

CONFORMED COPY

LOAN NUMBER 4786 IND

Loan Agreement

(Urban Sector Development Reform Project)

between

REPUBLIC OF INDONESIA

and

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

Dated October 20, 2005

LOAN NUMBER 4786 IND

LOAN AGREEMENT

AGREEMENT, dated October 20, 2005, between REPUBLIC OF INDONESIA (the Borrower) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) 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

(B) the Borrower intends to contract from Japan a grant under the Policy and Human Resources Development Fund (PHRD) to be administered by the Bank, in an amount equivalent to five million United States dollars (US\$5,000,000) (hereinafter, the PHRD Grant) to assist in financing Part A of the Project, on the terms and conditions set forth in an agreement to be entered into between the Borrower and the Bank (hereinafter, the PHRD Grant Agreement);

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 Single Currency Loans" of the Bank, dated May 30, 1995 (as amended through May 1, 2004) with the following modification (the General Conditions) constitute an integral part of this Agreement: Section 6.03(c) of the General Conditions is amended by replacing the words "corrupt or fraudulent" with the words "corrupt, fraudulent, collusive or coercive".

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) "Additional Participating ULG" means a Kabupaten or Kota, other than a Participating ULG, selected by the Borrower for participation in Parts A.1 and B of the Project in accordance with the eligibility and selection criteria set forth in the Project

Management Manual and in accordance with paragraph 5 of Schedule 5 to this Agreement.

(b) “Additional Sub-project ” means a project carried out or to be carried out by an Additional Participating ULG under Part B of the Project as part of its investment plan included in its PJM, which project is eligible for financing in part out of the proceeds of a Sub-project Loan in accordance with the provisions of paragraph 5 of Schedule 5 to this Agreement.

(c) “APBD” means the budget of a local government of the Borrower.

(d) “BAPPENAS” means the Borrower’s National Development Planning Agency, and any successor thereto.

(e) “Bupati” means the chief executive of a Kabupaten.

(f) “CPMU” means the project unit established and maintained within the Directorate General of Urban and Rural Development of MPW in accordance with the provisions of paragraph 1 of Schedule 5 to this Agreement, responsible for the overall management and coordination of the Project.

(g) “DPRD” means the local legislative assembly of a Kabupaten or a Kota.

(h) “Displaced Person” means a person who, on account of the execution of Part B of the Project, has experienced or would experience direct economic and social impacts caused by: (i) the involuntary taking of land, resulting in: (A) relocation or loss of shelter; (B) loss of assets or access to assets; or (C) loss of income sources or means of livelihood, whether or not such person must move to another location; or (ii) the involuntary restriction of access to legally designated parks and protected areas, resulting in adverse impacts on the livelihood of such person, and “Displaced Persons” means, collectively, all such Displaced Persons.

(i) “Eligible Categories” means Categories 1 and 2 set forth in the table in Part A.1 of Schedule 1 to this Agreement.

(j) “Eligible Expenditures” means the expenditures for goods, works and services referred to in Section 2.02 of this Agreement.

(k) “Financial Monitoring Report” or “FMR” means each report prepared in accordance with Section 4.02 of this Agreement.

(l) “Fiscal Year” and “FY” mean the Borrower’s fiscal year commencing January 1 and ending December 31.

(m) “Isolated Vulnerable Persons” means those social groups in Indonesia that have a distinct social and cultural identity, and that are susceptible to being disadvantaged in the development process induced by the Project or any part thereof.

(n) “Kabupaten” means a district, an administrative division of the Borrower.

(o) “Kepmen 35” means the Borrower’s Decree MOF-No.35/KMK.072/2002 or any successor legislation or decree thereto setting forth provisions for the on-lending and on-granting of funds borrowed by, or granted to, the Borrower from official development assistance sources.

(p) “MPW” means the Ministry of Public Works of the Borrower and any successor thereto.

(q) “Kota” means a municipality, an administrative division of the Borrower.

(r) “MOF” means the Borrower’s Ministry of Finance and any successor thereto.

(s) “IMSC” means the inter-ministerial steering committee established pursuant to Ministerial Decree 257/M.PN/05/2003 of the Minister of BAPPENAS, responsible for providing overall project supervision and policy coordination and guidance to achieve the objective of improving urban services in Participating ULGs.

(t) “Participating ULGs” means Kabupaten Musi Banyuasin, Kabupaten Manokwari, Kabupaten Parigi Muotong, Kabupaten Sidendeng Rappang, Kabupaten Sleman, Kota Blitar, Kota Cimahi, Kota Depok, Kota Palu, Kota Parepare, Kota Palopo, Kota Semarang and Kota Yogyakarta, and “Participating ULG” means any one of said Participating ULGs.

(u) “PIUs” means the project implementation units, established in accordance with the provisions of paragraph 3 of Schedule 5 to this Agreement and pursuant to decrees of a Bupati/Walikota of each Participating ULG, within those local government departments assigned with responsibility for carrying out Project implementation activities in accordance with the provisions of the Project Management Manual.

(v) “PJM” means a Program Jangka Menengah, the five-year development program prepared by a Participating ULG and an Additional ULG through a participatory process, including local stakeholders, pursuant to the urban development strategy prepared by such Participating ULG or Additional ULG, as the case may be, under Part A.1 of the Project, consisting of an urban reform agenda, a capacity building plan, and an investment plan.

(w) “PMU” means the Kabupaten/Kota level project management units established within a Participating ULG, in accordance with the provisions of paragraph 3 of Schedule 5 to this Agreement and pursuant to a decree of the Bupati/Walikota, responsible for the coordination and management of Project implementation at the Kabupaten/Kota level in accordance with the provisions of the Project Management Manual.

(x) “PPMU” means the Province-level project management unit established within the provincial local government of each of the PPMU Provinces in accordance with the provisions of paragraph 3 of Schedule 5 to this Agreement and pursuant to a decree of the Governor thereof, responsible for the coordination and management of Project implementation at the provincial level in accordance with the provisions of the Project Management Manual.

(y) “PPMU Provinces” means the Borrower’s provinces of Central Sulawesi, South Sulawesi, South Sumatra and West Java and the Borrower’s Special Province of Yogyakarta, in each of which a PPMU is to be established in accordance with the provisions of paragraph 3 to Schedule 5 to this Agreement and pursuant to a decree of the Governor thereof.

(z) “Procurement Plan” means the Borrower’s procurement plan, conveyed in the letter no. HL.02.02.DK/144 dated April 11, 2005, covering the initial eighteen (18) month period of Project implementation, as the same shall be updated from time to time in accordance with the provisions of Section 3.02 to this Agreement, to cover succeeding eighteen (18) month periods (or longer) of Project implementation.

(aa) “Project Management Manual” means the manual setting forth the project management procedures to be followed in the implementation of the Project, adopted by the IMSC pursuant to the provisions of Section 6.01(b) of, and paragraph 4 of Schedule 5 to, this Agreement, as such manual may be amended from time to time with the prior agreement of the Bank.

(bb) “Qualifying Urban Reform Action Plan” means an urban reform action plan prepared by: (i) a Participating ULG in accordance with the criteria set forth in the Project Management Manual; or (ii) an Additional ULG in accordance with the provisions of paragraph 5 of Schedule 5 to this Agreement, in each case consisting of a plan for reforms in public procurement, financial management and public decision-making and information disclosure policies and processes.

(cc) “Report-based Disbursements” means the Borrower’s option for withdrawal of funds from the Loan Account referred to in paragraph 4 of Part A of Schedule 1 to this Agreement.

(dd) “Safeguards Framework” means the framework adopted by the Borrower through MPW pursuant to Letter No. HL.0202.DK/144 of March 31, 2005, of

the Director General of Urban and Rural Development, MPW, on the Implementation of the Safeguards Framework for the Urban Sector Development and Reform Project, setting forth the measures and actions to be taken during the implementation of Part B of the Project: (i) to eliminate or offset adverse environmental impacts or to reduce such impacts to acceptable levels; (ii) to provide compensation, rehabilitation and resettlement assistance to Displaced Persons; and (iii) for: (A) the informed involvement of Isolated Vulnerable People, through a process of informed participation, in the design and implementation of each Sub-project to be, or being, carried out in a location in which such people reside or use for their livelihood; and (B) designing and implementing mitigation measures on possible impacts of the Project on Isolated Vulnerable People which are socially and culturally acceptable to them, as such framework may be amended from time to time with the prior agreement of the Bank.

(ee) “Safeguards Plans” means the plans identified in Part C of the Annex to Schedule 5 to this Agreement and prepared in accordance with the provisions of the Safeguards Framework, as such plans may be amended from time to time with the prior agreement of the Bank; and “Safeguard Plan” means any one of said Safeguard Plans.

(ff) “Special Account” means the account referred to in Part B of Schedule 1 to this Agreement.

(gg) “Sub-project Loan” means a loan made or to be made available by the Borrower through MOF out of the proceeds of the Loan to a Participating ULG or an Additional Participating ULG to finance part of the cost of a Sub-project or an Additional Sub-project, as the case may be, pursuant to the provisions of paragraph 5 of Schedule 5 to this Agreement and of the Annex to said Schedule 5.

(hh) “Sub-project Loan Agreement” means an agreement entered into between the Borrower through MOF and a Participating ULG or an Additional Participating ULG for the purposes of providing a Sub-project Loan to finance part of the costs of a Sub-project or an Additional Sub-project, as the case may be, under terms and conditions which shall have been approved by the Bank, which shall include the terms and conditions set out in paragraph 2 of Part A of the Annex to Schedule 5 to this Agreement.

(ii) “Sub-project” means a project carried out or to be carried out by a Participating ULG under Part B of the Project as part of its investment plan included in its PJM.

(jj) “Walikota” means the chief executive of a Kota.

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 this Agreement, an amount equal to forty five million Dollars (\$45,000,000).

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 goods, works and services required for the Project described in Schedule 2 to this Agreement and to be financed out of the proceeds of the Loan and in respect of the fee referred to in Section 2.04 of this Agreement.

Section 2.03. The Closing Date shall be June 30, 2011, 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 one percent (1%) of the amount of the Loan, subject to any waiver of a portion of such fee as may be determined by the Bank from time to time. On or promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of such fee.

Section 2.05. The Borrower shall pay to the Bank a commitment charge at the rate of three-fourths of one percent ($3/4$ of 1%) per annum on the principal amount of the Loan not withdrawn from time to time.

Section 2.06. (a) The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, at a rate for each Interest Period equal to LIBOR Base Rate plus LIBOR Total Spread.

(b) For the purposes of this Section:

- (i) "Interest Period" means the initial period from and including the date of this Agreement to, but excluding, the first Interest Payment Date occurring thereafter, and after the initial period, each period from and including an Interest Payment Date to, but excluding the next following Interest Payment Date.
- (ii) "Interest Payment Date" means any date specified in Section 2.07 of this Agreement.
- (iii) "LIBOR Base Rate" means, for each Interest Period, the London interbank offered rate for six-month deposits in Dollars for value the first day of such Interest Period (or, in the case of the initial

Interest Period, for value the Interest Payment Date occurring on or next preceding the first day of such Interest Period), as reasonably determined by the Bank and expressed as a percentage per annum.

- (iv) “LIBOR Total Spread” means, for each Interest Period: (A) three-fourths of one percent (3/4 of 1%); (B) minus (or plus) the weighted average margin, for such Interest Period, below (or above) the London interbank offered rates, or other reference rates, for six-month deposits, in respect of the Bank’s outstanding borrowings or portions thereof allocated by the Bank to fund single currency loans or portions thereof made by it that include the Loan; as reasonably determined by the Bank and expressed as a percentage per annum.

(c) The Bank shall notify the Borrower of LIBOR Base Rate and LIBOR Total Spread for each Interest Period, promptly upon the determination thereof.

(d) Whenever, in light of changes in market practice affecting the determination of the interest rates referred to in this Section 2.06, the Bank determines that it is in the interest of its borrowers as a whole and of the Bank to apply a basis for determining the interest rates applicable to the Loan other than as provided in said Section, the Bank may modify the basis for determining the interest rates applicable to the Loan upon not less than six (6) months’ notice to the Borrower of the new basis. The new basis shall become effective on the expiry of the notice period unless the Borrower notifies the Bank during said period of its objection thereto, in which case said modification shall not apply to the Loan.

Section 2.07. Interest and other charges shall be payable semi-annually in arrears on May 15 and November 15 in each year.

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

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall carry out, through MPW, the Project with due diligence and efficiency and in conformity with appropriate administrative, financial, engineering and land management practices, and social and environmental standards acceptable to the Bank, 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 shall carry out the Project in accordance with the Implementation Program set forth in Schedule 5 to this Agreement.

Section 3.02. (a) Except as the Bank shall otherwise agree, procurement of the goods, works and consultants' services required for the Project and to be financed out of the proceeds of the Loan and the PHRD Grant shall be governed by the provisions of Schedule 4 to this Agreement, as said provisions may be further elaborated in the Procurement Plan.

(b) The Borrower shall update the Procurement Plan in accordance with terms of reference acceptable to the Bank, and furnish it to the Bank not later than twelve (12) months after the date of the preceding Procurement Plan, for the Bank's approval.

Section 3.03. For the purposes of Section 9.07 of the General Conditions and without limitation thereto, the Borrower 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 designed to ensure the continued achievement of the Project's objectives; 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 establish and maintain a financial management system, including records and accounts, and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Bank, adequate to reflect the operations, resources and expenditures related to the Project.

(b) The Borrower shall:

(i) have the financial statements referred to in paragraph (a) of this Section 4.01 for each fiscal year (or other period agreed to by the Bank), audited, in accordance with consistently applied auditing standards acceptable to the Bank, by independent auditors acceptable to the Bank;

(ii) furnish to the Bank as soon as available, but in any case not later than six (6) months after the end of each such year (or such other period agreed to by the Bank): (A) certified copies of the

financial statements referred to in paragraph (a) of this Section for such year (or other period agreed to by the Bank), as so audited; and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Bank; and

- (iii) furnish to the Bank such other information concerning such records and accounts, and the audit of such financial statements, 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 reports referred to in Part A.4 of Schedule 1 to this Agreement (Report-based Disbursements) or on the basis of statements of expenditure, the Borrower shall:

- (i) retain, until at least one (1) year after the Bank has received the audit report for, or covering, 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;
- (ii) enable the Bank's representatives to examine such records; and
- (iii) ensure that such reports and statements of expenditure are included in the audit for each fiscal year (or other period agreed to by the Bank), referred to in paragraph (b) of this Section.

Section 4.02. (a) Without limitation upon the Borrower's progress reporting obligations set out in paragraph 9 of Schedule 5 to this Agreement, the Borrower shall prepare and furnish to the Bank a financial monitoring report, in form and substance satisfactory to the Bank, which:

- (i) sets forth sources and uses of funds for the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the Loan and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and explains variances between the actual and planned Project implementation; and
- (iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

(b) The first FMR shall be furnished to the Bank not later than forty-five (45) days after the end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under the Project through the end of such first calendar quarter; thereafter, each FMR shall be furnished to the Bank not later than forty-five (45) days after each subsequent calendar quarter, and shall cover such calendar quarter.

Section 4.03. The Borrower shall make publicly available, and agrees that the Bank may also make publicly available, each final audit report referred to in Section 4.01 of this Agreement, promptly after its issuance by the independent auditors referred to therein.

ARTICLE V

Remedies of the Bank

Section 5.01. Pursuant to Section 6.02(p) of the General Conditions, the following additional events are specified:

(a) any of Law No. 32 of 2004 Regarding Regional Governance, Law No. 33 of 2004 Regarding Fiscal Balance between the Central Government and the Regions, or Decree MOF-No. 35/KMK.072/2002, shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of the Borrower to perform any of its obligations under this Agreement; or

- (b) (i) Subject to sub-paragraph (ii) of this paragraph, the right of the Borrower to withdraw the proceeds of the PHRD Grant made to the Borrower for the financing of the Project shall have been suspended, canceled or terminated in whole or in part, pursuant to the terms of the PHRD Grant Agreement.
- (ii) Sub-paragraph (i) of this paragraph shall not apply if the Borrower establishes to the satisfaction of the Bank that: (A) such suspension, cancellation or termination is not caused by the failure of the Borrower to perform any of its obligations under such agreement; and (B) adequate funds for the Project are available to the Borrower from other sources on terms and conditions consistent with the obligations of the Borrower under this Agreement.

Section 5.02. Pursuant to Section 7.01(k) of the General Conditions, the following additional events are specified, namely that any of the events specified in paragraphs (a) and (b)(i) of Section 5.01 of this Agreement shall occur, subject to the provisions of (b)(ii) of that Section.

ARTICLE VI

Effective Date; Termination

Section 6.01. 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 PHRD Grant Agreement has been executed and delivered and all conditions precedent to its effectiveness or to the right of the Borrower to make withdrawals thereunder, except only the effectiveness of the Loan Agreement, have been fulfilled;

(b) the Project Management Manual, acceptable to the Bank, has been adopted by the Borrower through MPW in accordance with the provisions of paragraph 5 of Schedule 5 to this Agreement;

(c) the CPMU has been established in accordance with the provisions of paragraph 1(b) of Schedule 5 to this Agreement; and

(d) each Participating ULG has: (i) established a PMU; and (ii) adopted the Project Management Manual, in each case in accordance with the provisions of paragraphs 3, 4 and 5 of Schedule 5 to this Agreement respectively.

Section 6.02. The following is specified as an additional matter, within the meaning of Section 12.02(c) of the General Conditions, to be included in the opinion or opinions to be furnished to the Bank, namely that the Safeguards Framework has been adopted by the Borrower and is legally binding upon the Borrower and each Participating ULG in accordance with the laws of the Republic of Indonesia.

Section 6.03. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VII

Representative of the Borrower; Addresses

Section 7.01. The Minister of Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance
c/o Directorate General of Treasury
Jalan Lapangan Banteng Timur 2-4
P.O. Box 1139
Jakarta 10710
Indonesia

Cable address:	Telex:	Facsimile:
FINMINISTRY Jakarta	45799 DJMLN-IA 44319 DEPKEU-IA	(21) 381 2859

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:
INDEVAS Washington, D.C.	248423 (MCI) or 64145 (MCI)	(202) 477-6391

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

REPUBLIC OF INDONESIA

By: /s/ Mulia Nasution

Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By: /s/ Andrew Steer

Authorized Representative

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:

<u>Category</u>	Amount of the Loan Allocated (Expressed in Dollars)	% of Expenditures to be Financed
(1) Sub-project Loans	40,275,000	100% of Sub-project amount disbursed
(2) Consultants' Services	2,500,000	100%
(3) Front-end Fee	225,000	Amount due under Section 2.04 of the Loan Agreement
(4) Unallocated	2,000,000	
	<hr/>	
TOTAL	<u>45,000,000</u>	

2. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures prior to the date of this Agreement.

3. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditure for expenditures for: (i) Sub-project Loans; (ii) contracts for the employment of consulting firms costing less than \$100,000 equivalent; (iii) contracts for the employment of individuals costing less than \$50,000 equivalent; and (iv) studies; all under such terms and conditions as the Bank shall specify by notice to the Borrower.

4. The Borrower may request withdrawals from the Loan Account to be made on the basis of reports to be submitted to the Bank in form and substance satisfactory to the Bank, such reports to include the FMR and any other information as the Bank shall

specify by notice to the Borrower (Report-based Disbursements). In the case of the first such request submitted to the Bank before any withdrawal has been made from the Loan Account, the Borrower shall submit to the Bank only a statement with the projected sources and applications of funds for the Project for the six-month period following the date of such request.

B. Special Account

1. The Borrower may, for the purposes of the Project open and maintain in Dollars a special deposit account in Bank Indonesia or in a commercial bank acceptable to the Bank, on terms and conditions satisfactory to the Bank, including, in the case of a commercial bank, appropriate protection against set-off, seizure and attachment.

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) if the Borrower is not making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) if the Borrower is making Report-based Disbursements, 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 paragraph 2 of Part B of this Schedule, the Bank shall not be required to make further deposits into the Special Account:

(a) if the Bank, at any time, is not satisfied that the reports referred to in paragraph 4 of Part A of this Schedule adequately provide the information required for Report-based Disbursements;

(b) if the Bank determines at any time that all further withdrawals for payment of Eligible Expenditures 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 Special Account; or (B) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based

Disbursements or were made on the basis of statements of expenditure, as the case may be.

5. The Bank shall not be required to make further deposits into the Special Account in accordance with the provisions of paragraph 2 of Part B of this Schedule 1, 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

Report-based Disbursements

1. For the purposes of this Annex, the term “Authorized Allocation” means the amount of \$4,500,000 to be withdrawn from the Loan Account and deposited into the Special Account pursuant to paragraph 2 of this Annex.

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 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 paragraph 3 of Part B of Schedule 1 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 Association 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 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

Report-based Disbursements

1. 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. 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 reports referred to in paragraph 5 of Part A of Schedule 1 to this Agreement applicable to such withdrawal application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such reports.

SCHEDULE 2

Description of the Project

The objective of the Project is to assist the Borrower in improving the provision of urban services by Participating ULGs and Additional Participating ULGs.

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: Urban Reform

1. Strengthening institutional capacity in Participating ULGs and Additional Participating ULGs and at the national government level to develop and implement urban reform programs through:

(a) the provision of technical assistance and training to Participating ULGs and Additional Participating ULGs for: (i) the carrying out of core governance reform programs in the areas of civic participation and transparency, public procurement and financial management; (ii) the preparation and implementation of long-term urban development strategies and plans, including local economic development and urban poverty reduction strategies; and (iii) carrying out institutional and capacity development programs identified by ULGs; and

(b) the provision of technical assistance to central government ministries and state agencies and the carrying out of studies, to improve: (i) national urban strategy formulation and the development and implementation of national urban reform programs; and (ii) their capacity to support urban reform in Kabupatens and Kotas.

2. Strengthening the institutional capacity of MPW to carry out its administration, supervision and monitoring responsibilities under the Project.

Part B: Urban Investment Support Program for Participating ULGs and Additional Participating ULGs

Carrying out Sub-Projects in Participating ULGs and Additional Participating ULGs, including the provision of Sub-project Loans therefor.

* * *

The Project is expected to be completed by December 31, 2010.

SCHEDULE 3

Amortization Schedule

<u>Date Payment Due</u>	<u>Payment of Principal (Expressed in Dollars)*</u>
November 15, 2010	1,185,000
May 15, 2011	1,200,000
November 15, 2011	1,220,000
May 15, 2012	1,240,000
November 15, 2012	1,260,000
May 15, 2013	1,280,000
November 15, 2013	1,300,000
May 15, 2014	1,320,000
November 15, 2014	1,340,000
May 15, 2015	1,365,000
November 15, 2015	1,385,000
May 15, 2016	1,405,000
November 15, 2016	1,430,000
May 15, 2017	1,450,000
November 15, 2017	1,475,000
May 15, 2018	1,500,000
November 15, 2018	1,520,000
May 15, 2019	1,545,000
November 15, 2019	1,570,000
May 15, 2020	1,595,000
November 15, 2020	1,620,000
May 15, 2021	1,645,000
November 15, 2021	1,670,000
May 15, 2022	1,700,000
November 15, 2022	1,725,000
May 15, 2023	1,755,000
November 15, 2023	1,780,000
May 15, 2024	1,810,000
November 15, 2024	1,840,000
May 15, 2025	1,870,000

*The figures in this column represent the amount in Dollars to be repaid, except as provided in Section 4.04(d) of the General Conditions.

SCHEDULE 4

Procurement

Section I. General

A. All goods, works and services (other than consultants' services) shall be procured in accordance with the provisions of Section I of the "Guidelines for Procurement under IBRD Loans and IDA Credits" dated May 2004 (the Guidelines), the provisions of Annex A to this Schedule 4 and the provisions of this Schedule.

B. All consultants' services shall be procured in accordance with Sections I and IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004 (the Consultant Guidelines), the provisions of Annex A to this Schedule 4 and with the provisions of this Schedule. If the Borrower employs any procurement and inspection agents, it shall ensure that the requirements of Section 3.17 and 3.18 of the Consultant Guidelines are met.

C. The capitalized terms used below in this Schedule to describe particular procurement methods or methods of review by the Bank of particular contracts, have the meanings ascribed to them in the Procurement Guidelines, or Consultant Guidelines, as the case may be.

Section II. Particular Methods of Procurement of Goods, Works and Services (other than Consultants' Services)

A. International Competitive Bidding

Except as otherwise provided in Part B of this Section, contracts shall be awarded on the basis of International Competitive Bidding.

B. Other Procurement Procedures

1. National Competitive Bidding

Works estimated to cost less than \$3,000,000 equivalent per contract, and goods estimated to cost less than \$200,000 equivalent, per contract, may be procured under contracts awarded on the basis of National Competitive Bidding and in accordance with the provisions of Annex B to this Schedule 4.

2. Shopping

Goods and works estimated to cost less than \$50,000 equivalent per contract, may be procured under contracts awarded on the basis of Shopping.

Section III. Particular Methods of Procurement of Consultants' Services

A. Quality- and Cost-based Selection

Except as otherwise provided in Part B of this Section, consultants' services shall be procured under contracts awarded on the basis of Quality- and Cost-based Selection. For purposes of paragraph 2.7 of the Consultant Guidelines, the short list of consultants for services estimated to cost less than \$400,000 equivalent per contract may comprise entirely national consultants.

B. Other Procedures

1. Selection Based on Consultants' Qualifications

Services estimated to cost less than \$200,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1, 3.7 and 3.8 of the Consultant Guidelines.

2. Individual Consultants.

Services for assignments that meet the requirements set forth in the first sentence of paragraph 5.1 of the Consultant Guidelines may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.2 through 5.3 of the Consultant Guidelines. Under the circumstances described in paragraph 5.4 of the Consultant Guidelines, such contracts may be awarded to individual consultants on a sole-source basis in accordance with the provisions of paragraph 5.4 of the Consultant Guidelines, subject to prior approval of the Bank.

Section IV. Review by the Bank of Procurement Decisions

The Procurement Plan shall set forth those contracts which shall be subject to the Bank's Prior Review. All other contracts shall be subject to Post Review by the Bank.

**Annex A
to
SCHEDULE 4**

Without limitation on the provisions of Schedule 4 to the Loan Agreement (Schedule 4) and of the Guidelines and the Consultant Guidelines (as such terms are defined in said schedule and referred to hereafter as the Procurement Guidelines), the following provisions shall apply in respect of goods, works and consultants' services to be procured under the Project:

1. To ensure end-user participation in the procurement of goods, works and consultant services under the Project, the requestor/user of such goods, works or consultant services (as the case may be) to be acquired, shall be represented on the relevant procurement/selection committee. The criteria for the selection of procurement committee/selection members shall in all cases be consistent with the provisions of the Procurement Guidelines and the Project Management Manual (provided, however, that in the event of any inconsistency between the Project Management Manual and the Procurement Guidelines, the provisions of the Procurement Guidelines shall apply).
2. The Procurement Plan, including all updates thereof; shall be made publicly available promptly after its finalization.
3. All bidding documents and requests for proposals issued in accordance with Schedule 3 to this Agreement shall be made available to any member of the public promptly upon request, subject only to payment of a reasonable fee to cover the cost of printing and delivery. In the case of requests for proposals, the relevant documents will only be made available after notification of award to the successful firm. Each such document will continue to be made publicly available until a year after completion of the contract entered into for the goods, works or consultants' services in question.
4. All short lists of consultants and, in cases of pre-qualification, lists of pre-qualified contractors and suppliers shall be made available to any member of the public promptly upon request.
5. A summary of the evaluation of all bids and proposals for specific contracts shall be disclosed to all bidders and parties submitting proposals therefor, promptly after the notification of award to the successful bidder/consultant. Information in such summaries will be limited to a list of bidders/consultants, all bid prices and financial proposals as read out at public openings for bids and financial proposals, all bids and proposals declared non responsive (together with reasons for such an assessment), the name of winning bidder/consultant and the contract price. Such summaries will be made available to any member of the public promptly upon request.
6. Contract award information for all contracts for goods and works of \$100,000 equivalent or more and all contracts for consultants of \$50,000 equivalent or more shall

be made publicly available and published widely, and be made available to any member of the public upon request, promptly after such award.

7. A list of all contracts awarded in the three (3) months preceding the date of such request, including, with respect to each such contract, the name of the contractor/consultant selected, the contract amount, the number of bidders/makers of proposals in respect thereof, the procurement method followed and the purpose of such contract shall be made available, promptly upon request by member of the public.

8. Representatives of the end-users of goods or works being procured shall be permitted to attend public bid openings in respect thereof.

**Annex B
to
SCHEDULE 4**

1. General

Subject to the provisions of paragraph 1 of Section II.B to Schedule 4 to this Agreement, the procedures to be followed for national competitive bidding shall be those set forth in Presidential Decree No. 80/2003 of the Republic of Indonesia with the clarifications and modifications described in the following paragraphs required for compliance with the provisions of the “Guidelines for Procurement under IBRD Loans and IDA Credits” dated May 2004 (the “Guidelines”).

2. Registration

(a) Bidding shall not be restricted to pre-registered firms and shall not be a condition for participation in the bidding process.

(b) Where registration is required prior to award of contract, bidders: (i) shall be allowed a reasonable time to complete the registration process; and (ii) shall not be denied registration for reasons unrelated to their capability and resources to successfully perform the contract, which shall be verified through post-qualification.

3. Pre-qualification

(a) Pre-qualification shall not be used for simple goods and works. Normally, post-qualification shall be used. Pre-qualification shall be required only for large or complex works with the prior ‘no objection’ of the Bank. When pre-qualification shall be required:

(b) eligible bidders (both national and foreign) shall not be denied pre-qualification, and

(c) invitations to pre-qualify for bidding shall be advertised in at least one (1) widely circulated national daily newspaper a minimum of thirty (30) days prior to the deadline for the submission of pre-qualification applications.

4. Joint Ventures

A bidder declared the lowest evaluated responsive bidder shall not be required to form a joint venture or to sub-contract part of work or part of the supply of goods as a condition of award of the contract.

5. Preferences

(a) No preference of any kind shall be given to national bidders.

(b) Regulations issued by a sectoral ministry, provincial regulations and local regulations, which restrict national competitive bidding procedures to a class of contractors or a class of suppliers shall not be applicable to procurement procedures under the Loan Agreement.

6. Advertising

(a) Invitations to bid shall be advertised in at least one (1) widely circulated national daily newspaper allowing a minimum of thirty (30) days for the preparation and submission of bids and allowing potential bidders to purchase bidding documents up to twenty-four (24) hours prior the deadline for the submission of bids.

(b) Bid documents shall be made available, by mail or in person, to all who are willing to pay the required fee.

(c) Bidders domiciled outside the area/district/province of the unit responsible for procurement shall be allowed to participate regardless of the estimated value of the contract.

(d) Foreign bidders shall not be precluded from bidding. If a registration process is required, a foreign firm declared the lowest evaluated bidder shall be given a reasonable opportunity for registering.

7. Bid Security

Bid security, at the bidder's option, shall be in the form of a letter of credit or bank guarantee from a reputable bank.

(a) Bids shall be opened in public, immediately after the deadline for submission of bids, and if bids are invited in two (2) envelopes, both envelopes (technical and price) shall be opened at the same time.

(b) Evaluation of bids shall be made in strict adherence to the criteria declared in the bidding documents and contracts shall be awarded to the lowest evaluated bidder.

(c) Bidders shall not be eliminated from detailed evaluation on the basis of minor, non-substantial deviations.

(d) No bidder shall be rejected merely on the basis of a comparison with the owner's estimate and budget ceiling without the Bank's prior concurrence.

8. Rejection of Bids

(a) All bids shall not be rejected and new bids solicited without the Bank's prior concurrence.

(b) When the number of responsive bids is less than three (3), re-bidding shall not be carried out without the Bank's prior concurrence.

SCHEDULE 5

Implementation Program

The provisions of this Schedule shall apply for the purposes of Section 3.01(b) of this Agreement.

1. The Borrower shall: (a) maintain until completion of the Project the IMSC, with functions and responsibilities acceptable to the Bank; and (b) establish and maintain the CPMU, with functions and responsibilities, and headed by a Project Manager with qualifications and experience, acceptable in each case to the Bank, and provided with such facilities, staffing and funding as shall be necessary to accomplish its functions, responsibilities and objectives.

2. The Borrower shall, for purposes of the Project, employ management consultants at the national level with qualifications and experience and terms of reference satisfactory to the Bank and selected in accordance with the provisions of Part A of Section III of Schedule 4 to this Agreement, which provisions are included in the Project Management Manual, to provide management, administrative, supervisory and monitoring support to the CPMU under the Project and as described in the Project Management Manual.

3. The Borrower, through MPW, shall ensure that:

(a) each Participating ULG and each Additional Participating ULG shall: (i) establish and thereafter maintain, with functions and responsibilities acceptable to the Bank: (A) a PIU in each local government department responsible for implementing a part of the Project; and (B) a PMU; and (ii) provide said PIU and PMU at all times with adequate funds and other resources, and with qualified and experienced personnel in adequate numbers; and

(b) each PPMU Province shall, by no later than January 31, 2006: (i) establish and thereafter maintain, with functions and responsibilities acceptable to the Bank, a PPMU; and (ii) provide said PPMU at all times with adequate funds and other resources, and with qualified and experienced personnel in adequate numbers as shall be necessary to accomplish its functions, responsibilities and objectives.

4. The Borrower, through IMSC, shall adopt and thereafter, through MPW, apply, and cause each Participating ULG and each Additional ULG to adopt (through a Surat Keputusan) and thereafter apply, a Project Management Manual acceptable to the Bank for the carrying out of the Project and their respective responsibilities therefore. Such Project Management Manual shall include:

(a) the description of the institutional arrangements for carrying out the Project, including;

- (i) the functions and responsibilities of those entities referred to in paragraphs 1 and 3 above of this Schedule 5;
 - (ii) the responsibilities of all relevant government (national and local) agencies within the Participating ULGs and Additional ULGs; and
 - (iii) the terms of reference of the national-level consultants referred to in paragraph 2 of this Schedule 5;
- (b) the procurement procedures set out in Schedule 4 to this Agreement and in the Annexes thereto;
- (c) standard procurement documentation;
- (d) reporting requirements, financial management procedures and audit procedures as set out in Article 4 of this Agreement;
- (e) the Project Performance Indicators set out in Schedule 6 to this Agreement;
- (f) (i) the eligibility criteria for Kabupatens and Kotas to qualify as Additional Participating ULGs; and (ii) the eligibility criteria and preparation, appraisal and selection procedures for Additional Sub-projects, which criteria and procedures shall include those set out in the Annex to this Schedule 5;
- (g) the criteria for an urban reform action plan of a Kabupaten or a Kota to qualify as a Qualifying Urban Reform Action Plan; and
- (h) the Safeguards Framework.

For the purposes of ensuring that said manual at all times facilitates the attaining of the objectives of the Project, the Borrower, through the IMSC, shall carry out regular reviews of said manual as part of, and in accordance with, its undertakings set forth in paragraph 9 of this Schedule 5. The Borrower shall not amend, suspend, abrogate or waive the Project Management Manual or any part thereof without the Bank's agreement.

5. Without limitation upon the provisions and requirements of the Project Management Manual, the Borrower shall:

- (a) ensure that only those Kabupatens and Kotas that have met the eligibility criteria set forth in the Project Management Manual may participate in the Project as Additional Participating ULGs, which criteria include the adoption by the relevant Kabupaten or Kota of a Qualifying Urban Reform Action Plan;

(b) approve a proposed urban reform action plan of an Additional Participating ULG as a Qualifying Urban Reform Action Plan only where: (i) said plan meets the criteria set out in the Project Management Manual; and (ii) upon the written confirmation by the Bank of its acceptance that said plan meets the relevant eligibility criteria set forth in the Project Management Manual;

(c) not approve or otherwise agree to any amendment, suspension, abrogation or waiver of a Qualifying Urban Reform Action Plan of any Participating ULG or Additional Participating ULG without the Bank's prior agreement;

(d) make available Sub-project Loans to Participating ULGs and Additional Participating ULGs: (i) only in respect of Sub-projects and Additional Sub-projects, respectively; and (ii) only on terms and conditions that include those set forth in Part A of the Annex to this Schedule 5;

(e) ensure that only those investment projects: (i) which have met the eligibility criteria set forth in the Project Management Manual and in Part B of the Annex to this Schedule 5; (ii) for which a technical report has been issued in accordance with the provisions of said Part B; and (iii) which further comply with the procedures set forth in the Project Management Manual, qualify as Additional Sub-projects;

(f) ensure that the proceeds of Sub-loans shall not be used to finance the acquisition of land; and

(g) inform each Participating ULG and Additional Participating ULG that all auditing activities with respect to Sub-projects and Additional Sub-projects are to be carried out exclusively by independent auditors appointed by the CPMU in accordance with Section 4.01(b) of this Agreement and in accordance with the terms of reference referred to in paragraph 8 of this Schedule 5.

6. Without limitation upon the provisions of paragraph 5 of this Schedule 5, the Borrower shall only:

(a) declare: (i) a Kabupaten or Kota to be an Additional Participating ULG; (ii) an urban reform action plan to be a Qualifying Urban Reform Action Plan; and (iii) an Additional Participating ULG to be eligible for funding support through Sub-project Loans; and

(b) make a Sub-project Loan in respect of an Additional Sub-project;

after certifying to the Bank in each case that the relevant eligibility criteria and other provisions set forth in the Project Management Manual and the Annex to this Schedule 5 have been met.

7. Without limitation upon the requirements of the Project Implementation Plan, the Project Management Manual and the provisions of this Schedule 5, in carrying out Part B

of the Project, the Borrower shall ensure that: (a) each Participating ULG carries out its respective Safeguard Plan in accordance with its terms; and (b) each Participating ULG and Additional Participating ULG applies the Safeguards Framework, including:

(a) taking all appropriate measures to avoid or minimize the acquisition of land or assets of people and to avoid the displacement of said people;

(b) where the acquisition of land or assets or the displacement of people is unavoidable under a proposed Sub-project or Additional Sub-project, making available, before carrying out the works which would result in such acquisition or displacement to such people, compensation, resettlement and other rehabilitation measures in accordance with: (i), in the case of a Sub-project, the relevant Safeguards Plan; and (ii), in each case, the Safeguards Framework;

(c) where affected people are physically displaced or more than ten percent (10%) of their productive assets are lost or more than two hundred (200) people are displaced by a Sub-project or Additional Sub-project:

(i) preparing a resettlement plan in accordance with the Safeguards Framework and furnish such plan to the Bank for approval; and

(ii) prior to the carrying out of the Sub-project or Additional Sub-project, ensuring that all Displaced Persons shall have been compensated and provided with resettlement and rehabilitation measures in accordance with the provisions of said plan.

(d) taking all such measures and actions set out in said Safeguards Framework for the elimination or offsetting of adverse environmental impacts under a proposed Sub-project or Additional Sub-project, or the reduction of such impacts to acceptable levels, including, where a proposed Sub-project or Additional Sub-project is assessed as requiring a full environmental assessment (“AMDAL”) pursuant to the provisions of the Safeguards Framework, preparing such assessment in accordance with the Safeguards Framework and furnishing such plan to the Bank for approval; and

(e) taking all such measures as are necessary to:

(i) avoid adverse cultural, social and economic effects on Isolated Vulnerable People under the Project and, if not possible, take appropriate mitigating measures with respect to said effects; and

(ii) through a process of informed participation, involve concerned Isolated Vulnerable People in the design and implementation of Sub-projects so as to ensure that the benefits received by the Isolated Vulnerable People under the Project are in harmony

with their economic, social and cultural preferences and protect their customary user rights.

8. The Borrower shall ensure that auditing activities under the Project, including the audits referred to in Section 4.01 of this Agreement, are carried out in accordance with terms of reference agreed with the Bank.

9. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the indicators set forth in Schedule 6 to this Agreement, the appropriateness of the Project Management Manual in furthering the attainment of the objectives of the Project, the carrying out of the Project and the achievement of the objectives thereof;

(b) engage, by not later than March 31, 2006, consultants, each with terms of reference acceptable to the Bank, for the purpose of carrying out independent evaluation of the Project, including the Project Management Manual;

(c) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, by March 15 and October 15 of each year, commencing March 15, 2006, and until completion of the Project, a report integrating the results of the monitoring and evaluation activities performed pursuant to sub-paragraph (a) of this paragraph 9, on the progress achieved in the carrying out of the Project during the preceding six (6) months and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the six (6) months following such date, which measures shall include in each report due by March 15 in any year; (i) proposed modifications, where considered appropriate, to the Project Management Manual, for the Bank's consideration and approval; and (ii) the proposed update of the Procurement Plan pursuant to the provisions of Section 3.02(b) of this Agreement;

(d) review with the Bank, on or about April 15 and November 15 of each year, commencing April 15, 2006, or such later date as the Bank shall request, the report referred to in sub-paragraph (c) of this paragraph 9, and, thereafter, take all measures required to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the twelve (12) months following the date of such report, based on the conclusions and recommendations of said report and the Bank's views on the matter and subject to the provisions of paragraph 4 of this Schedule 5;

(e) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, on or about March 15, 2008, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this paragraph 9, on the progress achieved in the carrying out of the Project 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 achievement of the objectives thereof during the period following such date;

(f) review with the Bank, by April 15, 2008, or such later date as the Bank shall request, the report referred to in paragraph (d) of this paragraph 9, and, thereafter, take all measures required to ensure the efficient completion of 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, subject to the provisions of paragraph 4 of this Schedule 5; and

(g) make publicly available the report referred to in sub-paragraph (e) of this paragraph 9, at the same time as it is furnished to the Bank pursuant to said sub-paragraph.

**Annex
to
SCHEDULE 5**

Part A

1. The Borrower shall make available the proceeds of Sub-project Loans by entering into Sub-project Loan Agreements with Participating ULGs and Additional Participating ULGs on terms and conditions set forth in the Project Management Manual and in accordance with the provisions of paragraph 2 of this Part A.

2. Except as the Borrower and the Bank may otherwise agree, each Sub-project Loan Agreement shall be subject to the following terms and conditions: (a) the principal of the Sub-project Loan shall be Rupiah-denominated; (b) the overall maturity shall be twenty (20) years; (c) the grace period on repayment of the principal of the Sub-project Loan shall be five (5) years; and (d) the Sub-project Loan shall carry interest at a rate which shall be calculated by adding 5.02 percentage points to the LIBOR Base Rate applicable to the Interest Period (as such terms are defined in Article II of this Agreement) during which each disbursement of the Sub-project Loan is made to the ULG.

Part B

1. The Borrower shall make available the proceeds of Sub-project Loans to Additional Participating ULGs only in respect of Additional Sub-projects selected in accordance with the criteria set out in the Project Management Manual, including the following:

(a) No Additional Sub-project shall: (i) include expenditures intended for a military or paramilitary purpose; (ii) include civil works for government administration or religious purposes; (iii) relate to the manufacture or use of environmentally hazardous goods (including asbestos, pesticides and herbicides), arms or drugs; (iv) relate to the manufacture or use of fishing boats of ten (10) or more tons, tackle or dynamite; (v) include the financing of government salaries; (vi) relate to the production, processing, handling, storage or sale of tobacco or products containing tobacco; (vii) relate to activities within a nature reserve or any other area designated by the Borrower for the management and/or the protection of biodiversity, except with the prior written approval of the Borrower's agency responsible for the management and/or protection of such area; (viii) relate to mining or excavation of live coral; (ix) relate to water resources development on rivers which flow into or out of another country; or (x) relate to alterations to river courses.

(b) Each proposed Additional Sub-project shall:

- (i) be a project which is: (A) technically, financially, environmentally and socially and economically viable; (B) has been prepared in accordance with the provisions of the Safeguards Framework; and (C) is intended to be carried out on a cost recovery basis; and
- (ii) have been identified as a priority infrastructure development project in the Additional Participating ULG's PJM and have been approved by the Additional Participating ULG's APBD.

(c) The APBD of the Additional Participating ULG shall have made appropriate budgetary provision to ensure the availability of sufficient funds to meet the entire estimated costs of the proposed Additional Sub-project, including funding out of the proceeds of the Loan and counter-part funding.

2. The Borrower shall, through MPW, ensure that, prior to the carrying out of works under a Additional Sub-project, the relevant Kabupaten Bupati, or the Kota Wali Kota, as the case may be, shall have: (a) caused to be completed a technical review of such Additional Sub-project; and (b) confirmed in writing to the CPMU the following:

- (i) that the criteria described in paragraph 1 of this Part B have been complied with;
- (ii) that necessary funding to fully finance the proposed Additional Sub-project has been obtained;
- (iii) that appropriate engineering and environmental standards and practices that would minimize any acquisition of land and avoid involuntary resettlement of Displaced Persons have been considered in the design of the Additional Sub-project in accordance with the Project Management Manual;
- (iv) that the provisions of the Safeguards Framework have been complied with, including, where applicable, that:
 - (A) appropriate compensation arrangements have been completed and are satisfactory to all Displaced Persons; and
 - (B) where said proposed Additional Sub-project is assessed as requiring a full environmental assessment ("AMDAL") pursuant to the provisions of the Safeguards Framework, such assessment in accordance with the Safeguards Framework has been carried out;

- (v) that an implementation plan for the Additional Sub-project has been prepared in accordance with the provisions of the Project Management Manual; and
- (vi) that a maintenance program for the works to be carried out under the Additional Sub-project and related goods has been prepared in accordance with the provisions of the Project Management Manual.

Part C

The following table lists the references to documents pertaining to Sub-projects in Participating ULGs, which together constitute the Safeguard Plans for the purposes of Schedule 5 to this Agreement:

Participating LGU:	Environmental Plan:	Land Acquisition and Resettlement Action Plan/Action Plan for Traders:
Kabupaten. Musi Banyuasin	UKL/UPL 660/132/Bapedalda/2005, March 17, 2005	Letter No. 511.2/2089/KOPPMPP of November 30, 2004
Kabupaten Manokwari	UKL/UPL No. 511.2/42.b, February 8, 2005	Letter of Agreement No. 055.112/300 of February 2005
Kabupaten Parigi Muotong	UKL/UPL 010/09.02/DI5 PLH/05, January 13, 2005	Action Plan of Land Acquisition for the Development of Central Parigi Market of February 28, 2005
Kabupaten Sidendreg Rappang	UKL/UPL 660/123 a/Hutalin, March 4, 2005	Letter of Agreement No. 972/318/Dip. of January 29, 2005 Letter of Agreement No. 972/318/Dip. of February 1, 2005 Letter of Agreement No. 972/365/Dip of February 3, 2005
Kabupaten Sleman	UKL/UPL 660/05/2005, April 5, 2005	

Participating LGU:	Environmental Plan:	Land Acquisition and Resettlement Action Plan/Action Plan for Traders:
Kota Blitar	UKL/UPL 660/09/422.105/2005, January 13, 2005	
Kota Cimahi	UKL/UPL 660/62/DLH/2005, March 4, 2005	Letter of Memorandum of Understanding No. 912/615/Disperekop of March 2005
Kota Palu	UKL/UPL 25/237/Bapedal/2005, March 2, 2005	
Kota Parepare	UKL/UPL /Bapedalda/II/2005, February 14, 2005	Action Plan of the Rehabilitation of Lakessi Market, March 2005 Letter of Agreement No. 038/DPP/III/2005 of March 9, 2005
Kota Palopo	UKL/UPL 500/17/LH/II/2005, February 17, 2005	Letter of Agreement No. 645/104/PEMB./II/2005 of February 15, 2005 Letter of Agreement No. 551-21/043/Dishub/II/2005 of February 17, 2005
Kota Semarang	ANDAL, RKL, RPL, 660.1/322, December 30, 2003	
Kota Depok	SOP March 2005	
Kota Yogyakarta	UKL/UPL 660/090a, March 2, 2005	

SCHEDULE 6

Performance Indicators

Outcome Indicators	Baseline	YR1	YR2	YR3	YR4	YR5	Frequency
At least ten (10) ULGs improve priority urban services in areas financed with USDRP support.	0			5		10	Bi-annually
Results Indicators for Each Part of Project							
Part A: Greater public availability of information, especially related to plans, strategies, budgets, financial and procurement information audits, service fees in at least ten (10) ULGs.	NA			5		10	Annually
Participating ULGs have public feedback mechanisms in place (consultations, grievance resolution etc.)	NA			5		10	Annually
Participating ULGs have participatory planning processes and public consultations /hearings held re: strategies, plans and budgets.	NA			5		10	Annually

<p>Number of ULGs practicing sound financial and procurement management practices</p> <p>The Borrower implements UIDP. Percentage of UIDP's annual business plan undertaken</p>	0			5		10	Annually
<p>Part B: ULGs prepare and implement sub-projects in infrastructure services worth a minimum of US\$52.1 total during the Project period.</p>	\$0.0M	\$10.4M	\$20.9M	\$15.6M	\$5.2M		Annually