

**METROFINANCIERA MORTGAGE WAREHOUSE FACILITY
(ME-L1011)**

**ENVIRONMENTAL AND SOCIAL MANAGEMENT REPORT
(ESMR)**

I. INTRODUCTION

A. Project Background

- 1.1 Metrofinanciera S.A. de C.V. (“MF” or the “Company”) is the fifth largest specialized mortgage lending institution (“*Sofol*”) in Mexico. The Company was created in 1996 as Impulsa S.A. de C.V. by a group of private Mexican investors and was renamed Metrofinanciera in 1998. The main activities of the Company are to extend mortgage loans to low to middle-income individuals under the financing programs of the Sociedad Hipotecaria Federal (“SHF”) and to provide construction financing to developers of housing.
- 1.2 MF has grown at a rapid pace, driven by the high demand for low and middle income housing in Mexico. As of December 2005, its total assets were MX\$15,668 million (US\$1,478.11 million), and total shareholder’s equity stood at MX\$745 million (US\$70.3 million). In terms of loan portfolio, MF’s market share (among Sofoles) is 8.3%. MF is rated Baa2.mx by Moody’s and mxBBB+ by Standard & Poor’s.
- 1.3 MF operates throughout Mexico with six regional offices and 50 branches. As of August 2006, MF employed 744 individuals, of which 363 are located at MF’s headquarters in Monterrey, Nuevo León.
- 1.4 In order to continue its growth and to reduce its dependence on the SHF for long-term mortgage funding, MF’s strategy is to expand its ongoing securitization program. By taking assets off its balance sheet and selling them to the market, securitization allows MF to fund a whole new generation of mortgages. Among Sofoles, MF has been the most active user to date of the local capital markets.
- 1.5 The project involves the establishment of a revolving US\$175 million collateralized credit facility to be used by MF to finance the origination and accumulation of residential mortgages for securitization in the form of mortgage-backed securities (“MBS”) in the Mexican capital market. The mortgages will satisfy IDB-specified criteria and will be held in a trust separate from the borrower. The proceeds of the Warehouse Facility to be partially guaranteed by IDB will be used to originate and accumulate mortgage loans until there is sufficient volume to issue MBS in the Mexican or international capital markets; the partial credit guarantees under MBS Guarantee Facility will be used to credit enhance senior certificates of MBS issuances.
- 1.6 The vast majority of the mortgages that will be financed and/or guaranteed by the IDB are for social interest housing with a value between US\$10,000 and US\$40,000. The buyers of these houses are generally families in the C, D and D+ economic segments that have annual household incomes between US\$3,000 and US\$18,000 and constitute about 76% of Mexican households. The houses are generally part of new communities and are equipped with all basic infrastructure services (electricity, water and sanitation, telephone hookup). The communities are served by paved roads and often include schools and green areas for recreation. All the lots are titled. As

such, this project is fully consistent with the IDB's Building Opportunity for the Majority Initiative.

B. Transaction Structure

- 1.7 The transaction consists in providing two (2) guarantees. One partial credit guarantee would be provided to a revolving US\$175 million collateralized credit facility ("Warehouse Facility") to be used by Metrofinanciera to finance the origination and accumulation of residential mortgages for securitization in the form of mortgage-backed securities ("MBS") in the Mexican capital market. The mortgages will satisfy IDB-specified criteria and will be held in a trust separate from the borrower. Deutsche Bank Securities Inc. ("DBSI") would subscribe US\$175 million equivalent in senior notes denominated in Mexican Pesos indexed to UDIs at a fixed interest rate, and IDB would guarantee up to 30% of the outstanding principal amount of the notes, not to exceed the equivalent of US\$55 million. The IDB will also make available an MBS Guarantee Facility of up to US\$50 million to provide partial credit guarantees for individual MBS issuances to be made by special purpose trusts established by Metrofinanciera. Both Guarantee Facilities would make use of the local currency partial credit guarantee product.
- 1.8 The purpose of the IDB participation is to help MF sustain its securitization program by partially guaranteeing funding for MF to originate and accumulate mortgages on an interim basis until the necessary volume is reached to place MBS in the local capital market. It will also help MF reduce its dependence on the SHF for long-term mortgage funding, which is critical since the SHF will no longer provide funding after 2009. It is expected that the IDB partial credit guarantees will support at least MBS issuances with a value of at least US\$800 million.

C. Need for the Project

- 1.9 Based on the 2000 census, there was an estimated housing shortage in Mexico of about 4.3 million units, or about 20% of the country's housing stock at the time of 21.9 million units. This estimate was based on a need for 1.8 million new housing units and the upgrading, expansion or repair of 2.5 existing housing units. According to official projections, from the year 2000 to 2020 the number of households in Mexico will grow from 22.3 million to 36.3 million, or almost 63%. The Government of Mexico has estimated that 750,000 new units will need to be constructed annually to meet both the pent-up and new demand.
- 1.10 At the present time, housing construction represents about 3% of Mexico's GDP and matches the size of the automobile industry, one of the country's most important manufacturing sectors. According to the INEGI, the number of workers employed in the construction industry reached 8% of the total population at the end of September 2005.
- 1.11 The current administration has been very active in encouraging government agencies to expand the volume of mortgages authorized in order to increase production of housing. One of the objectives of the Government, however, is to reduce dependence on the public sector for housing finance. To that end, the SHF is shifting its strategy from that of providing direct credit to the private sector mortgage lending industry to that of providing guarantees to promote the development of the mortgage-backed securities ("MBS") market. The SHF will cease funding altogether after 2009.
- 1.12 While MF is more than willing to shift to the securities market as its primary long-term funding mechanism, it has a large need for financing the mortgage pools on an interim basis prior to securitization. This is the gap that the IDB is seeking to fill through this operation.

II. ENVIRONMENTAL AND SOCIAL

A. Environmental and Social Compliance

- 2.1 In January 2006 MF received an award for Corporate Social Responsibility (CSR) from the Mexican Center for Philanthropy. The CSR recognition was given for MF's workplace conditions, its involvement with some of the communities where it operates, and in consideration of environmental aspects of its operations.
- 2.2 MF conducts a generic assessment of environmental and social aspects during the credit review process (e.g. confirmation that potential developments are not located at or near environmental sensitive areas, areas susceptible to natural hazards, areas with soil contamination, development in compliance with land use regulations, etc). As part of IDB's participation by partially guaranteeing funding to MF, the Bank will assist the Project Company to develop environmental procedures commensurate to the potential environmental and social impacts and risk associated with MF securitization program.

B. Environmental and Social Impacts and Risks

- 2.3 Based upon the nature of this Mortgage Backed Securitization Project, there are limited direct environmental, social, or health and safety impacts or risks. The potential key environmental, social, health and safety, and labor risks associated with the Project include (i) environmental, social and health and safety impacts associated with individual mortgages financed by MF, (ii) MF environmental credit risks, and (iii) IDB Reputation Risks associated with MF environmental, social, health and safety, and/or labor practices.
- 2.4 The key potential project-related environmental, social, and health and safety impacts and risks are those typically associated with new moderate size construction works, such as: a) social issues associated with acquisition of the site, including any potential displacement of illegal settlements occupying the construction site, and any changes of land use; b) potential impacts from construction on brownfield sites with existing contamination (e.g. release/re-suspension of contaminants with consequent health issues); c) typical temporary impacts from construction related activities such as loss of vegetation, soil erosion; increased air emissions and noise as a result of construction, engine combustion from heavy equipment and machinery, increased generation of solid waste and construction debris, potential contamination or disruption of surface and ground waters; etc.; d) potential impacts on sites of archeological, cultural or historical value, if found; e) potential accidents or other health and safety risks to construction workers from activities associated with the use and handling of heavy equipment; f) other temporary related impacts associated to ancillary activities or facilities (e.g. landfills, quarries, etc) and g) permanent landscape disruption. Once developed, housing complexes could create a significant pressure over public services (e.g. potable water and sewers systems, electricity, access roads, schools, hospitals, etc) and create significant nuisances to nearby populations or sensitive habitat if any. Additionally, large housing developments may attract illegal settlement looking for proximities to improved public services and access roads, not only aggravating any environmental and social impact but also increasing the risks for additional environmental and social issues (e.g. land slides, vandalism, crime, etc.).
- 2.5 Environmental Credit Risks refer to potential negative effects on MF ability to repay the Warehouse Facility because of: (i) risks due to MF credit programs associated with the reduction in mortgage asset values or property guaranties/securities due to environmental or social issues

(e.g. environmental liabilities) or increased probability of non-repayment of loan due to environmental and social issues (e.g. law suits, fines, etc); and (ii) risks associated with MF facilities and operations, such as environmental liabilities in their buildings/offices due to PCB transformers, asbestos, lead paint, etc. or MF employees having occupational health and safety problems due to working conditions/environment (e.g. inadequate emergency preparedness, lack of fire exits, etc).

- 2.6 Reputation Risks are associated with MF involvement in projects, companies or activities considered unacceptable to the IDB and/or that will face significant public opposition or concerns, such as (i) inappropriate development siting; (ii) MF finance application and analysis process that is not equitable, fair, and unbiased in terms of social factors (e.g. gender, age, ethnicity, or cultural heritage, etc.); and (iii) significantly deficient labor practices by MF.

C. Environmental and Social Management

- 2.7 The environmental, social and health and safety impacts associated with the individual housing project of this operation are considered to be low and are related mainly to the magnitude and the location of the housing project. MF limits its assessment of environmental and social risks to compliance with the applicable environmental related regulations in Mexico (i.e. land use and construction permits, water discharge approval, environmental authorization when applicable, etc.). MF does not have a specific procedure to assess environmental risks associated with mortgage acquisition. However, MF has agreed to develop and apply an Environmental Mortgage Procedure that would incorporate environmental and social aspects as part of their current appraisal procedure.
- 2.8 Currently, the principal environmental credit risks associated with MF facilities are related to MF headquarters in Monterrey. Given MF rapid growth pace, current office space at headquarters for MF's 363 employees is reaching its limits. The building has been inspected by the Fire Department and the Mexican Civil Protection Agency and recommendations were given to strengthen fire fighting systems and emergency exits. A revised emergency response plan is being prepared, which will define a MF employees rescue squad, emergency procedures, training, evacuations drills, etc. MF is in the process of expanding its existing office space in the Monterrey downtown area by incorporating two buildings that are contiguous to its headquarters. Upon completion of the new buildings, the Fire Department and the Mexican Civil Protection Agency will inspect and certify the adequacy of the fire fighting systems and emergency related requirements of the buildings.
- 2.9 Reputation risks associated with MF providing mortgage financing for activities potentially damaging MF reputation (transferable to the IDB) were considered to be minor as the program is solely for residential mortgages. MF application and analysis process seems to be equitable and fair. Further, MF principal clients are low to middle income population. Lastly, reputational risks due to labor practices are also considered to be low. MF human resources related procedures are defined and are applied consistently as per the Human Resources Manual. Reportedly, MF employees received benefits and compensation above comparable competitors. The gender distribution is 60/40 males to females. At the time of the site visit one individual with disabilities was a full-time MF staff. It should be noted that in March 2006, MF was distinguished as one of the best companies to work for by the US based Great Place to Work for Institute.

D. Environmental and Social Requirements

- 2.10 The Bank will require as part of the Partial Credit Guarantee Agreement that MF (i) comply with all applicable environmental, social, health and safety, and labor Mexican regulatory

requirements and applicable IDB policies; (ii) prior to financial closure, develop and implement an Environmental Mortgage Procedure, in form and substance satisfactory to the IDB; and (iii) prior to financial closure, develop an Environmental, Health and Safety Action Plan, in form and substance satisfactory to the IDB, including, at a minimum, actions associated with MF contingency plans and procedures (i.e. emergency drills, emergency response programs, etc).

- 2.11 On a yearly basis, the IDB will require an Environmental and Social Compliance Certificate (ESCC) stating that mortgages originated by the Warehouse Facility (i) were originated according to the Environmental Mortgage Procedure, (ii) all properties (mortgages) comply with the predetermined environmental and social eligibility criteria, and (iii) MF is compliant with the environmental and social provisions of the guarantee agreement.
- 2.12 The Bank will monitor the environmental, social, health and safety, and labor aspects of the operation via internal Bank supervision actions (e.g. site visits, review of documentation, etc.) and may use an external independent environmental consultant. In addition, if needed, the Bank will have the right to perform an independent environmental, health and safety audit.