



Project Information Document/ Integrated Safeguards Data Sheet (PID/ISDS)

Concept Stage | Date Prepared/Updated: 13-Jan-2017 | Report No: PIDISDSC19054



BASIC INFORMATION

A. Basic Project Data

Country China	Project ID P158124	Parent Project ID (if any)	Project Name Shanghai New Urbanization Financing and Innovation Project (P158124)
Region EAST ASIA AND PACIFIC	Estimated Appraisal Date May 31, 2018	Estimated Board Date Dec 13, 2018	Practice Area (Lead) Social, Urban, Rural and Resilience Global Practice
Financing Instrument Investment Project Financing	Borrower(s) PEOPLE'S REPUBLIC OF CHINA	Implementing Agency Shanghai Municipal Investment (Group) Corporation	

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Financing (in USD Million)

Financing Source	Amount
Borrower	0.00
International Bank for Reconstruction and Development	350.00
Total Project Cost	350.00

Environmental Assessment Category
F-Financial Intermediary Assessment

Concept Review Decision
Track II-The review did authorize the preparation to continue

Have the Safeguards oversight and clearance functions been transferred to the Practice Manager? (Will not be disclosed)

No

Other Decision (as needed)

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B. Introduction and Context

Country Context

1. **More than half of China's population now lives in cities and 70 percent is expected to do so by 2030.** Unparalleled economic development experienced in the past three decades has successfully boosted domestic product growth, economic transformation, productivity increases, and employment creation. Over the next 20 years, urbanization is projected to reach about 65 to 70 percent, adding another 300 million urban inhabitants. By 2030, about



one billion people will be living in China's cities, seeking jobs, housing, infrastructure, and other services. Although China has avoided some common issues related to rapid urbanization, such as urban poverty and unemployment, strains are starting to show as its existing growth model is running out of steam with inefficient use of land, capital and labor.

2. **China's unprecedented urban development pace brought heavy environmental costs, including significant environmental degradation and heavy resource use.** The current urbanization path is not efficient because pollution imposes rising direct and indirect economic costs that are often not reflected in market transactions. China's environmental performance is of global importance. Today China is responsible for 30 percent of the world's total emissions from fossil fuel combustion and cement production¹, of which 70 percent comes from its urban areas.

3. **China is embarking on a new model of urbanization.** The GoC has recently launched a "New Urbanization Plan"² to sustain the country's economic growth by promoting further urbanization. This new normal³ sees a critical shift from a resources mobilization strategy to increased efficiency and sustainability. China started investing in infrastructure to support environmental management and gearing its cities to a low-carbon path. With environmental sustainability and climate change mitigation as key considerations, China's 13th Five-Year Plan aims at 50 percent reduction of China's CO2 emission in key sectors including building efficiency, green transportation and clean energy.

4. **The new path to sustainable growth implies financing challenges for different layers of government.** China's infrastructure investments have been astounding, at around 10 percent of its GDP for the past twenty years. Notwithstanding the success, the quality of some investment choices made by some local governments were deemed poor. Going ahead, in order to align low carbon economic growth with socioeconomic development goals, China is seeking improved access to long-term low-cost green infrastructure⁴ financing for all level of governments. Recognizing in particular the green investments expanding demand, the Government of China issued the "Guidance on Establishing Green Financial System" on August 31, 2016; this Guidance includes 35 action points to advance regulation on issues related to green finance markets, including support for green bonds issued by local governments through credit enhancements and special guarantees, as well as encouraging the establishment of regional green funds.

5. **With an increasingly critical role in China's urban landscape, small towns will require diversified finance to pursue their mandate.** From 1978 to 2014, the number of small towns increased from 2,173 to 21,826, accounting for 42 percent of urban population and 23 percent of the national population⁵. Small towns are expected to play an increasingly important role in China's urbanization, serving as both the nodal point of rural-urban migration, and the first level of urban agglomeration that provides public services to the surrounding areas⁶. However, in practice, infrastructure

¹ Zou et al. (2016), Pursuing an Innovative Development Pathway: Understanding China's INDC, World Bank.

² China's New Urbanization Plan for 2014-2020 was officially released in March 2014 by the State Council and is available at the national government's website: http://www.gov.cn/zhengce/2014-03/16/content_2640075.htm.

³ The 'new normal' is a reformed economic state that will have medium, rather than high-speed and higher quality economic growth, mainly driven by innovation. It will have greater reliance on domestic consumption, services and higher value added manufacturing, including energy efficiency and low carbon industries.

⁴ The term 'green infrastructure' here refers to a broad definition, as adopted by the Global Green Growth Institute (GGGI) encompassing all growth-enhancing new infrastructure that reduces emissions and/or the natural resource intensity of an existing or new system, including both stand-alone new infrastructure and additional infrastructure. This comprises energy efficient infrastructure, mass urban transport infrastructure, renewable energy infrastructure, as well as the green infrastructure which aims at integrating man-made systems into natural spaces, such as floodplains, green roofs and so on.

⁵ Ministry of Housing and Urban-Rural Development. http://www.mohurd.gov.cn/wjfb/201507/t20150703_222769.html. Small town count up to 200 million in 2014. Huang Xinwen (2010), The Status of small town development in China, Development and Planning Studies, No. 44 (in Chinese).

⁶ According to China's New Urbanization strategy and the 13th National Economic and Social Development Five-Year Plan, small towns will have an important function in becoming settlements for the newly urbanized population, offering lower costs of living, slower pace of life, and better air quality.



development in small towns lags considerably behind cities⁷, in part because small towns have little fiscal autonomy and capacity to borrow. In general, small towns have very limited capacity to raise funds for infrastructure projects⁸. Unbalanced allocation of fixed asset investments that favor cities over towns has led to disparities in the level of infrastructure and quality of municipal services. Consequently, compared to larger cities small towns have less attractive employment prospects and sub-optimal provision of public services, considerably hindering their ability to absorb the newly urbanized population. Choosing to put Chinese small and medium cities on a low carbon trajectory could yield multiple parallel benefits including limiting traffic congestion and air pollution, increasing labor productivity, reducing GHG emissions, and improving public health and quality of urban life. All these aspects will contribute in the long term to their competitiveness.

Sectoral and Institutional Context

6. The bulk of urban growth momentum is expected to unfold in small to medium-sized cities and significant green infrastructure investment opportunities might precisely reside in those urban areas⁹. While notable efforts are under way in Chinese megacities to protect the environment and reverse the prevailing trend of increasing energy intensity per GDP, the low-carbon trajectory may be neglected or discounted off-hand in small towns due to financial constraints. Many small towns in China are still struggling with bringing infrastructure provision at par and may overlook green investments due to the incremental cost of environmental mitigation. The demand for environmentally friendly public transport, buildings and water supplies, sanitation and energy is significant, and estimated to be up to 30 trillion RMB for the period 2014-2020 for the whole country. Of these, only about one fourth currently has sufficient resources and is indeed receiving investments¹⁰. The demand is expected to multiply by over threefold in the following decade.

7. China's traditional local government financing system has left many small towns poorly served on the infrastructure front. Most small towns have limited capacity to borrow given their low revenue base, lack of independent budget and heavy reliance on upper level government transfers¹¹. Over the last 10 years the third-tier and fourth-tier municipalities have over-developed land resulting in oversupply of housing inventory, which will take a few years to absorb. Without continuing real estate development, land-based financing will not work and these cities will not be able to borrow further. Urban Development Corporations (UDICs)¹² have also been a common source of financing, via loans from banks and the shadow banking system¹³, based on land use rights and future revenue from land development projects as security. While their purpose, structures, and capacities differ widely across sub-national

⁷ For instance, the percentage of population with access to water supply, road space per resident, and length of drainage pipes per square kilometer of built-up area were respectively 89, 74 and 67 percent lower than the national level. In 2009 the coverage rate of wastewater treatment was 75 percent in cities, but only 42 percent for county towns. Available at <http://documents.worldbank.org/curated/en/2012/04/16432410/china-small-medium-towns-overview>

⁸ World Bank, 2012. China Small and Medium Town's Overview. Washington DC.

⁹ Seto, K.C., S. Dhakal et al. (2014), "Human Settlements, Infrastructure, and Spatial Planning", in IPCC, Climate Change 2014: Mitigation of Climate Change Contribution of Working Group III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change, Cambridge, UK and New York: Cambridge University Press.

¹⁰ The report foresees a low case scenario financing gap of RMB 14.9 trillion, and a high case scenario of up to RMB 30 trillion. For 2013 alone, a gap of RMB 3.7 trillion was identified, with current investments of RMB 0.9 trillion. China Council for International Co-operation on Environment and Development, 2015, Green Finance Reform and Green Transformation. Annual Conference of CCICED.

¹¹ The China National Audit Office's audit results of 54 counties released in 2012 found that 49.4 percent of their public expenditure relied on upper level government transfers; in 45 western counties, the share of such transfers was 61.7 percent. Only three counties had primary budget surpluses to meet public expenditures.

¹² UDICs are municipal corporations locally capitalized by providing them land use rights, cash and shares in state owned enterprises; they are treated as municipal state-owned enterprises (SOEs) under China's Company Law and mobilize financing for infrastructure investments and maintenance.

¹³ The primary "shadow banking" sources used by UDICs are wealth management products sold to retail customers, trust loans sold to high-net-worth investors and entrusted loans from large companies. See McKinsey & Company, Debt and (Not Much) Deleveraging (2015), Chapter 4.



governments, overall UDICs represent a large stream of business to commercial and policy banks; municipal governments are assumed to provide implicit guarantees and collateral. UDICs also issue mid-term notes, trust products and enterprise bonds whose creditworthiness is linked to the local governments. The rapid expansion of UDICs has also triggered concerns related to systemic risk¹⁴, long term impact on land prices, and maturity mismatch. The Government recognizes the embedded risks in implicit guarantees as well as the other risks and is attempting to take a significant step to sever this link by turning to alternative means of infrastructure financing with proper risk allocation.

8. **The amended State Budget Law (SBL)¹⁵ provides challenges and opportunities for small town financing.** The amended SBL aims place legal constraints on government income and spending and favors transparency. Under the new framework, municipalities can no longer access UDICs and will have two main channels for debt-financing of urban infrastructure: local government bonds through the provincial government (with a share of the proceeds to be passed down to lower levels of government); and corporate bonds or commercial bank loans for revenue-earning utilities and infrastructure service providers. While the amended SBL is a step forward in terms of allowing local governments to access the capital market directly, it may not permit small towns to access this finance due to competing priorities. At the same time, other debt-finance is under strict control, leaving small towns largely unserved by capital markets. The law also encourages PPP arrangements (which have so far had a slow uptake in China¹⁶) and the establishment of revenue-earning entities that can provide services through concession contracts or service agreements.

9. **No one single funding source can address the size of the green infrastructure gap and low cost long term financing mechanisms are urgently needed.** Estimates foresee that only 10 to 15 percent of the financing need will be fulfilled by public sources, while the rest will have to be mobilized through the private sector¹⁷. Exploring non-traditional sources of debt financing that could help channel long term capital to revenue-earning entities and prudent borrowing could contribute to promoting sustainable urbanization and foster shared prosperity¹⁸.

10. **The Shanghai Municipality Government (SMG) has been actively exploring ways to support the development of urban green infrastructure in the metropolitan region.** Through a long-standing cooperation with the World Bank, the SMG has been a pioneer in seeking private sector leverage for the investment needs of its small towns. A District Financing Vehicle (DFV) was established in 2005 under a Bank financed Urban Environment Project, to pilot an intermediate financial facility. Early lessons include the importance of sufficient fund capitalization (the pilot was capitalized twice for USD 30 million each time, but the demand was largely superior), flexible financial engineering that can adjust as the regulatory framework evolves (the DFV could not seek additional investors in its original legal format for instance, and could not on-lend outside its pre-established focus of operation), and strong execution of pipeline (which has been excellent). With the support of NDRC and MOF, SMG intends to step up the game for infrastructure development of small towns, and set up an institutional mechanism that addresses the financing needs of small towns.

¹⁴ IMF, 2013. Local Government Financing Platforms in China – A Fortune or Misfortune?, Washington DC

¹⁵ On August 31, 2014 the Amendment of the Budget Law of the People’s Republic of China was passed by the National People’s Congress and it became effective on January 1, 2015.

¹⁶ There are a variety of reasons for the low uptake in the China PPP space, including the still ambiguous / emerging regulations, enforcement and arbitration rules; lack of credibility of local governments in contract enforcement; local governments’ unwillingness to open up profitable projects to the private sector; difficulties of privately owned enterprises in obtaining finance; and entrenched and powerful SOEs.

¹⁷ Green Finance Task Force (2015). Establishing China’s green financial system. Co-sponsored by People’s Bank of China and UNEP Inquiry into the Design of a Sustainable Financial System: Beijing.

¹⁸ World Bank. 2016. Sustainable Small Town Infrastructure Financing-Phase II, Washington DC



Relationship to CPF

11. The proposed project will support the latest China CPS (FY2013-2016) by contributing to the CPS strategic themes of promoting greener growth and more inclusive development. Under the first strategic theme, the project will contribute to the outcome of enhancing urban environmental services. By enhancing financing capacity and viability of small towns green infrastructure in the Shanghai greater metropolitan region, the proposed project will contribute to expanding access to safe water supply, improving sanitation, solid waste and other basic urban services, supporting private-sector investments in water and sanitation projects, and helping small cities build resilience to natural disasters. Under the second strategic theme, it will contribute to enhancing opportunities in rural areas and small towns, particularly by enhancing secondary town development through financing small town infrastructure. By improving access to infrastructure finance, and enhancing the urban environment and service provision, the project will contribute to promote shared prosperity in small towns.

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C. Proposed Development Objective(s)

The project development objective is to provide sustainable long-term financing to green infrastructure in selected small towns in the Shanghai metropolitan area and Yangtze river delta region.

Key Results (From PCN)

12. The achievement of the PDO will be measured through the following Key Performance indicators: (1) Quantity of own capital provided by institutional investors to set up the facility; (2) Total amount of long term funding lent to targeted green investments (placeholder PDO indicator for 'green' element); (3) Number of sub-national entities accessing the lending facility; (4) Medium term bond that pools financing needs of small towns issued.

13. A number of intermediate outcome indicators will be developed during preparation. Some could include (i) Number of potential borrowers that access Technical assistance services of the facility on investment screening and debt management provided under the project; (ii) Percentage increase in debt-financed capital expenditures for municipal infrastructure among qualified beneficiaries; (iii) Maintenance of IFF Leverage Ratio (debt/equity) below 5:1; (iv) ratio of non-performing loans (NPLs); (v) Concentration of the total loan portfolio in a single sector. Adequate gender and citizen engagement indicators will also be developed during preparation as appropriate.

D. Concept Description

14. **The proposed project is part of the World Bank's long-term engagement to support sustainable infrastructure development and efficient urbanization in China.** The Shanghai Municipality consists of the central city of Shanghai and nine suburban districts / counties. In order to improve small town access to private sector debt financing, a pilot District Financing Vehicle (DFV) was set up during the preparation of Shanghai APL 2 (P075732). The facility, hosted within the Shanghai Municipal Investment Corporation (SMI), has been operating successfully throughout APL 2 and APL implementation. It has played an innovative role in appraising, managing and leveraging private sources of financing in infrastructure projects for small towns within Shanghai Municipality.



15. **The World Bank has collaborated with the National Development and Reform Commission (NDRC) in a two-phased assessment to evaluate potential financing strategies for small towns.** The 2014 Bank report on “Financing Small-Town Infrastructure” (P143473) provided recommendations based on key findings and lessons, and proposed a feasibility study as next step. The follow up 2016 report on “Sustainable Small Town Infrastructure Financing” (P150179) included an analysis of the fiscal situation of small towns under the new SBL and a feasibility analysis of potential structures for the facility.

16. **The report highlights that a full-fledged intermediate green urban infrastructure financial facility (GUIFF) can be an alternative source of debt-financing for small towns’ needs.** Small towns are faced with the problem that individually their financing needs are too small, their stand-alone credit-worthiness too weak, and their expertise too limited to allow them to access low-cost long-term financing for infrastructure on their own. The small towns’ limitations in terms of financial resources and capacities represent for the GoC an emerging challenge that hinders its efforts at national level to promote the transition to low carbon trajectory. By pooling financing needs from small towns, SOEs, utilities or projects, an IFF can support liquidity for timely repayment and enhance credit quality to enable low-cost borrowing, overcoming a major obstacle in the current financial framework.

17. **GUIFFs could be open to public utilities and revenue-earning entities that are the service providers for small towns in Shanghai Metropolitan Area and possibly to adjacent provinces in the Yangtze Delta.** They would be responsible for raising the initial financing and would repay loans from operating revenues and/or government subsidies. Projects are expected to be bankable with contract terms, tariffs, and subsidies agreed between the sponsoring governments and service providers. Any subsidy would be reflected in the annual local government budget; however, there will be no government guarantee for loan repayment. The geographic scope of the facility is under discussion and could expand beyond the Shanghai Metropolitan region after a successful launch.

18. **The current market conditions in China also signal a strong demand of low-risk government or quasi-government instruments.** A pooling vehicle would be able to satisfy such demand by issuing bonds in the capital markets, and on-lending the proceeds to participating small local governments. Such instruments could provide critically needed diversification opportunities to institutional investors, many of whom may have investment portfolios that are concentrated in national government securities. GUIFF will issue bonds with longer tenors than most corporate debt, which can be an additional feature attractive to portfolio managers who are attempting to do asset – liability management of their portfolios.

19. **In 2015, following the recommendations from the Phase II report, Shanghai Municipality requested Bank assistance for establishment and operationalization of a full-fledged financing facility for green investments.** SMG proposed to transform the DFV into a full-fledged Green Urban Infrastructure Financing Facility (GUIFF) with the capacity to raise funds in domestic (and possibly international) capital markets, as well as to on-lend to specific sub-projects based on project appraisal and fiduciary oversight capacity. The primary benefits of the Facility include access to low-cost, long-term and more sustainable funds for small town municipal infrastructure and improved transparency of



infrastructure development. The facility would rely on SMI's strong record of resource mobilization and project implementation to build its pipeline and intends to offer technical assistance to potential beneficiaries. The facility would pool projects from small towns and finance them by raising medium to long term funds from capital markets.

20. **The GUIFF would have four primary functions: raising funds, lending, supporting liquidity and credit quality, and providing advisory services.** A Special Purpose Vehicle (SPV) will be created to borrow in the bond market and to on-lend to small towns. The legal structure of the facility will be defined during preparation. The facility will lend funds that it has raised and will repay debt primarily from the debt service charges on loans to sub-borrowers. The facility would also use reserves, liquidity facilities and its own equity to ensure that such repayments are made on a timely basis and in full. The facility will be established with an initial equity (public bodies, e.g., SMG, SMI and private investors) that will be used to cover startup expenses and capital reserves.

21. **Pooled infrastructure financing facilities have been used for a long time¹⁹ in Europe, and the US and Canada followed suit in 1970 to support local entities infrastructure needs.** More recently they have been adopted also by a number of developing countries, including South Africa, India, Colombia and the Philippines. Several lessons can be extrapolated from the international cases and selectively applied to China, particularly the importance of providing not only funds but also managerial and technical advisory services to the local borrowers to counter their low capacity (see the case of the Municipal Infrastructure Investment Unit in South Africa which created partnerships with its borrowers to enhance their revenue collection capacity), the importance of credit enhancement for the pooled bonds (see case of Tamil Nadu and US Aid's partial credit guarantee), the need for fully staffed entity that articulate its business development efforts across sectors and geographies (see case of Findeter in Colombia).

22. **Given the incipient nature of NBF regulatory framework in China, GUIFF would operate through a trustee bank at onset.** A regulatory assessment undertaken under the Small Town Financing study highlighted that as part of the long term government reform plan, considerations around NBFs will need to be addressed. The amended Budget Law does not clearly exclude the potential of establishing IFFs in China, but the introduction of specialized financial intermediaries for small towns must be synchronized with the changes in the amended Budget Law and other related regulations, particularly with those relating to on-lending licensing, capacity to issue debt, and an adequate prudential supervision.

23. **The proposed project will include three components, as outlined below.**

24. **Component 1. Facility Capital Funding (IBRD Loan: US\$ 290 million).** This component will provide initial low-cost long-term funding for small town green infrastructure to accelerate the facility start-up. It will finance the debt arm of the facility at onset and will focus on covering construction risks in the early period of sub-project execution. Once the facility has a significant portfolio of performing projects, it will pool project finance qualification and demands and issue bonds to raise funds from the capital market. These funds will in turn be on-lent to small town infrastructure projects,

¹⁹ The first experience dates 1898 in Denmark with the Kommunekredit which is still a functioning entity.



under a revolving fund mechanism. The structure of each loan to the end borrower will be defined during preparation; however in principle it is envisaged that the final borrower will contract a medium to long term loan, with a duration between 7 to 15 years, depending on the specifics of the sub-project activity. . After 3-5 years, when the sub-project has passed the construction phase and it starts to produce income, the borrower will start loan repayments. At the same time, the loan will be revolved via mini-perm into a longer term pooled bond, (e.g., 5, 10 or 15 years). Eventually the facility is expected to function as a sustainable revolving fund.

25. **Component 2. Guarantee for Bond Issuance (IBRD Loan: US\$ 50 million).** The objective of this component is to support the facility's ability to issue medium to long-term bonds with attractive pricing by providing a guarantee for bond issuance to enable the bonds to obtain a sufficiently high credit rating. The guarantee will help ensure timely debt service payments and provide first loss enhancement in the event of defaults or late payment, when projects are either delayed or face financial challenges.

26. **Component 3. Facility Capacity Enhancement and Project Management (IBRD Loan: US\$ 10 million).** This component will support capacity building within the Facility to scale up of operations. It will support the setting up of a fully staffed entity with trained personnel in all departments, ramped up functions (including business development, financial structuring departments and technical operational departments) that would support clients in sub-project identification, planning and preparation. Advisory services will also be provided to eligible borrowers for the selection and packaging of infrastructure investment projects. Activities eligible for financing under this component will include: project preparation and preliminary structuring; project preparation studies (including feasibility studies, detailed review of engineering designs, and safeguard instruments); design and supervisory assistance; advisory services related to financial management, environmental and social assessments; and support in the preparation of procurement and contract documents.

27. **The project includes a line of credit and an OP 10 review will be carried out to ensure the integrity of the financial sector.** The F&M GP has been requested to carry out the necessary due diligence, covering financial systems, performance and governance issues.

28. **The team and the borrower have been in discussions with IFC and other donors and stakeholders to increase leverage of the operation.** Several rounds of conversations have been held with IFC staff and IFC is considering supporting the GUIFF facility in multiple ways: either by participating as an equity investor, or by participating via issuance of a subordinated debt tranche, or as an advisor to the GUIFF most complex transactions (particularly those with PPP structure). Their exact role and involvement will be further defined during preparation. The team has initiated informal conversation with the recently established National Development Bank, and it seems that a potential co-financing could be set up around the GUIFF. Finally, the borrower has already been quite active in exploring market appetite from institutional investors in China and potential interest has been voiced by large market players such as China Development Bank Capital (CDB Capital).

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29. The pipeline of green sub-projects to be financed by GUIFF will be informed during project preparation.

Recognizing the potential for misallocation and wasteful investments, the team will work on developing a strict eligibility, screening and prioritization criteria. Project selection will be oriented towards investments that address an identified need for improved service delivery in a priority area, are aligned with low carbon development and compact city principles and informed by prioritization criteria. The project portfolio is expected to consist of 'green' urban projects, including, among others, wastewater treatment, flood management, solid waste management, energy efficiency, mass urban transport, renewable energy infrastructure.. Project evaluation will follow a "portfolio management" approach to minimize potential risks, while maximizing the use of financing, taking into account sub-sector composition criteria, geographic location, type and size. By appraisal, it is expected that a phased pipeline to jump start implementation of the project will be identified. The client already has a long list of projects and potential sub-borrowers, and these will be subject to additional screening and consideration. This pro-active approach will mitigate pipeline risk which is common in FI type project. The proposed GUIFF will benefit from SMI's strong technical capacity and its familiarity with urban environmental projects. A preliminary study of the pipeline and selection criteria is included in the annex to this PCN.

30. Safeguards discussion have been held with the Regional Safeguard Secretariat (RSS).

It has been agreed that two possible approaches can be adopted in this project, i.e. either a traditional framework approach applying to Financial Intermediary operations or a Country System approach. The former would be in line with the current approach adopted under the APL 3 for the DFV, and fairly straightforward. The latter would bring an innovative approach to China projects, however its feasibility, efficiency and adequacy are under discussion. A choice will be finalized during preparation, with the assistance of the RSS team.

SAFEGUARDS

A. Project location and salient physical characteristics relevant to the safeguard analysis (if known)

The project will follow a framework approach. Specific location of subprojects to be supported by the Facility will be identified during project implementation. The Facility will provide financing services to small towns in Shanghai Metropolitan Area, including Shanghai Municipality and possibly to adjacent provinces in the Yangtze Delta. The project area is highly urbanized and the most vibrant in terms of economic development in China.

B. Borrower's Institutional Capacity for Safeguard Policies

Through a long-standing cooperation with the World Bank spanning over 3 decades, the Shanghai Municipality Government has been a pioneer in seeking private sector leverage for the investment needs of its small towns. The proposed FI will be implemented by Shanghai Municipality Investment Corporation (SMI, formerly Shanghai Chengtou) which has gained rich experiences in managing safeguards through implementation of Bank-financed urban infrastructure development projects over the past decades. The GUIFF's set up and operations will build on the experiences of District Financing Vehicle (DFV) already operating under SMI. The screening, appraisal and implementation of DFV projects adopt a framework approach following the Environmental Impact Analysis Policy Framework as part of the DFV Operational Manual developed in 2006. During APL2 and APL3 implementation, DFV has successfully implemented 6 projects in several counties/small towns in Shanghai Municipality covering the sectors of water supply, wastewater management and solid waste management. DFV has demonstrated strong capacity and



track records in managing environmental and social safeguard during project screening, appraisal, implementation, supervision and monitoring. The GUIFF will be developed based on the experiences and lessons learnt from DFV operation in the past 12 years. Experienced consultants will be hired to prepare the safeguard instruments for the project during preparation, and the project will also develop safeguard capacity building plan for the GUIFF and its sub-borrowers, which will help to build and maintain a well-functional mechanism and strong capacity for safeguard management throughout the project preparation and implementation.

C. Environmental and Social Safeguards Specialists on the Team

Songling Yao, Social Safeguards Specialist
Ning Yang, Environmental Safeguards Specialist
Xiaodan Huang, Social Safeguards Specialist

D. Policies that might apply

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Safeguard Policies	Triggered?	Explanation (Optional)
Environmental Assessment OP/BP 4.01	Yes	<p>The proposed project intends to improve environmental services through building and operating an innovative financing vehicle to finance urban environmental infrastructure. Specific activity and location of subprojects will be identified during project implementation, and both category A and category B subprojects could potentially be supported. The project will have apparent environmental and social benefits as by design the project aims to address environmental problems and imbalances of infrastructure and basic public services. Activities to be supported by the project may include new building, improvement or rehabilitation of wastewater, water supply, municipal solid waste management infrastructure and river rehabilitation.</p> <p>Two safeguard options are proposed, namely, 1) the traditional approach to apply OP4.01 and assign FI category to the project, and an Environmental and Social Management Framework (ESMF) will be developed during the project preparation. 2) to adopt OP 4.00 - Piloting the Use of Borrower Systems to Address Environmental and Social Safeguard Issues in Bank-Supported Projects. The appropriate option will be determined during the project preparation.</p> <p>For option 1, namely adopting OP4.01, given the project will target towns and subprojects' service area will be limited, the construction and operation</p>



will have both potential environmental and social impacts. Hence the OP 4.01 will be triggered.

The ESMF will guide the screening and assessment of environment and social impacts of various subproject to be identified during the project implementation. The ESMF will also provide the details on the type, level and depth of environmental and social impact assessments (ESIAs) required for each of the investments and contains measures and plans to avoid, mitigate and/or offset adverse impacts, based upon the outcomes of the screening.

The ESMF will be prepared in parallel with the social assessment of the project. Social and environmental baselines will be included in the safeguards instruments, which will provide a comprehensive and in-depth understanding of the socio-economic structure, environmental and ecological conditions of the project area.

Specific to the project, the ESMF will include procedures for subproject screening, environmental document preparation, public participation, review and approval. It will also include a PMO capacity building plan, a generic Environmental Management Plan (EMPs).

Public consultation and information disclosure will be carried out during development of the ESMF following OP4.01.

During project preparation, the TT will support the client to identify and prepare the Year 1 subprojects in order to facilitate the smooth implementation of this project. ESIA, EMP and RAP will be prepared as per the Bank safeguard requirements for those Year 1 subprojects to be identified prior to appraisal.

Under the circumstance of Option 2, before deciding on the use of client's systems, the Bank will assess the client's domestic law and regulatory requirements in terms of environmental and social safeguards, as well as its supervision and enforcement capacity and track records. Then OP 4.00 will be triggered if agreement is reached to use Country Safeguard Systems. If gaps identified, measures to fill the gaps have to be designed and



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implemented before the client undertakes implementation of the project activities.

The client will be responsible for achieving and maintaining equivalence as well as acceptable implementation practices, track record, and capacity, in accordance with the Bank's assessment.

The Bank will make public its intent to use country systems in a proposed pilot operation and makes publicly available its analysis of equivalence of the client's systems and Bank requirements and its assessment of the acceptability of client's implementation practices, track record, and capacity (including a description of the applicable client's systems and of actions that would achieve and sustain equivalence and acceptability). In addition, the Bank will ensure that relevant project-related environmental and social safeguard, including the procedures prepared for projects involving subprojects, are disclosed in a timely manner before project appraisal formally begins, in an accessible place and understandable form and language to key stakeholders.

Natural Habitats OP/BP 4.04

Yes

Although the likelihood of involving any natural habitat is not so high based on previous experience of similar projects in this highly urbanized region, the policy is still triggered from precautionary perspective considering project uncertainty at this stage. The project design will include an environmental analysis of any natural habitat issue, including identification of natural habitat sites, their ecological functions and potential project impacts on the sites. Necessary mitigation measures proposed to avoid or minimize anticipated impacts will then be integrated into the ESMF for future implementation.

Forests OP/BP 4.36

No

The subprojects to be supported by the FI will take place in already established small towns and the project is not anticipated to involve any forests.

Pest Management OP 4.09

No

The project is not anticipated to involve the use or procurement of any pesticides.

Physical Cultural Resources OP/BP 4.11

Yes

Though the specific location of subprojects will only be identified during the project implementation, based on past experiences for the type of project, it is proposed to trigger the policy from precautionary



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			perspective.
	Indigenous Peoples OP/BP 4.10	No	The projects in the past decade in Shanghai Municipal area and even in Yangtze Delta area demonstrated there is no ethnic minority issue. In addition, the team screening did not find any ethnic minority community present in or collectively attached to the project areas.
	Involuntary Resettlement OP/BP 4.12	Yes	<p>Potential subprojects mentioned in the mission include, among others, construction or improvement of wastewater, solid waste, water supply in urban area or small towns in Shanghai. Therefore, the possible social impacts comprise physical and economical displacement due to land acquisition and resettlement, as well as social disturbance or other impact due to construction, improvement or operation of those infrastructure, etc. Therefore, the OP 4.12 should be triggered.</p> <p>Two options are proposed for consideration: i) the traditional Category FI approach which foresees a Social Management Framework (as part of the ESMF) to be developed during project preparation. RAPs will be prepared for year 1 subprojects that will be identified prior to appraisal.; ii) the innovative Country Systems approach. The appropriate option will be determined during the project preparation.</p> <p>In the first option, the social safeguards approach of the project could be very similar with the DFV approach under the current Shanghai APL. The proposed SMF is deemed to be a superior instrument as it not only includes a RPF, but also ensures coverage of other social issues, like social issues mentioned in OP4.01, gender and poverty. On the other hand, the second option needs more guidance from the RSS.</p>
	Safety of Dams OP/BP 4.37	TBD	Since the project pipeline criteria are still to be established and the proposed operation focuses on urban environment, the triggering of OP4.37 at this point remains to be determined until further project information is provided during project preparation. The process to meet the policy requirements will also be covered by the ESMF if OP4.37 is determined to be triggered during next step project preparation.



Projects on International Waterways OP/BP 7.50	No	Not applicable since the project is impossible to involve any international waters.
Projects in Disputed Areas OP/BP 7.60	No	Not applicable since the project is impossible to involve any disputed areas.

E. Safeguard Preparation Plan

Tentative target date for preparing the Appraisal Stage PID/ISDS

May 24, 2017

Time frame for launching and completing the safeguard-related studies that may be needed. The specific studies and their timing should be specified in the Appraisal Stage PID/ISDS

A Resettlement Policy Framework and a social assessment framework should be prepared. Other safeguards instruments like ESMF, ESIA's and RAPs for year 1 subprojects will be prepared before project appraisal in addition to the RPF and Social Assessment. Should a decision is made on using country system, a Country Systems Diagnostic Report and Gap Filling will be prepared during preparation.

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APPROVAL

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