

EBRD's Environmental & Social (E&S) Risk Management Procedures for Mortgage Lending

Any EBRD partner Financial Intermediary (FI) must have clearly defined environmental and social management systems in place, commensurate with the nature of the FI and the level of environmental and social risks associated with its business activities and consistent with EBRD's Performance Requirement 9.

Introduction

The following Procedures apply to the portfolio of mortgages that are funded with the proceeds of the EBRD loan.

The objective of the E&S risk management procedures for mortgage lending is to:

- Support FIs to meet EBRD requirements to manage environmental and social risks in business activities; and to
- Provide FIs with step-by-step guidance on identifying, assessing and managing E&S risks with respect to mortgage lending.

These should be integrated into an FI's standard procedures for assessing mortgage applications.

There are two types of mortgages:

- Residential Mortgage - where the lending is used to finance the purchase or development of domestic property.
- Commercial or non-residential Mortgage - where the lending is used to finance the purchase or development of business premises. N.B.: The provision of non-residential mortgages potentially involves higher environmental risks and therefore requires a different environmental and social due diligence process. Therefore, *for non-residential mortgages, lenders should use the EBRD's Environmental and Social Risk Management Procedures for Corporate Loans.*
- Leasing of property or land - *lenders should refer to the EBRD's Environmental and Social Risk Management Procedures for Leasing.*

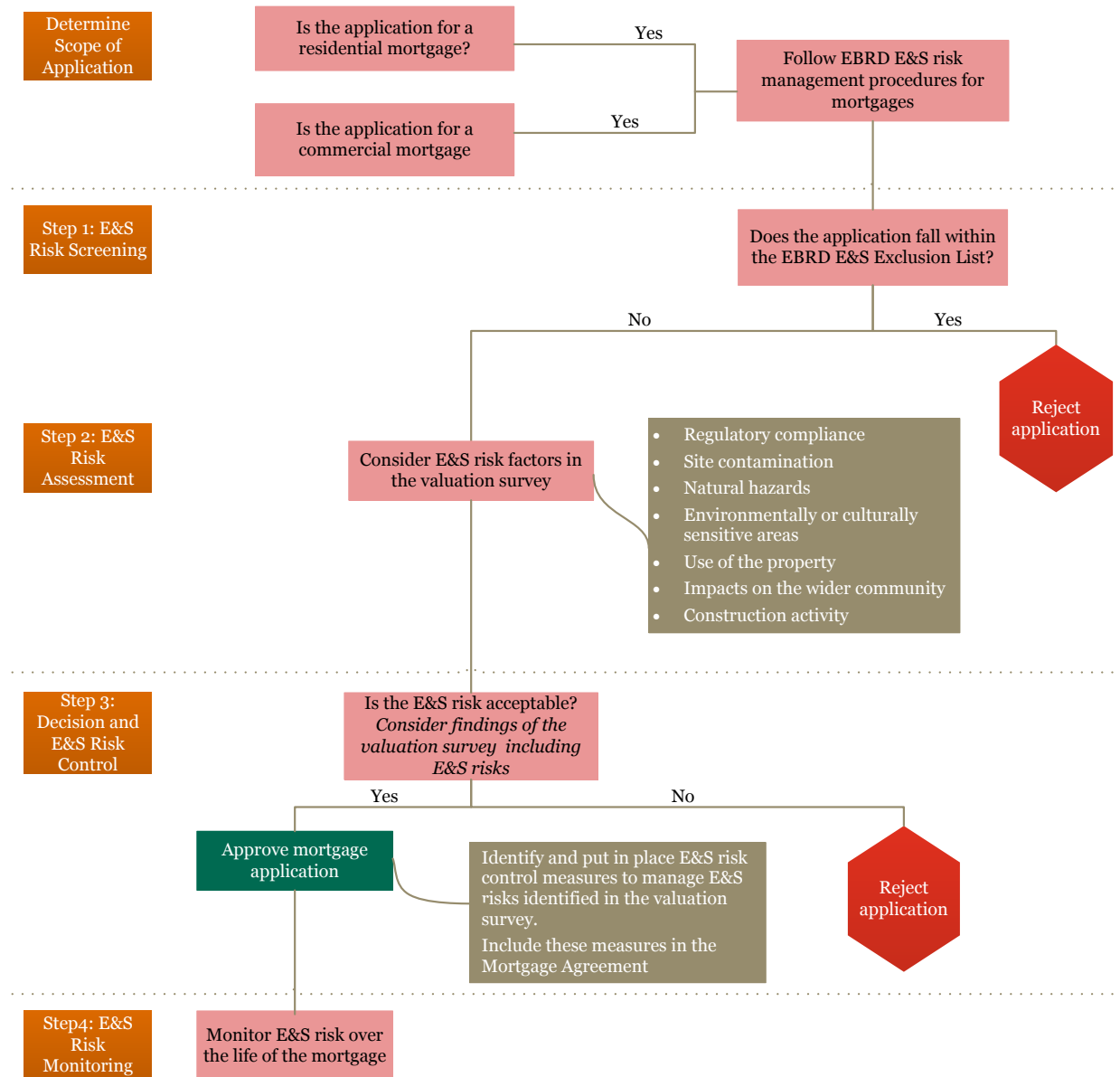
Scope of Application

These procedures apply to both commercial and residential mortgage applications.

Summary

The diagram below summarises the E&S risk management procedures for mortgage lending. Detailed guidance is provided for each step outlined below.

Flow Chart Mortgage Lending



Step 1: E&S Risk Screening

Screen against EBRD's E&S Exclusion List

- Screen the mortgage applicant's business activity against EBRD's E&S Exclusion List (attached as Annex I to this document).
- If the borrower is involved in any activity listed here, reject the application.

Further Guidance

What is EBRD's E&S Exclusion List?

- EBRD's E&S Exclusion List contains activities that are excluded under all circumstances because they are illegal or severely restricted under national or international law.

Step 2: E&S Risk Assessment

Consider E&S risk issues in property valuation

- When arranging for the property valuation survey to be carried out, ensure that the surveyor / property valuer considers E&S issues that could negatively affect the value or saleability of the property being taken as security for the mortgage.

Key E&S risk factors for the FI and/or the surveyor / property valuer to consider are:

- **Regulatory compliance** - Confirm the property's compliance with applicable national laws, regulations and standards, including environmental regulations, planning permissions, building permits, health and safety and conservation standards.
- **Site contamination** - Check the property for the presence of, or the potential for, pollution of land and groundwater. Investigate contamination risk from current activities, previous uses of the site, and neighbouring activities.
- **Natural hazards** - Assess the property's current and future exposure to, and ability to withstand, floods, droughts, radon, coastal erosion, seismic activity, extreme weather events and other natural hazards over the life of the mortgage.
- **Hazardous materials** - Investigate the presence of hazardous materials that can cause harm to human health and safety. Commonly found hazardous materials in buildings include asbestos, lead paint, polychlorinated biphenyls (PCB). Avoid such materials in construction and/or check that they are handled and disposed of in accordance with the law and good industry practice.
- **Environmentally or culturally sensitive areas** - If a property is under development, check if it is expected to have a significant impact on areas of environmental or cultural importance. This may lead to additional legal or regulatory restrictions or requirements.
- **Use of the property** - Investigate how the property will be used and if it is suitable for this purpose.

- **Impacts on the wider community** - Where a property is under development, investigate whether local communities and other stakeholders have been consulted on their views and concerns, and whether appropriate action has been taken as a result.
- **Construction activity** - Assess E&S risks associated with construction activity, such as employment of illegal labour or public health and safety concerns.

Further Guidance

Who should carry out the property valuation survey?

- The valuation survey should be carried out by a qualified surveyor.

Should a valuation survey be carried out if the property is not the security for the mortgage?

- Yes. Any E&S risks related to the property could negatively impact the borrower's ability to re-pay the loan from property derived revenue streams.

Which types of properties should be checked for contamination?

- All properties should be assessed for the presence, of or risk, contamination.
- The risk of contamination is higher if a property is used for, or nearby, industrial activities, or if using previously developed land, particularly if it was once used for industrial purposes.
- The risk is lower for properties built on greenfield sites or those that have always contained residential dwellings.

What if FIs are providing mortgages to multiple borrowers in a given area or a single borrower has multiple properties in an area?

- Some E&S risks, such as exposure to natural hazards or contamination, may impact a larger geographical area, and should be considered for other properties in the area.

What should FIs do if E&S risks are found?

- Analyse the impact of these issues on the value and saleability of the property.
- Take into account any cost considerations related with achieving compliance, clean-up, removal or other activities required to avoid, minimise, or mitigate the risks identified.
- Consider the potential impact on future buyers. Even if E&S risks, such as contamination, are adequately addressed, some buyers may still be deterred by a property's history.

Step 3: Decision and E&S Risk Control

- Assess the E&S risks identified in the valuation survey and decide whether to approve or reject the mortgage application from an E&S risk perspective.
 - Reject the application if significant E&S risks found and the borrower is unable or unwilling to mitigate the risks.
 - Consider approving the mortgage from an E&S risk perspective if E&S risks are acceptable and/or the borrower agrees to E&S risk control measures.
- Consider the cost of any E&S risk control measures when determining the final loan amount.
- Formalise E&S risk control measures agreed with the borrower, in the mortgage agreement, as appropriate.

What are appropriate E&S risk control measures FIs can agree with mortgage borrowers?

- This depends on the E&S risks identified in the valuation survey. See Step 4 for common E&S risk control measures FIs can employ to manage E&S risks.

Step 4: E&S Risk Monitoring

- Monitor the mortgage for E&S risks because they may change during the typically long life of the mortgage.
- Monitoring for E&S risks can take place alongside standard mortgage reviews.
- There are two areas to consider when monitoring E&S risks:
 - Events or changes that could present new or increased E&S risks.
 - Borrowers' progress in meeting agreed E&S risk control measures.

What events or changes should FIs look out for when monitoring mortgages for E&S risk?

- Key events or changes that can raise, or present new, E&S risks include:
 - Change in the use of the mortgaged property
 - Regulatory investigations, fines or penalties imposed on the property.
 - Public complaints or adverse media reports.
 - Accidents or incidents causing significant damage to the environment or human health and safety.
 - Amendments to relevant E&S laws and regulations.
 - New developments or changes in land / property use, on adjacent land.

What should FIs do if a borrower is not meeting agreed E&S risk control measures?

- Engage in discussions to address areas of non-compliance.
- Consider terminating the mortgage loan if necessary.

Reporting to EBRD

Under the requirements of PR 9, an FI is required to report annually to EBRD on the implementation of its Environmental and Social Management System (ESMS) and the E&S performance of its portfolio.

The level of reporting required on a FI's portfolio depends on the nature of the contractual relationship with EBRD.

- If EBRD has an equity stake in the FI, the FI is required to report on the E&S risk management of its full portfolio of business activities.
- If EBRD does not have an equity stake in the FI, but provides, for example, a credit line, the FI is required to report on the E&S risk management of transactions carried out using EBRD financing.

EBRD recommends that FIs document E&S risk management activities on an ongoing basis in order to have easily accessible information for reporting.

Reporting format

The EBRD FI Sustainability Index is an online tool designed to help FIs understand and report on how they are responding to the E&S risks in their own operations and business activities, as required by EBRD's PR 9. The Index should be completed by the FI's Authorised Representative and submitted to EBRD. FI's should e-mail: ebrdsusindex@ebrd.com for access to the Index.

Annex I: EBRD Environmental and Social Exclusion List

EBRD will not knowingly finance, directly or indirectly, projects involving the following:

- (a) the production of or trade in any product or activity deemed illegal under host country (i.e. national) laws or regulations, or international conventions and agreements, or subject to international phase out or bans, such as:
 - (i) Production of or trade in products containing PCBs.¹
 - (ii) Production of or trade in pharmaceuticals, pesticides/herbicides and other hazardous substances subject to international phase-outs or bans.²
 - (iii) Production of or trade in ozone depleting substances subject to international phase out.³
 - (iv) Trade in wildlife or production of or trade in wildlife products regulated under CITES.⁴
 - (v) Transboundary movements of waste prohibited under international law.⁵
- (b) Production or use of or trade in unbonded asbestos fibres or asbestos-containing products.
- (c) Activities prohibited by host country legislation or international conventions relating to the protection of biodiversity resources or cultural heritage.⁶
- (d) Drift net fishing in the marine environment using nets in excess of 2.5 km. in length.
- (e) Shipment of oil or other hazardous substances in tankers which do not comply with IMO requirements.⁷
- (f) Trade in goods without required export or import licenses or other evidence of authorization of transit from the relevant countries of export, import and, if applicable, transit.

¹ PCBs: Polychlorinated biphenyls are a group of highly toxic chemicals. PCBs are likely to be found in oil-filled electrical transformers, capacitors and switchgear dating from 1950-1985.

² Reference documents are Council Regulation (EEC) No 2455/92 of 23 July 1992 Concerning the Export and Import of Certain Dangerous Chemicals, as amended from time to time; United Nations Consolidated List of Products whose Consumption and/or Sale have been Banned, Withdrawn, Severely Restricted or not Approved by Governments; Convention on the Prior Informed Consent Procedures for Certain Hazardous Chemicals and Pesticides in International Trade (Rotterdam Convention); Stockholm Convention on Persistent Organic Pollutants; World Health Organisation Recommended Classification of Pesticides by Hazard.

³ Ozone Depleting Substances (ODS): Chemical compounds which react with and deplete stratospheric ozone, resulting in the widely publicised 'ozone holes'. The Montreal Protocol on Substances that Deplete the Ozone Layer lists ODSs and their target reduction and phase out dates. A list of the chemical compounds regulated by the Montreal Protocol, which includes aerosols, refrigerants, foam blowing agents, solvents, and fire protection agents, together with details of signatory countries and phase out target dates, is available from the United Nations Environment Programme.

⁴ CITES: The Convention on International Trade in Endangered Species of Wild Fauna and Flora. A list of CITES listed species is available from the CITES secretariat.

⁵ Reference documents are: Regulation (EC) No 1013/2006 of 14 June 2006 on shipments of waste; Decision C(2001)107/Final of the OECD Council concerning the revision of Decision C(92)39/Final on the control of transboundary movements of wastes destined for recovery operations; Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal.

⁶ Relevant international conventions include: Convention on the Conservation of Migratory Species of Wild Animals (Bonn Convention); Convention on Wetlands of International Importance, especially as Waterfowl Habitat (Ramsar Convention); Convention on the Conservation of European Wildlife and Natural Habitats (Bern Convention); Convention Concerning the Protection of the World Cultural and Natural Heritage; Convention on Biological Diversity.

⁷ This includes: tankers which do not have all required International Convention for the Prevention of Pollution from Ships (MARPOL), International Convention for the Safety of Life at Sea (SOLAS) certificates (including, without limitation International Safety Management Code compliance), tankers blacklisted by the European Union or banned by the Paris Memorandum of Understanding on Port State Control (Paris MOU) and tankers due for phase out under MARPOL regulation 13G. No single hull tanker over 25 years old should be used.