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

Appraisal Stage | Date Prepared/Updated: 15 February-2018 | Report No.: 123955

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Pakistan	P162095	Pakistan Housing Finance Project	
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
SOUTH ASIA			Finance & Markets
Lending Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Islamic Republic of Pakistan	PMRC,State Bank of Pakistan (SBP)	

Proposed Development Objective(s)

Components

Financing (in USD Million)

Financing Source	Amount
International Development Association (IDA)	145.00
Total Project Cost	**145.00**

Environmental Assessment Category	Concept Review Decision
FI-2-Financial Intermediary	

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

No

Decision

B. Introduction and Context

Country Context

1. **Pakistan's economic performance remained robust during the fiscal year (FY) 2017 as growth continued to accelerate, reaching its highest level in the last decade while inflation stayed well below target.** Strong private consumption, recovery in agriculture, and vibrancy in the services sector has resulted in an increase of 0.2 percentage points in gross domestic product (GDP) (at constant market prices) in the last year to reach 5.7 percent in FY17.[1] In the medium-term, Pakistan's growth is expected to continue to accelerate, reaching 5.8 percent in FY19 driven by public and private consumption, aided by a steady increase in public investment, especially due to projects under the China-Pakistan Corridor (CPEC). The Pakistan Rupee (PKR) remained largely stable with a small depreciation of about 0.1 percent against the US Dollar during FY17.

2. **The low and stagnant investment rate, however, continues to pose significant challenges to economic growth**. After strong growth in FY15 of 13 percent, Investment to GDP as a share of GDP grew marginally from 15.6 percent in FY16 to 15.8 percent in FY17. Pakistan's much lower rate of investment, compared with an average rate in South Asia of 34 percent between 2010 and 2015, is driven by its security situation, energy shortages and poor business regulatory environment - ranked 147 of 190 countries (DB Report 2018) - despite recent progress. Pakistan also has very low levels of financial intermediation which contributes to this situation and hinders its progress towards more inclusive and higher growth. In 2016 financial sector assets stood at about 69 percent of GDP, below that of other relevant emerging markets. Private sector credit to GDP, which declined significantly from 2008-2015, was just 15 percent, significantly below the regional average of 48 percent.

Sectoral and Institutional Context

3. **Pakistan's financial sector has evolved from being dominated by underperforming state-owned banks to a modern and sound financial sector dominated by private banks.** The banking sector, consisting of 36 commercial banks and 10 microfinance banks (MFBs), accounts for about 75 percent of total assets of the financial sector. The non-bank sector which consists of insurance, mutual funds, pension funds, development finance institutions, microfinance institutions (MFIs), account for about 8 percent, with National Savings Scheme (NSS) constituting the remaining 17 percent of assets. The regulatory framework and market infrastructure for bond markets (conventional and Islamic) is in place, but the market has seen limited activity and has a very limited investor base.

4. **Housing finance in Pakistan is particularly low with mortgage finance to GDP ratio of 0.25 percent.** This is one of the lowest in South Asia (3.4 percent regional average) with 3 percent in Bangladesh and 11 percent in India.[2] Overall access to financial services also remains limited, with less than 20 percent of adults having access to a formal account in 2014/15, leading to a limited role of the financial sector in contributing to sustained and inclusive growth and dealing with the increasing housing shortage.

[1] Source: World Bank Group. Pakistan Economic Development Update. Making Growth Matter. November 2017.
[2] International Financial Statistics (IFS) database, IMF.

5. **The estimated housing shortage in Pakistan is up to 10 million units[3], of which about 40 percent occurs in urban areas).[4]** Over the next 20 years, annual urban population increase is expected to be about 2.3 million per year (around 360,000 households at 6.5 individuals per household). A decline in family size and increased household formation rates (stemming from the large cohort of young individuals) are expected to further increase the demand for housing. The gap continues to increase by roughly 350,000 units per year, as new housing production falls short of household formation and as existing housing units become obsolete. The quantitative housing shortage is exacerbated by qualitative deficits such as overcrowding, low quality and continuous deterioration. Around 47 percent of urban households live in substandard housing, often located in informal settlements called *Katchi Abadis*, which lack basic urban infrastructure and have poor health conditions. Existing housing stock is also extremely overcrowded.

6. **Significant affordability challenges exist in the housing sector in Pakistan.** Preliminary affordability analysis indicates that existing mortgage products are consistent with higher income borrowers' payment capacity and real estate prices. Mortgage loans are typically extended to the extreme end of the high-income group, i.e., 10th income decile of urban households (See Figure 1).[5] Annually, only 1,500 new mortgage credits are extended (equivalent to 0.4 percent of annual urban household formation). The average loan size in 2016 was PKR 6.1 million (US$60,000) and out of reach for most households given a low average loan to value (LTV) ratio of 48 percent, requiring a substantial amount of savings to use as a down payment when applying for a mortgage loan. The average annual interest rate remains relatively low at one- year KIBOR[6] + 3.5 percent (around 10 percent currently) but variable rates and short tenors limit debt servicing capacity. There is considerable potential for the housing finance market to move to middle and lower-income segments by developing innovative products and instruments.

7. **Important policy and sectoral steps have been taken to support revival of affordable residential mortgage lending**. The government established a National Financial Inclusion Steering Committee chaired by SBP Governor, with a sub-committee on housing finance issues. In 2014 SBP adopted a specific prudential framework for mortgage lending, which had been previously regulated uniformly with other forms of consumer credit. Parliament also passed a key amendment to the mortgage recovery law, although there is still a need to train the judiciary to make the revised framework effective. In 2016 the government created the Pakistan Mortgage Refinance Company (PMRC), a mortgage refinancing facility. Sporadic progress is being made on the titling issues and strengthening of the property registration system, for example through the ongoing Land Record Management Information System (LRMIS) project in Punjab and computerization efforts in Karachi. SECP is establishing rules for the qualification and the conduct of real estate valuators.

8. **The creation of PMRC marks an important step in achieving the Government of Pakistan (GoP)'s objective to improve access to housing finance in Pakistan.** PMRC is expected to foster both access to mortgage finance as well as capital markets. PMRC has been established as a Development Finance Institution (DFI) with majority private sector ownership (51 percent private commercial banks) and 49 percent public sector banks and the

[3] Enclude, "Final Report: Diagnostic Survey of Housing Finance in Pakistan". Submitted to the State Bank of Pakistan. November 2015.
[4] International Growth Centre (ICG). "Housing inequality in Pakistan: The case of affordable housing." Note. February 2016.
[5] Each decile represents 10 percent of all urban households.
[6] The Karachi Interbank Offered Rate, or **KIBOR**, is the average interest rate at which term deposits are offered among prime banks in the Pakistani wholesale money market or interbank market.

GoP/Ministry of Finance. PMRC is expected to address several of the existing market failures that would improve mortgage affordability such as: (i) supporting lending at fixed rate, (ii) facilitating the standardization of origination and servicing standards and enhancing their quality; and (iii) providing an efficient capital market long term funding channel.

9. **PMRC's three-phased strategy will enable it to serve as a secure source of long-term funding at attractive rates while ensuring sound lending habits amongst Primary Mortgage Lenders (PMLs)**. In Phase 1, PMRC will fund its refinancing activities from its capital (Tier I and Tier II). In Phase 2, which will begin in 2019, PMRC will make its debut in the local bond market to fund its refinancing operations. From 2019, PMRC's principal source of funding will be from the bond market. Phase 3 will involve the purchase of mortgage loans without recourse to be held in a portfolio and financed by PMRC's bonds and the pooling of mortgages into mortgage-backed securities which will be sold to investors.[7] This approach will boost confidence in PMRC's refinancing capacity as it progressively expands its role in the mortgage market. Overall, PMRC will bring security to the housing finance system through the basic characteristics of its business model.

10. **The availability of fixed rate mortgages and longer maturity loans will allow more middle and lower-middle class households to have access to a mortgage loan**. Thus, a higher LTV of 80 percent and a tenor of 20 rather than 15 years will allow middle and low-middle income households from the 7th down to the 3rd income decile, who were previously priced out of the market, to afford mortgages as low as PKR500,000 (see Figures 1 & 2). Increasing access to housing finance to a larger segment of the population remains an important objective of the central bank - the State Bank of Pakistan (SBP) - which has been championing reforms for financial inclusion for over a decade with significant milestones achieved, including on the regulatory framework, credit information, payment and settlement systems and financial literacy. These reforms are inscribed in the National Financial Inclusion Strategy (NFIS) which identifies housing finance as a priority area for government intervention to address the country's housing shortage.

11. **The proposed project aims to build upon the efforts of SBP and GoP by extending financial and technical support to PMRC and other market stakeholders to help address the challenges described above.** Key project counterparts such as PMRC, commercial banks and Non-Bank Financial Institutions (NBFIs), the Ministry of Housing and Works and the Planning Commission (through its Member, Infrastructure and Regional Connectivity) will be instrumental in developing sustainable housing finance in Pakistan).

C. Proposed Development Objective(s)

Development Objective(s) (From PAD)

12. The Development Objective of the project is to increase access to housing finance for households and support capital market development in Pakistan.

Key Results

13. The following indicators will be used to measure achievement of project objectives:
(i) Number of total mortgage loans refinanced by PMRC
(ii) Number of total outstanding mortgage borrowers

[7] Based on the present state of the market, Management does not see this taking place in the next 7-10 years.

(iii) Percentage of outstanding women mortgage borrowers refinanced by PMRC
(iv) PMRC bond issuance volume

D. Project Description

14. The proposed project will have three main components: (i) Supporting PMRC in Strengthening its capital base; (ii) Supporting the Expansion of Mortgage Loans; and, (iii) Capacity building for housing policy and Analytics.

Component 1. Supporting PMRC in Strengthening its Capital Base (US$60 million)

15. The objective of this component is to help strengthen PMRC capital base so it can operate on a sustainable basis and become a highly-rated bond issuer in Pakistan. Project support will be provided in the form of long term subordinated loan from the MoF that PMRC can use for Tier II capital, including to refinance current market demand of housing loans before it is able to access the capital market to issue bonds, invest in low risk government securities, as well for issuance of non-participatory additional Tier 1 capital acceptable to SBP. The MoF will lend to PMRC in Pakistani Rupees, and will thus assume the exchange rate risk. The subordinated 20+ year loan will allow PMRC to refinance loans beyond 15 years and up to 20 years, and support PMRC standing in the bond market, in particular by providing a higher credit ranking to future bondholders. Tier II capital increases bond holders 'protection by providing the equivalent of an over-collateralization of their claims. The IDA credit will also help PMRC cushion interest rate risks incurred by lending on a fixed rate basis before issuing symmetric bonds. With a rate below the funding cost of bond issuance, PMRC will be able to leverage the IDA credit further, and through blending of IDA and market rates, offer competitive rates to PMLs.[8] The lending rates proposed by PMRC in its business plan are based on a market spread of 75 basis points over the cost of funding for tenors of about 20-30 years.

Component 2. Supporting the Expansion of Mortgage Loans (US$80 million)

16. This component aims to provide incentives for primary mortgage lenders to increase access to mortgage loans to a larger segment of the population. The mortgage product can be made more affordable and better secured by offering fixed rather than variable interest rates, higher LTV and lengthening the tenor beyond 15 years. By helping Primary Mortgage lenders (PMLs) offer loans as low as 0.5 million, the project can help reach down market to households in the 3rd income decile. The project will provide: (i) a line of credit as well as a (ii) guarantee/risk sharing facility (RSF) to eligible PMLs.

Subcomponent 2a. Line of credit (US$70 million)

17. The line of credit of US$70 million will be managed by PMRC and made available to Eligible partner financial institutions (PFIs)--banks and microfinance banks–that will be selected through transparent and clearly defined eligibility criteria based on their financial health, institutional capacity to on-lend, governance, and quality of operational processes. (See Box in Annex 6). PFIs will also be required to adopt underwriting and other minimum quality standards.

Subcomponent 2b. Risk Sharing Facility (US$10 million)

18. The RSF of US$10 million (covering the seed capital and management fees for PMRC) will provide an incentive for PMLs (banks and MFBs) to reach down to an unfamiliar clientele and offer loans of PKR 0.5 to 3 million to lower income households where the largest market gap exists. The RSF will be issued for a partial risk sharing with PMLs and cover the first loss in case of defaults by mortgage borrowers and be payable on first demand when a loan is in default based on precise criteria such as specified number of days (e.g. 360 days), foreclosure process initiated, etc. Beneficiaries will pay risk-based premiums calibrated to cover expected losses and PMRC operating expenses. TA will be provided to PMRC

[8] The coupon rates for PMRC bonds are expected to be 50-60 basis points above benchmark rates such as Pakistan Investment Bonds (PIB).

for the overall design of the RSF and to define parameters such as loan features, including for Islamic finance, coverage rate and premium level, and procedures designed to avoid moral hazard and adverse selection risks.

Component 3. Capacity Building for Housing Policy and Analytics (US$5 million)

19. The objective of this component is to enhance analytical capacity and policy formulation for sound national housing policy and supply side constraints hampering the development of affordable housing stock in Pakistan. Main support will be provided for the recently created Urban and Housing Policy Unit under the Ministry of Planning, Development and Reform in its role as a convening and coordinating body for formulating urban and housing policy, streamline the regulatory framework for the housing market (e.g. professional licensing), develop a national repository for housing statistics and other relevant data, and research or promote pilot projects that have a high potential for scaling up nation-wide. Support will be directed towards increasing the institutional and technical capacity of the Urban and Housing Policy Unit and other stakeholders such as the Ministry of Housing and Public Works and selected provincial and local governments through financing: a) a multi-year research program understanding main supply side constraints such as land management, land titling/registry, land financing instruments, reforms on regulatory requirements for developers, and developers' financing, keeping abreast of the requirements and issues covered by the World Bank safeguard policies; b) strategy and implementation of establishing data repository of spatial information on land and housing market; and c) analytical support to updating the national affordable housing policy and implementation strategy; and d) demand-based capacity building and knowledge exchange activities for housing sector policy.

E. Implementation

Institutional and Implementation Arrangements

20. The Ministry of Finance (MOF), Finance Division, will be the executive division representing the borrower, the Islamic Republic of Pakistan. Project activities will be implemented by PMRC, and the Housing Unit within the Planning Commission (PC) at the Ministry of Planning, Development and Reforms. Adequate resources for project implementation and coordination will be provided by both entities, including in-kind contributions, operational staff, and government civil servants. Bank funds will flow through separate Designated Accounts (DAs) to be set up for PMRC, and the PC, as soon as feasible.

21. PMRC will be responsible for implementation of components 1 and 2 of the project. PMRC staff will undertake project activities alongside their regular responsibilities including for financial management (FM), and environmental and social (E&S) risk management. The focal point for the project will be a high-level staff of PMRC. The Housing Unit at the PC in the Ministry of Planning will be responsible for Component 3 of the project. It will maintain a team of technical specialists with adequate capacity on project management, FM, and procurement, some of whom will be hired on competitive basis as needed. To facilitate project implementation, a detailed POM will be prepared by PMRC and PC and a first draft made available by the time of project negotiations.

ENVIRONMENTAL AND SOCIAL RISK MANAGEMENT

F. Project location and salient physical characteristics relevant to the E&S risk management analysis (if known)

22. Pakistan Housing Finance Project aims to increase access to mortgage loans to households in Pakistan. This will be done through directly supporting PMRC to refinance mortgage loans originated by primary mortgage lenders (PMLs) as well as providing capacity building to various stakeholders. Main types of activities and their characteristics relevant to environmental and social (E&S) risk management analysis are as follows:

(1) **Technical assistance and capacity building component**, i.e. Component 3; will involve analytical and policy research, and capacity building, and no activities under this Component will lead to the identification/development of specific physical activities which would cause E&S risks or impacts. However, this analytics that aims to contribute to creating foundations of housing market in Pakistan, good practices on environmental and social risk management as per World Bank safeguard policies and national laws (as mentioned in section G below) can help contribute to greater market sustainability. For example, the component will focus on strengthening analytical understanding of supply-side constraints at the national level, which can and should include aspects of mitigating housing-specific risks that may be anticipated downstream, which is absent in the country and will support setting up and strengthening the capacity of the urban and housing policy unit. Therefore, the project would ensure that during implementation of component 3, due attention be given to E&S issues while reviewing and proposing improved measures for land management, land titling/registry, land financing instruments, reforms on regulatory requirements for developers, and developers' financing, etc. A TOR for such work would be prepared and agreed with the borrower to focus on studying the impacts of improper land management, land titling/registry and land development, land acquisition, land use restrictions and involuntary resettlement.

(2) **Component involving Financial Intermediation using commercial lending instruments with individual mortgage borrowers as end borrowers (Mortgage Finance)**, i.e. Component 2 (Line of Credit and Risk Sharing Facility managed by PMRC). Proceeds of financing under these components will benefit Primary Mortgage Lenders (PMLs) in Pakistan to enable them to expand their portfolios, with PMRC meeting the refinancing needs of the market until it is able to access the capital market refinancing is expected to be backed by portfolios of mortgages[9] for purchase of existing housing. The activities identified above cover refinancing eligible loans originated by PMLs for purposes of increasing their ability to provide access to mortgage loans to households. It is expected that the project's indirect positive contributions will spearhead increased growth on the supply side of the market. Thus, it would be important for the project to ensure that such financing does not support environmentally and socially unsustainable supply-side activities.

Rationale for classification as Category FI-1, FI-2, or FI-3:

23. OP/BP 4.03 ("Performance Standards for Private Sector Activities") will be applicable to the project in lieu of the World Bank's safeguard policies. OP/BP4.03 is better suited for this project given that it will constitute private sector activities and is executed through PMLs, which are commercial private sector financial institutions. Additionally, OP4.12 is applied to component 3 of the project.

24. The project is categorized as FI-2 in accordance with OP4.03. This categorization is based on the review of the prospective portfolio that would be presented to PMRC by PMLs for refinancing. Project components 1 and 2 support refinancing of eligible loans originated by PMLs for purposes of acquisition of residential housing. E&S risks arise when

9 Terms "Mortgage loans" and "mortgages" are used interchangeably.

refinancing is supported / guaranteed by mortgage portfolios where they were originated for properties constructed in an environmentally and socially unsustainable way that translates into either credit or reputational risks to PMLs and PMRC. It should be noted that PMRC and PMLs have limited leverage over the supply side of the market and risk management approach is, therefore, focused on an exclusion-based model.

G Environmental and Social Specialists on the Team

1. Babar Naseem Khan, Social Development Specialist (GSU06)
2. Ekaterina Grigoryeva (GEN03)

POLICIES THAT APPLY

E&S Policies	Triggered?	Explanation (Optional)
OP/BP 4.03 – World Bank Performance Standards for Private Sector Activities	YES	OP/BP 4.03, and more specifically, provisions related to private sector activities involving Financial Intermediaries, will be applied to the project. **<u>OP/BP 4.03 Applicable E&S Requirements for financing provided under the project</u>** Given the nature of the project and the financial products involved in PMRC refinancing (retail/ individual Mortgage loans), ***Applicable E&S Requirements*** under OP/BP 4.03 will be as follows: (i) Compliance with applicable national and local laws and regulations,[10] as required by para. 17(b) of BP 4.03. In the case of housing finance, these may include national and local laws, municipal by-laws and other provision regulating housing development and certification by relevant authorities (e.g. building safety); waste management; life and fire safety; access to basic services such as water and sanitation. (ii) Exclusion list for mortgage/ Mortgage loans not eligible for refinancing based on associated environmental and social risk and impacts. Exclusion List is as follows: 1. Real estate construction deemed illegal or non-compliant according to applicable national and local laws and regulations.[1] 2. Properties or land associated with illegal forced evictions of previous owners or occupants.[2] 3. Properties built on land from which government agencies or builders have removed / involuntarily resettled local communities, including squatters or encroachers, without proper compensation.[3] 4. Properties involving outstanding land disputes.

[10] This would include, among others, an E&S assessment required under GoP regulations for any new housing construction schemes. All housing schemes after 1997 n Pakistan require IEE and EIA and notifications are reported in newspaper, especially if located in environmentally sensitive / prone to disasters zones.

5. Properties built in locations and / or in a manner that involves significant degradation or conversion of critical habitats[4] and/or legally protected areas.[5]
6. Properties built in locations and / or in a manner that involves significant adverse impacts on critical cultural heritage.[6,7]

Footnotes

1. Examples include unauthorized construction; housing construction in zones not designated as residential; encroachment on public / government land or private land etc.

2. Permanent or temporary removal against their will of individuals, families and/or communities from the homes and/or land which they occupy, without the provision of, and access to, appropriate forms of legal or other protection. Prohibition on forced evictions does not, however, apply to evictions carried out by force in accordance with national law and is conducted in a manner consistent with basic principles of due process, including provision of adequate advance notice, meaningful opportunities to lodge grievances and appeals, and avoidance of the use of unnecessary, disproportionate or excessive force. These criteria will apply where land associated with such evictions was subsequently used for construction of housing developments in which Participating Banks and Non-Bank Financial Institutions are seeking to originate mortgages.

3. Resettlement activities should follow the process through which adverse social and economic impacts are minimized through (i) providing compensation for loss of assets at replacement cost defined as the market value of the assets plus transaction costs and (ii) ensuring that resettlement activities are implemented with appropriate disclosure of information, consultation, and the informed participation of those affected. These criteria will apply where land associated with such resettlement / displacement was subsequently used for construction of housing developments in which Participating Banks and Non-Bank Financial Institutions are seeking to originate mortgages.

4. Critical habitat is a subset of both natural and modified habitat that deserves particular attention. Critical habitat includes areas with high biodiversity value that meet the criteria of the World Conservation Union (IUCN) classification, including habitats of significant importance for critically endangered or endangered species as defined by the IUCN Red List of Threatened Species; habitats of significant importance for endemic or restricted-range species; habitats supporting globally significant concentrations of migratory species and /or congregatory species; areas with unique assemblages of species or which are associated with key evolutionary processes. Primary Forests or forests of High Conservation Value (HCV) shall be considered Critical Habitats. HCV areas do not directly correspond with definitions for modified, natural and critical habitat. The HCV Resource Network, an internationally-recognized group, provides information and support on the evolving usage of HCV to ensure a consistent approach. https://www.hcvnetwork.org/

5. These criteria will apply where land associated with such degradation or conversion was subsequently used for construction of housing developments in which Participating Banks and Non-Bank Financial Institutions are seeking to originate mortgages and/or these impacts are likely to occur or continue post-construction.

6. Critical cultural heritage consists of one or both of the following types of cultural heritage: (i) the internationally recognized heritage of communities who use, or have used within living memory the cultural heritage for long-standing cultural purposes; or (ii) legally protected cultural heritage areas, including those proposed by host governments for such designation.

7. These criteria will apply where land associated with such impacts was subsequently used for construction of housing developments in which Participating Banks and Non-Bank Financial Institutions are seeking to originate mortgages and/or these impacts are likely to occur or continue post-construction.

		Applicability of Performance Standards provisions to the Environmental and Social Management System (ESMS) ESMS will incorporate, as appropriate for the project circumstances, relevant principles and elements of an ESMS described in Performance Standard 1 (PS1) on Assessment and Management of Environmental and Social Risks and Impacts. In addition, financial institutions will manage the working conditions of their own workforce in accordance with relevant aspects of Performance Standard 2 on Labor and Working Conditions, as required by para. 17(b) of BP 4.03. Such a system will include processes and implementation capacity within the multilevel project structure (PMRC and PMLs) to manage key identified E&S risks and impacts. As the project funds will be provided to support PMRC's capitalization in the form of equity as well as subordinated debt, the ESMS and the Applicable E&S Requirements for PMRC contained therein would be institutional and cover all its operations (including retroactive financing envisioned under the project).[11] At the level of PMLs, the ESMS will apply to PMRC refinancing only. The ESMS will also incorporate a grievance mechanism at PMRC level that will accept and address complaints and concerns regarding PMRC's lending operations in a manner accessible and understandable for affected parties.[12]
OP4.12 Involuntary Resettlement	YES	This policy is applicable to component 3 of the project. Component 3 will not lead to the identification/development of specific physical activities which would cause E&S risks or impacts. However, technical assistance provided under the component will involve support to urban and housing policy. To address relevant potential downstream impacts from policy work, a TOR for reviewing and proposing improved measures for land management, land titling/registry, land financing instruments as part of policy formulation will be prepared and agreed with the Borrower.
Projects on International Waterways OP/BP 7.50	NO	If issues covered by this policy are identified in activities to be financed under the project components 1 or 2, which is unlikely, such activities will be excluded.
Projects in Disputed Areas OP/BP 7.60	NO	As above

KEY E&S ISSUES AND THEIR MANAGEMENT

A Summary of Key E&S Issues

1. Describe any E&S issues and impacts associated with the proposed project. Identify and describe any potential large scale, significant and/or irreversible impacts:

11 A specific procedure to ensure compliance with World Bank Applicable E&S Requirements will be developed by PMRC with participating mortgage lenders and be based on a sampling verification method and representation approach.
12 Grievance mechanism will be required for PMRC by the Financing Agreement and will be developed by them separately from E&S Policy and corresponding E&S Procedures and approved by the Bank.

25. Within the context of the project, key types of E&S risks are primarily associated with (i) the quality of the collateral (properties to be refinanced) and (ii) the ability of the mortgage borrowers to repay loans. Therefore, screening for these factors can help reduce such risk exposure and, ultimately benefit PMRC and PMLs. If not managed properly, these are likely to have adverse impacts on credit and reputational risk for the PMLs and to a lesser extent PMRC[13.]

(i) *Building safety.* Key risks involve health and safety issues linked to improper techniques during construction of mortgaged properties (e.g. use of hazardous materials, inadequate life and fire safety, weak structural integrity etc.). This can affect both quality of collateral and personal health and safety of end borrowers. Compliance with national building codes/ regulations, including requirements provided in E&S assessments required pursuant GoP regulations, can reasonably mitigate these risks for formal housing, which is the primary target segment for this project. Additionally, when individual housing is constructed within existing housing schemes, checking for approved plans would help mitigate such risks.

(ii) *Risks presented by locations of the housing/ properties in unsuitable areas.* The locations are expected to be predominantly in urban areas that can be often densely populated. Locational characteristics may include sites in poorly managed areas with limited or no basic services such as water supply and sanitation[14], which could sometimes lead to health risks and impacts for end borrowers or impact property values. Risks should also be minimized by avoiding locations which are prone to disasters (e.g. causing landslides) and/or cause adverse impact on natural environment and/or human health (e.g. locations near waste dump sites, high tension cables, canals etc.).

(iii) *Impacts on natural and critical habitats and critical cultural property.* While most housing is expected to be built in dense urban areas, some risk of degradation of natural habitats may exist as cities expand their limits. Similarly, destruction of critical cultural property is also possible. Where such activities took place in anticipation of construction for which Mortgage loans were subsequently originated by PMLs, financing should be avoided.

(iv) *Resettlement/ displacement/ illegal forced evictions/ other adverse impacts on vulnerable communities*.[15] While on the supply side loans would only be provided to people with evidence of tenure (right to occupy their dwellings), availability of land is very limited. Originating and refinancing mortgages for properties built on land from which government agencies or developers may have removed communities, squatters or encroachers without proper compensation could represent a risk to the project and must be avoided.

(v) *Household activities hazardous to the environment and / or human health and safety.*[16] Household activities of end borrowers, such as those related to livelihood earning, may pose risk in terms of fire safety and/or health hazards that may put the collateral at risk. Examples include storage and use of hazardous fuels and chemicals.

2. Describe any potential indirect and/or long term impacts due to anticipated future activities in the project area:

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13 In line with this Financial Intermediation structure, PMRC will provide refinancing with full recourse, i.e. delinquent loans are transferred back to the PMLs who have to replace them. Thus, credit risk and thus any E&S risks that may affect credit risk are predominantly borne by the PMLs.

14 This may happen, for example, when construction is done by developers without obtaining relevant permits from local authorities responsible to ensure housing schemes have such assess.

15 The term "vulnerable communities" refers to those communities that may be most marginalized in the country context and lack access to resources and public services.

16 This factor cannot normally be checked ex ante by the financial institutions so in practice PMLs would require end borrowers to represent that they would not undertake such activities.

26. It is also expected that the project's indirect positive contributions will be the overall growth of the market with an increase in the supply of houses that would be available for mortgage financing. Thus, it would be important for the project to ensure that refinancing is not supported / guaranteed by mortgage portfolios where they were originated for properties built in a way that has had adverse E&S impacts.

3. Describe any project alternatives (if relevant) considered to help avoid or minimize adverse impacts:

27. The key alternative to help minimize E&S risks and impacts would be to not support the project. However, with proper risk mitigation in place, it would be expected that positive impacts outweigh the potential risks.

4. Describe measures taken by the borrower to address E&S policy issues. Provide an assessment of borrower capacity to plan and implement the measures described:

28. Per the requirements of OP/BP 4.03 (Section C), for projects involving Financial Intermediaries, it is required by the World Bank for FIs to develop and operate an Environmental and Social Management System (ESMS) that is commensurate with the level of risk in exiting and/or prospective activities. Specifically, Pakistan Housing Finance ESMS will ensure that adequate measures are in place to screen loans for E&S risks as part of acceptance criteria for the portfolios.

29. Over the course of project preparation, PMRC has developed a well-documented ESMS consisting of five main components:

- E&S policy with clearly specified applicable E&S requirements and standards. The policy specifies the Applicable E&S Requirements, consistent with OP/BP4.03 as specified above.
- E&S risk management procedures for screening, identification, assessment, mitigation, monitoring and reporting of E&S risks; the procedures include PMRC's due diligence process with regard to PMLs' systems and capacity to implement E&S screening measures in accordance with PMRC requirements (which would constitute an ESMS as required by OP4.03 at the PMLs' level). To that extent, PMRC has integrated compliance with Applicable E&S Requirements (namely national law and exclusion list) into its overall eligibility criteria for housing finance loans as part of the refinance agreements with PMLs (the "Master Refinance Agreement).
- Reporting requirements for internal and external stakeholders on implementation, namely a representation form that is integrated in the MRA and will be required to be submitted by each PML to confirm conformity of the mortgage portfolios submitted for refinancing with Applicable E&S Requirements.
- Capacity, roles and responsibilities within the organizational structure for managing and monitoring E&S risks are clearly articulated in PMRC's E&S procedures. PMRC is a relatively new institution established less than two years ago and has not yet started operations. Currently, total staff of PMRC is 10 people. Nevertheless, PMRC has appointed one of its senior staff to be formally responsible for E&S risk management, with a view of integrating it into the overall risk assessment in lending activities. Responsible staff has expertise in E&S risk management, as prior to joining PMRC he was leading the E&S agenda at the State Bank of Pakistan, including spearheading the development of Green Banking Guidelines that were issued by SBP in 2017.
- Management commitment by PMRC to implement policies and procedures through formal disclosure of the E&S policy and provision of adequate support and resources for implementation, including to capacity building among PMLs. This commitment shall be demonstrated by formal adoption of the PMRC E&S Policy by their Board.
- PMRC will also develop a grievance mechanism at its level to address concerns from the public regarding its operations. This mechanism will be publicly disclosed (this will become a Condition of Disbursement of Component 2 or Effectiveness condition).

Training / Capacity Building

30. PFIs/ PMLs that will actually apply for refinancing with PMRC will not be known until project implementation. Nonetheless, putting in place ESMS at their level will involve: (i) raising awareness about the importance of E&S risks specifically for their housing finance portfolios17 and links of E&S aspects to credit, reputational, and legal risks in financing (such awareness raising activities have already commenced by PMRC with support of SBP through two workshops for potentially interested banks in Pakistan in July and September 2017); (ii) assistance with developing or strengthening E&S policies and screening procedures specifically for housing/ mortgage finance that is tailored to how each of these institutions operates in the housing sector18 (providing templates, guidance, tools, questionnaires etc.); (iii) training and capacity building on how to implement these processes in practice.

31. To ensure that PMLs that submit their portfolios for refinancing are in compliance with the E&S requirements, PMRC will exercise reasonable efforts to support PMLs in meeting Applicable E&S Requirements. The following conditions shall be communicated to PMRC in writing in order to effectively implement the written policy and procedures and build capacity at PMLs level:
    a. PMRC will formally adopt E&S Policy and corresponding E&S Procedures by their Board before negotiations and will disclose following PMRC Board approval;
    b. PMRC will also develop a grievance mechanism at its level to address and concerns from the public regarding its operations. This mechanism will be publicly disclosed (this will become a Condition of Disbursement of Components 1 and 2);
    c. PMRC will develop an E&S Capacity Building Plan, satisfactory to the World Bank, to describe measures for enhancing ESMS at its own as well as PMLs' level, including qualification and members of E&S staff (this will become a Condition of Disbursement of Components 1 and 2);
    d. PMRC will consistently verify compliance of PMLs with E&S requirements (namely national law and exclusion list, as consistent with the compliance requirements of World Bank Operational Policy 4.03, Performance Standards for Private Sector Activities and relevant WBG EHS Guidelines) into its overall eligibility criteria for refinancing housing finance loans;
    e. PMRC will exercise reasonable efforts to support PMLs in meeting PMRC's E&S requirements. To that extent, PMRC will actively participate in the development and rollout of training and capacity building activities for PMLs, in collaboration with the World Bank. In particular, in terms of capacity building at the PML's level, this should include:
        - Support with developing systems and capacity for E&S risk management measures specific to lending in the housing finance sector, assistance in enhancing of the PMLs' E&S screening procedures and tools;
        - Recruitment or, more likely, identification among existing staff, of individuals in each PML to take up the responsibility of E&S screening in the housing finance sector;
        - As part of E&S Action Plans, development of monitoring procedures, stakeholder engagement mechanisms, including grievance mechanism[19], and capacity building plans;

[17] While some FIs in Pakistan may have an institutional ESMS, either through requirements of international lenders such as IFC or as a step towards compliance with the new Green Banking Guidelines, these systems do not necessarily cover housing finance on the demand side. PMRC, using its E&S Procedures, will review and evaluate this to determine what specifically needs to be improved/ added for housing finance segment of banks' operations. Similarly, PMRC would not require a participating bank to have an institutional ESMS that covers all their operations, as this would be well beyond PMRC's mandate. PMRC's analysis of ESMS for PMLs will be limited to housing/ mortgage finance requirements, screening processes and capacity. Exception would be specialized mortgage banks for whom ESMS for housing finance would cover their entire operation.

18 It is very important to link ESMS to the overall credit risk / operational risk analysis for PMLs. Since each institution is organized differently, this is achieved through looking at their current systems and adding E&S aspect to risk screening and analysis.

[19] Or an external communications mechanism, as per requirements of PS1 for FIs.

- The above persons would attend the training and ensure that the knowledge and tools are internalized within PMLs and applied by relevant staff during overall credit appraisal of end borrowers, i.e. "Training of Trainer" approach);
- PMLs will also be encouraged to lend to women by providing additional incentives and guarantee to lend to female-headed households. Also adding the wife's name in addition to the husband to the mortgage contract will help women become asset owners.

Role of the World Bank

32. The Bank will assist PMRC and PMLs in fulfilling their respective roles, and in particular: (i) assist and advise on improving and enhancing Environmental and Social Management System during project implementation, including capacity building activities; (ii) review annual consolidated E&S Performance Report submitted by PMRC as required by BP4.03 paragraph 26; (iii) conduct supervision activities at the World Bank's discretion, as commensurate with the ongoing needs of the project.

5. Identify the key stakeholders and describe the mechanisms for consultation and disclosure, with an emphasis on potentially affected people:

33. The concept stage and appraisal stage ISDSs are prepared and disclosed by the Bank as the source of summary information on the Bank's findings regarding environmental and social issues. PMRC will disclose its E&S Policy on its website. During the preparation of the E&S Policy, PMRC will also seek inputs and participation in the development of its E&S risk management approach from its shareholder banks. As PMLs refinanced by PMRC are also its shareholders, PMRC will continue to consult and engage with them throughout the project.

B. Disclosure Requirements (N.B. The sections below appear only if corresponding policy is triggered)

Environmental Assessment/Audit/Management Plan/Other

Date of receipt by the Bank	Date of submission to World Bank External Website	For category A projects, date of distributing the Executive Summary of the EA to the Executive Directors
		N/A

"In country" Disclosure

Comments

As part of its preparation of the project under OP/BP4.03, the Bank assesses E&S risk management systems and plans for capacity building for the wholesale and retail PFIs (in this case PMRC and PMLs). Based on this assessment, strengthening of existing systems is recommended and should follow the principle of continuous improvement to ensure that ESMS enables PMRC and PMLs to meet applicable E&S requirements for the project. For this project, such assessment and recommended improvements are included in the ISDS and Project Appraisal Document (PAD). Once key elements of the ESMS – such as E&S policy, procedures, and capacity at the level of wholesale FI - are in place and satisfactory to the Bank, the Bank approves the ESMS in an internal memorandum, following which E&S policy and a summary of procedures shall be approved by PMRC Board and disclosed as per OP/BP4.03 provisions stated below. In line with the overall design of this project, such approval is expected to be completed before negotiations and disclosed following PMRC Board approval. This approach allows the project an opportunity to enhance E&S systems and capacity. This is expected to ensure effective implementation and tangible outcomes for E&S risk management.

Overall, in accordance with BP4.03, overall disclosure requirements for projects involving FIs are as follows:

The FI to disclose through the FI's website, if a website exists, and to permit, in writing, the Bank to disclose at the Bank's External Website and local public information center (as may be appropriate, in country), the following elements of the FI's ESMS:

(a) The FI's policy statement which describes specific objectives, metrics, and aspirations that the FI has set with regard to its environmental and social performance;

(b) The FI's procedures for screening and assessing risks and impacts of subprojects or individual transactions;

(c) After Bank review, the summary of the environmental and social assessment that is required for any subproject considered high risk in accordance with the ESMS (this is not expected for this project).

C. Compliance Monitoring Indicators at the Corporate Level (to be filled in when the ISDS is finalized by the project decision meeting) (N.B. The sections below appear only if corresponding safeguard policy is triggered)

OP/BP 4.03 - WB Performance Standards for Private Sector Activities

Does the project require a stand-alone EA (including EMP) report?
No

If yes, then did the Regional Environment Unit or Practice Manager (PM) review and approve the EA report?
N/A

Are the cost and the accountabilities for the EMP incorporated in the credit/loan?
N/A

The World Bank Policy on Disclosure of Information

Have relevant E&S policies documents been sent to the World Bank's External Website?
No

Have relevant documents been disclosed in-country in a public place in a form and language that are understandable and accessible to project-affected groups and local NGOs?
No

All E&S Policies

Have satisfactory calendar, budget and clear institutional responsibilities been prepared for the implementation of measures related to E&S policies?
Yes

Have costs related to E&S policy measures been included in the project cost?
Yes

Does the Monitoring and Evaluation system of the project include the monitoring of E&S impacts and measures related to E&S policies?
No

Have satisfactory implementation arrangements been agreed with the borrower and the same been adequately reflected in the project legal documents?
Yes

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APPROVAL

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