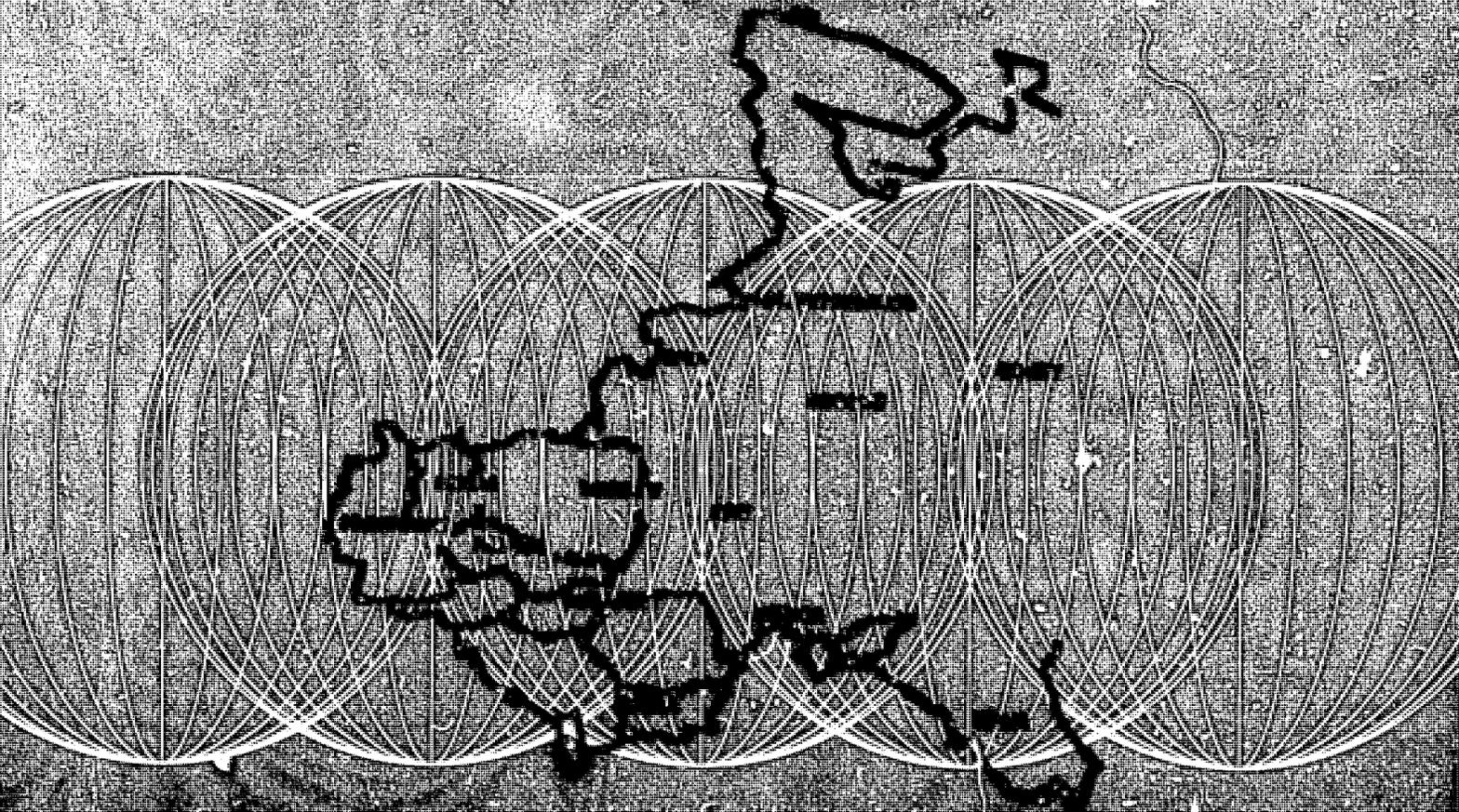
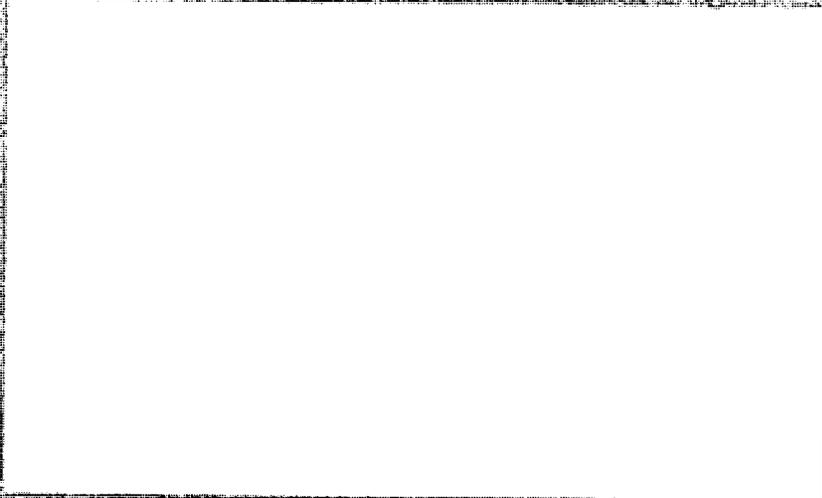


PN DEN-1971

**AN INTERNATIONAL ACTIVITIES PROJECT**

**FROM PLANNING TO MARKETS**

**HOUSING IN EASTERN EUROPE**



**THE URBAN INSTITUTE**  
Prepared for the Office of Housing and Urban Programs (USAID)

**Assistance in Urban Planning  
and Development**

**Report of Field Mission  
to Budapest**

**September 25 to October 9, 1992**

by

David Dowall  
Katharine Mark  
Iván Tosics

UI Project 6283-08

(in cooperation with the International  
City-County Management Association  
and the Urban Land Institute)

October 1992

USAID Contract EUR 0034-C-002034-00

## Assistance in Urban Planning and Development

### Report of Field Mission to Budapest

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#### I. SUMMARY OF MISSION

At the request of Budapest Mayor Demszky, the Office of Housing and Urban Programs of the United States Agency for International Development sent a mission to Budapest to assess possible technical assistance needs related to urban development planning, public real estate development, economic strategic planning, development regulation and control, public participation in planning, and the prioritization, capital budgeting and financing of urban development projects. The mission team consisted of David Dowall, Katharine Mark and Iván Tosics. From September 25 to October 9, team members met with over 30 decision-makers, planners and technical staff from the City of Budapest, Budapest Water Works, Districts IV, VIII and XVII, private real estate developers, urban development consultants and faculty of the Technical University. The Annex contains a list of persons contacted. The mission's activities were coordinated by the Office of the Deputy Mayor of Budapest, Dr. István Schneller. Dr. Zoltán Csorba served as the principal counterpart for coordination, and the team is grateful to him and his staff for their assistance.

The scope of discussions was wide-ranging focusing on strategic planning for economic development, industrial and residential rehabilitation, transportation and public works development, project budgeting and financing methods and the system of City-level and District-level approaches to master planning, urban design and development control. Throughout the interviews, the mission attempted to identify critical problem areas and opportunities for technical assistance.

Based on these discussions, the Office of Housing and Urban Programs of the U.S. Agency for International Development proposes a collaborative USAID-Municipality of Budapest program of technical assistance to:

- 1) develop a strategy for the urban economic revitalization and restructuring of the city's industrial, commercial and residential areas which is based on a careful assessment of the Budapest economy and a realistic capital budget program;
- 2) facilitate the development and self-financing of infrastructure and major public investments by providing technical assistance on: methods of cost recovery, new approaches to resource mobilization, municipal-level capital budgeting and project prioritization;
- 3) introduce new methods of public-private real estate development; and
- 4) promote new methods for strengthening citizen and intergovernmental participation and cooperation as it relates to urban economic development planning and policy-making.

- 1 -

As is fully described in section III, we propose a program of technical assistance which links top down broad analytical and policy support with bottom up activities aimed at defining and supporting specific urban development projects. This dual approach will enable the Municipality to develop much-needed skills across municipal staff and to assist in the direct application of new analytical tools, policies and procedures to concrete projects. In the short run we propose a series of technical assistance activities to help the city implement targeted urban development projects. In the longer run we intend to assist the Municipality in preparing urban economic development strategies and prioritizing and designing realistic financing structures for major capital investment projects. The proposed technical assistance will also address in all efforts the importance of building cooperative relationships between the Municipality and districts.

Before leaving Budapest, the team presented a broad outline of the proposed program to the City and received a general positive response. Some conditions that the city will need to agree to were touched upon, including the establishment of a Municipal Economic Information Office, assignment of counterparts to work on each part of the technical assistance program, and serious efforts to develop productive cooperation with the districts in each component of the assistance. To address this last issue directly, a City-District steering committee should be set up for the overall assistance program. It is envisaged that this committee would meet at the inception of the program and at regular intervals (perhaps every three months) thereafter to be briefed on progress and results.

This report outlines the results of the team's assessment of technical assistance needs of the Budapest Municipality. The next section provides an assessment of Budapest's critical urban development issues. Section III outlines a detailed set of recommendations for technical assistance activities. Section IV proposes a schedule for the detailed technical assistance activities.

## **II. URBAN DEVELOPMENT ISSUES AND OPPORTUNITIES FOR BUDAPEST**

Budapest is and will continue to serve as Hungary's major center of economic activity. It is the principal engine of national economic growth, serving as an incubator for new and emerging enterprises and the market where goods, information, labor and other services are exchanged. As the capital and the main business center of the nation, Budapest serves as the front-door through which foreign investors enter the nation. If the city is inefficient and outmoded and if it is difficult to do business there, foreign capital will go elsewhere.

### **Increasing Urban Economic Productivity**

At present the Budapest Municipality has no coherent framework for addressing either the short run problems posed by the transition to a market economy or the longer term challenges concerned with positioning the City in an integrated European economy. Instead crisis management prevails. Technical assistance is needed to help municipal decision makers. In the

short run, the Municipality must respond to the myriad of economic pressures created by the transition to a market economy by providing a politically and economically appropriate framework for economic restructuring. This requires a strategic plan for realizing future economic development objectives, a flexible but environmentally friendly planning and development control system and a municipal finance system that reflects the new realities of dwindling fiscal resources and the imperatives of self-financing and cost-recovery. Central to this municipal finance system is a framework for project evaluation, prioritization and capital budgeting.

In the longer term Budapest must consider how to make its city more economically productive so that it can effectively compete in an integrated Europe. The extent to which Budapest can attract international capital to spark its emerging market economy will depend on the city's competitive position relative to other central European cities, such as Prague, Vienna, Berlin, Warsaw and Kiev. However, decades of limited capital investment, and poor planning have eroded the city's economic efficiency. Consequently, urban development planning and project implementation will play a critical role in rejuvenating Budapest's economy and repositioning the city in Europe's market economy.

Increasing Budapest's economic productivity will require major improvements to its urban infrastructure and land use patterns: modernization of its air and rail terminals, upgrading the telecommunication system, increasing the supply of modern warehouse and industrial estates, promoting the development of modern office buildings, improving the quality of its housing stock and increasing the quality and skill level of its labor force. Additionally, the Municipality should concentrate on providing development opportunities for the private sector, by facilitating the redevelopment of industrial areas.

Such activities are underway in Western Europe, where governments have launched large-scale urban redevelopment projects to provide land for economic restructuring and modernization. Projects carried out in Lyon, and Glasgow and the new urban development proposals being prepared for Berlin illustrate the urgency of urban development initiatives to improve urban economic productivity and the priority they are accorded by municipal and national governments.

Successfully meeting these challenges requires a number of new initiatives to modify the current structure and process of urban development planning, project finance and intergovernmental relations. First and foremost, the present approach to master planning, where reliance for urban planning is based on urban design-oriented static master and detailed structure plans must be recast on the basis of an economic development strategy which seeks to position Budapest as a major regional center of economic activity in a new unified Europe. Such a strategy must be grounded on a careful and realistic assessment of the city's economic strengths and weaknesses and its competitive advantages compared to cities in other transition economies. It must also identify and prioritize the critical capital investment projects needed to enhance the city's competitive position. Given the critical nature of the proposed urban economic analyses and strategies, a new center for economic development should be established in the city and staffed with two to three senior economists.

The urban economic development strategy should formulate concrete plans for attracting international capital, enterprises and businesses and identify what new public and private investment programs are necessary to attract these activities. Strategies should be developed to restore and revitalize the physical assets of the city, including its infrastructure, its housing stock and other public and private properties. The overall master planning process should be modified to reflect this new orientation to economic development with more emphasis placed on implementation and programming and less on development and urban design control.

The second area for reform centers on municipal finance. One of the most dramatic effects of the transition to a market economy is the decline in fiscal resources flowing from the central to local government. The current prospect for continued central government support is grim; next year the city's share of personal income tax receipts is projected to decline by 40 percent because of a country-wide policy to reduce central-local subventions. These cuts make it difficult for the city and the districts to finance urban development projects from the budget. Therefore the city and the districts must develop new methods of financing urban development--to the extent possible, infrastructure improvements should be self-financing. Technical assistance should center on identifying a range of tools for resource mobilization such as user fees and charges, assessment districts, beneficiary charges, and joint public-private development of projects which can cross-subsidize infrastructure investments. In an era of dwindling resources and the urgent need to revitalize the Budapest economy, the Municipality should prioritize urban development projects to insure that investments essential to rebuilding the city's economy quickly move forward.

A third area of reform and technical assistance centers on the institutional structure for urban economic development planning, specifically the overlapping and sometimes adversarial roles of the city and the districts. The current process of master planning and development control, where both the Municipality and the districts have authority to plan and regulate urban development, is cumbersome and inefficient. The process makes real estate development difficult and costly to carry out and consequently it limits the ability of the municipality to attract capital. New cooperative approaches to urban economic development planning must be created. Such approaches should be based on collaborative policy and strategic planning activities with the districts and joint initiatives between municipal utility providers like the Budapest Water Works and specific districts.

The rest of this section provides an overview of urban development problems, issues and technical assistance opportunities, including: the institutional setting for urban development planning, industrial restructuring, infrastructure conditions, housing conditions and municipal finance practices.

### **Institutional Setting for Urban Development Planning**

The ability of planners and decision-makers to respond to short and long term urban economic development challenges is largely conditioned by the institutional structure in which

they work. This section provides a brief overview of the institutional environment, highlighting the major issues affecting urban development. Unique in Hungary, the administrative structure of Budapest consists of 22 district local governments (each having a mayor and an assembly) and a municipal government. This "double-level local government" structure generates numerous problems and contradictions.

### Municipal Government Decision-Making Structure

A key feature of the new institutional system is the authority given to the local assembly. After the local elections of September 1990, a new local assembly has been formed, consisting of 88 members, 22 of whom are delegated by the districts and 66 of which are directly elected by the parties. Following the elections, the structure of the Office of the Mayor was changed, and 25 departments were formed. Mainly because of the bad legacy of the powerful executive committee the new elected local assembly did not accept the formation of any executive body. This new structure provides no formal institutional mechanism for the coordination of the Municipality's 25 departments. It also fails to provide a process for liaison between the City and the Assembly. Consequently, this new institutional structure produces a complex, difficult to follow process.

### Relationship Between the Municipal and the District Governments

A second major change is that the previous hierarchy between the Budapest municipality and the districts (with the clear dominance of the municipal level) has been dissolved and the municipality has lost almost all of its 'county government like' rights which were generally withdrawn in Hungary after the change in political system. The Capital Act defines the responsibilities of both levels but in general the district level has been considered as local government. This is easy to be seen from the fact that all normative grants in connection with the 'basic tasks' are channeled from the state budget directly to the districts, (personal income tax, P.I.T. revenue is shared between the municipality and the districts on the basis of a joint decision). The Law on Transfer of State Property transferred the ownership of public housing to the districts; the municipal level's asset consists of some of the previously state-owned plots and of all the utility companies.

The Capital Act has been accepted by Parliament and took only partly into account the political compromise (achieved after several months' fighting) between the Mayor of Budapest and the majority of district mayors. In its present form this law is generally considered to be unsatisfactory and its total revision seems to be unavoidable before the next local elections. Some efforts at administrative reform are now underway under the municipality's sponsorship.

These new laws make it difficult for the Municipality to coordinate urban development effectively. The city has lost much of its property, and most of its direct administrative power

over the districts. There are some possible directions which the city can pursue to better manage urban development. These include:

1) developing the remaining property of the municipality (some plots, public work enterprises) in order to promote key economic development objectives;

2) providing a leading role (although conditioned by the consent of a majority of districts) in resolving budgetary issues such as the allocation of PIT revenue and in setting the rules on local taxes;

3) using its ownership of key utilities such as the water works to stimulate economic development and pioneer new approaches to the financing of major urban development projects; and

4) using its authority to prepare master plans as a vehicle to coordinate planning and capital budgeting aimed at the long term economic and physical development of the city.

The municipality and the districts seem to have similar amounts (2000-2500 each) of vacant properties.<sup>1</sup> The right of first refusal is given to both when either executes a real estate transaction. The municipality is creating its own asset-inventory and the same is being done by the districts. While there are cases of cooperation, most districts are distrustful of the Municipality and are reluctant to share information. As a result, there is not much likelihood of developing an integrated database on the assets available for developers in the capital.

Distrust is strong and results not only in withholding information from a joint database but also inclines districts to pursue independent real estate development projects. In the municipal government all properties with a value over 100 million forints fall under the exclusive decision making authority of the assembly; the Property Committee deals with properties in the value range 10-100 million and the Mayor can only decide about properties below 10 million. There are districts where all actions (even those covering a single property) require assembly decision. These assemblies have long weekly sessions which are inefficient and time consuming.

The municipality plays a leading role in budget preparation concerning those tasks which do not exclusively belong to the districts. After long discussions a quite complicated but well designed and functioning system has been worked out to allocate personal income tax revenue between districts and the Municipality. Districts are fully involved in this process and their interests are seriously taken into account because the final agreement requires the consent of a majority of districts.

The municipality also has a role in setting (again with the consent of the majority of districts) the rules on local taxes. According to the recent praxis, the decision making power over

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<sup>1</sup>There are no exact figures available and the exact numbers of properties is a subject of considerable debate.

all local taxes (except of the entrepreneurship-tax) has been given to the district level but some types of local taxes are not permitted. In general, the range of possible local taxes is limited by Parliament and there are few feasible options. Provisions for property taxation are so conditioned with exemptions that little revenue would be generated. Local governments are not permitted to levy betterment taxes and the only way localities can recover the costs of providing infrastructure to new developers is to levy development exactions on developers requesting rezoning. But beyond these limitations the low paying capacity of the population makes resource mobilization difficult.

Tariff setting for public services is partly still on the central level (electricity, gas, postal service, water-sewage; although the latter will become a municipal responsibility starting next year). The Budapest Municipality can determine the price of public transport and district heating and the price-setting of other services is unconstrained. There are some subsidy mechanisms still in existence in the case of district heating and also for public transport. Price increases in these services are considered as political issues even if the increase of the price of the service does not mean the decrease of the state subsidy.<sup>2</sup>

### Planning procedures

As should be clear from the overview of institutional arrangements, "planning rights" constitute an important element of the tools of the municipality to direct and control the development of the capital. In connection with the serious limits on the other tools discussed above, some people consider planning rights the Municipality's most powerful control tool. However, the real extent of planning rights is much debated and some commentators see them as extremely weak when compared to the planning controls used during in the previous system (when many more direct tools existed for central control of the development of the capital).

Budapest can be considered a "well planned" city. Its first planning commission, the Public Works Commission (PWC) was established in 1871, two years after the aggregation of Pest, Buda and Obuda. The Public Works Commission was a very powerful organization, and operated until 1949. As a result, Budapest has developed according to unified development ideas. The creation of Grand Boulevard (Nagykörút) and Andrásy út are tangible evidence of the PWC's coherent planning activities.

Plans for the capital were based from the beginning on zoning prescriptions. The first really accepted zoning regulation contained four zones, regulating the minimum plot width, deepness, the maximum floor number and building density. Functional regulation did not exist except for the regulation of "smelly factories" which were only allowed to be built in given areas. Zoning regulations were refined in 1914.

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<sup>2</sup>In the case of public transport, the central government subsidy increases as tariffs are raised, to cover the larger gap between the new tariff and the low regulated fares for students and the elderly.

The PWC devoted considerable attention to preparing guidelines for the future development of Budapest and its surrounding area, including extending the spatial extent of its planning powers. However, for political and financial reasons the 1932 and 1940 plans to join Budapest with several outlying districts were not accepted. After 1949, the new political system with the dominance of the party's political aims over experts' views brought about the integration of suburban districts with the city. In 1950 the Budapest Municipality, with its 22 districts was founded. In the beginning the Budapest Municipal Council had limited power compared with the sectorial organizations (e.g. functional Ministries) and the Communist Party. Later on (around 1954-55) most of the planning decisions were shifted to the municipal government and the local Party organization. In this process of decentralization, however, the municipality played the key role, and districts were completely subordinated.<sup>3</sup>

The last Master Plan of Budapest was accepted quite recently, in September 1989. However, because of the political changes (the statute of the municipality and the districts has been changed totally) and the new way of economic development (privatization and the bankruptcy of many enterprises), the introduction of a new planning approach became unavoidable.

The 1990-1991 regulations (including the Capital Act) took almost all property and power away from the municipality and transferred them to the district governments. The right to establish the master plan remained more or less the only planning tool the municipality has to influence city development. For this reason master planning has become one of the most politically sensitive areas in which the municipality insists on its rights in confrontation with some of the districts (especially outer ones) which would like to have almost total control over development in their areas.

Within the municipal government two departments deal with planning: the City Development Department has the responsibility to prepare the master plan, while the City Planning Department is responsible for preparing more detailed plans for those areas which are surrounded by more than one district and for areas which are considered especially important for the municipality. It must be mentioned that both these sectorial and territorial planning activities are taken much more seriously than the overall economic planning, partly because of the legacy of the previous rigid one-year, five-year and long-term planning system. Economic planning is nowadays almost totally ignored and considered to be against the principles of market-type development.

Except for very small developments which are in complete accordance with the given area, new developments require the existence of a detailed plan for the given area. This marks a substantial difference in practice from most other cities, where only accordance with zoning regulations is required.

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<sup>3</sup>At the time District Council presidents had almost no power, other than to determine the color of houses to be built in planned areas.

In many districts, there is no detailed plan, or the plan which exists is in conflict with the master plan. In such cases development cannot be approved until a new detailed plan is prepared. At the present time there are very few districts (Ujpest, Józsefváros) which will have their total area covered with detailed plans. In other districts many areas do not have detailed plans and private developers have to ask for the preparation of such plans in order to gain development permission. Detailed plans must fulfill master plan and zoning prescription for the given area. The local assembly has to approve the plan and the municipality has the right to control it. The process of preparing a detailed plan can take up to a year, and costs at least HUF 100,000.

Key points of debate regarding master and detailed planning between the municipality and some districts center around the following issues: how detailed should the master plan be? what kind of land-use categories should be used and what should be the procedure of the planning process (of interest-harmonization)? At the present time two basic approaches are emerging from these debates:

1) A new type of master plan should be created which deals in detail only with those areas which are for some reason important to the municipality. Other areas should remain blank and be planned by the districts.

2) The Municipality should continue preparing master plans for the entire city but the level of detail should be reduced in the areas with less importance to the municipality.

At the present time, the second approach seems to be in favor. Advocates of this more centralistic version like to emphasize that the first approach would give too much freedom to the districts to direct the development of their territory and would lead to plans which are incompatible on a city-wide level. Besides, in their opinion, districts should not have the right to issue zoning regulations (this is against the present regulation of planning and would lead to the emergence of different zoning categories). The key argument, however, is the protection of the municipality's power to influence the development of the city, at least through the master plan, if all other possibilities are abolished.

Districts react differently to the efforts of the municipality to build up broad control over the development of the city through detailed master plan prescriptions. Some of the districts seek to create their own master plan (basic plan) which could possibly also include zoning regulations, and thus in effect partly "overwrite" the Master plan. Other districts "start from below" and build up a new version of land use categories and compulsory prescriptions (not determining exactly the use of a given plot or area but providing principles for environment protection, density and "character" allowing developers to build all types of buildings within these frameworks). This seems also be an effective way to create local regulation which is quite independent of the master plan - simply because it is incompatible with the master plan categories. There is a third possibility, to use the "official way" and ask for the modification of the master plan if it is in conflict with a district plan. This process, however, seems to be extremely complicated and lengthy. Finally, there are also districts - mainly in the inner area - which build up their plans

in accordance with the valid master plan regulations and try to coordinate the most important issues with the relevant departments of the municipality.

The fluid nature of current approaches to municipal- and district-level master planning poses significant problems for the design and implementation of an urban economic development strategy. Multiple plans make it difficult to plan and develop key urban projects and conflicts between the Municipality and districts over spatial development may make it difficult to attract foreign capital.

The current debate over master planning needs to be opened up to also include discussions regarding economic and strategy planning and capital budgeting. Budapest's static master planning needs to be changed to incorporate modern techniques of strategic planning, economic development promotion and municipal finance. Integrating these new tools into the planning system will require initiatives to explore new institutional approaches to urban development planning as well as technical assistance activities to introduce new tools.

## **Industrial Restructuring**

This part describes current conditions, industrial decline and describes proposed technical assistance activities related to industrial restructuring and the reuse of vacant industrial land.

### Current Conditions

Industrial restructuring in Budapest is taking place on a massive scale. In the mid 1980s, the municipality contained nearly 3,000 industrial sites and had an industrial land area of 4,548 hectares-- 13.4 percent of the total urbanized area of the municipality. For example, as illustrated in Table 1, eight districts have an industrial area which exceeds 15 percent of the total urbanized area of the district. These districts (III, IV, VIII, IX, X, XIII, XV, and XXI) are located in an arc around the inner city, extending from Obuda on the northeast to Csepel Island to the south. Map 1 shows the location of industrial areas in Budapest.

The bulk of industrial enterprises are cooperatives and state owned enterprises. As of 1985, 2,990 industrial plants were operating in the City. Table 2 provides a tabulation of cooperatives and state-owned enterprises by district, reflecting the spatial pattern illustrated in Map 1. The greatest concentration of industrial activities is to the south of the city center, extending from the Lágymányos area (District XI) on the Buda side of the Danube to Csepel Island (District XXI), Ferencváros (District IX), and Kobánya (District X).

These patterns reflect the historical development of industrial areas of the city, and most of the eight districts were industrialized around the turn of the century. Industrial facilities in these areas are very old and are outmoded. The last significant wave of industrial development

in Budapest was after the end of World War II, when central planners aggressively launched a massive reindustrialization program.

In the early 1950s 15 large industrial enterprises were established by the state in Budapest. These enterprises were located in existing industrial areas in the city, relying to the extent possible on existing infrastructure. Since planners single-mindedly pursued an industrialization policy, environmental and urban planning considerations were accorded little importance when industrial siting decisions were made. As a consequence, industrial districts became congested and residential enclaves in these industrial districts suffered from industrial encroachment. Industrial pollution problems abound in these areas. Map 2 illustrates areas with harmful environmental conditions.

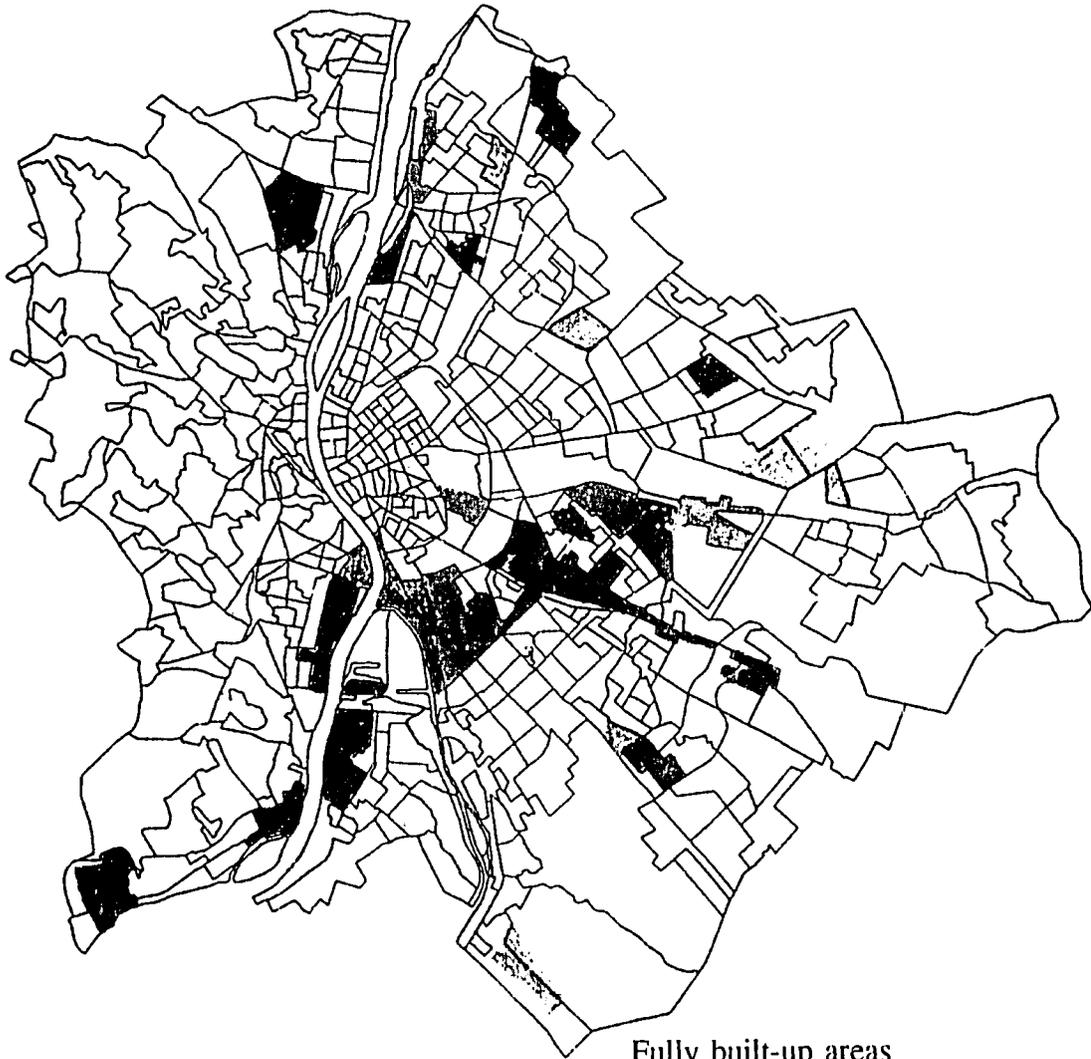
Table 1

## Industrial Land Use by District, 1987

District	Industrial Land use (ha)	Urbanized Land Area of District (ha)	Percent Industrial (%)
I	0.0	341.0	-
II	19.1	2246.0	1.0
III	457.7	2652.3	17.3
IV	274.9	1441.5	19.3
V	0.0	237.0	-
VI	0.9	233.0	0.4
VII	5.7	204.8	3.0
VIII	101.5	642.6	15.8
IX	327.3	1129.9	29.0
X	892.0	2512.8	35.5
XI	283.9	2471.1	11.5
XII	5.2	1685.9	0.3
XIII	266.9	1216.2	21.9
XIV	126.6	1590.2	8.0
XV	277.7	1325.5	21.0
XVI	147.2	2038.2	7.2
XVII	95.5	2291.7	4.2
XVIII	299.6	2945.3	10.2
XIX	48.0	894.3	5.9
XX	209.6	1793.9	12.0
XXI	427.8	2167.4	20.0
XXII	281.3	2069.1	14.0
TOTAL	4,548.4	34,062.0	13.4

Source: Budapest Master Plan, 1987.

## Industrial Areas in Budapest



### Fully built-up areas

-  - good quality
-  - needs planning intervention
-  - needs environmental protection intervention

### Areas with further development possibilities

-  - good quality
-  - potential for development based on planning

### Areas recommended for changes in function

-  industrial area

*Source: Draft Rehabilitation Concept for Budapest*

*Describing the Situation and Conflicts*

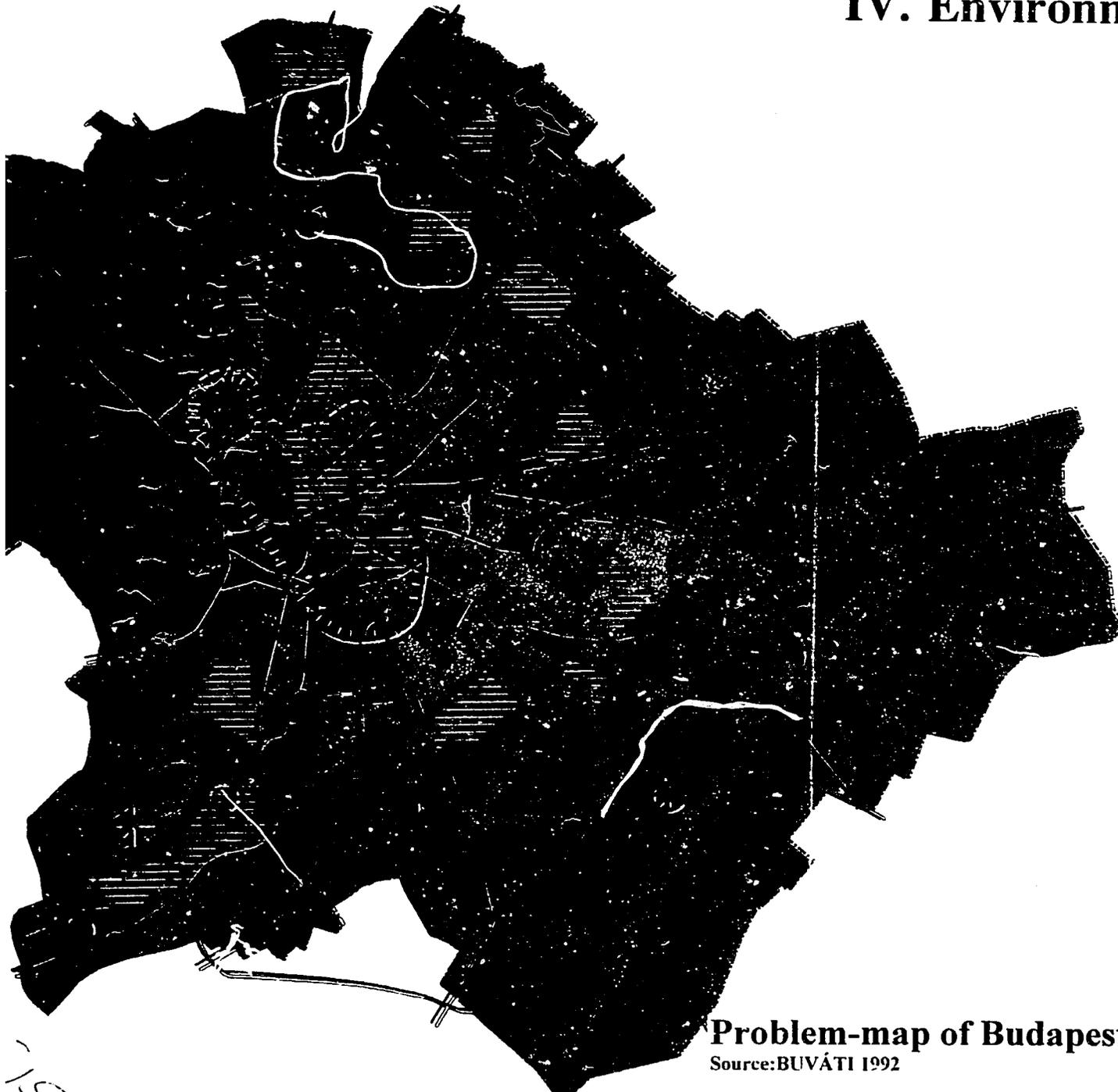
Buváti (Budapest City Planning Office)  
September 1992

Table 2  
Industrial Enterprises and Plants by District, 1985

District	State Owned		Cooperative Owned		Total	
	Enterprises	Plants	Enterprises	Plants	Enterprises	Plants
I	2	10	6	34	8	44
II	8	20	21	60	29	80
III	10	33	15	63	25	96
IV	17	50	32	103	49	153
V	20	44	42	107	62	151
VI	9	33	38	116	47	149
VII	13	46	48	196	61	242
VIII	17	64	38	163	55	227
IX	18	79	30	134	48	213
X	35	97	54	147	89	244
XI	30	68	57	144	87	213
XII	2	14	14	41	16	55
XIII	43	134	83	235	126	369
XIV	26	66	56	138	82	204
XV	5	23	15	52	20	75
XVI	4	13	13	38	17	51
XVII	2	7	3	19	5	26
XVIII	6	14	16	50	22	64
XIX	4	18	9	38	13	42
XX	6	30	15	66	21	96
XXI	12	31	14	42	26	73
XXII	9	46	13	63	22	109
TOTAL	298	940	636	2050	934	2990

Source: City of Budapest, 1985.

# IV. Environment Protection



-  Area critical due to air pollution and noise
-  Main road critical due to air pollution and noise
-  Most important conflict-zones of industrial pollution
-  Bigger areas of industrial pollution
-  Area contaminated with toxic waste
-  Waste-dump in operation (danger of pollution of ground and subterranean water)
-  Depository for sewage sediment (pollution of ground and subterranean water)
-  Direct influx of sewage (endangering the water quality of the river Danube)
-  Region in lack of green areas.
-  Sensitive area. Ecosystem to be protected.

PROPORTION OF BIOLOGICALLY ACTIVE SURFACE

-  below 35%
-  35-65%
-  above 65%

**Problem-map of Budapest**

Source: BUVÁTI 1992

15

By 1959, concern over the over-concentration of economic activities in the capital caused central planners to cease promoting heavy industrial development in Budapest. Instead, policies were adopted to redirect industrial activities to other cities in other parts of the nation. While few plants were relocated, from 1959 until the start of the economic transition in the 1980s, industrial investment in Budapest was essentially frozen.

A major implication of the redirection of state capital away from industrial enterprises in Budapest is that little modernization of industrial facilities has taken place. Much of the building stock in the industrial districts is old and the layout of industrial facilities is inefficient. Consequently, with few exceptions, most buildings are not suitable for modernization. Environmental pollution also makes the reuse of such facilities expensive and potentially risky.

### Industrial Decline

The demand for industrial space is unraveling as hundreds of state-owned enterprises slide into bankruptcy. Since 1989, industrial output in Hungary has decreased by 20 percent. In the machine and textile industries, the decline is even greater with economic output contracting by 50 percent. Economic projections for 1992 foresee another year of economic decline in national output. These trends have enormous implications for shaping new patterns of land use.

With the economic reforms, state subsidies to enterprises have been either eliminated or vastly reduced. Many firms are now facing hard budget constraints and others have severe cashflow problems. Input prices for water, electricity, energy and other resources have dramatically risen, driving up production costs and putting severe financial pressure on industrial enterprises. Firms are shutting down and others are reducing output. A dramatic symptom of the economic hardships faced by these firms is the growing arrears they are building up with utility providers. According to the Budapest Water Works, state-owned enterprises account for 50 percent of the arrears of all water users, despite the fact that they have fewer than 20 percent of the connections. At the current time industrial arrears are HUF 200,000,000.

A recent study prepared for the Municipality estimates that 35 to 40 percent of the city's industrial enterprises are close to bankruptcy. These enterprises will attempt to sell or lease out their property. Another 35 to 40 percent of Budapest's industries are under extreme economic and financial pressure and could easily slip into bankruptcy or be forced to liquidate their holdings. Numerically, the number of industries in Budapest suffering from severe economic hardship is large, likely to exceed 600 enterprises. In terms of industrial facilities, as many as 2,000 factories could be closed over the next two to five years as enterprises cease operations or attempt to liquidate assets to solve financial problems.

While we were not able to obtain precise information on industrial plant closures, we do know that industrial employment in the city has declined by over 100,000 since 1980, falling from 358,000 in 1980 to 248,000 in 1990. While some of the employment decline may reflect the relocation of industrial jobs to more modern suburban facilities outside of the municipality,

much of the decrease (especially over the past three years) is the result of closures and reduction of output. Fortunately, unemployment in Budapest remains very low (under 3 percent) as displaced workers shift to other industries.

Much of the industrial areas of both southern and northern Budapest, particularly the areas of Lágymányos, Ferencváros and Csepel Island in the south and the Buda and Pest abutments of the Arpád bridge to the north were occupied by medium- and large-sized state-owned-enterprises and many of these facilities will be liquidated.

### Technical Assistance for Industrial Restructuring

The development of initiatives to improve the economic productivity of Budapest poses a great challenge to its policy-makers. Urban land policy will play a critical role in facilitating such programs-- targeting where trunk infrastructure should go, clearing derelict industrial parcels, assembling land for new business and residential districts, designing redevelopment projects, and improving housing and working conditions. To be successful, Budapest needs an urban land policy framework that incorporates sustainable mechanisms for recovering the costs of public sector infrastructure investments, a public sector enabling strategy to support private sector land development and, last but not least, an urban planning framework for coordinating and reshaping spatial development so that the land requirements of a growing economy can be met with the least amount of adverse environmental impacts. The key feature of this new approach is the great stress placed on market-responsive planning systems, where urban land use planning aims to support and encourage new development, not stifle it. A key objective of this approach is to facilitate the reuse of industrial land to alternative economic activities.

In the course of our meetings we found little capacity to assess the current and future directions of the Budapest urban economy. At the most fundamental level there is a dearth of statistics on economic activity. Secondly there is no institutional capacity for carrying out urban economic assessments and studies of the demand for new urban development projects. Neither the City of Budapest nor the districts have any staff assigned to these activities. Planners preparing master and detailed plans have little information about economic conditions, and planning solutions are therefore not based on assessments of market demand for new facilities in terms of absorption, rents, sales prices or leases.

Market-based approaches to urban development require detailed knowledge of the demand for and supply of land and properties to support economic development. Therefore a fundamental objective of USAID's urban development technical assistance activities to the City of Budapest should be to create the capacity to carry out urban economic assessments and to gauge the market for urban development. More will be said about this in the section below.

The dramatic decline in industrial output poses an enormous challenge to the City. Can Budapest retain or "regrow" new industrial activities? If so, where should these new activities be located? If it is not possible to retain or "regrow" new industrial activities what alternative types

of economic activities can be attracted to Budapest? How can Budapest's old industrial areas be redeveloped? What is the range of feasible alternative uses for these areas? To answer these and other related questions we propose technical assistance on urban economic analysis, preparation of an urban economic development strategy, and assistance with the redevelopment and revitalization of the Lágymányos industrial district.

### Lágymányos Industrial Project

At the present time, the City is engaged in developing plans and programs for the industrial redevelopment of the Lágymányos and Ferencváros areas. Factories in these areas are being privatized or liquidated and some plant sites will become available for development. The Lágymányos project is being jointly managed by the Department for City Development, Rehabilitation Section, and District XI. Discussions are underway to create a private real estate development corporation (a joint stock company) consisting of the City of Budapest, District XI, the State Property Agency, the Ministry of Industry and Quo Vadis Consult, a real estate development advisor.

The project area is 300 hectares. The site contains 4,153 dwelling units located on 34 hectares. Other portions of the project area are used for industrial and public facilities. In total there are approximately 130 individual parcels in a variety of ownership forms: ownership and management rights held by enterprises; property owned by state but management right held by local District (IKV, a district-owned property management company); property owned by private entities; and property owned and managed by the state.

Planning and prefeasibility activities for the project have been started, and a proposal and assessment is to be completed by the end of the year. The outputs will largely be focused on possible land use development alternatives and preliminary assessment of the market potential for the proposed uses. After a thorough review of the prefeasibility proposals and assessments additional studies will be carried out to further elaborate the development concept and to more rigorously assess market feasibility.

At present there is some notion that the area can be developed as a high technology park, drawing on the nearby strengths of the Technical University. While this idea has merit, there have apparently been no market studies conducted to gauge the degree to which high technology activities are being established in Budapest and whether this particular site is able of attracting such activities. On the other hand the site is well-located in relationship to the new Lágymányos bridge, a new highway bordering the west bank of the Danube (the M6), and the forthcoming Budapest World Expo site. These infrastructure improvements will enhance the attractiveness of the Lágymányos area.

## **Infrastructure Development**

This section outlines present infrastructure problems and issues, and identifies several projects for technical assistance.

### Current Conditions

The Municipality is responsible for the direct provision of eleven public utilities: water, sewerage treatment, transport, gas, district heating, baths, solid waste, septic tank cleaning, parks and gardens, cemeteries and chimney cleaning. Responsibilities for roads are divided between the municipality and the districts according to the capacity of the road. Major arterials and any streets with BKV tram or bus routes are managed by the municipality. A new legal framework permits local governments to privatize these activities and the Municipality is proceeding to privatize certain functions. Our mission focused on assessing the adequacy of existing infrastructure provision, excluding energy and transport, and to identify capacity constraints which impede urban development. Discussions revealed that there are two principal problems: a near universal lack of sewerage treatment and limitations on water capacity in certain areas of Budapest.

The sewerage treatment problem is serious. The municipality estimates that during dry periods, less than 20 percent of waste water is treated. Three treatment plants are needed. Preliminary costs are set at HUF 750 billion (\$10 billion USD).

The water problem in eastern Budapest is the result of limited water pressure. The current water mains in the city run north-south along the Danube, connecting to wells and treatment facilities to the north and south of the city. Currently, eastern areas of the city are served by trunk mains which also serve the central city. During peak periods, water demand in the inner city makes it impossible to maintain sufficient pressure in eastern areas.

The ultimate solution to this problem is the construction of a circumferential 1000 mm main extending from the northern wells through the eastern side of the city to the southern wells. The cost of this facility is quite expensive: a recent estimate to extend the trunk from the southern service area to District XVII is nearly HUF 2 billion (USD 27 million). Ordinarily, the Budapest Water Works would pay for main trunk infrastructure, but because of the high cost it is seeking the financial participation from eastern districts.

The financial problems associated with the provision of expensive infrastructure networks is compounded by the fact that the Water Works does not have the authority to set water tariffs. Water rates are set by the Ministry of Transportation, Post, and Infrastructure. At the present time the Budapest Water Works estimates that rates of HUF 25/m<sup>3</sup> would cover operating and maintenance costs and provide a modest sum for new development planning. However, the current water rate is set at HUF 13/m<sup>3</sup>. Similar tariff issues exist for sewerage treatment as well. A critical issue facing all utility providers is to determine mechanisms for financing infrastructure development. Such new methods must fully recognize the relatively low ability to pay and the

current high levels of arrears carried by most service providers. Assessments should consider billing and collection enhancements as well as modifications to fees and charges.

In the past major infrastructure projects were financed through budget allocations from central government sources. However, given the severe financial constraints faced by the state such allocations seem unlikely. What is needed is a fresh approach to municipal infrastructure finance with emphasis placed on recovering the costs of the facilities from users and benefiting property owners.

### Technical Assistance for Infrastructure Development

To assist the Municipality address these infrastructure development and financing issues we propose structuring three independent activities. First we plan on providing municipal finance experts to review relevant international experience with infrastructure cost recovery methods and their applicability to Budapest. We will review existing and proposed laws related to local taxing and revenue generation and we will determine the feasibility of adopting user charges, fees and assessments to recover the capital and operating costs of infrastructure services.

Second, we propose working jointly with the Budapest Water Works, the Municipality, and district governments where there are critical infrastructure needs. The objective of this activity is to develop a concrete "demonstration project" to illustrate the practical application of tools identified from the international review.

One possible candidate area is District XVII. Located to the east of the inner city, District XVII is currently experiencing water service and sewer treatment constraints. The principal problem stems from the lack of sufficient trunk water main capacity. Although the Budapest Water Works has responsibility for constructing such facilities they have proposed that a portion of the costs be shouldered by the district. Given the costs of the trunk extension this arrangement poses obvious challenges for the District XVII. A project could be structured to identify new approaches to project finance at both the Municipal and District level including establishing water improvement districts, assessment charges and users fees.

Another candidate for an infrastructure development and finance project would involve the Municipality's Transportation Department to explore the possibilities of joint public-private real estate development. This activity will focus on the final construction of the Hungária Ring Road project in Districts VIII and IX.

A long planned major surface transportation project to be completed in the city is the Hungária Ring Road project. This project will link the outer fringes of the city from north to south. The northern portions of the project have been completed and now attention has turned to the southern end, between the Danube and Ulloi út. The right-of-way runs through an old industrial area which needs rehabilitation. At the present time the City of Budapest Transportation Department is conducting various feasibility studies, but it is not considering developing an

area-specific rehabilitation district such as in the case of Lágymányos. We propose working with the Municipality to determine whether it is possible to expand the project area to create an opportunity for capturing the increased value of properties adjacent to the project by including them in a public private real estate development project.

## **Housing Conditions and Inner City Revitalization**

This section describes the principal housing problems and issues confronting Budapest and outlines the possible technical assistance activities.

### Current Conditions

New housing construction dramatically dropped in the last several years compared to the previous periods in Hungary. Budapest is no exception under this general tendency as only 4,816 new flats were built in the city in 1991, less than one third of the 15,000 average of the first half of the 1980s. Not only the construction of big state financed housing estates ceased to exist but also the National Savings Bank stopped investments in the housing sector. New buildings are to be found only in the best areas of the town (upper class housing built for sale) and in the outer districts (self-help construction of single family housing).

The last Budapest-wide plan for rehabilitation was adopted in 1986, proposing 104,000 housing units (in 204 blocks) for rehabilitation. In the plan's first five years 13 blocks were completed, and in the 1991-95 period 40-60 blocks are likely to be rehabilitated. The plan's short-fall is a reflection of its failure to consider the realities of project financing and cost recovery. Instead it was based on the notion that central budget money for rehabilitation would be available on a wide scale. By the end of the 1980s, such an assumption became untenable: not only was the ownership of the stock transferred to the district level but also the responsibility for rehabilitation, and direct state subsidies for housing renewal have been eliminated.<sup>4</sup> To compound problems the Budapest-level temporary unit stock (which was an important element of the rehabilitation processes making possible temporary rehousing of families) disappeared. With frozen rents, and the cut-off of state subsidies, rehabilitation activities have significantly slowed down.

Only in cases in which residential rehabilitation can be linked with commercial or office development are projects likely to be carried out. This is an option for only a few well-located districts: VI-VII-VIII-IX around the CBD area. All are in direct competition with each other to attract foreign capital for office and hotel construction.

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<sup>4</sup>There is an existing interest-rate subsidy for renovation undertaken by tenants or condominium owners.

## Legal, Administrative and Financial Regulation

The new institutional and legal framework which has been successfully set up in the last two years has not extended to the housing sector. The responsibility for housing at the ministerial level has been split among many ministries. Partly because of this, revisions to the Housing Law, the Housing Concept (and also the Social Law containing the subsidy system proposal) are delayed.

According to the Capital Act, housing policy is almost exclusively the right of district governments in Budapest. The rights of the municipal government are very limited in this regard.<sup>5</sup> As a consequence, in principle it is possible to have 22 districts all with different rent policies and housing allowance systems. However, the absence of a Social Law has restrained district governments from experimenting with rent increases. Furthermore, the design of a housing allowance system is apparently too difficult for local governments, and most would prefer to wait for central budget subsidies.

There is a discussion going on among housing specialists over the importance of unified housing regulations. Almost every-one agrees that it would be important to have unified rules or at least broad guidelines for rents and unified regulations for the low-income segment of the housing hierarchy (allowances, treatment of the homeless problem, etc). However, at the moment there is no sign of an imminent development of such a unified social housing policy. On the contrary, some important aspects of housing policy have already been regulated differently among districts. Privatization is one such example.

The regulation of housing privatization differs across Budapest's 22 districts. Until 1991 there was a unified central regulation which gave the right to set sales prices (as a percentage of market value) to local governments. Until 1991, the Budapest city council set this figure. However, with the loosening of the power of the municipality, districts began to override the municipal regulation. At first this seemed to be unlawful but later it became common practice and now no one thinks that privatization rules could again be unified in Budapest. There are now very substantial differences in privatization regulations: some districts have sold most of their stock while others have imposed moratoria on sales.

## Need for New Municipal Housing Concept

Is it possible to promote cooperation between the districts and the municipality? Past initiatives have centered on creating a Budapest Rehabilitation and Housing Fund which required districts to pay a given share of residential privatization revenue to this fund. This idea, however, was not accepted by many of the districts. As a result, there is now no system of cooperation

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<sup>5</sup>Capital Act, Section 10 (3).

for residential rehabilitation despite the fact that Budapest has over 100,000 rundown public rental flats in the inner districts.

### Proposed Technical Assistance Project for Inner City Revitalization

Based on current conditions and the lack of a viable model for inner city residential revitalization we propose a project on inner revitalization. The project would contain a detailed examination of existing legal and financial regulations and conditions of urban development (expropriation, relocation for renovation; possibilities of taxing local industrial activity, capturing gains in property value resulting from revitalization; and different options for local government to get revenue from the sale or leasing of its property ). The possible role of development corporations would be examined and we would also assess how central, municipal and district governments can best participate in the process. The search for new approaches will be based on international surveys of best practice approaches, market assessments, and the identification of possible models of inner district cooperation which incorporate roles for the municipal and central government.

Beyond the wider policy assessments and broad feasibility studies, the project will also consider developing several demonstration projects to provide concrete opportunities for testing policy options. One possible case study is the District VIII, where both the district and the municipal government are interested in preparing a joint action for residential revitalization.

### **Municipal Finance Issues and Opportunities**

Urban development projects in Budapest rely on the City budget for financing. Similarly the city--like all local governments in Hungary--relies heavily on central transfers for over 70 percent of its revenues. In an era of unpredictable resources--with central transfers expected to decline dramatically next year--the city needs to train its staff to expand its ability to mobilize financial resources for the projects that the City most wants to undertake and which have a sound basis for expectations of success.

### Local Government Budgets

Local governments depend heavily on central transfers. In 1991 total local revenues budgeted were HUF 368.5 billion, of which own revenues accounted for 17.7 percent. The share of personal income tax (PIT) revenues that localities received declined from 25.3 percent in 1990 to 12.7 percent of revenues in 1991. Estimated state subsidies and grants were 51.4 percent of total revenues in 1991. This included an increase in normative grants (transfers based on per capita need in a number of areas) to 39.9 percent of local revenues from 26 percent in 1990, to offset partially the decline in PIT transferred. However, there is no guarantee that either total

transfers or the normative grant will be maintained in real terms, as this is decided annually in keeping with the capacity of the Budget.

### Transfers from the Central Government

Total central transfers--including both subsidies and the returned share of personal income tax--to the City of Budapest come to HUF 40.6 billion and HUF 42.3 billion respectively in 1991 and 1992, or 74.7 and 71.2 percent of revenues. This compares to an average of 39 percent for central government grants to OECD local governments.<sup>6</sup>

A certain percentage of the Personal Income Tax (PIT)--determined annually in the Budget Law voted and approved by Parliament--is returned to the local government with a two year lag. In 1990 the percentage was 100 percent, but it has been 50 percent for the last two years; moreover, the new budget is expected to specify a transfer of only 30 or 40 percent for next year, which would be a huge blow. The two year delay also creates a big reduction given the recent high inflation; for example, in 1991 Hungarian local governments received only a little over a quarter of the total PIT budgeted to be collected in that year. The City of Budapest's share of PIT came to HUF 9.4 billion in 1991 (estimated) and HUF 12.1 billion in 1992 (planned), i.e., 17.3 and 20.4 percent of total revenues.

Normative grants for Budapest were HUF 12.5 billion in 1991 (estimated), and HUF 13.8 billion in 1992 (planned). In addition to normative grants which are intended to cover operation and maintenance expenditures, targeted (matching) grants are available for localities undertaking investments consistent with central government priorities. These are general in nature--e.g., sewage development. The city applies for these and Parliament decides whether to allocate the funds. The matching requirement differs by sector, ranging from 25% to 60%. Grants are allocated on a competitive basis, within limits set by the annual Budget allocation, so that all eligible projects are not necessarily funded. It was further decided by Parliament in 1991 that eligible but unfunded investments would be funded the following year. However, it is not clear if this will be an addition to the 1992 investment grants or a subtraction from those grants. Budapest received HUF 0.3 billion for targeted grants in 1991 and requested HUF 1 billion in 1992. One more targeted grant which will be submitted by the City and District together, is for assistance financing the connection of District XVII's water network to central water main. Two local governments applying together are eligible for a subsidy of 40 percent of the total bill of HUF 2 billion.

In addition localities can apply for 'addressed grants', intended to fund the completion of specific projects initiated under the earlier regime. However, the Act on Local Government does not guarantee that funds will be available for these grants. In Budapest, addressed grants came

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<sup>6</sup>This comparison is not entirely fair for several reasons. A substantial part of central transfers--27.5 percent of Budapest's "revenues" in 1992--are a direct transfer from the Social Security Fund to hospitals.

to HUF 1.6 billion in 1991; an amount of HUF 1.2 billion was requested for 1992 for planned construction of three hospitals, a theater and a secondary school.

In the case of both normative grants connected with the operation of the city (dependent on total population) and the personal income tax, after the money is allocated to Budapest it is subdivided among the 23 local governments (the City and the 22 districts) as specified in a municipal decree.<sup>7</sup> The principal criterion for allocation is the list of tasks mandated for each level of authority. The proportions this year are 56 percent to the City and 44 percent divided among the district. As with the criteria for normative grant allocation, one difficulty of this system is that this allows no room for innovation: funding is only divided for mandated tasks or projects that have been undertaken in the past, so that no new initiatives have access to this source of funding. Moreover, if a new institution is set up through the district's own revenues, no central funds can be used to assist with operation. One other significant central transfer is the Social Security Fund transfer which goes directly to hospitals.

### The City's Own Revenues

Planned city revenues for 1992 excluding central transfers came to 28.8 percent of total revenues, up from an estimated 25.3 percent in 1991.

The Law on Local Governments and the Capital Act specify which taxes can be levied by each level of government. The only tax the City of Budapest can collect is the entrepreneurial tax, based on the previous year's turnover--but again this total is reallocated to the districts in the same proportion (i.e., 44 percent this year).

There are currently some user fees charged by the City. Some prices are set by the national government, and others are at the discretion of the city (as discussed above). City officials described some of these as being set at the discretion of the city-owned enterprise providing the service--public baths were given as one example--but it was then revealed that these could not rise faster than inflation. If fees started from low levels, they may therefore still be too low to cover costs. There is evidence of some further limited use of benefit charges--e.g., connection charges for water are used in some districts, though they do not fully recover costs.

One severe problem with cost recovery is the high level of arrears. Current figures are total arrears of HUF 800 million for electricity, 500 million for district heating, 300 million for gas, and 400 million for water. Various reasons include the recent decline in real income, the decision not to disconnect users--due to legal prohibitions in some instances (e.g., for health reasons in the case of water and sewage)--and possible inefficiencies on the part of the state-owned collection company that acts for all utilities. The development of a strict, fair, and workable arrears policy is an essential part of the effort to improve cost recovery.

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<sup>7</sup>This is Decree 2/1992 (I.23) of the Budapest Municipal Assembly.

Revenues from sales of plots, which were expected to form almost a quarter of revenues for Budapest, have been far below expectation. (The planned amount was HUF 4.3 billion whereas sales to date have amounted only to half a billion, with some officials believing that another 3 billion worth of sales may be consummated by year end.) City officials believe the disappointing sales figures are due to the slow sales process. The city needs to have a coherent land policy in which decisions are made strategically about which plots to sell, and the process itself is streamlined to maximize efficiency. Instead, city procedures seem fragmented and complex.

The Property Management Center, a stock company with 98 percent city ownership, was set up in March of this year to restructure companies that became city property, to manage the Budapest portfolio, and to sell marketable plots. However, the decision to buy or sell--not only real estate, but all City property--is not made by the Center, but by the Owner's Committee elected by the City's General Assembly.<sup>8</sup> The City Planning Department is also charged with the management of the empty plots owned by the City and it is in process of computerizing its property roll. Developers can come to this department to buy city-owned plots; the department then drafts an opinion to be submitted to the Owner's Committee. The decision is then taken by the Committee, and the Property Management Center carries out the sale. In addition, there are further distinctions between different types of property--non-marketable, restrictedly marketable, and free marketable--which entail different regulations regarding sale and lease.

On the other hand, developers who might be interested in a joint venture with the City in which the City's contribution would be land, would have to negotiate with a different Department, the Property Management and Entrepreneur Department affiliated with the Office of the Mayor.

Prices for land are set by the Property Committee after an appraisal has been undertaken. Not only is this a time consuming role for the Property Committee, but it is likely to be quite inefficient. The Committee will be unable to quickly consider all aspects of a possible deal, a developer will have no room for negotiation, and the Committee may not understand the cost of not selling if a price is set too high.

### Investment Decisions

City funds allocated directly to investment amount to HUF 7.7 billion (12.5 percent of the budget), of which 6.3 billion is strictly earmarked and must be spent for the specified purpose. If a similar amount is allocated for 1993, it will fall far short of the totals from planned projects mentioned by the City.

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<sup>8</sup>As discussed above, the Assembly legally cannot delegate decisions for disposal of property.

The General Assembly must make all investment decisions, on the strength of proposals prepared by the City staff, reviewed by other departments--but not amended--and by the relevant Committees. Two decisions are required: once when the purpose of the project is announced; once when the concrete project proposal is presented. Because of this time-consuming process, the Assembly must rely heavily on accurate and informative proposals, and would also benefit from a clearer idea of priorities. At present there is no function outside the Assembly--even at the Committee level--to assign priorities to projects.

Given the shortage of budgetary funds, a strong emphasis should be placed on setting clear priorities among projects and on writing project proposals which thoroughly examine the financial aspects of the planned investments.

But financing considerations are not an integral part of project design. Currently, proposals prepared by the city frequently do not include sound financial analysis. Where economists do participate in project preparation, their contributions are to assess the cost--although even in this area proposals are reportedly quite uneven in quality and detail--as opposed to contribute during the design phase, examine alternatives, and explore possibilities for cost recovery. If financial analysis was present from the inception of project, those considerations would contribute to project design, as well as providing detailed and accurate cost information. In addition, without consistent demand studies at an early stage of planning, possible financial sources may be precluded.

Large capital expenditures, such as the building of bridges or sewage networks, will provide benefits for users over a long period of time. It is therefore both fair and efficient to spread the costs of the investment over time through debt financing. The riskiness of lending to local governments may make it difficult to borrow, but reliable revenue streams that can be earmarked for repayment--can improve creditworthiness. For example, it can be specified in a debt agreement that repayment has first priority on project revenues, and that fees will be automatically increased when revenue of the amortization payment falls below a certain ratio, and that a reserve fund will be established.

Bond issues and bank loans are the only financing sources available,<sup>9</sup> but seem to be rarely used. Budapest has currently two 5-year loans from OTP (the National Savings Bank) at market interest rates, and has not issued bonds. Long term borrowing requires the approval of the local assembly.

### Technical Assistance for Municipal Finance

Technical assistance proposed can be divided into two categories: the development and enhancement of analytical skills and the design of administrative reforms. Technical assistance

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<sup>9</sup>However, an European Bank for Reconstruction and Development project with OTP is apparently underway to create a window for municipal borrowing, which may be operating as early as Spring, 1993.

in the areas of analytical skills will be provided both directly in the form of a study and seminars on municipal finance and project evaluation, evolving into a training program in this area, and practical application through the assistance provided to the specific development projects.

Two administrative changes can have a huge impact on the quality of project finance. One is the establishment of the economic information office already mentioned, which by providing information about demand in the city, will make possible the incorporation in project design of realistic potential sources of finance and cost recovery.

The second reform would be the development and enforcement of guidelines for proposal preparation which required the inclusion of detailed cost information, examination of design and financing alternatives, and systematic addressing of the question of financial sources. This should include possible beneficiary assessments, private investment, and debt financing as well as budget financing. It should be emphasized that while the ability for municipal staff to prioritize projects is essential, this function of establishing rigorous criteria for proposals is a different one which is purely administrative and not evaluative, and which simply requires the inclusion of these various analytical components.

However, this reform of proposal preparation is a *sine qua non* for the establishment of a clear and systematic city-wide process in which economic demand, urban strategy, and financial issues are analyzed together to reach a rational decision about which projects should be given highest priority.

In addition to these analytic tasks, assistance will also be provided in each of the development projects, by working with project staff on finance issues at every stage of the project. In the proposed District XVII water project described above, for example, experts would work with the Water Works, the district and the city on cost recovery.

### **III. PROPOSED TECHNICAL ASSISTANCE PROGRAM**

We propose a program of technical assistance which links top down broad analytical and policy support with bottom up activities aimed at defining and supporting specific urban development projects. This dual approach will enable us to develop much-needed skills across municipal staff and to assist in the direct application of new analytical tools, policies, and procedures to concrete projects. The proposed technical assistance will also address in all efforts the importance of building a cooperative relationship between the Municipality and districts in which both levels of government make defined and productive contributions. This program is intended to assist the municipal staff in the creation of a coherent and directed urban development strategy for the City of Budapest.

The proposal technical assistance program includes a number of long-term efforts. Each of the development projects is expected to be implemented over several years, with assistance provided at critical moments. The attached time line covers only the first year.

## **Building Institutional Capacity**

Assistance at a general level is designed to build capacity and facilitate institutional change in the City and District Governments in six areas. These fall into two categories. The first and most urgent of these, the development of an economic analysis capability, should evolve into an established function of the Budapest City Government. The other four topics -- the market feasibility of industrial reuse in Budapest, public finance, prioritization of urban development projects, the establishment of public-private development corporations, and citizen participation -- will be addressed through free-standing analytic work useful to both the city and the districts, which will feed into the technical assistance efforts related to the four development projects. Similarly, the four projects will check and hone the practicality of the analytic inputs through their implementation in actual development efforts. A training program will be developed from the core of the analytic work through the collaboration of a Hungarian institution and USAID advisors, so that the material will continue to be made available to municipal staff. Figure 1 illustrates the overall structure of the proposed technical assistance.

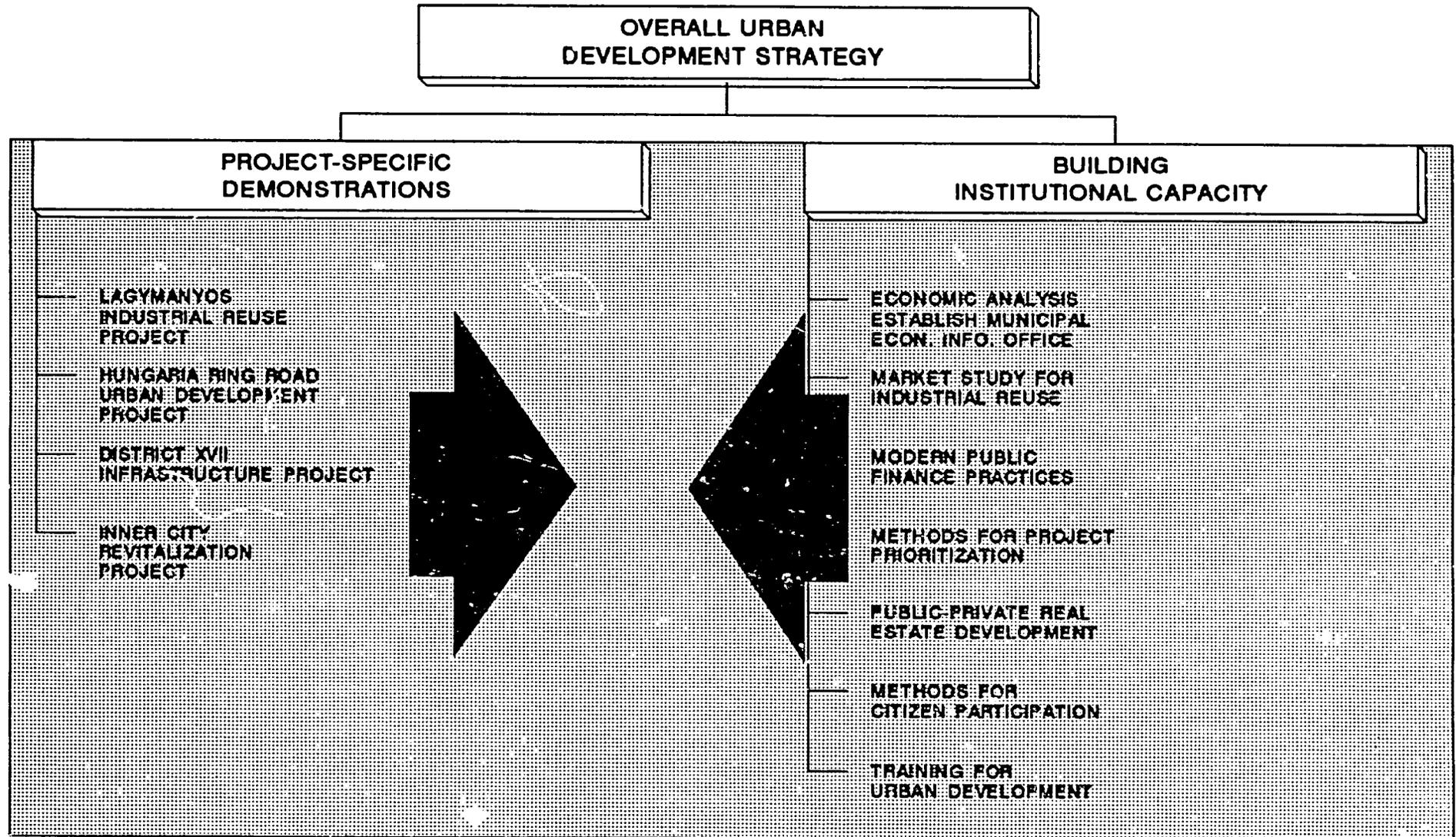
### 1. Economic Analysis: Establishment of a Municipal Economic Information Office

It is currently difficult to obtain information about economic growth trends. No office within the city now gathers or analyzes economic data. In no case do departments preparing development projects assess market demand or possibilities for cost recovery. City departments, international donors, and districts could all benefit from this information but the city has not had the resources to pursue this systematically.

This function should take place on a continuing basis within the municipal government, while remaining fully responsive to the needs of the Districts. USAID's assistance will take the form of both undertaking analytical work and working with the City to build capacity.

Initially, expatriate and Hungarian analysts will work with City staff to gather data and write an initial economic report. A new office of Municipal Economic Information Office (MEIO) needs to be set up within the city government to ensure that the economic information produced will be fully available to all municipal activities. The establishment of this office should be one of the initial conditions agreed to by the City before the beginning of the technical assistance program. At the same time, as in all aspects of this program, cooperation with districts will be an important component: in this case we recommend that a technical steering committee to the MEIO be established which includes representatives from all the districts. It is hoped that this will ensure that the MEIO remains fully responsive to district needs.

# BUDAPEST TECHNICAL ASSISTANCE FOR URBAN DEVELOPMENT



## 2. Market Study for Industrial Reuse

It is currently estimated that somewhere between 35 and 40 percent of Budapest's industrial enterprises are bankrupt and that another 35 to 40 percent are in precarious financial condition. Many of these enterprises will close down, and finding new users for upwards of 1000 to 1200 industrial sites poses a major challenge to the city. The market study for the potential reuse of these sites will play a critical role in shaping the city's real estate development and marketing strategy.

The market study will assess the supply and demand for vacant and underutilized industrial land in Budapest, placing particular emphasis on the Lágymányos and Ferencváros areas of south Budapest. The study will gauge the locational and physical characteristics of vacant industrial sites, taking into consideration possibilities for alternative uses such as light industrial, high tech flex space, warehousing, retail, office and institutional users as well as residential and recreational activities. Assessments will be made of the annual effective demand and potential net absorption of space over the next five years for these property types and surveys will be conducted to determine user needs and preferences for vacant industrial space. Demand surveys will gauge the competitive position of the Lágymányos and Ferencváros areas relative to other Budapest locations.

## 3. Modern Public Finance Practices

Urban development projects in Budapest rely on the budget for financing. Without issuing debt, the City is unable to spread large costs over time. Nor are financing considerations an integral part of project design. Currently, proposals prepared by the city do not include sound financial analysis. Where economists do participate in project preparation, their contributions are to assess the cost as opposed to contribute during the design phase, examine alternatives, and explore possibilities for cost recovery. In addition, without consistent demand studies at an early stage of planning, possible financial sources may be precluded. In fact, proposals are in general often inadequate: inaccurate, short, incomplete.

In an era of unpredictable resources with central transfers expected to decline dramatically next year the city needs to train its staff to expand its ability to mobilize financial resources for the projects that the City most wants to undertake and which have a sound basis for expectations of success.

This task will consist of two separate parts. The first will be the preparation of a paper and delivery of a seminar or seminars on municipal finance, which will inventory existing skills and provide ideas and methods for improving the way municipal and district staff look at project finance. The second will be the development of proposal preparation guidelines which can then be issued to all departments. This will establish an accepted format for that will ensure a certain level of completeness and quality. It will also formalize the methods explained in the finance seminars as standard approaches to urban development projects.

Technical assistance in this area must be coordinated with other donors. For example, related projects at very early stages of development are planned by the EEC (solid waste), EBRD (a window for municipal borrowing), and the World Bank (water and sewerage sector development, although probably not in Budapest).

#### 4. Methods for Prioritization of Urban Development Projects

In conjunction with technical assistance activities to promote modern approaches to municipal finance, we propose to provide technical support to the Municipality in the area of cost-benefit analysis, project evaluation, and analytical and process techniques for prioritizing urban development projects. This task will be closely linked with the previous three activities so that the process of priority setting and capital budgeting can be carried within the framework of an overall urban economic strategy and market demands and be predicated on careful financial assessments of project financial feasibility. While a realistic and useful prioritization of urban development projects cannot be completed until these first three technical assistance tasks are close to completion, we propose to develop prioritization and project evaluation skills early on in the project so that when the Municipality has developed a concrete urban economic development strategy, carried out an assessment market conditions and mastered project financial analysis, priority setting can be quickly carried out.

To enhance technical capacity, we propose holding a series of technical seminars and training courses to illustrate how other cities evaluate competing projects, and set urban development priorities. To the fullest extent possible we will use actual projects currently being considered for implementation. Once the Municipality has developed an urban economic development strategy, completed its market assessments and concerned staff have mastered the techniques of project financial feasibility and cost-recovery, we propose holding a workshop to help Municipal decision-makers prioritize urban development projects.

#### 5. Public-Private Real Estate Development: Alternatives for Forming a Development Corporation

Once the city has designed an overall real estate development strategy it will need to determine what type of institutional structure is best suited for implementing real estate development projects. Numerous questions need answering: Should the city set up a corporation outside of the city government? Should the city establish a real estate program within the city's administrative structure? Where should such an internal unit be lodged? Should the city have one real estate development corporation or should it establish several corporations to take on projects in various areas of the city or to address particular types of projects?

To clarify and find answers to these and other institutional questions, this task will review and evaluate the range of approaches taken by cities in North America, Europe and Asia to implement public real estate development programs. A paper identifying the range of

institutional design options will be prepared and presented at a seminar held for senior city staff to discuss institutional design options and to identify what actions if any should be taken. The paper will also be presented to and discussed with Department of City Development and the Department of Transportation staff working on the Lágymányos and Hungária Ring Road projects, and results will be evaluated for possible use in inner city revitalization.

## 6. Citizen Participation

Both the Division of Rehabilitation and the Department of Transportation raised the difficult issue of involving the public productively and managing to complete work despite objections from local groups who would like to have unpopular projects located elsewhere. This topic should also be of serious interest to district governments. This task will involve a specialist in public participation presenting a series of seminars on techniques that can be used in presenting projects and persuading citizens to work productively with the process. This work can be put into action fairly quickly in providing advice to the Hungária Ring Road and the inner city revitalization projects.

## 7. Training for Urban Development

It is clear that professional training in a number of areas could be useful to municipal officials -- within the government of the City of Budapest, within the district governments, and within the governments of other cities. Three topics will be addressed: Market feasibility for real estate development, techniques for public-private real estate development, and municipal finance, including project feasibility analysis, methods of cost-recovery, evaluation and priority setting. Relevant courses in Europe and the United States will be identified for small groups of City and district officials. Further ongoing training will be developed and offered through one of the universities in Budapest. The courses will be developed through a collaborative effort with USAID advisors over a several month period starting with the self-contained studies and seminars that form the analytic core of the technical assistance program. Courses are expected to be short and intensive, e.g., held over three consecutive days. Courses will be first offered by U.S. and Hungarian instructors together; later increasingly by Hungarians. They will be open to municipal officials from all over Hungary.

## **Project-Specific Demonstrations**

Working on specific projects will provide the opportunity for institutional strengthening in a practical context, while facilitating the timely and successful completion of urban development priorities. Critical elements to be incorporated into the process of each of these projects are City-District cooperation and a greater focus on demand-driven financial analysis.

For each of these projects, the same general process would be undertaken. These projects are at different stages, so the later projects would learn from earlier ones. Lágymányos is furthest along and so would be of the first priority. The improvement and extension of the Hungária Ring Road has a slower schedule, but will benefit from the technical assistance provided to the Lágymányos project. The structure of the work with District XVII is not yet clear.

The fourth project emerges from the thorny problem of promoting inner-city revitalization. It will be addressed initially through an analytic effort with the aim of producing a proposal for a joint development project undertaken by the City and the inner city districts.

It should be emphasized that the selection of a project in no way indicates an assignment of a higher priority to that project over others, but rather reflects the belief that the project is likely to offer the opportunity to apply certain analytical tools which can eventually be applied broadly across many projects. Likewise, selection here is not a guarantee of success in the sense of completion as now envisioned. "Success" may in fact take the form of an informed decision to change the concept of the underlying project as now envisaged. In each case, results of the project work will be shared with the rest of the municipality on a regular basis through seminars on critical issues.

### 1. The Lágymányos Project

USAID contractors would work with the City and District XI to form a legal entity including participation by the Ministry of Industry and the State Property Agency, and assist the group throughout the development of the project. Assistance would start with using the results of the prefeasibility study to prepare a proposal to the State Property agency and design the structure of the project management entity; further efforts will be to help assess the financial feasibility of the project, strengthen analysis of demand, and mobilize resources.

### 2. The Hungária Ring Road

USAID contractors would start by reviewing the plan for development of public transport, with an emphasis on the plan's examination of alternatives and its use of financial analysis. Subsequently assistance will be provided to the city in its preparation of a feasibility study of the project and its organization of a project development entity in conjunction with District IX. In addition, assistance will be provided to foster productive citizen involvement in the project.

### 3. District XVII Infrastructure Project

USAID assistance will focus on exploring infrastructure finance, in cooperation with all interested parties: District XVII and possibly other districts benefiting from the water connection, the City, the Water Works, and other public works municipal companies.

### 4. Strategies for Inner City Revitalization

While District V is clearly at the center of the Central Business District and has benefitted from commercial investment, the surrounding districts (XIII, VI, VII, VIII, and IX) have found that investment is less certain. Because the vitality of the downtown area is important to Budapest as a whole, the City should have a role to play in coordinating efforts in this area.

This task will begin with a presentation about successful inner city revitalization activities undertaken in other cities, an effort to define the unique problems of the inner city in Budapest, and studies of current citizen-initiated activities and other District efforts in Budapest, and a feasibility study for establishing neighborhood community projects. In combination with the results from the economic analysis undertaken along with the other studies underway with USAID assistance, this work is intended to result in a proposal for a specific project of inner-city revitalization which would focus on defining a productive role for the City Government in assisting the Districts.

#### IV. SCHEDULE FOR TECHNICAL ASSISTANCE

December	* Lágymányos: review prefeasibility study; prepare proposal for the State Property Agency.
December	Examine alternatives to set up development corporation; present to City and Districts.
January-March	<b>Economic analysis</b> ; complete an economic study of Budapest and explore institutional option for new Municipal Economic Information Office and district involvement.
January	* Lágymányos: set up legal entity which will carry out the project; preliminary meetings with all potential members; identify different owners and encourage them to participate.
January	* District XVII: review cost studies prepared by Water Works from technical and financial standpoint.
February	Establish Municipal Economic Information Office.
February	* Lágymányos: Advisory Panel Review of prefeasibility study; begin <b>market study</b> for reuse of industrial areas.
February	* Hungária Ring Road: review new transport plans with respect to financial feasibility and market research.
February	* Study on <b>inner city revitalization</b> projects undertaken in other countries; begin to examine Budapest neighborhood projects.
February	Seminar on <b>municipal finance</b> ; propose preliminary finance possibilities for District XVII <i>infrastructure</i> ; draft guidelines for proposal preparation in the City government.
March-April	* Lágymányos: complete market feasibility study; including study of demand for land, housing, transport.
March	Paper on methods for effective and productive <b>citizen participation</b> in urban development projects; seminar.
April-May	* Hungária Ring Road: assist with start of feasibility study.
April	* Develop proposal for inner-city revitalization project.

- June First offering of new training course.
- June \* Hungária Ring Road: panel advisory review of feasibility study; assist City and District IX in setting up development corporation.

\* Asterisk indicates project-specific tasks.

## **V. LEVEL OF EFFORT FOR TECHNICAL ASSISTANCE**

### **A. Building Institutional Capacity**

#### **1. Economic Analysis and the Establishment of a Municipal Economic Strategy Office**

Senior Economist	50 days
Economist	60 days
Economist (CCN)	40 days

#### **2. Market Study for Reuse of Industrial Area**

Economist/Planner	20 days
Industrial Redevelopment Specialist	20 days
Economist (CCN)	10 days

#### **3. Modern Public Finance Practices**

Public Finance Specialist	50 days
European Finance Specialist	20 days
Attorney	20 days
Financial Analyst (CCN)	20 days

#### **4. Methods for Prioritization of Urban Development Projects**

Project Evaluation Specialist	20 days
Public Finance Specialist	20 days
Group Process Specialist	20 days

#### **5. Public-Private Real Estate Development: Alternatives for Forming a Development Corporation**

Developer/Planner	35 days
Attorney	15 days
Developer/Financial Analyst (CCN)	20 days

#### **6. Citizen Participation**

Public Participation Specialist	30 days
Advisor (CCN)	10 days

## **7. Training for Urban Development**

Market Feasibility Trainer	20 days
Public Private Development Trainer	20 days
Municipal Finance Trainer	20 days
Coordinator	20 days
Trainers (CCN)	120 days
Coordinator (CCN)	20 days

## **B. Project-Specific Demonstrations**

### **1. The Lágymányos Project**

Economist/Planner	15 days
Attorney	20 days
Advisory Review Panel	25 days
Real Estate Developer	40 days
Economist (CCN)	30 days
Advisor (CCN)	30 days

### **2. Hungária Ring Road**

Advisory Review Panel	25 days
Real Estate Developer	20 days
Advisor (CCN)	15 days

### **3. District XVII Water Connection Project**

Municipal Finance Specialist	20 days
Urban Development Specialist	20 days
Civil Engineer (CCN)	20 days
Urban Development Specialist (CCN)	20 days

### **4. Strategies for Inner City Revitalization**

Urban Development Specialist	40 days
Attorney	20 days
Urban Development Specialist (CCN)	30 days

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## ANNEX

### List of Contacts

#### City of Budapest

Dr. István Schneller  
Deputy Mayor of Budapest  
Budapest Főváros Főpolgármesteri Hivatal

Dr. Zoltán Csorba  
Dipl. Arch.  
Technical Advisor

Viktória Hegedüs  
Technical Advisor

Ágoston Péterffy  
Member of the Board of Representatives of Budapest  
President of the City Management Committee

Dr. Pál Vécsei  
Member of the Board of Representatives of Budapest  
President of the Economy and Budget Committee

Aladár Madarász  
Counsellor  
Municipality of Budapest

Mr. Sándor Simonyi  
Head of Department for Town Development

Mrs. Angéla Pataki  
Architect  
Head of section of Rehabilitation of the Department  
of City Development

Katalin Korompay-Ágh  
Architect, City Planner  
Section of Rehabilitation of the Department of City Development

Katalin Pongrácz  
Head of the City Planning Department

Sándor Balázs Arató  
Head of the Traffic Department

Pál Bernula  
Centre for Property Management

Balázs Tökés  
Dipl. Transport Engineer  
Department of Transport Development

Dr. Károly Oszkó  
M.Sc., Mech. Eng.  
Head of Public Utilities Department

Mrs. Ferencné Fekete  
Financial and Budget Department

Richard Ongjerth  
Dip. Arch., Deputy Head of Department  
Department for Townplanning and Urban Research  
Buváti

#### Water Works Company

Pál Cséry  
General Manager  
Waterworks of Budapest

László Csernyánszky  
Assistant General Manager for Technical Affairs  
Waterworks of Budapest

Bálint Nagy  
Economic Manager  
Rocla Company, subsidiary of Waterworks

#### District Governments

István Nagy  
Deputy Mayor  
Budapest IV. District, Ujpest Local Government

Pál Vajda  
Deputy Mayor  
Budapest IV. District, Ujpest Local Government

András Berényi  
Chief Architect  
Budapest IV. District, Ujpest Local Government

László Szabó  
Real Estate Manager  
Chief Architect's Office  
Budapest IV. District, Ujpest Local Government

Péter Kátai  
Deputy Mayor  
Budapest XVII. District, Local Government

Judit Tóth  
Chief Architect  
Budapest XVII. District, Local Government

László Perlaki  
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Budapest XVII. District, Local Government

Pal Baross, M.Sc.  
Urban and Regional Planner  
Institute for Housing and Urban Development Studies

Agnes Mozsar  
Chief Architect  
District VIII

Mrs. Bokonyvári  
Head, District Management Department  
District VIII

#### Private Developers

Balázs Barts  
Managing Director, Chairman of the Board  
Revital Developer and Construction Management Company

Gábor Aczél  
Architect, Urban Planner  
Managing Director  
SEM IX  
SA, d'ménagement Urbain

Jean-Francois Serre  
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SEM IX  
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Dr. Howard L. Barnes  
International Real Estate Consultants  
Colliers International

Other Advisors

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