

CONFORMED COPY

LOAN NUMBER 7077-CO

Loan Agreement

(Water Sector Reform Assistance Project)

between

REPUBLIC OF COLOMBIA

and

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

Dated December 17, 2001

LOAN NUMBER 7077-CO

LOAN AGREEMENT

AGREEMENT, dated December 17, 2001, between REPUBLIC OF COLOMBIA (the Borrower) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS the Borrower, having satisfied itself as to the feasibility and priority of the project described in Schedule 2 to this Agreement (the Project), has requested the Bank to assist in the financing of the Project; and

WHEREAS the Bank has agreed, on the basis, inter alia, of the foregoing, to extend the Loan to the Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Loan and Guarantee Agreements for Fixed-Spread Loans" of the Bank, dated September 1, 1999 (the General Conditions) constitute an integral part of this Agreement.

Section 1.02. Unless the context otherwise requires, the several terms defined

in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) "Adjusted Tariff" means a Tariff for which the different rates have been adjusted by a Participating Municipality on the basis of the recommendations of the technical assistance received by such Municipality under the corresponding Technical Assistance Agreement, with the purpose of enabling such Municipality to set forth said rates at levels it judges compatible with: (1) the average income of the different groups which compose the corresponding Population; (2) the portion of said income that is reasonable to expect each such different group may be able and willing to spend as payment for the provision of adequate water supply and sanitation services; and (3) the reasonable profit expectations of a private profit earning entity which wishes to become either the Operator or the Constructor/Operator, as the case may be, of a given Subproject;

(b) "Administrator Account": see "Project Agreement";

(c) "Assistance Entity" means entity established by an international organization of countries, of which the Borrower is a member, and which has the expertise, facilities and personnel required to carry out, on behalf or the Borrower through MED (as hereinafter defined), certain activities under the Project such as administrating funds, contracting services and entering into agreements therefore, all connected with expenditures to be financed with Loan proceeds allocated to Categories 1 and 2 of the table, for Subprojects under Parts A1 and A2 of the Project, and Categories 3 and 4 of the table for Technical Assistance, provided, however, that if the Borrower determines that it shall use the services of two Assistance Entities, the one connected with Subprojects shall be called "Assistance Entity One", and the one connected with Technical Assistance Subprojects shall be called "Assistance Entity Two";

(d) "Banco República" means Banco de la República de Colombia, the Borrower's central bank;

(e) "Banking Day" means a day on which Banco República and other banks in the Borrower's territories are open for general business, including foreign exchange transactions;

(f) "Caribbean Region" means the territories of all of the following Departments of the Borrower: Atlántico, Bolívar, César, Córdoba, La Guajira, Sucre, Magdalena and Archipiélago de San Andrés, Providencia y Santa Catalina;

(g) "Constructor/Operator" means: (i) a privately owned and/or controlled legal entity or a mixed economy company (i.e., a combination of public and private partners) or, in exceptional circumstances subject to the Bank's prior approval, a public entity (or a joint venture among two or more of such entities), which shall be also subject to the Bank's prior approval in case the entities in question are public entities with proven capacity to construct and/or rehabilitate water supply and sewerage systems of a size comparable to that of a Small Municipality; and (ii) which has been selected by a Participating Municipality, with the main purpose of carrying out, under the terms and conditions of the corresponding Subproject Agreement into which such entity (or joint venture) shall enter: (A) the construction or rehabilitation of the facilities for the water and sewerage systems of a given Local Water Utility or Regional Water Utility in a Small Municipality; and (B) the operation of said systems during a ten to fifteen year period, all in accordance with the provisions of the Implementation Program and the aforesaid Subproject Agreement;

(h) "DANE" means the Borrower's National Administrative Department of Statistics (Departamento Administrativo Nacional de Estadística) or any successor thereto;

(i) "Department" means "Departamento", a political subdivision of the Borrower that constitutes one of the types of Territorial Entities (Entidades Territoriales) referred to in article 286 of the Borrower's Constitution;

(j) "Designated Account for Technical Assistance": see "Project Agreement";

(k) "Early Subproject" means a Subproject proposed under the eligibility criteria set forth to in paragraph 3 (c) of the Implementation Program;

(l) "Eligible Categories" means Categories 1, 2, 3 and 4 set forth in the

Table;

(m) "Eligible Expenditures" means the expenditures for works and goods for Subprojects under Categories 1 and 2 of the Table, and for services and goods in support thereof under Categories 3 and 4 of the Table, as referred to in Section 2.02 (a) of this Loan Agreement;

(n) "Entity's Account" means the account to be opened by an Assistance Entity acceptable to the Bank, as referred to in Section 3.01 (b) (i) (B) of this Agreement, for purposes of carrying out Parts B, C and D of the Project;

(o) "Fiduciaria" means a financial institution with which the Participating Municipality in question shall enter into a trust agreement, pursuant to the provisions of Section 3.01 (d) of this Loan Agreement and shall thus serve as trustee;

(p) "Implementation Program" means the provisions contained in Schedule 5 to this Agreement;

(q) "INDEMUN Index Value" means Indice de Desarrollo Municipal, the index of municipal development as calculated from time to time by the Borrower's Departamento Nacional de Planeación (National Planning Department);

(r) "Law 60" means the Borrower's Law No. 60 of August 12, 1993 (that, inter alia, distributes certain Borrower's resources to one or more Municipalities, and to other political subdivisions of the Borrower), as amended as of June 15, 2001 and as may be further amended provided any such further amendment does not adversely affect the carrying out of the Project or of any Subproject;

(s) "Law 60 Income" means each of the bi-monthly transfers that the Borrower shall make to any given Participating Municipality from the Borrower's current income for the year in question, in connection with the provision of water supply and sanitation services, in conformity with the provisions of Law 60, particularly Articles 22 through 24 thereof, and to the extent such transfers are made or have been made as provided for in the corresponding Subproject Agreement either: (i) through the corresponding Subsidiary Trust Agreement in respect of Subprojects under Parts A.1 and A.3 (a) of the Project; or (ii) by means of direct payments made or to be made to the corresponding Constructor/Operator on behalf of the Participating Municipality in question, in respect of Subprojects under Parts A.2 and A.3 (b) of the Project;

(t) "Local Water Utility" means any entity with legal personality, in whichever form such legal personality may have been adopted, that is legally able to provide water and sewerage services to the general public within the territory of no more than one Participating Municipality;

(u) "Manual" means the manual to be put into effect for purposes of paragraph (b) of Section 7.01 of this Loan Agreement, as modified from time to time with the prior approval of the Bank;

(v) "Mayor" means Alcalde, the head of the executive power of a Municipality;

(w) "MED" means the Borrower's Ministry of Economic Development (Ministerio de Desarrollo Económico);

(x) "Medium Size Municipality" means either a Municipality with a Population of more than 12,000 but not more than 300,000 persons (except as allowed by paragraph 3 (b) (i) of the Implementation Program), and is being served by a Local Water Utility, or a group of two or more Municipalities which are being served by a Regional Water Utility, and which, in the aggregate, are within said Population parameters;

(y) "Model" means, depending of the context, one of the models referred to in paragraph (c) or paragraph (d) of Section 7.01 of this Loan Agreement;

(z) "Municipal Council" means Concejo Municipal, the legislative power of a

Municipality;

(aa) "Municipality" means Municipio, a political subdivision of the Borrower that constitutes one of the types of Territorial Entities (Entidades Territoriales) referred to in article 286 of the Borrower's Constitution;

(bb) "Operator" means a privately owned and/or controlled legal entity or a mixed economy company (i.e., a combination of public and private partners) or, in exceptional circumstances subject to the Bank's prior approval, a public entity (or a joint venture among two or more of such entities, which shall be also subject to the Bank's prior approval in the case the entities in question are public entities) with proven experience in managing and operating water and sewerage systems of a size comparable to that of a Medium Size Municipality, selected under procedures satisfactory to the Bank, for the purposes of carrying out, under the terms and conditions of the corresponding Subproject Agreement, the operation and management of a Local Water Utility or a Regional Water Utility for a period within the range of 20 to 30 years, with or without investing capital in the process, all in accordance with the provisions of the Implementation Program, Schedule 4 to this Loan Agreement and the Manual;

(cc) "Participating Municipality" means any Medium Size Municipality or Small Municipality that: (i) has entered into, and remains bound by, a Technical Assistance Agreement or, in the case of an Early Subproject, that has been selected under the eligibility criteria set forth in paragraph 3 (c) of the Implementation Program; (ii) expects to carry out a Subproject and to enter, for that purpose, into the corresponding Subproject Agreement; or (iii) has already entered into a Subproject Agreement;

(dd) "Pesos" means the lawful currency of the Borrower;

(ee) "PIU" means Project Implementation Unit, the unit established under MED's General Directorate of Water Supply and Basic Sanitation, with the personnel, facilities, equipment and operational ability in place as of the Effective Date, including the additional personnel to be hired for purposes of paragraph (a) of Section 7.01 of this Loan Agreement, as such personnel, facilities and equipment may vary from time to time to the satisfaction of the Borrower and the Bank;

(ff) "POI" means Programa de Obras e Inversión, the program of works to be carried out and investments to be made under a given Subproject Agreement, on the terms and conditions provided for in said agreement;

(gg) "Population" means, for purposes of the Project, the number of inhabitants of a given Municipality or group of Municipalities at a given point in time, as established at that point and for the urban area (cabecera) of the Municipality or Municipalities in question, on the basis of the relevant data shown in the applicable annual statistical publication of DANE;

(hh) "Project Account" means the system of accounts acceptable to the Bank, where Borrower's counterpart funds allocated specifically for financing Subprojects under Part A.3 (a) of the Project shall be paid into from time to time on their way to eventual deposit into the corresponding Subsidiary Trust Account opened or to be opened for purposes of funding the specific Subproject in question;

(ii) "Project Agreement" means an agreement to be entered into by the Borrower through MED and an Assistance Entity acceptable to the Bank, pursuant to the provisions of Section 3.01 (b) (i) (B) of this Loan Agreement; provided, however: (i) if the Borrower enters into two such Agreements, the one entered into with Assistance Entity One shall be called "Project Agreement One" and the one entered into with Assistance Entity Two shall be called "Project Agreement Two"; and (ii) that any reference to "Project Agreement" in this Loan Agreement, shall be a reference to Project Agreement One or Project Agreement Two depending of the context and further provided that the accounts where Loan proceeds flowing through the Special Account and specifically withdrawn from Categories (1) or (2) of the Table or Categories (3) or (4) of the Table, shall be paid into from time to time to fund within thirty days expenditures under the Project, shall be called, respectively "Administrator Account" and "Designated Account for Technical Assistance";

(jj) "Project Management Report" means each report prepared in accordance with Section 4.02 of this Agreement;

(kk) "Regional Water Utility" means any entity with legal personality, in whichever form such legal personality may have been adopted, that is legally able to provide water and sewerage services to the general public in the territory of more than one Participating Municipality and is, or the facilities it operates are, owned or controlled or both by the Participating Municipalities in question;

(ll) "Small Municipality" means either a Municipality with a Population of more than 2,000 but not more than 12,000 persons (except as allowed by paragraph 3 (a) (i) of the Implementation Program), served by a single Local Water Utility, or a group of two or more Municipalities served by a Regional Water Utility which, in the aggregate, are within said Population parameters;

(mm) "Special Account" means the account referred to in Part B of Schedule 1 to this Agreement;

(nn) "Subproject" means any given set of activities which: (i) have been designed to attain, under the auspices of the Project, and maintain thereafter, the transfer to the private sector or to a mixed economy company (i.e., a combination of public and private partners) or, in exceptional circumstances subject to the Bank's approval, to a public entity (or to a joint venture among two or more of such entities) of the full management and operation responsibility of a Local Water Utility or a Regional Water Utility and/or the construction and/or rehabilitation of the facilities thereof, as the case may be; (ii) have been prepared under a Technical Assistance Agreement, except in the case of an Early Subproject; (iii) should result in the commitment (by all entities or combination of entities referred to in subparagraph (i)) to provide investment funds into the Water Utility in question, or alternatively, in valuable benefits for the users of the services thereof, both in amounts compatible with the agreed tariff rate levels provided by, or based on the preparation work carried out under either the corresponding Technical Assistance Agreement or, in the case of an Early Subproject, a process satisfactory to the Bank; and (iv) are expected to be, or are being, carried out under the corresponding Subproject Agreement;

(oo) "Subproject Agreement" means each agreement to carry out a Subproject or an Early Subproject, entered or to be entered into among: (i) the Borrower, through MED and PIU, as provided for in the Manual; (ii) the Participating Municipality or Municipalities in question and, if required, the corresponding Local Water Utility or Regional Water Utility, acting through the respective Mayor (Alcalde) or Mayors and with the approval of the respective Municipal Council (Concejo Municipal) or Councils and, if required, another legal representative of the Local Water Utility or Regional Water Utility; and (iii) the corresponding Operator or Constructor/Operator, as the case may be, all pursuant to Section 3.01 of this Loan Agreement and the provisions of the Implementation Program and the Manual, as such agreement may be amended from time to time in form and substance satisfactory to the Bank; and the term "Subproject Agreement" includes all schedules thereto; provided, however, that, if the Borrower so determines, the content of a Subproject Agreement may be divided into two different but accompanying agreements, one for which the signatories shall be those referred to in subparagraphs (i) and (ii) of this paragraph (oo), and another for which the signatories shall be those indicated in subparagraphs (ii) and (iii) of this paragraph (oo);

(pp) "Subsidiary Trust Account" means each separate account provided for in the corresponding Subsidiary Trust Agreement, opened (or to be opened) by a Fiduciaria: (i) to receive the funds to be paid into said account i.e. either: (A) the proceeds of Borrower's counterpart funds (flowing from the Project Account), or Loan proceeds (flowing from the Special Account directly or indirectly through the Administrator Account (as defined in (ii) above) in connection with a Subproject under Parts A.3 (a) and A.1 of the Project, respectively; or (B) to receive the corresponding Law 60 Income or funds from other sources, or both, of the Participating Municipality in question, contributed by such Municipality in respect of each of the Subprojects, so as to enable said Subprojects to be financed jointly either with Loan proceeds (Part A.1 of the Project) or with Borrower's counterpart funds (Part A.3 (a) of the Project) as the case may be; (ii) in connection with each Subproject in respect of which the corresponding Subproject Agreement has been entered into as required by paragraph (b) (i) (A) of Section 3.01 of this Loan Agreement; and (iii) all of the

above pursuant to the provisions of the Implementation Program;

(qq) "Subsidiary Trust Agreement" means each trust agreement (Contrato de Encargo Fiduciario) entered into between a Fiduciaria, the corresponding Participating Medium Size Municipality (and, if required, Water Utility), and, if required, the Operator in question, in respect of a given Subproject under Parts A.1 or A.3 (a) of the Project, all as provided for in this Loan Agreement, particularly in Section 3.01 (d) thereof, the Implementation Program, the Manual and the corresponding Subproject Agreement;

(rr) "Supplemental Letter" means the letter of even date herewith from the Borrower to the Bank setting forth the action plan referred to in section 4.02 (a) of this Agreement and the Project monitoring indicators referred to in Section 5.02 (a) of this Agreement;

(ss) "Table" means the table set forth in Part A.1 of Schedule 1 to this Agreement;

(tt) "Tariff" means the set of different rates that a given Local Water Utility or Regional Water Utility has been authorized, by the lawful authorities of the corresponding Municipality, to charge for the provision of water supply and sanitation services to such Water Utility's customers within the jurisdiction of such Municipality or Municipalities;

(uu) "Technical Assistance Agreement" means each agreement (referred to, in the Borrower's territory and in the context of this Project, as Convenio de Asistencia Técnica) to be entered into between: (i) the Borrower, through MED and PIU, as provided for in the Manual; and (ii) the Participating Municipality or Municipalities in question and, if required, the Local Water Utility or Regional Water Utility in question, all acting through the respective Mayor (Alcalde) or Mayors, all pursuant to Section 3.01 of this Loan Agreement and in accordance with the provisions of the Implementation Program, as such agreement may be amended from time to time in form and substance satisfactory to the Bank, and the term Technical Assistance Agreement includes all schedules thereto; and

(vv) "Water Utility" means a Local Water Utility, or a Regional Water Utility, or both, as the context will require.

ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Loan Agreement, an amount equal to forty million Dollars (\$40,000,000), as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.09 of this Agreement.

Section 2.02. The amount of the Loan may be withdrawn from the Loan Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Bank shall so agree, to be made) in respect of the reasonable cost of: (a) works and goods for Subprojects under Parts A.1 and A.2 of the Project; and (b) technical assistance services and goods in support thereof, all required for the Project and to be financed out of the proceeds of the Loan.

Section 2.03. The Closing Date shall be June 30, 2007 or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a front-end fee in an amount equal to \$400,000. Such fee shall be payable not later than sixty (60) days after the Effective Date.

Section 2.05. The Borrower shall pay to the Bank a commitment charge on the principal amount of the Loan not withdrawn from time to time, at a rate equal to: (a) eighty-five one hundredths of one per cent (0.85%) per annum from the date on which such charge commences to accrue in accordance with the provisions of section 3.02 (b) of the General Conditions to but not including the fourth anniversary of such date;

and (b) seventy-five one hundredths of one per cent (0.75%) per annum thereafter.

Section 2.06. The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, in respect of each Interest Period at the Variable Rate; provided, that upon a Conversion of all or any portion of the principal amount of the Loan, the Borrower shall, during the Conversion Period, pay interest on such amount in accordance with the relevant provisions of Article IV of the General Conditions.

Section 2.07. Interest and commitment charges shall be payable semiannually in arrears on February 15 and August 15 in each year.

Section 2.08. The Borrower shall repay the principal amount of the Loan in accordance with the provisions of Schedule 3 to this Agreement.

Section 2.09. (a) The Borrower may at any time request any of the following Conversions of the terms of the Loan in order to facilitate prudent debt management:

- (i) a change of the Loan Currency of all or any portion of the principal amount of the Loan, withdrawn or unwithdrawn, to an Approved Currency;
- (ii) a change of the interest rate basis applicable to all or any portion of the principal amount of the Loan from a Variable Rate to a Fixed Rate, or vice versa; and
- (iii) the setting of limits on the Variable Rate applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding by the establishment of an Interest Rate Cap or Interest Rate Collar on said Variable Rate.

(b) Any conversion requested pursuant to paragraph (a) of this Section that is accepted by the Bank shall be considered a "Conversion", as defined in Section 2.01 (7) of the General Conditions, and shall be effected in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.

(c) Without limitation upon the provisions of paragraph (a) of this Section, the Borrower and the Bank hereby agree that unless otherwise notified by the Borrower in accordance with the provisions of the Conversion Guidelines, the interest rate basis applicable to the aggregate principal amount of the Loan withdrawn during each Interest Period shall be changed from the initial Variable Rate to a Fixed Rate for the full maturity of such amount in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project, and, to this end, shall carry out the Project through MED with due diligence and efficiency and in conformity with appropriate public utility and environmental practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Borrower and the Bank shall otherwise agree, the Borrower through MED:

- (i) shall carry out:
 - (A) Parts A.1 and A.2 of the Project in accordance with the Implementation Program, under Technical Assistance Agreements and Subproject Agreements (one or two per Subproject, as determined by the Borrower): (1) firstly, by assisting through PIU each Participating Municipality, or the corresponding Water Utility, or both as the case may be, to prepare the basis for a Subproject under the

corresponding Technical Assistance Agreement; (2) secondly, by financing said assistance with a portion of the proceeds of the Loan allocated to Category 4 of the Table, as provided for in the said Technical Assistance Agreement; and (3) if such Participating Municipality enters in due time into the corresponding Subproject Agreement (either with both the Borrower and the Operator (or the Constructor/Operator as the case may be) jointly, or separately with the Borrower, and, as the case may be, the Operator or the Constructor/Operator) pursuant to the provisions set forth in the Implementation Program, by making available to such Municipality (or, if so required, to the Water Utility in question), either through the corresponding Subsidiary Trust Account (in the case of Medium Size Municipalities) or directly to the applicable Constructor/Operator (in the case of Small Municipalities), the corresponding portion of proceeds of the Loan allocated under Categories 1 and/or 2 and/or 4 of the Table, on a grant basis, in order to enable each such Municipality or Water Utility to defray expenditures incurred or to be incurred to carry out the corresponding Subproject with the assistance of PIU and of the Operator or Constructor/Operator, as the case may be;

(B) Parts B, C and D of the Project, under one or two agreements to be entered into with one or two Assistance Entities (each such agreement hereinafter referred to as Project Agreement One and Project Agreement Two) under terms and conditions which shall have been approved by the Bank, as well as any amendment thereof, and;

(C) Part A.3 of the Project in accordance with the Implementation Program, under Technical Assistance Agreements and Subproject Agreements (one or two per Subproject, as determined by the Borrower): (1) assisting through PIU each Participating Municipality prepare the basis for a Subproject under the Technical Assistance Agreement; (2) said assistance with a portion of allocated to Category 4 of the Borrower's counterpart question, as provided for Agreement; and (3) Municipality enters Subproject Agreement Operator (or the jointly, or may

firstly, by
to
corresponding
secondly, by financing
the proceeds of the Loan
Table or a portion of
funds allocated to the Subproject in
in the said Technical Assistance
thirdly, if such Participating
in due time into the corresponding
(either with both the Borrower and the
Constructor/Operator as the case may be)
separately with the Borrower, and, as the case
be, the Operator or the Constructor/Operator) pursuant
to the provisions of the Implementation Program, by making
available to such Participating Municipality or the
corresponding Water Utility, if so required, either through
the corresponding Subsidiary Trust Account (in the case of
Medium Size Municipalities) or directly to the applicable
Constructor/Operator (in the case of Small Municipalities)
the corresponding portion of Borrower's counterpart funds
allocated for the Project, on a grant basis, in order to
enable each such Municipality (or Water Utility) to defray
expenditures incurred or to be incurred to carry out the
Subproject in question, with assistance of PIU and of the
Operator or the Constructor/Operator, as the case may be,
under the corresponding Subproject Agreement;

(ii) shall cause:

(A) one or two Assistance Entities acceptable to the Bank, as referred to in paragraph (b) (i) (B) above of this Section, to perform in accordance with the provisions of the Project Agreement all the obligations of such Assistance Entity or Entities;

(B) each Participating Municipality (and the corresponding Water

Utility, if so required) to comply with all their respective obligations under the corresponding Technical Assistance Agreement and the Subproject Agreement and, if applicable, each Operator or Constructor/Operator (as the case may be) to comply with all its respective obligations under the Subproject Agreement; and

- (C) each Participating Municipality to cause the respective Operator or Constructor/Operator, as the case may be, to perform in accordance with the provisions of the corresponding Subproject Agreement, all the obligations of such Operator or Contractor/Operator, as the case may be, if the Borrower is not a party to the Subproject Agreement with the Operator or the Constructor/Operator in question;
- (iii) shall take and cause to be taken all action, including the provision of funds (exclusively in the case of a Participating Municipality and in that case, including, but not being limited to, funds pertaining to Law 60 Income of such Municipality), facilities, services and other resources, necessary or appropriate to enable each Assistance Entity or the other Entity referred to in paragraph (b) (i) (B) of this Section (in the case there is more than one) or a Participating Municipality (or the corresponding Water Utility, if so required) or Operator or Constructor/Operator, as the case may be, to perform their respective obligations under the Project Agreement or the corresponding Subproject Agreement, as the case may be; and
- (iv) shall not take or permit to be taken any action which would prevent or interfere with any performance referred to in paragraphs (b) (ii) and (b) (iii) of this Section.

(c) The Borrower shall not change the terms and conditions of any of the Models accepted by the Bank for purposes of paragraphs (c) or (d) of Section 7.01 of this Loan Agreement, without the prior approval of the Bank.

(d) Without limitation to any other provision of this Agreement, the Borrower, through MED, shall cause each Participating Municipality to: (i) enter into one or more Subsidiary Trust Agreements (one Subsidiary Trust Agreement per each Subproject Agreement in respect of Part A.1 or Part A.3 (a) of the Project), all satisfactory to the Borrower and the Bank, with one or more Fiduciarias acceptable to the Borrower and the Bank which shall have established offices in the territory of the Borrower; (ii) establish, with each of the Fiduciarias, a separate Subsidiary Trust Account to be opened in respect of each Subproject Agreement entered into by a Medium Size Municipality in question (and the corresponding Water Utility, if so required); (iii) ensure that each such account operated by the corresponding Fiduciaria under explicit instructions to maintain records and accounts adequate to reflect in accordance with sound accounting practices the operations, resources and expenditures, in respect of each Subproject, of the respective Municipality or Municipalities, Operators, and to the extent required, Water Utilities involved; and (iv) ensure that the flow of funds to finance each Subproject occurs as set forth in paragraph 5 of the Implementation Program.

(e) The Borrower through MED shall exercise its rights under the Project Agreement (s), each Technical Assistance Agreement, each Subproject Agreement (be it with the Municipality only or also with the Operator) and each Subsidiary Trust Agreement, and perform all its obligations thereunder, in such a manner as to protect the interests of the Borrower and the Bank and to accomplish the purposes of the Loan, and, except as the Bank shall otherwise agree, the Borrower shall not assign, amend, abrogate or waive or fail to enforce any of the above agreements or any provision thereof.

Section 3.02. Except as the Bank shall otherwise agree, procurement of goods, works and consultants' services required for the Project and to be financed out of the proceeds of the Loan shall be governed by the provisions of Schedule 4 to this Agreement.

Section 3.03. (a) Without limitation to the provisions of Section 3.01 of this Agreement, the Borrower through MED shall carry out the Project, and shall cause each Participating Municipality to carry out its activities under the Project, in

accordance with the applicable provisions of the Manual, as such Manual may be amended from time to time with the prior approval of the Bank.

(b) In case of conflict between the terms of the Manual and those of this Agreement, the terms of this Agreement shall prevail.

Section 3.04. (a) The Borrower shall, through the PIU, give, every three months, notice to the Bank, starting on a date 15 days after the Effective Date, on the estimated withdrawals from the Project Account expected to take place in connection with Subprojects during the next six-month period immediately following the date of the notice in question, as calculated with a methodology satisfactory to the Bank, and on the amounts required to be deposited by the Borrower into such Project Account to meet the immediate financial requirements for the funding of Subprojects.

(b) The Borrower shall neither introduce changes in the number of positions of the PIU nor in the professional skills required for occupying such positions, without the consent of the Bank.

Section 3.05. For the purposes of Section 9.07 of the General Conditions and without limitation thereto, the Borrower through MED shall:

(a) prepare, on the basis of guidelines acceptable to the Bank, and furnish to the Bank not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Bank, a plan for the future operation of the Project; and

(b) afford the Bank a reasonable opportunity to exchange views with the Borrower on said plan.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall, through MED, maintain a financial management system in the PIU, including records and accounts, and prepare financial statements in a format acceptable to the Bank, adequate to reflect the operations, resources and expenditures related to the Project.

(b) The Borrower, through MED and PIU, shall:

- (i) have the records, accounts and financial statements referred to in paragraph (a) of this Section and those for the Special Account, for the Administrator Account, for the Designated Account for Technical Assistance, and including those for each Subsidiary Trust Account for Subprojects under Part A.1 of the Project, and for the Project Agreement, and for each Participating Municipality and, if so required, the Water Utility in respect of which a Subproject is being financed under the Project and with proceeds of the Loan, as well as the records, accounts and financial statements referred to in paragraph (a) of this Section in connection with each Subproject Agreement, for each fiscal year audited, in accordance with auditing standards acceptable to the Bank, consistently applied, by independent auditors acceptable to the Bank;
- (ii) furnish to the Bank as soon as available, but in any case not later than six months after the end of each such year: (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year as so audited; and (B) an opinion on such statements, records and accounts and report of such audit, by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and
- (iii) furnish to the Bank such other information concerning such records and accounts, and the audit thereof, and concerning said auditors,

as the Bank may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Loan Account were made on the basis of Project Management Reports or statements of expenditure the Borrower, through MED and PIU, shall:

- (i) maintain or cause to be maintained, in accordance with paragraph (a) of this Section, records and separate accounts reflecting such expenditures;
- (ii) retain or caused to be retained, until at least one year after the Bank has received the audit report for the fiscal year in which the last withdrawal from the Loan Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
- (iii) enable the Bank's representatives to examine such records; and
- (iv) ensure that such records and accounts are included in the annual audit referred to in paragraph (b) of this Section and that the report of such audit contains a separate opinion by said auditors as to whether the Project Management Reports or statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals.

Section 4.02. (a) Without limitation upon the provisions of Section 4.01 of this Agreement, the Borrower, through MED and PIU, shall carry out a time-bound action plan acceptable to the Bank (as set forth in the Supplemental Letter), for the strengthening of the financial management system referred to in paragraph (a) of said Section 4.01 in order to enable the Borrower to prepare quarterly Project management reports, acceptable to the Bank, each of which:

- (i) (A) sets forth actual sources and applications of funds for the Project, both cumulatively and for the period covered by said report, and projected sources and applications of funds for the Project for the six-month period following the period covered by said report; and (B) shows separately expenditures financed out of the proceeds of the Loan during the period covered by said report and expenditures proposed to be financed out of the proceeds of the Loan during the six-month period following the period covered by said report;
- (ii) (A) describes physical progress in Project implementation, both cumulatively and for the period covered by said report; and (B) explains variances between the actual and previously forecast implementation targets; and
- (iii) sets forth the status of procurement under the Project and expenditures under contracts financed out of the proceeds of the Loan, as at the end of the period covered by said report.

(b) Upon the completion of the action plan referred to in paragraph (a) of this Section, the Borrower shall prepare, in accordance with guidelines acceptable to the Bank, and furnish to the Bank and the Borrower's Departamento Nacional de Planeación (National Planning Department) not later than 45 days after the end of each calendar quarter a Project Management Report for such period.

ARTICLE V

Other Covenants

Section 5.01. The Borrower through MED shall cause each Participating Municipality or the corresponding Water Utility, as the case may be, in respect of any Subproject carried out in such Municipality by an Operator or a Contractor/Operator,

as the case may be (or, through such Municipality, the Borrower shall cause each such Operator or Contractor/Operator, as applicable), in all cases under the corresponding Subproject Agreement:

(a) to take out and maintain with responsible insurers, or to make other provision satisfactory to the Bank, for insurance against such risks and in such amounts as shall be consistent with appropriate practice;

(b) to carry on its operations and conduct its affairs in accordance with sound administrative, financial, and Water Utility practices under the supervision of qualified and experienced management assisted by competent staff in adequate numbers; and

(c) at all times to operate and to maintain its plants, machinery, equipment and other property, and from time to time, promptly as needed, to make all necessary repairs and renewals thereof, all in accordance with sound engineering, financial and Water Utility practices.

Section 5.02. The Borrower through MED shall:

(a) maintain, and cause each Participating Municipality and Assistance Entity to maintain, policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators acceptable to the Bank, as set forth in the Supplemental Letter, the Manual and in each Subproject Agreement, the carrying out of: (i) each respective Subproject; and (ii) the Project as a whole, and the achievement of the objectives thereof; the aforesaid notwithstanding, it is further agreed that for purposes of (ii) above the following shall be used also as evaluation indicators, i.e. that at the end of the 5th year (counted from the Effective Date) the number of Subproject Agreements entered into should be 2, in respect of Part A.1 of the Project, and 15, in respect of Part A.2 of the Project;

(b) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, on or about March 15 and September 15 in each year a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project and each Subproject, during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the respective Subprojects, and the achievement of the objectives thereof during the period following such date; and

(c) review with the Bank, by April 15 and October 15 in each year, or such later date as the Bank shall request, the report referred to in paragraph (b) of this Section, and, thereafter, take or cause to be taken all measures required to ensure the efficient completion of each Subproject and the Project, and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Bank's views on the matter.

ARTICLE VI

Remedies of the Bank

Section 6.01. Pursuant to Section 6.02 (p) of the General Conditions, the following additional event is specified, namely that as a result of events which have occurred after the date of the Loan Agreement, a situation shall have arisen, be it as a result of a change in law or otherwise, which shall make it improbable, in the Bank's opinion and after consultation with the Borrower, that: (i) a given Participating Municipality will be able to perform its obligations under the applicable Technical Assistance Agreement; or (ii) a given Participating Municipality or the corresponding Water Utility, if required, Constructor/Operator or Operator, as the case may be, will be able to perform its respective obligations under the corresponding Subproject Agreement.

ARTICLE VII

Effective Date; Termination

Section 7.01. The following events are specified as additional conditions to the effectiveness of the Loan Agreement within the meaning of Section 12.01 (c) of the General Conditions:

(a) the PIU is fully operational for purposes of the Project and has been provided with an adequate team of experienced professionals, which shall include an additional procurement specialist and two additional financial management specialists, all in form and substance satisfactory to the Bank;

(b) a manual for the operation of the Project, satisfactory to the Bank, has been put into effect by MED through its General Directorate of Water Supply and Basic Sanitation;

(c) a model to be used for the preparation of Technical Assistance Agreements, satisfactory to the Borrower and the Bank, has been put into effect by PIU;

(d) a model to be used for the preparation of Subproject Agreements, to be signed between the Borrower and the Participating Municipality(ies), satisfactory to the Bank, has been put into effect by PIU;

(e) an environmental task force, comprising representatives of the Borrower's Ministry of the Environment and MED, shall have been established under terms of reference satisfactory to the Bank;

(f) the Project Agreement shall have been signed on terms and conditions satisfactory to the Bank; and

(g) the actions set forth in the action plan referred to in Section 4.02 (a) of this Loan Agreement shall have been complied with in a manner satisfactory to the Bank.

Section 7.02. The date March 18, 2002 is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VIII

Representative of the Borrower; Addresses

Section 8.01. The Minister of Finance and Public Credit of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 8.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance and Public Credit
Palacio de los Ministerios
Plaza San Agustín
Carrera 7A, No. 6-45, Piso 3
Bogotá
Colombia

Cable address:

MINHACIENDA

Telex:

43289 MHAC CO

Facsimile:

(571) 3509344

For the Bank:

International Bank for
Reconstruction and Development

1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:	Facsimile:
477-6391	248423 (MCI) or	(202)
INTBAFRAD	64145 (MCI)	
Washington, D.C.		

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

REPUBLIC OF COLOMBIA

By /s/ Luis Alberto Moreno
Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ David de Ferranti
Regional Vice President
Latin America and the Caribbean

SCHEDULE 1

Withdrawal of the Proceeds of the Loan

A. General

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Loan, the allocation of the amounts of the Loan to each Category and the percentage of expenditures for items so to be financed in each Category:

Category	Amount of the Loan Allocated (Expressed in Dollars)	% of Expenditures to be Financed
(1) Works under Subprojects for Parts A.1 and A.2 of the Project	26,500,000	93%
(2) Goods under Subprojects for Parts A.1 and A.2 of the Project	3,000,000	100% of foreign expenditures and 84 % of local expenditures
(3) Goods under Parts B,C and D of the Project	200,000	100% of foreign expenditures and 84% of local expenditures
(4) Consulting and training services procured through	7,300,000	100%

the Project Agreement for
Parts B, C and D of the
Project

(5)	Unallocated	3,000,000
	TOTAL	40,000,000

2. For the purposes of this Schedule:

(a) the term "foreign expenditures" means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower; and

(b) the term "local expenditures" means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawal shall be made in respect of:

(a) payments made for expenditures under any of the Categories in the Table, unless and until the Borrower shall have paid to the Bank in full the front-end fee referred to in Section 2.04 of this Agreement;

(b) payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding \$4,000,000, may be made in respect of Category (4) set forth in the Table on account of payments for expenditures incurred in connection with services under Part D.1 of the Project made not earlier than January 1, 2001; and

(c) payments made for expenditures under Categories (1) and (2) of the Table unless: (i) the information received by the Bank pursuant to paragraph (a) of Section 3.04 of this Agreement shows, in the opinion of the Bank, that the funds in the Project Account are adequate so as to meet, in a timely fashion, the immediate financial requirements of each Subproject for which the corresponding Subproject Agreement shall have been entered into by all the parties thereto and shall have come into force and effect; and (ii) the PIU has issued two models, satisfactory to the Bank, to be used for the preparation of Subproject Agreements (one to be signed between the Municipality(ies) and an Operator, and the other to be signed between said Municipality(ies) and a Constructor/Operator).

4. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditure for expenditures for goods and works under Subprojects and for goods and services under the Project Agreement which are not subject to prior review by the Bank pursuant to Section I, Part D.2 and Section II, Part D.2, both of Schedule 4 to this Agreement.

B. Special Account

1. The Borrower shall open and maintain in Dollars a special deposit account in Banco República, on terms and conditions satisfactory to the Bank.

2. After the Bank has received evidence satisfactory to it that the Special Account has been opened, withdrawals from the Loan Account of amounts to be deposited into the Special Account shall be made as follows:

(a) until the Bank shall have received: (i) the first Project Management Report referred to in Section 4.02 (b) of this Agreement; and (ii) a request from the Borrower for withdrawal on the basis of Project Management Reports, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) upon receipt by the Bank of a Project Management Report pursuant to Section 4.02 (b) of this Agreement, accompanied by a request from the Borrower for withdrawal on the basis of Project Management Reports, all further withdrawals shall

be made in accordance with the provisions of Annex B to this Schedule 1.

3. Payments out of the Special Account shall be made exclusively for Eligible Expenditures. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Bank shall reasonably request, furnish to the Bank such documents and other evidence showing that such payment was made exclusively for Eligible Expenditures.

4. Notwithstanding the provisions of Part B.2 of this Schedule, the Bank shall not be required to make further deposits into the Special Account:

(a) if the Bank determines at any time that any Project Management Report does not adequately provide the information required pursuant to Section 4.02 of this Agreement;

(b) if the Bank determines at any time that all further withdrawals should be made by the Borrower directly from the Loan Account; or

(c) if the Borrower shall have failed to furnish to the Bank within the period of time specified in Section 4.01 (b) (ii) of this Agreement, any of the audit reports required to be furnished to the Bank pursuant to said Section in respect of the audit of: (A) the records and accounts for the any Special Account; or (B) the records and accounts reflecting expenditures with respect to which withdrawals were made on the basis of Project Management Reports.

5. The Bank shall not be required to make further deposits into the Special Account in accordance with the provisions of Part B.2 of this Schedule if, at any time, the Bank shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Loan Account pursuant to Section 6.02 of the General Conditions. Upon such notification, the Bank shall determine, in its sole discretion, whether further deposits into the Special Account may be made and what procedures should be followed for making such deposits, and shall notify the Borrower of its determination.

6. (a) If the Bank determines at any time that any payment out of the Special Account was made for an expenditure which is not an Eligible Expenditure, or was not justified by the evidence furnished to the Bank, the Borrower shall, promptly upon notice from the Bank, provide such additional evidence as the Bank may request, or deposit into the Special Account (or, if the Bank shall so request, refund to the Bank) an amount equal to the amount of such payment. Unless the Bank shall otherwise agree, no further deposit by the Bank into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Bank determines at any time that any amount outstanding in the Special Account will not be required to cover payments for Eligible Expenditures during the six-month period following such determination, the Borrower shall, promptly upon notice from the Bank, refund to the Bank such outstanding amount.

(c) The Borrower may, upon notice to the Bank, refund to the Bank all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Bank made pursuant to sub-paragraph (a), (b) or (c) of this paragraph 6 shall be credited to the Loan Account for subsequent withdrawal or for cancellation in accordance with the provisions of the Loan Agreement.

Annex A to SCHEDULE 1

Operation of Special Account When Withdrawals Are Not Made On the Basis of Project Management Reports

1. For the purposes of this Annex:

The term "Authorized Allocation" means the amount of \$3,500,000 to be withdrawn from the Loan Account and deposited into the Special Account pursuant to paragraph 2 of this Annex; provided, however, that unless the Bank shall otherwise agree, said Authorized Allocation shall be limited to the amount of \$1,500,000, until the aggregate amount of withdrawals from the Loan Account, plus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General Conditions, shall equal or exceed the equivalent of \$5,000,000.

2. Withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Bank a request or requests for deposit into the Special Account of an amount or amounts which in the aggregate do not exceed the corresponding Authorized Allocation. On the basis of each such request, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account such amount as the Borrower shall have requested.

(b) For replenishment of the Special Account, the Borrower shall furnish to the Bank requests for deposit into the Special Account at such intervals as the Bank shall specify. Prior to or at the time of each such request, the Borrower shall furnish to the Bank the documents and other evidence required pursuant to Part B.3 of Schedule 1 to this Agreement for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for Eligible Expenditures. Each such deposit into the Special Account shall be withdrawn by the Bank from the Loan Account under one or more of the Eligible Categories.

3. The Bank shall not be required to make further deposits into the Special Account, once the total unwithdrawn amount of the Loan allocated to the Eligible Categories minus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General Conditions, shall equal the equivalent of twice the amount of the Authorized Allocation. Thereafter, withdrawal from the Loan Account of the remaining unwithdrawn amount of the Loan shall follow such procedures as the Bank shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Bank shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for Eligible Expenditures.

Annex B to SCHEDULE 1

Operation of Special Account When Withdrawals Are Made On the Basis of Project Management Reports

1. Except as the Bank may otherwise specify by notice to the Borrower, all withdrawals from the Loan Account shall be deposited by the Bank into the Special Account in accordance with the provisions of Schedule 1 to this Agreement. Each such deposit into the Special Account shall be withdrawn by the Bank from the Loan Account under one or more of the Eligible Categories.

2. Each application for withdrawal from the Loan Account for deposit into the Special Account shall be supported by a Project Management Report.

3. Upon receipt of each application for withdrawal of an amount of the Loan, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account an amount equal to the lesser of: (a) the amount so requested; and (b) the amount which the Bank has determined, based on the Project Management Report accompanying said application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such report; provided, however, that the amount so deposited, when added to the amount indicated by the said Project Management Report to be remaining in the Special Account, shall not exceed the equivalent of \$7,000,000.

SCHEDULE 2

Description of the Project

The objectives of the Project are: (a) to support water sector reform in the Borrower's territory by facilitating an increased participation of the private sector in the management and operation of Water Utilities, with the purpose of: (i) creating and maintaining an appropriate environment for improving the efficiency and sustainability of such Water Utilities; and (ii) providing Participating Municipalities, which choose to participate in the Project, with financial support to ensure the viability of their Water Utilities; (b) to expand the coverage of water supply and sewerage services provided in Participating Municipalities; (c) to facilitate the access to water and sewerage services by the population of low income areas in such Participating Municipalities; and (d) (i) to improve environmental protection practices in connection with the provision of water and sewerage services in the Borrower's territory; and (ii) to define rural water and sanitation policies, and to develop adequate methods for increasing coverage, both in connection with water and sewerage services in the Borrower's rural sector.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Bank may agree upon from time to time to achieve such objectives:

Part A: Investments in Participating Municipalities

1. Carrying out of Subprojects in Medium Size Municipalities in the Caribbean Region.
2. Carrying out of Subprojects in Small Municipalities in the Caribbean Region.
3. Carrying out of Subprojects in: (a) Medium Size Municipalities; or (b) Small Municipalities, both in regions of the Borrower other than the Caribbean Region.

Part B: Capacity Strengthening of Environmental Sector Management

1. Provision of advice on modification and strengthening of key environmental regulations, especially those currently existing for water quality and effluent discharge.
2. Establishment of sector-wide criteria for the environmental management of water supply and sanitation projects in the territory of the Borrower.
3. Stipulation of mandatory environmental requirements to be included in bidding documents and contracts involving private sector operations in the water and sanitation sector in the territory of the Borrower, including Subprojects.
4. Stipulation of methodologies and programs for environmental audits of water supply and sanitation facilities in the territory of the Borrower.
5. Strengthening of the environmental management capabilities of the Borrower's water sector as a whole, especially the Directorate of Water and Sanitation of MED.
6. Provision of advice on streamlining the rules and procedures for the granting of environmental licenses for water and sanitation services in the territory of the Borrower.
7. Sponsorship of training programs on environment for water supply and sanitation system operators and contractors in the territory of the Borrower.
8. Stipulation of public participation and community consultation criteria and procedures for water supply and sanitation projects in the territory of the Borrower.

Part C: Rural Water Supply and Sanitation Policy Development

Provision of technical assistance to support the development of rural water supply and sanitation sector policy, strategies and methods for incrementing water and

sanitation coverage by Municipalities and other local authorities in the Borrower's rural sector.

Part D: Project Management and Training, Technical Assistance, Studies and Supervision of works in connection with Subprojects

1. Maintenance of the PIU throughout Project execution, with a team of about 17 consultants who shall be trained and put in charge of providing technical assistance and training for, and overseeing activities in connection with, Subprojects including, for each Municipality which may be a candidate to become a Participating Municipality: (a) the provision of information and advice to interested Mayors and members of Municipal Councils in connection with Subprojects and the benefits and advantages available to Municipalities that become Participating Municipalities; and (b) the carrying out of public information and consultation campaigns in connection with Subprojects.

2. Provision of technical assistance to help the processing and monitoring of Subprojects for about 3 Medium Size Municipalities and about 25 Small Municipalities, such assistance to include in addition to the foregoing: (a) reviewing management and operation of the respective facilities; (b) reviewing the work of all consultants hired for preparing and structuring Subprojects (especially the POI and financial projections, bidding documents and process, including evaluation of proposals and recommendations on selection of the Operator, or Constructor/Operator, as the case may be); and (c) after the award, advising on the hiring of consulting firms to supervise each Operator's and Constructor/Operator's work.

* * *

The Project is expected to be completed by December 31, 2006.

SCHEDULE 3

Amortization Schedule

1. The following table sets forth the Principal Payment Dates of the Loan and the percentage of the total principal amount of the Loan payable on each Principal Payment Date (Installment Share). If the proceeds of the Loan shall have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined by the Bank by multiplying: (a) the total principal amount of the Loan withdrawn and outstanding as of the first Principal Payment Date; by (b) the Installment Share for each Principal Payment Date, such repayment amount to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

Payment Date	Installment Share (Expressed as a %)
On each February 15 and August 15	
Beginning February 15, 2009 through August 15, 2016	6.25%

2. If the proceeds of the Loan shall not have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined as follows:

(a) To the extent that any proceeds of the Loan shall have been withdrawn as of the first Principal Payment Date, the Borrower shall repay the amount withdrawn and outstanding as of such date in accordance with paragraph 1 of this Schedule.

(b) Any withdrawal made after the first Principal Payment Date shall be repaid on each Principal Payment Date falling after the date of such withdrawal in amounts determined by the Bank by multiplying the amount of each such withdrawal by a fraction, the numerator of which shall be the original Installment Share specified in

the table in paragraph 1 of this Schedule for said Principal Payment Date (the Original Installment Share) and the denominator of which shall be the sum of all remaining Original Installment Shares for Principal Payment Dates falling on or after such date, such repayment amounts to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

3. (a) Withdrawals made within two months prior to any Principal Payment Date shall, for the purposes solely of calculating the principal amounts payable on any Principal Payment Date, be treated as withdrawn and outstanding on the second Principal Payment Date following the date of withdrawal and shall be repayable on each Principal Payment Date commencing with the second Principal Payment Date following the date of withdrawal.

(b) Notwithstanding the provisions of sub-paragraph (a) of this paragraph 3, if at any time the Bank shall adopt a due date billing system under which invoices are issued on or after the respective Principal Payment Date, the provisions of such sub-paragraph shall no longer apply to any withdrawals made after the adoption of such billing system.

4. Notwithstanding the provisions of paragraphs 1 and 2 of this Schedule, upon a Currency Conversion of all or any portion of the withdrawn principal amount of the Loan to an Approved Currency, the amount so converted in said Approved Currency that shall be repayable on any Principal Payment Date occurring during the Conversion Period, shall be determined by the Bank by multiplying such amount in its currency of denomination immediately prior to said Conversion by either: (i) the exchange rate that reflects the amounts of principal in said Approved Currency payable by the Bank under the Currency Hedge Transaction relating to said Conversion; or (ii) if the Bank so determines in accordance with the Conversion Guidelines, the exchange rate component of the Screen Rate.

5. If the principal amount of the Loan withdrawn and outstanding from time to time shall be denominated in more than one Loan Currency, the provisions of this Schedule shall apply separately to the amount denominated in each Loan Currency, so as to produce a separate amortization schedule for each such amount.

SCHEDULE 4

Procurement

Section I. Procurement of Goods and Works

Part A: General

Goods and works shall be procured in accordance with the provisions of Section I of the "Guidelines for Procurement under IBRD Loans and IDA Credits" published by the Bank in January 1995 and revised in January and August 1996, September 1997 and January 1999 (the Guidelines) and the following provisions of Section I of this Schedule.

Part B: International Competitive Bidding

1. Except as otherwise provided in Part C of this Section, goods and works shall be procured under contracts awarded in accordance with the provisions of Section II of the Guidelines and paragraph 5 of Appendix 1 thereto.

2. The following provisions shall apply to goods and works to be procured under contracts awarded in accordance with the provisions of paragraph 1 of this Part B.

(a) Grouping of Contracts

To the extent practicable, contracts for goods and works shall be grouped in bid packages estimated to cost, respectively, more than the equivalent of \$250,000 and \$4,000,000 each.

(b) Notification and Advertising

The invitation to bid for each contract for works estimated to cost \$10,000,000 equivalent or more shall be advertised in accordance with the procedures applicable to large contracts under paragraph 2.8 of the Guidelines.

Part C: Other Procurement Procedures

1. National Competitive Bidding

Goods and works estimated to cost not more than \$250,000 and \$4,000,000 equivalent, respectively, per contract or per bid package, up to an aggregate amount not to exceed \$3,000,000 and \$15,000,000 equivalent, respectively, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines regarding national competitive bidding procedures. Bidding documents acceptable to the Bank and in a standardized form for the Project shall be also used in the procurement under this Part C.1. Without limitation to any other provision of this Schedule or the Guidelines or Schedule 5 to this Loan Agreement, the following shall apply to the procurement of goods or works to be undertaken pursuant to this Part C.1:

(a) All bidders, irrespective of whether they are foreigners or Colombians, will be treated equally and, particularly, no preference will be granted to any bidder or group of bidders for bid evaluation purposes. Bidders shall be allowed to submit their bids by hand or through the post office or private mailing services. There shall not be any requirement for any bidder to show evidence of the bidder's registration in any public registry, chamber of commerce or similar entity, whether in Colombia or elsewhere, or to appoint a representative domiciled in Colombia, unless and until such bidder is awarded the corresponding contract.

(b) Bids shall be opened in a public meeting to which bidders and their representatives shall be allowed to attend if they so wish. Date, time and place for the opening meeting shall be set forth in the bidding documents. Bid opening shall coincide with, or take place promptly after, the final date and time of the period for bid submission stipulated in the bidding documents.

(c) Each bid shall be evaluated and the corresponding contract awarded to the responsive bidder who meets appropriate technical and financial standards of capability and whose bid has been determined to be the lowest evaluated bid. Such determination shall be made exclusively on the basis of the specifications, conditions and evaluation criteria stipulated in the bidding documents. If any factor additional to the amount or amounts of each bid is to be considered in bid evaluation, such factor or factors and the quantified manner on which they will be applied for purposes of determining the lowest evaluated bid shall be precisely stipulated in the bidding documents. For purposes of bid evaluation and comparison, the only bid amount or amounts to be used as a factor shall be the bid amount or amounts as quoted in the corresponding bid, including correction of arithmetic errors.

(d) The provisions of paragraph 2.46 of the Guidelines shall fully apply and, more specifically, bids shall not be disclosed to persons other than the persons officially charged with the task of comparing and/or evaluating the bids while they are performing their official duties, without the corresponding bidder's written authorization. Moreover, bidders shall not be required to provide such authorization as a condition to be entitled to bid. This confidentiality requirement shall apply until the award of contract is notified to the successful bidder. Thereafter, confidentiality of the bids shall be limited to those bid portions for which confidentiality has been specifically requested by the bidder in question.

2. Shopping

Goods estimated to cost less than \$50,000 equivalent per contract, up to an aggregate amount not to exceed \$500,000 equivalent, may be procured under contracts awarded on the basis of international or national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

3. Procurement of Small Works

Works estimated to cost less than \$350,000 equivalent per contract, up to an

aggregate amount not to exceed \$2,000,000 equivalent, may be procured under lump-sum, fixed-price contracts awarded on the basis of quotations obtained from three (3) qualified domestic contractors in response to a written invitation. The invitation shall include a detailed description of the works, including basic specifications, the required completion date, a basic form of agreement acceptable to the Bank, and relevant drawings, where applicable. The award shall be made to the contractor who offers the lowest price quotation for the required work, and who has the experience and resources to complete the contract successfully.

4. BOO/BOT/BOOT Procurement

In respect of each Subproject under Part A.2 of the Project, the terms and conditions of the draft Subproject Agreement and the rest of the bidding documents for such Subproject, including the corresponding POI, shall describe the construction or rehabilitation works to be undertaken, in connection with the Water Utility in question, by the corresponding Constructor/Operator. Each Constructor/Operator: (a) shall be selected, for such Subproject, on the basis of national competitive bidding procedures in accordance with the provisions of paragraphs 3.3, 3.4 and 3.13 (a) of the Guidelines; and (b) shall be responsible for the execution of part or all of the corresponding works in its role as constructor. Each Constructor/Operator in question shall start performing under the corresponding Subproject Agreement by discharging its responsibilities as operator of then current water system. Once the construction phase commences the two types of responsibilities (as constructor and as operator) will overlap until a point in time in which, by the acceptance by the corresponding Participating Municipality of all the works to be executed by the Constructor/Operator, and without prejudice to any subsisting legal responsibility as constructor for the works so executed, the Constructor/Operator in question will return to one single role, that of operator. Subsequently, at any point in time, and subject to the provisions of the applicable Subproject Agreement and POI, and the then current circumstances, if the Constructor/Operator in question, as operator, determines that there is need for additional works, then, subject to the decision of the Participating Municipality in question, the additional works shall be procured in accordance with the applicable procedures of the Constructor/Operator, including the execution of such additional works by the Constructor/Operator itself.

Part D: Review by the Bank of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Bank for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Guidelines. Procurement of all goods and works shall be undertaken in accordance with such procurement plan as shall have been approved by the Bank, and with the provisions of said paragraph 1.

2. Prior Review

(a) With respect to each contract to be procured under Part B. 1 of this Section (regardless of its Dollar equivalent value, and including all contracts selected under international competitive bidding procedures pursuant to Part C.4 (a) of this Section), and to each contract for works for Subprojects under Part A.2 of the Project to be procured under Part C.1 of this Section and estimated to cost the equivalent of \$350,000 or more, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

(b) With respect to each contract for goods to be procured in accordance with the procedures referred to in Part C.1 above and estimated to cost the equivalent of \$ 50,000 or more, the procedures referred to in paragraph 2 (a) of this Part D shall also apply.

(c) With respect to each selection of Operator for a given Subproject under Part A.1 of the Project, the procedures referred to in paragraph 2 (a) of this Part D shall also apply.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Guidelines shall apply.

Section II. Employment of Consultants

Part A: General

Consultants' services shall be procured in accordance with the provisions of the Introduction and Section IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" published by the Bank in January 1997 and revised in September 1997 and January 1999 (the Consultant Guidelines) and the following provisions of Section II of this Schedule.

Part B: Quality- and Cost-based Selection

1. Except as otherwise provided in Part C of this Section, consultants' services shall be procured under contracts awarded in accordance with the provisions of Section II of the Consultant Guidelines, paragraph 3 of Appendix 1 thereto, Appendix 2 thereto, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

2. The following provisions shall apply to consultants' services to be procured under contracts awarded in accordance with the provisions of the preceding paragraph. The short list of consultants for services under of the Project, including training, estimated to cost less than \$200,000 equivalent per contract, may comprise entirely national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Part C: Other Procedures for the Selection of Consultants

1. Selection Under a Fixed Budget

Services for studies estimated to cost less than \$200,000 equivalent may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.5 of the Consultant Guidelines.

2. Selection Based on Consultant's Qualifications

Services for studies estimated to cost less than \$50,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.7 of the Consultant Guidelines.

3. Individual Consultants

Services for tasks that meet the requirements set forth in paragraph 5.1 of the Consultant Guidelines shall be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultant Guidelines.

Part D: Review by the Bank of the Selection of Consultants

1. Selection Planning

Prior to the issuance to consultants of any requests for proposals, the proposed plan for the selection of consultants under the Project shall be furnished to the Bank for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Consultant Guidelines. Selection of all consultants' services shall be undertaken in accordance with such selection plan as shall have been approved by the Bank, and with the provisions of said paragraph 1.

2. Prior Review

(a) With respect to each contract for the employment of consulting firms procured under Part B of this Section estimated to cost the equivalent of \$200,000 or more, and those procured under Part C.1 of this Section, the procedures set forth in paragraphs 1, 2 (other than the third subparagraph of paragraph 2 (a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(b) With respect to each contract for the employment of consulting firms procured under Part C.2 of this Section, the procedures set forth in paragraphs 1, 2 (other than the second subparagraph of paragraph 2 (a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(c) With respect to each contract for the employment of individual consultants estimated to cost the equivalent of more than \$50,000, the qualifications, experience, terms of reference and terms of employment of the consultants shall be furnished to the Bank for its prior review and approval. The contract shall be awarded only after the said approval shall have been given.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply.

SCHEDULE 5

Implementation Program

1. Introduction

The core and principal purpose of the Project is the carrying out of Subprojects in Participating Municipalities: (a) in the Caribbean Region; and (b) in regions of the Borrower's territories other than the Caribbean Region, and the increased provision of financial support to said Subprojects from financial sources other than, and as an alternative to, the Borrower's or, to some extent, the Municipality (ies)' in question. The provisions of this Schedule shall provide the framework for certain activities related to the Subproject cycle, from identification to execution, and shall apply to all Subprojects, with the exception of those provisions concerning or referring exclusively to the Loan or Loan proceeds, which shall apply only to Subprojects in the Caribbean Region.

2. Subprojects

Each Subproject in a Participating Municipality will consist in the execution of civil works and the acquisition and installation of equipment, both for water supply and sanitation purposes, and the management and operation of the corresponding facilities, all of which shall be financed with a combination of funds provided from different sources, which may vary for every Subproject and will consist of one or more of the following, as the case may be:

(a) a contribution from the Borrower to the cost of said infrastructure investments in the Subproject in question, to the extent the investments in question cannot be fully financed by the private sector under (b) (i) because the Tariff levels will not be sufficient to recover the cost of the private sector investments in question;

(b) (i) the investment funds committed by every Operator of Subprojects in Medium Size Municipalities or by some or all of the Constructor/Operators of Subprojects in Small Municipalities, under the corresponding Subproject Agreement, which funds said Operators or Constructor/Operators, as the case may be, expect to recover from the income to be earned as managers of the Water Utility in question; and (ii) the contributions committed by the corresponding Participating Municipality or Municipalities under the corresponding Subproject Agreement, for each fiscal year during the agreed term for the carrying out of said Subproject, derived from: (A) a given portion of such Municipality's or Municipalities' Law 60 Income; or (B) other

alternative source or sources available to the Municipality or Municipalities in question.

3. Eligibility Criteria

The following eligibility criteria shall be met by every Municipality wishing to become a Participating Municipality. The General Director of Water and Basic Sanitation of MED, as provided for in the Manual, will decide on each petition received in order to determine whether the Municipalities in question (individually or grouped) qualify as a Small Municipality or Medium Size Municipality. Since the participation of Municipalities in the Project will be demand driven, based on the premise of first come, first served, while the funds available will be limited, there will be a need for establishing a ranking order. Said order shall be determined by the date stipulated under the corresponding Technical Assistance Agreement to begin, in accordance with the terms of the agreement in question, the activities provided for under said agreement. Every Technical Assistance Agreement to be entered into shall be drafted following the Model for that type of agreement to be accepted for purposes of compliance with the effectiveness condition stipulated under paragraph (c) of Section 7.01 of this Loan Agreement. Any material change in said model or departure from its provisions shall require the prior approval of the Bank. All other decisions in connection with the acceptance or rejection of a given Municipality shall be made by MED's General Director of Water and Basic Sanitation, as provided for in the Manual.

(a) Eligibility criteria for Small Municipalities:

- (i) Population shall be within the range of more than 2,000 but not more than 12,000 inhabitants; provided, however, that on an exceptional basis, as provided for in the Manual, Municipalities with somewhat larger Populations, particularly in the case of a group of Municipalities served or proposed to be served by a Regional Water Utility, may be deemed a Small Municipality (as long as the excess Population in question shall not exceed the high limit of the range described above by more than 20%);
- (ii) the level of low income Population in the Municipality in question, as determined by PIU, should represent an INDEMUN Index Value of 5 or lower;
- (iii) the water coverage rate, as determined by PIU, is lower than 80%;
- (iv) the design of the works, especially in the case of sewerage: (A) will have been based on an appropriate technology for low cost wastewater collection network methodologies such as: (I) the methodology which was developed in Brazil and is in use in various cities in that country, including Brasilia, such methodology commonly referred to as "condominial approach"; and (II) the methodology applied in Colombia commonly known as "asas" (alcantarillados sin arrastre de sólidos); (B) will have excluded any possibility of resettlement for each member of the Population involved, caused by the Subproject in question; and (C) will have required that works be carried out in accordance with the environmental urban guidelines to be set forth in the Manual;
- (v) the subsidy per connection is capped with a value that cannot be higher than the equivalent of 500 Dollars, such value to be calculated in the manner to be provided for in the Manual;
- (vi) the corresponding Mayor, with the approval of the Municipal Council of the Municipality (or of each Municipality, as the case may be) in question, whenever such approval is required or merely deemed convenient as provided for in the Manual, shall have entered into the corresponding Technical Assistance Agreement which, inter alia, shall include commitments to the effect that: (A) the proposed model for private sector participation in the provision of water and sewerage services has been accepted and that the Municipality or each of the grouped Municipalities, as the case may be, shall repay 80% of the costs of preparation for said participation if the Municipality or Municipalities fail to fulfill their commitments under said agreement or somehow

terminate or rescind, or cause the termination or rescission of, said agreement; (B) the Tariff for said provision of services shall be brought to levels that will ensure coverage of, at least, administration, operation and maintenance; (C) an amount equivalent to a certain and specific percentage of the Law 60 Income corresponding to the Municipality in question or to each of the Municipalities in question, ranging from 8% to 20%, shall be provided by such Municipality(ies) either from such Municipality's(ies') Law 60 Income or from other specific municipal resources; (D) the corresponding Mayor(s) shall carry out a campaign aimed at informing the community of the Municipality(ies) in question about the proposed reform, the private sector participation model to be used, and the principles of the Tariff adjustment necessarily involved; and (E) the corresponding Subproject Agreement shall include: (I) the Constructor/Operator's obligations to prepare the environmental assessment of the required construction and/or rehabilitation works under, and to carry out contemporaneously with the execution of said works an environmental concern mitigation plan for, the Subproject, both of which shall require the approval of the Bank prior to their implementation; and (II) the corresponding Municipality's(ies') obligation to obtain the applicable environmental license or licenses, if and when required; and

(vii) the corresponding Mayor and Local Water Utility or Regional Utility, as the case may be, have agreed to the subsidy principles of the applicable Subproject, i.e. that the subsidies will only benefit the poorer segments of the Population, such segments to be determined by the residences classified by the Permanent Committee of Socioeconomic Stratification of the Municipality in question, using the methodologies elaborated by the Borrower's National Planning Department, as belonging to the three lower strata (1, 2 and 3), all in accordance with and within the terms of the Borrower's Laws 142 of 1994 and 505 of 1999.

(b) Eligibility Criteria for Medium-Size Municipalities other than those included in (c) below:

(i) Population shall be within the range of more than 12,000 but not more than 300,000 inhabitants provided, however, that on an exceptional basis and as provided for in the Manual, Municipalities with somewhat larger Populations, particularly in the case of a group of Municipalities served or proposed to be served, by a Regional Water Utility, may be deemed a Medium Size Municipality (as long as the excess Population shall not exceed the high limit of the range by more than 20%);

(ii) the corresponding Mayor and Local Water Utility or Regional Utility, as the case may be, have agreed to the subsidy principles of the applicable Subproject, i.e. that the subsidies will only benefit the poorer segments of the Population, such segments to be determined by the residences classified by the Permanent Committee of Socioeconomic Stratification of the Municipality in question, using the methodologies elaborated by the Borrower's National Planning Department, as belonging to the three lower strata (1, 2 and 3), all in accordance with and within the terms of the Borrower's Laws 142 of 1994 and 505 of 1999;

(iii) the design of the works: (A) will have excluded any possibility of Population resettlement; and (B) will have required works to be carried out in accordance with the environmental urban guidelines of the Manual;

(iv) the investment per connection is capped with a value that cannot be higher than the equivalent of 250 Dollars, such value to be calculated in the manner to be provided for in the Manual; and

(v) the corresponding Mayor(s) with the approval of the applicable Municipal Council(s), whenever such approval is required or merely

deemed convenient, shall agree to enter into the corresponding Technical Assistance Agreement which, inter alia, shall include commitments to the effect that: (A) the proposed model for private sector participation in the provision of water and sewerage services has been accepted and that the Municipality in question or each of the grouped Municipalities, as the case may be, shall repay 80% of the costs of preparation for said participation if such Municipality or Municipalities fail to fulfill their commitments under said agreement or somehow terminate or rescind said agreement or cause the termination of rescission thereof; (B) the Tariff for the said provision of services shall be brought to levels that will ensure the coverage of, at least, administration, operation and maintenance costs and will further reach, if not yet attained, the maximum socially acceptable levels so as to make possible a contribution to the corresponding water system expansion costs; (C) an amount equivalent to a certain and specific percentage of the Law 60 Income corresponding to the Municipality or to each of the Municipalities in question, ranging from 8% to 20%, shall be provided by such Municipality(ies) either from such Municipality'(ies') Law 60 Income or other specific municipal resources; (D) the Mayor(s) of the corresponding Municipality(ies) shall carry out a campaign aimed at informing the community of the Municipality(ies) in question about the proposed reform, the private sector participation model to be used, and the principles of the Tariff adjustment necessarily involved; and (E) the corresponding Subproject Agreement shall include the following Operator's obligations: (I) to prepare the environmental assessment of the required construction and/or rehabilitation works under, and to carry out contemporaneously with the said works an environmental concern mitigation plan for, the Subproject, both of which shall require the approval of the Bank prior to their implementation; and (II) the corresponding Municipality's(ies) obligation to obtain the applicable environmental license or licenses, if and when required.

(c) Eligibility Criteria for Medium-Size Municipalities under Part A.1 and Part A.3 (a) of the Project which, as of the Effective Date have on-going contracts involving private sector participation in the management and operation of Water Utilities, provided that the parties to said contracts are agreeable to modify, if necessary, certain terms and conditions of the corresponding contracts in order to make them eligible for financing under the Project:

- (i) that the Operator shall have been selected through a competitive bidding process acceptable to the Bank;
- (ii) that the agreed Tariff levels, and the amount of Borrower's or Municipality'(ies') resources to be provided, for the proposed Early Subproject in question, are compatible with the provisions of (b) (v) (B) above and (b) (v) (C) above, respectively or, alternatively, that the parties to the Subproject Agreement are willing to bring said Tariff and amounts to the required levels;
- (iii) if and when necessary, that the proposed Operator and the Municipality or Municipalities involved agree: (A) to modify the performance indicators stipulated in the contract for the proposed Early Subproject, so as to add indicators for low income areas; and (B) to introduce to said contract such other amendments as shall be required by the Borrower, acting through MED, and the Bank; and
- (iv) that all other criteria under (b) (i), (b) (ii), (b) (iii) and (b) (iv) above, shall have been met.

4. Technical Assistance and Subproject Agreements

Each Municipality that wishes to participate in the Project and meets the criteria for eligibility stipulated in paragraph 3 of this Schedule shall enter into a Technical Assistance Agreement with the Borrower, using, for that purpose the Model prepared by the Borrower and accepted by the Bank for purposes of compliance with the effectiveness conditions stipulated under Section 7.01 (c) of this Agreement. Such Model shall not be changed without the prior approval of the Bank and, unless the

change or changes in question had been accepted in the Bank for any further use of the Model, said changes shall not be used by other Municipalities without the prior approval by the Bank. The PIU shall provide the technical assistance required by the Participating Municipality in question and the respective costs shall be defrayed with proceeds of the Loan allocated to Category (4) of the Table.

Once a Technical Assistance Agreement shall have become effective, the services of engineering and financial consultants shall be hired by the Participating Municipality in question to prepare, respectively, the POI and the financial projections, both for the corresponding Water Utility to be privatized. The PIU, in cooperation with the authorities of the Participating Municipality in question, will incorporate the investment and financial data produced with the technical assistance into the corresponding draft Subproject Agreement to be entered into between the Borrower and/or the Participating Municipality and the selected Operator or Constructor/Operator in question. For that purpose, the PIU shall use the corresponding Model to the maximum extent possible, as well as the model bidding documents approved by the Bank so as to be used in the bidding process that will be followed in order to select the corresponding Operator or Constructor/Operator, as the case may be, a bidding process that will require, as well, the approval of the Bank in respect of Parts A.1 and A.2 of the Project in conformity with the provisions of Part D.2 (a) and (c) of Section I of Schedule 4 hereto.

The investment to be made in the Subproject by the selected Operator or Constructor/Operator will depend on the rate levels of the Adjusted Tariff of the Participating Municipality in question, since the basic principle of the Subproject contract is that the investment commitment of the Operator or Constructor/Operator shall be compatible with the level of income to be earned under the Adjusted Tariff from the users of the water and sewerage services in question.

The proceeds of the Loan allocated to each Participating Municipality will be determined on the basis of the financial model utilized during the preparation of the Subproject in question, subject to the degree of progress achieved by the Municipality in question in the preparation of such Subproject and the availability of Loan proceeds. If the amount of Loan proceeds requested by the winning bidder during the bidding process to select an Operator for such Project is not available, the amount to be provided will at least ensure the sustainability of the Subproject. The proceeds in question shall not be transferred to said Operator, but rather used to finance the works considered of high priority by said Operator to the extent approved by the authorities of the Participating Municipality in question and by the PIU.

5. Flow of funds

The proceeds of the Loan to be used for the financing of Parts A.1 and A.2 of the Project, shall flow first into the Special Account upon receipt by the Bank of satisfactory withdrawal applications from the Borrower for such proceeds.

(a) Part A of the Project:

The Administrator Account and the Project Account shall receive all funds allocated, respectively: (i) for goods and works for Subprojects under Parts A. 1 and A.2 of the Project from Loan proceeds; and (ii) for goods and works for Subprojects under Part A.3 of the Project, from Borrower's counterpart funds:

- (A) The funds flowing through the Administrator Account shall be Loan proceeds first withdrawn from the Loan Account and deposited into the Special Account, with the specific purpose of defraying expenditures eligible for financing under the Loan and incurred (or to be incurred) in the carrying out of the aforesaid Subprojects under Parts A.1 and A.2 of the Project. In no case may proceeds from the Special Account be deposited in the Administrator Account if such proceeds to be deposited exceed the amount that would be necessary to maintain in the said Administrator Account funds sufficient to cover no more than those Project expenditures under Subprojects for Parts A.1 and A.2 of the Project expected to be incurred during the thirty consecutive calendar days immediately after such deposit shall be made.
- (B) With the same thirty days restriction referred to above: (I) a portion of the Loan proceeds deposited in the Administrator Account to finance one or more specific

Subprojects under Part A.1 of the Project shall flow to the sub-account of a Subsidiary Trust Account opened specifically for funding expenditures under a given specific Subproject under Part A.1 of the Project; and (II) the remaining portion of Loan proceeds so deposited in the Administrator Account shall be used to make direct payments to the Constructor/Operator of each Subproject under Part A.2 of the Project for specific expenditures for goods or works under such Subproject.

- (C) Law 60 Income and/or funds from other resources of the Participating Municipality in question may result in additional sources to fund either: (I) Subprojects under Part A. 1 of the Project through the corresponding sub-account of the Subsidiary Account from which payments shall be made to constructors and suppliers for such Subprojects; or (II) Subprojects under Part A.2 of the Project by means of direct payments to the Constructor/Operators of each such Subproject.
- (D) (I) A portion of the Borrower's counterpart funds deposited in the Project Account to finance one or more specific Subprojects under Part A.3 (a) of the Project shall flow therefrom to the sub-account of a Subsidiary Trust Account opened specifically for funding expenditures under a given specific Subprojects under Part A.3 (a) of the Project; and (II) the remaining portion shall be used to make direct payments to the Constructor/Operator of each Subproject under Part A.3 (b) of the Project for specific expenditures for goods or works under such Subproject.
- (E) Law 60 Income and/or funds from other resources of the Participating Municipality in question may result in additional sources to fund either: (I) Subprojects under Part A.3 (a) of the Project through the corresponding sub-account of the Subsidiary Account from which payments shall be made to constructors and suppliers for such Subprojects; or (II) Subprojects under Part A.3 (b) of the Project by means of direct payments to the Constructor/Operators of each such Subproject.

(b) Parts B, C and D of the Project:

The Designated Account for Technical Assistance shall receive all funds allocated under Categories (3) and (4) of the Table.

The funds flowing through the said Designated Account shall be Loan proceeds first withdrawn from the Loan Account and deposited into the Special Account with the specific purpose of defraying expenditures eligible for financing under the Loan and incurred in the carrying out of Parts B, C and D of the Project, which include technical assistance services to be provided in connection with the preparation and execution of Subprojects under the Project. In no case may proceeds from the Special Account be deposited in the said Designated Account if such proceeds to be deposited exceed the amount that would be necessary to maintain in the said Designated Account funds sufficient to cover no more than Project expenditures under said Parts of the Project expected to be incurred during the thirty consecutive calendar days immediately after such deposit shall be made.

In the case of unexpected situations that, in the Bank's opinion, impede, or otherwise create significant delays in the aforesaid flow of funds procedures, the Bank may undertake to make direct payments with Loan proceeds to providers of goods or services under the Project (other than Part A.3 thereof), or to the Borrower so as to reimburse Borrower's payments to such providers.



