

**DEVELOPMENT BANK OF MINAS GERAIS**  
**MUNICIPAL INFRASTRUCTURE AND SERVICES FINANCING PARTNERSHIP (PROJECT)**  
**(BR-L1403)**  
**ENVIRONMENTAL AND SOCIAL MANAGEMENT REPORT (ESMR)**

## **1. Project Description and Background**

1.1 The objective of the “Banco de Desenvolvimento de Minas Gerais” (“BDMG”) Municipal Infrastructure and Services Financing Partnership (the “Project”) is to establish a strategic partnership with BDMG, the largest municipal lender in number of clients in the state of Minas Gerais (“MG”), to support financing infrastructure projects as well as the acquisition of essential equipment and machinery for road maintenance and for garbage collection, in municipalities of the state of MG.

1.2 The proposed financing (the “Loan”) consists of a senior loan of up to one hundred fifty million dollars (US\$150 million) that would provide BDMG with long-term funding needed to continue expanding its municipal infrastructure and equipment lending activities in the state of MG. Through BDMG, the Inter-American Development Bank (the “Bank” or the “IDB”) expects to reach a larger number of municipalities and support financing highly developmental municipal infrastructure projects.

1.3 BDMG was founded in 1962 to foster the sustainable development of MG and it provides long-term financing to support public and private sector investment in various sectors of the MG economy. BDMG is one of the main funding providers for municipal lending in MG financing the acquisition of machinery and equipment for use in public works, infrastructure projects including resurfacing and drainage sanitation, as well urban solid waste treatment projects. BDMG offers an important partnership opportunity for the IDB to support municipal infrastructure and basic services projects in the state of MG.

## **2. Project Status and Compliance**

2.1 Based on Directive B.13 of the Environment and Safeguards Compliance Policy (OP-703), the Project is classified as a financial intermediary and as such is not categorized according to its potential environment and social (E&S) impacts and risks.

2.2 BDMG has confirmed that it is in compliance with Directive B.2 (country laws and regulations) of IDB Environmental and Safeguards Compliance Policy, complying with all applicable legal and regulatory environmental, social, health and safety, and labor (ESHS&L) laws and regulations.

2.3 BDMG portfolio concentration is in industry with more limited exposure in funding services, public sector and commerce. Lending to certain productive sectors in its portfolio may present low to high risk. Based on portfolio composition, and the intended use of proceeds as further described in paragraph 3.3 this operation is classified as medium risk (FI-2).

### **III. Environmental and Social Risks and Impacts**

3.1 BDMG's current portfolio presents the following sector concentrations as of March 2014: (i) 52% in industry (automobile, dairy production and mining), (ii) 18.5% in services, (iii) 13.3% in public sector funding, (iv) 8.3% in commerce and (v) 0.7% percent in others. Funding to BDMG is through the partnership will be directed to Municipal financing of projects including: (i) paving and drainage, (ii) construction of public buildings, (iii) machinery for road maintenance and construction as well as (iv) garbage collection and sanitation. The proposed Project is expected to have a high developmental impact in the well-being and life quality of the population of MG as it will finance municipal infrastructure projects and acquisition of essential equipment for road maintenance and for garbage collection.

3.2 The environmental, social, health and safety (ESHS) and labor impacts and risks associated with sub-loans to municipalities in BDMG's portfolio are likely to be low to significant, with the major risks depending on the size of municipal construction projects. The ESHS and labor impacts and risks could include: (i) land contamination (poor planning of construction and garbage collection), (ii) stress/contamination of water resources due to inadequate wastewater discharges, (iii) inadequate waste management, transport and disposal, (iv) use of migratory or informal labor, (v) transport, traffic safety and noise as well as dust management, and (vi) occupational, health and safety standards.

3.3 The maximum loan amount is three million reais (R\$ 3 million) for municipalities of up to 100,000 (one hundred thousand) inhabitants and five million reais (R\$ 5 million) for the municipalities of more than 100,000 (one hundred thousand) inhabitants. BDMG financing limit will not surpass the aforementioned amounts, in case municipalities present more than one proposal for funding of different activities. The Project has received average funding requests of one million and six hundred reais (R\$1,6 million)<sup>1</sup>.

### **IV. Environmental and Social Management**

4.1 BDMG has a sustainability advisory unit –“Assessoria de Inovação e de Sustentabilidade,” which is connected to the Director-Presidency of the bank, and is responsible for, among other things, increasing partnerships and financing opportunities that foster social and environmental responsibility and that provides internal training on sustainability matters. It also seeks opportunities to work closely with the Environmental State System – SISEMA – and to disseminate BDMG's best environmental and social practices in projects and related-activities. The “Assessoria de Inovação e de Sustentabilidade” is not responsible for assessing projects and/or advising on financing of operations.

4.2 BDMG, as a state bank, is required to comply with the state and Federal environmental and social laws and regulations in place and to request authorizations from the pertinent public institutions for its works and activities. In this regard, BDMG has developed its own social environmental policy (Resolution N°216), based on the existing Federal and state laws and regulations, and has conditioned financing approval to environmental regularization. The required licensing regulations for projects and activities are issued by the state of MG and related public

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<sup>1</sup> The exchange rate on April 4, 2014 is 1USD equals 2.28 Brazilian Reais.

institutions. BDMG also has an exclusion list of activities, largely based on Brazilian constitutional principles of separation of powers and potential conflict of interests and jurisdictions.

4.3 The Public Sector Department of the BDMG analyses the public sector financing proposals and identifies potential environmental and social matters. BDMG relies on the regulations of the General Manual for Project Design (“Cartilha Geral para Elaboração de Projetos”) the project classification of Resolution N°216, “Deliberação Normativa 74/04” as well as applicable Federal and state laws that specify the regulations on environmental licensing and monitoring of social and environmental matters.

4.4 BDMG is required to ensure that any client applying for a sub-loan is in compliance with the environmental and social requirements established under the laws and regulations of the state of Minas Gerais as well as the applicable Brazilian Federal law. The state environmental agency grants environmental licenses and permissions, according to projects potential environmental and social impacts and may waive environmental licenses and permissions if it deems that the project does not present risks. BDMG requests from the state and municipal environmental agencies a “manifestação ambiental” for every single project, even if the environmental agency has waived licenses and permissions. (In some cases, the responsibility for the “environmental manifestation” belongs to the municipal agencies).

4.5 Prior to approving financing for projects involving potential negative environmental impacts, BDMG requests from clients documents as well as state and/or municipal permits that demonstrate that the proposed project complies with the applicable environmental law and social standards. BDMG also requires the application of the technical norms and related procedures of the “Associação Brasileira de Normas Técnicas” (“ABNT”). BDMG relies on qualified consultants or external firms to ensure that works are bid out and the allocation of resources carried out in accordance with all fiduciary and technical requirements, and if applicable any requirements specified in environmental licenses and permits. This process includes document review and when needed may include site visits and interviews with local affected groups. For specific environmental aspects, BDMG relies primarily on evidence that the project is designed and operated in accordance with all standards, permits and approvals required by responsible State or Municipal environmental agencies (see for example, Annex IX of BDMG’s *Cartilha Geral para Elaboração de Projetos*).

4.6 The financing requests received by BDMG are screened taking into consideration the environmental protection regulations established in Resolution N°216, “Deliberação Normativa 74/04” as well as applicable Federal and state laws. Although BDMG did not develop its own system of operation classification of environmental and social risks and impacts, it follows the “Cartilha Geral para Elaboração de Projetos”, “Deliberação Normativa 74/04” as well as Resolutions N°216, and No. 201. The documentation includes the municipalities’ commitment to comply with social and environmental laws and regulations and to report to BDMG on social and environmental mitigation measures.

4.7 BDMG has a monitoring system in place that includes hiring of external consultants or firms that assess compliance with relevant environmental and social standards. BDMG publishes on-line the financing contract with the municipalities and has access to a government system to track

environmental permits and related documentation and has a grievance mechanism (“Ouvidoria”) in place.

## V. Environmental and Social Requirements

5.1 For this Project, which involves lending to MG’s municipalities of on average one million six hundred reais (R\$1,6 million) and up to five million reais (R\$5 million), the Bank will require BDMG as part of the Loan Agreement to:

(i) Comply with all applicable Federal and MG state and municipal legal and regulatory requirements, and in relation to the financing of each sub-loan require and obtain satisfactory assurance that all municipalities/use of proceeds comply with, at a minimum: (a) host country ESHS and labor regulations and standards, in accordance with existing procedures and requirements as outlined in paragraphs 4.1 to 4.7 above; (b) BDMG’s own policies as well as the General Manual for Project Preparation (“*Cartilha Geral para Elaboração de Projetos*”) on ESHS and labor matters for sub-loans (c) the IDB List of Excluded Activities for Non-Sovereign-Guaranteed (NSG) operations and (d) the Fundamental Principles of the Rights at Work.

(ii) Agree with IDB on how to integrate the IDB exclusion list and high risk exclusions<sup>2</sup> in the BDMG project approval process and implement the agreed changes.

(iii) Designate the staff members who will have primarily responsibility to screen for environmental and social issues and to ensure that the designated staff member, and other staff as appropriate, take part in the IIC/IDB Environmental Risk Management training course, or a similar workshop by other organizations such as UNEP-FI, or another training agreed upon with the IDB.

(iv) Present an Annual Environmental and Social Compliance Report (ESCR) with information on the BDMG portfolio and any particular risk issues identified during screening, mitigation measures agreed with clients as well as compliance status.

5.2 The IDB will supervise the ESHS and labor aspects related to the use of the proceeds of the IDB loan, annually or as otherwise necessary either by an IDB in-house specialist or with external consultants (costs to be included in the annual supervision fee). If necessary, IDB will ask for corrective actions or measures to enhance the management of impacts and risks. To this end, BDMG will provide and facilitate access by IDB to all relevant documentation, personnel and sub-project facilities.

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<sup>2</sup> In addition to the products and activities included in the IDB Exclusion List, the Borrower will not use the proceeds of the IDB loans in accordance with a covenant as follows: “**High Risk Activities.** The IDB Loan will not be used to finance any Sub-Loans that finance activities that: (i) support IDB Category A Projects; (ii) adversely affect lands, territories or intellectual property of or have potentially significant adverse impacts on indigenous communities; or (iii) result in the involuntary resettlement or displacement of livelihood activities, unless a Resettlement Plan is approved by the IDB prior to Sub-Loan approval.”