

ANNEX III

DRAFT ENVIRONMENTAL AND SOCIAL STRATEGY (ESS)

1. Transaction Overview

- 1.1. The objective of the Project is to contribute to reducing the qualitative and quantitative housing deficit for the Base of the Pyramid (BOP) in Mexico by facilitating access to financing for home improvements and self-construction. To achieve this objective, the Opportunities for the Majority Sector is proposing to provide a loan of up to US\$5 million to FOMEPADE S.A. de C.V. (“FOMEPADE”), a Mexican non-bank financial institution (SOFOM) with an innovative financing program via payroll deduction for low-income public sector employees at the state and municipal levels. FOMEPADE provides families not only with a complete financing solution (including access to government housing subsidies), but also with a technical solution through its housing partners, all certified by the Sociedad Hipotecaria Federal (SHF). The IDB resources would support FOMEPADE’s loan origination activity and allow it to expand its existing low-income housing portfolio.
- 1.2. The Project seeks to achieve its objective through both an innovative financing program and FOMEPADE’s business model, which seeks to correct an important coordination failure among the different actors in the housing sector: (i) collaboration agreements with public entities, FOMEPADE structures convenient repayment plans via payroll deduction leading to lower administrative costs and lower credit risk; (ii) coordination with public housing schemes, allows FOMEPADE to complete the financial package and tap directly into the federal subsidy “Esta es tu Casa” for qualifying beneficiaries; (iii) access to high-quality housing solutions through MexVi and other providers, allows FOMEPADE to offer housing solutions built under a patented construction system, which combines high quality materials at market costs, appropriate quantity of material supply, scheduled material delivery program, technical assistance, fast construction and environmentally-friendly construction techniques.
- 1.3. Beneficiaries that wish to become eligible for the loans must meet the following requirements:
 - a. Be formally employed by any municipal or state government institution
 - b. do not have any kind of affiliation to one of the national housing assistance programs
 - c. Own or possess a land in order to construct the dwelling
 - d. Monthly wage must not exceed 5 minimum wages
 - e. 5% of the total unit cost as down payment
 - f. Have access to basic facilities (sewer, electricity, and water)
- 1.4 It is important to note that the SHF certifies homebuilders based on several environmental and construction standards. Moreover, in order to qualify for a federal housing subsidy, the use of funds must comply with certain construction and environmental standards as well.

2. Environmental and Social Impacts and Risks

- 2.1 Based upon the nature of this operation, which consist on financing construction of social housing units and home improvements, there may be minimal to moderate direct environmental, social, health and safety (ESHS) and labor risks and impacts, and thus a limited environmental assessment is required.

2.2 The main ESHS risks and impacts involved with this operation are the ones associated with the construction of social housing units that include location, integrity of the houses and basic facilities (sewer, electricity, water) as well as social aspects such as:

- Potential impacts on houses located in areas of previous use activities that may result in localized environmental problems, such as abandoned landfills or waste disposal areas, industrial facilities, etc.
- Potential impacts on houses located in areas susceptible to natural hazards, such as tornadoes, hurricanes, floods, seismic events, and fires.
- Potential discrimination and barriers for an equitable process of providing the mortgages taking into consideration ethnicity, sex, religion, age, etc.
- Potential risks on houses with low construction standards.
- Potential impacts on houses if lacking the basic facilities mentioned above.

2.3 The Project presents certain indirect lesser risks and impacts related to the improvement of the houses associated with:

- The sites where the housing improvement takes place (e.g. risk of contaminated site, or natural disaster risk)
- The design of the housing improvement (e.g. unsafe or vulnerable structures)
- The housing improvement works themselves (e.g. health and safety risks to construction workers from activities associated with the use and handling of heavy equipment, air and noise pollution)
- The materials that will be used in construction (e.g. banned or dangerous materials)

2.4 These risks may be minimal to moderate and will be assessed during the due diligence.

3. Strategy for Environmental and Social Due Diligence

3.1 Based on Directive B.13 of the Environment and Safeguards Compliance Policy (OP703), and given that this is a loan to a financial intermediary, this operation is not subject to an environmental impact classification.

4. Strategy for Environmental and Social Due Diligence

4.1 As per the IDB Environment and Safeguards Compliance Policy and Guidelines, and as part of its due diligence process, the Bank will assess FOMEPADE's capacity for environmental management, through an analysis of the ESHS and labor impacts and risks associated with its mortgage business. During this process the Bank will establish whether appropriate environmental procedures are in place to appropriately assess and manage these potential risks and impacts.

4.2 To that end, the environmental and social due-diligence will specifically include the components listed below:

- Assess FOMEPADE's compliance status with the applicable environmental, social, health and safety, and labor regulatory requirements in Mexico.
- Assess the current credit appraisal, approval, and monitoring procedures to manage environmental and social liabilities, risks and/or impacts of home improvement and self-construction loans, including a quick analysis of FOMEPADE's loan portfolio. Current procedure should at a minimum be able to (i) include in the application and analysis process consideration of environmental or social aspects (such as risks from location of the houses, construction standards and lack of basic facilities) and assess potential environmental financial/credit risks and liabilities that may be associated with home improvement and self-construction loans and (ii) include

provisions to have credit officers trained to identify potential environmental, social, health and safety, and labor issues/liabilities.

- Verify the institution(s) responsible of the quality control assessment of the home renovations and self-constructed houses. This assessment will assure the compliance of construction national standards, laws and regulations for the housing sector.
- Assess FOMEPADE's home improvement and self-construction loan portfolio, as well as a summary analysis of its broader portfolio, to establish potential reputational risks associated with FOMEPADE's involvement in projects, companies or activities considered unacceptable to the IDB.
- Evaluate the inventory of present environmental, social, and health and safety liabilities in FOMEPADE's loan portfolio, and facilities, and if they exist, assess the adequacy of an action plan to properly resolve them.
- Verify FOMEPADE's use of any geo-referenced information system to identify potential risks for new house developments, and access to existing data related to previous projects.
- Evaluate FOMEPADE's compliance with the Fundamental Principles and Rights at Work and whether they practice fair and unbiased labor practices related to sex, age, ethnicity, cultural heritage, and collective bargaining. An assessment of the adequacy of FOMEPADE procedures to ensure that finance application and analysis process is equitable, fair, and unbiased in terms of social factors (e.g. age, gender, cultural heritage, etc).
- Evaluate FOMEPADE's information strategy to promote the access to loans for home improvement and self-construction programs.
- Assess FOMEPADE's procedures to select the beneficiaries who will get access to both home improvement and self-construction loans. This assessment has to include the approach to give opportunities for vulnerable groups such as single parents, senior people, and people with disabilities to get access to these loans.
- Evaluate the self-construction model to build new houses as well as the house renovation activities. This evaluation has to include all the related health, safety and labor aspects.

The results of the due diligence will be presented in an Environmental and Social Management Report and summarized in the Loan Proposal