); (ii) when the project was rated as unsatisfactory, the XPSRs identified several non-compliances of its reporting covenants for more than 6 months (*ME0228*).

IV. LESSONS IDENTIFIED FROM THE XPSRS

4.1 Lessons learned represents one of the most important issues in the XPSR exercise because their identification brings the opportunity to improve PRI investment as well as its role and its operational effectiveness in the future. However, from the XPSRs analysis, OVE hardly found prescriptive or operationally oriented lessons in order to provide guidance for future Bank's performance.

4.2 Regarding the three overall performance indicators, the XPSRs presented an asymmetrical capacity of assimilation of lessons from project implementation. While all XPSRs extracted lessons from the IDB's operational effectiveness performance and 80% of them did the same regarding project development outcome, only 40% of the XPSRs did it from project investment profitability for IDB. One positive aspect was that most of the lessons were extracted from the indicators with the poorest performances. It is worth noting that the Peer Reviews did not help to fulfill the gap of lessons learned in the other dimensions.

4.3 Following the ECG Guidelines, OVE classified the Lessons learned extracted from the XPSR discussed above in the three general categories of indicators, as following: (i) project development outcome, (ii) project investment profitability for IDB and (iii) IDB's operational effectiveness. These lessons are displayed in the next sections.

[8] The *PE210* XPSR's acknowledged that "the sponsor jeopardized the negotiations for the structuring of the financing and proper risk allocations and by the refusal by the sponsor to contract directly US counsel and to rely mainly on its local counsel only made negotiations process more complicated and lengthy."

A. Project Development Outcome

4.4 The XPSRs underline three issues in their lessons learned regarding the project development outcome performance of the projects: (i) strengthening of the project evaluability; (ii) improvement of the coordination intra IDB's areas and (iii) promotion of local market interventions.

4.5 *Strengthening of the Project Evaluability*. The lack of logical frameworks (LF), which were started to be prepared by PRI in 2004 - impaired the verification of the project development objectives. This is particularly important regarding projects in which their expected ERR is bigger than their FRR, i.e. projects situated in isolated areas.

> **Box 1: Lessons Learned as stated in the XPSRs**
> *Strengthening of the Project Evaluability*
>
> " There could have been more recognition from the Bank regarding positive aspect of the Project – mainly the achievement of its development objectives – rather than focusing on the financial issues faced by the project and the lenders. (…) The assessment of the development outcome of this project must take in account its difficulties such as to be located in an isolated area, with limited growth potential and subject to natural aspects not common in most of the projects financed by the Bank" (*BR0316*).

4.6 *Improvement of the coordination intra IDB's areas*. The projects' execution stressed the importance of the an in-depth coordination among the public and private branches of IDB Group to boost the implementation of overall structural reforms in the sector put in place concomitantly with the project.

> **Box 2: Lessons Learned as stated in the XPSRs**
> *Improvement of the coordination intra IDB's areas*
>
> "When the potential benefit to the private sector development include the overall structural reform of the regulatory framework of the sector, its impact should not be overestimate. However, the involvement of the Bank in the preparation of the specific project would still contribute to the improvement of the regulatory framework. Proper sector analysis and coordination with the Regional Department would be the key in this regard". (*ME0225* and *ME0228*).

4.7 *Promotion of Local Market Interventions.* The highly satisfactory ratings of the project performance were achieved by projects that supported local funding mechanisms.

> **Box 3: Lessons Learned as stated in the XPSRs**
> *Promotion of Local Market Interventions*
>
> "The use of innovative financial instruments, such as Partial Credit Guarantee for the bond issuance in the local capital market strengthen the Bank's contribution to the financial viability of the project by supporting clients access to local currency resources, as well as to the country's private sector development by developing local capital market and mobilizing local investors such as pension funds" (*CH0167*)

B. Project Investment Profitability to the IDB

4.8 The XPSRs emphasize two issues in their lessons learned regarding the project investment profitability to the IDB: (i) flexibility to response to market conditions; and (ii) adequate contractual mechanisms to mitigate project execution delays.

4.9 *Flexibility in Response to Market Conditions*. Several XPSRs identified changes in the market conditions that led the clients to prepay the loan. The occurrence of Loan prepayments is evidence that the clients have been finding better alternatives in the market to replace their financial obligation with the IDB. Therefore, the Bank should develop new mechanisms in order to maintain strategic clients in the Bank's portfolio. It could be facilitated by the implementation of client surveys about quality of the Bank's services in order to better identify client levels of dissatisfaction with Bank services.

Box 4: Lessons Learned as stated in the XPSRs

Flexibility in Response to Market Conditions

"The Bank should find a way to flexibly adjust its lending rate, while safeguarding its financial return and the principle of the market-based pricing". (*ME0225*) "The Bank should structure the loan to protect against prepayment to the extent possible. Prepayment premium cannot always work as a deterrent to the prepayment". (*BR0316*).

4.10 *Adequate Contractual Mechanisms to Mitigate Project Execution Delays.* The XPSRs identify the importance of contractual obligations to Enforce Client's Compliance. The Bank succeeded in this regard given that even poorly performing projects did not result on payment delays or defaults.

Box 5: Lessons Learned as stated in the XPSRs

Adequate Contractual Mechanisms to Mitigate Project Execution Delays

" Even before such reorganization, despite the financial difficulties faced by the Project, the Borrower honored all its payment obligations to the Bank, evidencing that a poorly performing project does not necessarily result in payment delays or defaults. The Bank's borrowers generally assign a very high priority to the Bank's debt service, regardless of their financial situation."(*BR0316*) "Construction delay could impact not only financial/business viability, but also the development impact (i.e. ERR) of the project. In order to mitigate the financial impact of the construction delay, financial strength and commitment of the sponsors toward the success of project is important, since some compensation, such as liquidated damage, would be required should a delay occur". (*ME0225* and *ME0228*).

C. IDB's Operational Effectiveness

4.11 The XPSRs underscore three issues in their lessons learned regarding the IDB's operational effectiveness: (i) the need for a reduction in legal costs; and (ii) local knowledge can improve the appraisal work.

4.12 *The need of measures in order to reduce legal costs*. High transaction costs leave the Bank at a competitive disadvantage regarding other financial institutions. The XSPRs brought evidence of client dissatisfaction with the IDB's transaction costs, mainly linked with due diligence and some of them identified lessons stressing the need to hire local lawyers in order to mitigate these costs.

Box 6: Lessons Learned as stated in the XPSRs
The need of reduction of legal costs

"The complicate structure of the deal (potential sale to the third parties) resulted in the relatively high legal costs, which were born by clients. Some measures need to be developed to reduce the transaction costs associated with legal aspect". (*ME0225*).
"To avoid the distortions on the interest spread charged to the Borrower, that might result from a delay in the achievement of project milestones, it is advisable that the Interest Spread Schedules be linked to fixed dates and not to project milestones (i.e. Project Completion). Otherwise, delays in Project Completion will automatically imply delays in the application of higher interest spreads"(*ME0228*).

4.13 *Local knowledge can improve the appraisal work*. Regarding the preparation of projects, some lessons addressed the need of incorporation of local knowledge as a measure to improve the appraisal work thereby mitigating execution projects risks. The hiring of local lawyers would also contribute to reduce legal costs. Similarily, some projects addressed the need of hiring US counsels to mitigate the lack of experience of local sponsors.[9]

Box 7: Lessons Learned as stated in the XPSRs
Local knowledge can improve the appraisal work

"Thee original projection of the construction was optimistic on the prospect on the construction, particularly on the geographical condition (isolated area) of the project. It is recommended to involve local engineers or specialist familiar with the region in order to plan the construction and anticipate the progress in a more accurate manner."(*BR0316*). (…)" Presence of the local sponsors those are familiar with the local condition and the quality of due diligence were critical in the accurate prediction of traffic revenue". (*CH0167*).

[9] As states in the XPSR: "Projects with sponsors new to the Region and or inexperienced in project finance transactions are likely to be more complicated due to the learning curve of the sponsors. Use of US counsel with project finance experience by sponsors is recommended to avoid lengthy negotiations that would otherwise not be necessary "(*PE0210*).

4.14 *Close monitoring is key to project supervision*. The adoption of corrective actions on time was correlated to the Bank's close monitoring of project executions.

Box 8: Lessons Learned as stated in the XPSRs
Closing Monitoring of the project execution

"The close monitoring of the environmental and social aspects was a key to solve the resettlement issue through the Corrective Action Plans. (Monitoring visits) Annual monitoring visits have helped the company and IDB, as Guarantor representative, to improve communication, to plan on the project's ongoing requisites with respect to certain milestones (i.e. projects completion), and/or request for more flexibility under the project documents." (*CH0167*) (…)
"The Bank should carefully analyze and monitor the sponsors' overall business and financial strength so that the Bank can take immediate mitigation and remedial action when a sign of deterioration of the company's performance and business is detected. Frequent contact with the Borrower and the Independent Engineer helped to obtain revised/updated estimates of the project's achievement of key milestones (i.e. Project Completion Date), in spite of the Borrower's optimistic expectations." (*ME0228*).

V. CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

5.1 Although the first exercise of XPSR elaborated by PRI in 2006 represents a step forward, PRI did not comply with the ECG Requeriments yet because the number of projects (five) evaluated by PRI is lower than the minimum amount of projects necessary to comply with the ECG requirements – all ten projects that achieved early operational maturity must be evaluated. Because the number of projects is too small to be representative, it is also restricted the OVE's capacity of extracting lessons learned and findings from the XPSR exercise.

5.2 In general terms, OVE concurred with the PRI's ratings. Indeed, the problems verified layed more on the adequacy of the rating justifications and information completeness than in the suitability of the ratings. Indeed, OVE downgraded 13% of the ratings while verified that 31% of the justifications and supporting information should be improved or completed.

5.3 The XPSR analysis underscored that PRI projects performed better both in development outcome and investment profitability (40% of highly satisfactory) than in the their IDB's Operational Effectiveness ratings (none highly satisfactory, 80% satisfactory). In general, these performances reveal a strong contribution to the projects regarding financial, environmental, regulatory and corporate governance as well as economic viability and contribution to country living.

5.4 The XPSR also showed that further efforts should be made in terms of screening, appraisal and structuring work, and monitoring and supervision quality, which are the standards where the projects presented worse performance. In particular, the XPSRs identified the occurrence of some non-compliance on the reporting requirements and some evidence that the client was not satisfied with the conducting of the Bank's work.

5.5 The small quantity of projects self-evaluated by PRI during this XPSR exercise limited the possibility of extraction and generalization of in depth lessons learned from project implementation. Despite this, it is worth noting that the major part of the lessons learned addressed the IDB's operational effectiveness, in particular, it stressed the importance of local knowledge to improve the appraisal work, of closer monitoring to permit the adoption of promptly corrective actions during the project implementation and the need to reduce legal costs.

B. Recommendations

5.6 PRI should apply the lessons from this first XPSR exercise in order to comply with the ECG Guidelines in the exercise of 2007 by committing itself with the evaluation of a representative sample of projects that have achieved early maturity;

5.7 The compliance with the ECG Guidelines should be based on a predictable schedule agreed between OVE and PRI. This would permit a better feedback process; thereby improving the XPSR exercise;

5.8 PRI should implement a systematic effort to fill the data gap presented in the XPSRs, especially those related to the IDB's operational effectiveness such as client prepayments, client survey links and project fee analysis, which should be available in the XPSRs;

5.9 PRI should increase its efforts to identify lessons learned from all project dimensions, by stimulating the staff to excersise lesson identification from the project implementation experience.

5.10 Therefore, in the next XPSR, PRI should stress whether some of the recommendations raised from the staff have been implemented and what their results have been.

5.11 Based on the identified lessons learned, PRI should identify how other similar financial institutions are dealing with the following issues raised from the project reviews: (i) the reduction risk in loans prepayments and (ii) the reduction of legal costs.

ANNEX

Universe of PRI projects that were eligible to be self-evaluated in 2006

Project Number	Project Name	Approval Year	Was the project Disbursed?	Was the Project Completed?	Are there more than 18 months of operating revenues or lending operations?	Is the Financial Statement Covering 12 month of operating revenues?
BR0304	Cana Brava Hydroelectric Power	2000	Yes	Yes	Yes	Yes
BR0315	Power Plant Dona Francisca	2000	Yes	Yes	Yes	Yes
BR0316	North Energy	2000	Yes	Yes	Yes	Yes
BR0350	Light – Electricity Services (Guarantee)	2000	Yes	Yes	Yes	Yes
CH0167	Santiago-Val Paraiso – Vina Toll Road (Guarantee)	2000	Yes	Yes	Yes	Yes
ME0225	Bajio Power Plant	2000	Yes	Yes	Yes	Yes
ME0228	Vitro Cogeneration	2000	Yes	Yes	Yes	Yes
ME0229	Monterrey III Power	2000	Yes	Yes	Yes	Yes
PE0210	Redesur Transmission Line	2000	Yes	Yes	Yes	Yes
PN0136	Chorrera Power	2000	Yes	Yes	Yes	Yes