

CONFORMED COPY

LOAN NUMBER 4690-BR

Loan Agreement

(Recife Urban Upgrading Project - PROMETRÓPOLE)

between

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

and

STATE OF PERNAMBUCO

Dated July 23, 2003

LOAN NUMBER 4690-BR

LOAN AGREEMENT

AGREEMENT, dated July 23, 2003, between the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and the STATE OF PERNAMBUCO (the Borrower).

WHEREAS (A) the Federative Republic of Brazil (the Guarantor) and the Borrower, having been satisfied as to the feasibility and priority of the project described in Schedule 2 to this Agreement (the Project), have requested the Bank to assist in the financing of the Project;

(B) by an agreement (the Guarantee Agreement) of even date herewith between the Guarantor and the Bank, the Guarantor has agreed to guarantee the payment obligations of the Borrower in respect of the loan set forth in Section 2.01 of this Agreement (the Loan);

(C) certain components of the Project will be carried out by the Municipality of Recife (Recife) or the Municipality of Olinda (Olinda), which, by agreements of even date herewith between the Bank and each such Municipality (the Recife Project Agreement and the Olinda Project Agreement, respectively), have agreed to carry out such Project components and to undertake the other obligations set forth in those agreements;

(D) certain components of the Project will be carried out by CONDEPE/FIDEM (as hereinafter defined) and COMPESA (as hereinafter defined), for the execution of which components the Borrower shall enter into agreements with CONDEPE/FIDEM and COMPESA as set forth in Article III of this Loan Agreement; 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 Single Currency Loans” of the Bank, dated May 30, 1995 (as amended through October 6, 1999), 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) “Beberibe River Basin” means the area in the RMR which surrounds the Beberibe River;

(b) “COMPESA” means *Companhia Pernambucana de Saneamento*, the Borrower’s water supply and sanitation company, or a successor thereto satisfactory to the Bank;

(c) “COMPESA Agreement” means the agreement referred to in Section 3.06 (a) (i) of this Agreement;

(d) “CONDEPE/FIDEM” means *Agência Estadual de Planejamento e Pesquisa de Pernambuco-CONDEPE/FIDEM*, the Borrower’s planning and research agency (*autarquia*), created pursuant to Article 59 of the Borrower’s *Lei Complementar* No. 49, of January 31, 2003;

(e) “CONDEPE/FIDEM Agreement” means the agreement referred to in Section 3.07 (a) (i) of this Agreement;

(f) “EMP” means the environmental mitigation plan referred to in Section 3.09 (a) of this Agreement;

(g) “FMR” means financial monitoring report as referred to in Section 4.02 of this Agreement;

(h) “Municipalities” means Recife and Olinda;

(i) “Operational Manual” means the manual referred to in Section 6.01 (c) of this Agreement;

(j) “Pilot Subprojects” means the Subprojects to be carried out in UEs 17 (O) and 23 (R) under Part C of the Project;

(k) “Resettlement Framework” means the document, issued by the Borrower on October 15, 2001, which contains the principles and policies that shall apply to the preparation and carrying out of any action plan for the resettlement of population that may be required under any Subproject;

(l) “RMR” means Região Metropolitana do Recife, the metropolitan region in the territory of the Borrower comprised of the following municipalities: Recife, Olinda, Ipojuca, Cabo de Santo Agostinho, Moreno, Jaboatão dos Guararapes, São Lourenço da Mata, Camaragibe, Paulista, Abreu e Lima, Araçoiaba, Igarassu, Itapissuma, and Itamaracá;

(m) “Special Account” means the account referred to in Section 2.02 (b) of this Agreement;

(n) “Subproject” means any of the projects referred to in Parts A and C of the Project;

(o) “Subsidiary Agreement” means any of the agreements referred to in Section 3.05 of this Agreement; and

(p) “UE” means *unidade de esgoto*, a drainage unit in the Beberibe River Basin which is identified in the Borrower’s *Estudo de Consolidação e Complementação de Diagnóstico Sobre a Qualidade das Águas, Relativo à Preparação do Programa de Investimentos nas Bacias dos Rios Beberibe, Jaboatão e Ipojuca (PQA/PE)*.

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 six million Dollars (\$46,000,000).

Section 2.02. (a) 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 consultants' services required for the Project and to be financed out of the proceeds of the Loan, and in respect of the front-end fee referred to in Section 2.04 of this Agreement.

(b) The Borrower may, for the purposes of the Project, open and maintain in Dollars a special deposit account in a commercial bank on terms and conditions satisfactory to the Bank, including appropriate protection against set-off, seizure and attachment. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Schedule 5 to this Agreement.

Section 2.03. The Closing Date shall be March 31, 2009 or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower, the Guarantor and the Municipalities of such later date.

Section 2.04. The Borrower shall pay to the Bank a front-end fee in an amount equal to one per cent (1%) of the amount of the Loan. 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 said 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 and the Guarantor 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 and the Guarantor of the new basis. The new basis shall become effective on the expiry of the notice period unless the Borrower or the Guarantor 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 semiannually 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. The Borrower declares its commitment to the objective of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall:

(a) cause (i) CONDEPE/FIDEM to carry out Part A of the Project, the Pilot Subprojects, and the activities under the Borrower's responsibility in Parts D and E of the Project (i.e. the activities under such Parts D and E not assigned to Olinda and Recife pursuant to Section 2.01 of the Olinda Project Agreement and the Recife Project Agreement), and (ii) COMPESA to carry out Part B of the Project, all with due diligence and efficiency and in conformity with appropriate administrative, financial, environmental, and urbanization practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project; and

(b) without limitation or restriction upon any of its other obligations under this Agreement, cause Recife and Olinda to perform all their respective obligations set forth in the Recife Project Agreement and the Olinda Project Agreement, shall take or cause to be taken all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable the Municipalities to perform such obligations, and shall not take or permit to be taken any action which would prevent or interfere with the carrying out of the Project as provided in this Agreement, the Recife Project Agreement and the Olinda Project 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 shall be governed by the provisions of Schedule 4 to this Agreement.

- (b) The Borrower shall cause CONDEPE/FIDEM to:
- (i) maintain or cause to be maintained procurement records adequate to reflect in accordance with sound procurement practices (including related supervision, review and auditing) the procurement activities carried out by CONDEPE/FIDEM, the Municipalities and COMPESA; and
 - (ii) ensure that all such procurement records evidencing such procurement activities are retained until at least two (2) years after the Closing Date.

- (c) The Borrower shall cause CONDEPE/FIDEM to:
- (i) have such procurement records audited annually, in accordance with internationally accepted procurement standards consistently applied, by independent procurement experts acceptable to the Bank;
 - (ii) furnish to the Bank, as soon as available, but in any case no later than June 30 of each year during the execution of the Project, a report on the audit referred to in paragraph (i) above, including an account on the compliance by CONDEPE/FIDEM, COMPESA and the Municipalities during the calendar year preceding the issuance of such report, with the procurement procedures set forth or referred to in this Agreement; and
 - (iii) at any time during Project implementation, furnish to the Bank such other information concerning said audit, as the Bank may reasonably request.

Section 3.03. The Bank and the Borrower hereby agree that the obligations set forth in Sections 9.04, 9.05, 9.06, 9.07, 9.08 and 9.09 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition, respectively) shall be carried out by Recife and Olinda, pursuant to Section 2.03 of the Recife Project Agreement or the Olinda Project Agreement, as the case may be, with respect to their respective activities under the Project.

Section 3.04. The Borrower shall cause CONDEPE/FIDEM to employ, as provided in Section II of Schedule 4 to this Agreement, a consulting firm to assist CONDEPE/FIDEM, during the execution of the Project, in the management, coordination and implementation of the Project.

Section 3.05. (a) The Borrower shall, under agreements satisfactory to the Bank (the Subsidiary Agreements), make available, promptly as needed on a grant basis, to Recife and Olinda, as the case may be, the proceeds of the Loan and the counterpart funds required on the part of the Borrower which are allocated from time to time to finance the components of the Project under the respective responsibility of the Municipalities.

(b) The Borrower shall exercise its rights and comply with its obligations under each Subsidiary Agreement in such a manner as to protect the interests of the Bank

and the Borrower and to achieve the objective of the Project, and shall not, except as the Bank shall otherwise agree, assign, amend or fail to enforce any such Subsidiary Agreement or any provision thereof.

Section 3.06. (a) (i) The Borrower shall enter into an agreement with COMPESA (the COMPESA Agreement), under terms and conditions satisfactory to the Bank, for the execution of Part B of the Project.

(ii) The Borrower shall exercise its rights and comply with its obligations under the COMPESA Agreement in such a manner as to protect the interests of the Bank and the Borrower and to achieve the objective of the Project, and shall not, except as the Bank shall otherwise agree, assign, amend or fail to enforce the COMPESA Agreement or any provision thereof.

(b) (i) The Borrower shall cause COMPESA to carry out technical studies, satisfactory to the Bank, for the feasibility of the activities under Part B.3 of the Project and technical and legal studies, satisfactory to the Bank, providing alternative options for the efficient operation and management of water and sanitation services in the UEs.

(ii) After COMPESA has carried out the technical and legal studies referred under Section 3.06 (b)(i) above, and in the event the Borrower and the Bank agree on an alternative option for the efficient operation and management of water and sanitation services in the UEs, the Borrower shall cause COMPESA to enter into arrangements, satisfactory to the Bank, for the implementation of said alternative option. After said arrangements have been carried out, the Borrower shall cause COMPESA not to, except as the Bank shall otherwise agree, assign, amend, repeal, waive, or modify in any way said arrangements.

Section 3.07. (a) The Borrower shall enter into an agreement with CONDEPE/FIDEM (the CONDEPE/FIDEM Agreement), under terms and conditions satisfactory to the Bank, for the general coordination of the Project and the execution of Part A of the Project, the Pilot Subprojects, and the activities under the Borrower's responsibility in Parts D and E of the Project (i.e. the activities under such Parts D and E not assigned to Olinda and Recife pursuant to Section 2.01 of the Olinda Project Agreement and the Recife Project Agreement).

(b) The Borrower shall exercise its rights and comply with its obligations under the CONDEPE/FIDEM Agreement in such a manner as to protect the interests of the Bank and the Borrower and to achieve the objective of the Project, and shall not, except as the Bank shall otherwise agree, assign, amend or fail to enforce the CONDEPE/FIDEM Agreement or any provision thereof.

Section 3.08. Without limitation or restriction to the provisions of Section 3.01 of this Agreement, the Borrower shall ensure that the Project is carried out, as applicable, in accordance with the provisions of the Operational Manual, the EMP, the action plans, furnished by the Borrower to the Bank on October 15, 2001, for resettlement of the population affected by the Pilot Subprojects, the environmental management plans, dated May 5, 2001, for the Pilot Subprojects, and any other population resettlement action plan and environmental management plan that may be approved by the Bank pursuant to Section 3.09 of this Agreement. In case of any conflict between the provisions of the Operational Manual and those of this Agreement, the Recife Project Agreement or the Olinda Project Agreement, the terms of said Agreements shall prevail.

Section 3.09. Prior to initiating any bidding procedure for works under any Subproject under Part A of the Project, the Borrower shall furnish to the Bank:

(a) a plan, acceptable to the Bank (the EMP), for the mitigation of the environmental impacts resulting from the carrying out of Part A of the Project, to be issued by the Borrower on the basis of the environmental impact assessment of Part A of the Project, dated November 12, 2001; and

(b) for the Bank's review and approval:

(i) the engineering design for such Subproject; and

(ii) whenever the Subproject shall require resettlement of population, the corresponding resettlement action plan, such plan to be prepared in accordance with the Resettlement Framework.

Section 3.10. Without limitation upon the provisions of Sections 9.01 (a) and 9.07 of the General Conditions, the Borrower shall:

(a) not later than January 1, April 1, July 1 and October 1 of each year during Project implementation, furnish to the Bank a report, of such scope and in such detail as the Bank shall reasonably request, on the progress in the implementation of the

Project during the previous three-month period, such progress to be measured against the Project monitoring indicators set forth in the Operational Manual; and

(b) in the month of June 2005, hold an in-depth review with the Bank, CONDEPE/FIDEM, COMPESA and the Municipalities of the progress of the Project and the attainment of its objective, such review to be based on the reports referred to in (a) above and, thereafter, take or cause to be taken all such action which shall have been agreed upon by the Borrower and the Bank during such review as necessary for the efficient execution of the Project or the achievement of its objective, such action to be taken in the manner and within the timetable agreed upon during such review.

Section 3.11. The Borrower shall:

(a) prepare, on the basis of guidelines acceptable to the Bank, and furnish to the Bank not later than six 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 cause CONDEPE/FIDEM to maintain a financial management system, including records and accounts, and to prepare financial statements in a format acceptable to the Bank, adequate to reflect the respective operations, resources and expenditures of CONDEPE/FIDEM, COMPESA and the Municipalities in respect of the Project.

(b) The Borrower shall cause CONDEPE/FIDEM to:

- (i) have the records, accounts and financial statements referred to in paragraph (a) of this Section and the records and accounts for the Special Account 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, 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 financial statements, 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 statements of expenditure, the Borrower shall:

- (i) cause CONDEPE/FIDEM to maintain, in accordance with paragraph (a) of this Section, records and separate accounts reflecting such expenditures;
- (ii) cause CONDEPE/FIDEM to retain, 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 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 Borrower's progress reporting obligations set out in Section 3.10 (a) of this Agreement, the Borrower shall cause CONDEPE/FIDEM to prepare and furnish to the Bank a financial monitoring report, in form and substance acceptable 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 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 such report shall be furnished to the Bank not later than 45 days after each subsequent calendar quarter, and shall cover such calendar quarter.

Section 4.03. The Borrower shall cause COMPESA to maintain a financial management system, including records and accounts, with respect to Part B of the Project. The Borrower shall cause COMPESA to provide CONDEPE/FIDEM with all relevant information required by the Borrower to comply with its obligations under Sections 4.01 and 4.02 of this Agreement.

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) Recife or Olinda shall have failed to perform any of their respective obligations under the Recife Project Agreement or the Olinda Project Agreement.

(b) As a result of events, which have occurred after the date of this Agreement, an extraordinary situation shall have arisen, which shall make it improbable that Recife or Olinda will be able to perform its respective obligations under the Recife Project Agreement or the Olinda Project Agreement.

(c) CONDEPE/FIDEM or COMPESA shall have failed to perform any of their respective obligations under the CONDEPE/FIDEM Agreement or the COMPESA Agreement.

(d) As a result of events, which have occurred after the date of this Agreement, an extraordinary situation shall have arisen, which shall make it improbable that CONDEPE/FIDEM or COMPESA will be able to perform its respective obligations under the CONDEPE/FIDEM Agreement or the COMPESA Agreement.

(e) As a result of events, which have occurred after the date of this Agreement, an extraordinary situation shall have arisen which shall make it improbable that the arrangements for the implementation of an alternative option for the efficient operation and management of water and sanitation services under Part B.3 of the Project (as referred to under Section 3.06 (b) of this Agreement) be implemented.

Section 5.02. Pursuant to Section 7.01 (k) of the General Conditions, the following additional event is specified, namely, that any event specified in Section 5.01 of this Agreement shall occur and shall continue for a period of 60 days after notice thereof shall have been given by the Bank to the Borrower and the Municipalities.

Section 5.03. Without limitation to the Bank's rights under Articles VI and VII of the General Conditions the Bank shall, when exercising its rights under Section 5.01 above, make its best efforts to suspend disbursements only in relation to the parts of the Project (as said parts are identified in Schedule 2 to this Agreement) that, in the Bank's sole opinion, have been affected by the event that triggers such suspension.

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 terms of reference, the short-list of firms and the request for proposals to be sent to such firms, regarding the consulting services referred to in Section 3.04 of this Agreement, have been presented to, and found satisfactory by, the Bank;

(b) the financial management systems referred to in Sections 4.01 and 4.03 of this Agreement and in Section 3.01 of the Recife Project Agreement and the Olinda Project Agreement have been established, and the relevant staff of CONDEPE/FIDEM, COMPESA and the Municipalities have received a minimum of 40 hours of training in the use of such systems;

(c) a manual, satisfactory to the Bank, has been issued by CONDEPE/FIDEM with the policies and procedures for the carrying out of the Project, including, inter alia, the roles and responsibilities of CONDEPE/FIDEM, COMPESA and the Municipalities in the carrying out of the Project, their Project related reporting obligations, guidelines for the works under the Project including environmental specifications to be included in the bidding documents, standard bidding documents to be used for national competitive bidding procedures, and indicators to measure the progress of the Project (the Operational Manual); and

(d) the Subsidiary Agreements, the CONDEPE/FIDEM Agreement and the COMPESA Agreement have been entered into between the respective parties thereto.

Section 6.02. The following are specified as additional matters, 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:

(a) the Loan has been validly registered by the Guarantor's Central Bank;

(b) the Recife Project Agreement and the Olinda Project Agreement have been duly authorized, and are legally binding upon Recife and Olinda, respectively, in accordance with their terms; and

(c) the CONDEPE/FIDEM Agreement and the COMPESA Agreement have been duly authorized, and are legally binding upon CONDEPE/FIDEM and COMPESA, respectively, in accordance with their terms.

Section 6.03. The date October 21, 2003, 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 Secretary of Planning and Social Development 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 Bank:

International Bank for
Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

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

For the Borrower:

Secretaria de Planejamento e Desenvolvimento Social
Rua da Moeda, 46, Bairro do Recife
50030-040, Recife, Pernambuco
Brazil

Facsimile: (011-55-81) 3224-7061

With copies to:

Ministério do Planejamento, Orçamento e Gestão
Secretaria de Assuntos Internacionais
Esplanada dos Ministérios, Bloco "K" - 5º andar
70040-906, Brasília, D.F.
Brasil

Facsimile: (011-55-61) 225-4022

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.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

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

STATE OF PERNAMBUCO

By /s/ Jarbas de Andrade Vasconcelos
Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Loan

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>	<u>Amount of the Loan Allocated (Expressed in Dollars)</u>	<u>% of Expenditures to be Financed</u>
(1) Works under:		55%
(a) Part A of the Project	6,200,000	
(b) Part B.1 of the Project	1,000,000	
(c) Part B.3 of the Project	1,700,000	
(d) the Pilot Subprojects	4,100,000	
(e) Subprojects under Part C of the Project other than the Pilot Subprojects	23,320,000	
(2) Goods under Part B.2 of the Project	320,000	55%

<u>Category</u>	<u>Amount of the Loan Allocated (Expressed in Dollars)</u>	<u>% of Expenditures to be Financed</u>
(3) Consultants' services		
(a) under Part D of the Project	5,600,000	70%
(b) under Part E of the Project	3,300,000	100% of foreign expenditures and 70% of local expenditures
(4) Front-end fee	460,000	Amount due pursuant to Section 2.04 of this Agreement
	<hr/>	
TOTAL	<u>46,000,000</u>	

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 Guarantor for services supplied from the territory of any country other than that of the Guarantor; and

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

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

(a) payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding \$1,000,000, may be made on account of payments made within one year before the date of this Agreement;

(b) expenditures under Category 1 (e) of the table in paragraph 1 above, unless the Borrower has furnished to the Bank a detailed analysis, satisfactory to the Bank, of the actual investment costs of the Pilot Subprojects;

(c) Expenditures under Categories (1) (a) and (1) (e) of the table in paragraph 1 above, unless Section 3.08 of this Agreement or Section 2.07 of the Olinda Project Agreement or of the Recife Project Agreement has been complied with in regard to the Subproject for which the relevant works covered by such Categories were constructed; and

(d) expenditures under Category (1) (c) of the table in paragraph 1 above unless: (i) technical studies regarding the feasibility of the activities under Part B.3 of the Project have been carried out in a manner satisfactory to the Bank; (ii) technical and legal studies providing alternative options for the efficient operation and management of water and sanitation services in the UEs have been carried out in a manner satisfactory to the Bank; and (iii) arrangements satisfactory to the Bank have been made to implement an option satisfactory to the Bank from the alternative options referred in subparagraph (ii) above.

4. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditures under: (i) contracts for works costing less than the equivalent of \$5,000,000 each; (ii) contracts for goods costing less than the equivalent of \$350,000 each; (iii) contracts for consulting services to be provided by firms costing less than the equivalent of \$100,000 each; and (iv) contracts for consulting services to be provided by individuals costing less than \$50,000 each, all under such terms and conditions as the Bank shall specify by notice to the Borrower.

SCHEDULE 2

Description of the Project

The objective of the Project is to improve the wealth and well being of the urban poor in the RMR by increasing the institutional capacity of public (at the state and municipal level) civic entities to plan for, deliver and maintain basic shelter and urban services for the RMR's low-income population in a coordinated and sustainable manner.

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

Part A: Beberibe River Basin Investments

Carrying out of infrastructure and environmental projects for the overall improvement of the built and natural environment of the Beberibe River Basin, consisting of: (a) creation or rehabilitation of parks, including the ecological park along the margins of the Beberibe River, pocket parks within each of the UEs, and the Matadouro de Peixinhos complex of historic buildings; (b) construction or rehabilitation of roads and accesses, including improvements in the general flow of traffic; (c) improvements in macro drainage to reduce flooding; and (d) improvements in the transport systems of sewage to be treated by the Peixinhos waste water treatment plant.

Part B: Water Distribution

1. Installation of pipes and carrying out of the associated works to improve water supply and distribution within the UEs.
2. Acquisition of micro meters for household installation in the UEs.
3. Installation of macro meters and the carrying out of associated works required to isolate the water distribution network within the UEs.

Part C: Low-Income Investments

Carrying out of urbanization projects in groups of low-income settlements located in the UEs 03 (R), 04 (R), 08 (R), 17 (R), 19 (R), 20 (R), 21 (R) and 23 (R), which are in Recife, and 07 (O), 12 (O), 13 (O), 15 (O) and 17 (O), which are in Olinda, consisting of water supply and sanitation improvements and household connections,

secondary road improvements, micro drainage works, installation of public lighting, creation or rehabilitation of public parks and open spaces, resettlement of population from risk prone areas, and other related investments.

Part D: Complementary Urbanization Activities

Carrying out of activities complementary to the activities under the preceding Parts of the Project, consisting of: (a) engineering design services for the Subprojects; (b) development of social outreach and community participation activities; (c) provision of environmental education to the communities; (d) feasibility studies for a sites and services project; (e) studies for expanding to other areas in the RMR the investments made under the Project; (f) Project monitoring and evaluation activities; (g) a feasibility study for the establishment and operation of a micro credit program for housing improvement and small business development in the Beberibe River Basin (and provision of technical assistance for the operation of such micro credit program); and (h) formulation of the EMP.

Part E: Project Management

Provision of technical assistance to CONDEPE/FIDEM and the Municipalities in the management, implementation and coordination of the Project.

* * *

The Project is expected to be completed by September 30, 2008.

SCHEDULE 3

Amortization Schedule

<u>Date Payment Due</u>	<u>Payment of Principal (expressed in Dollars)*</u>
On each May 15 and November 15	
beginning May 15, 2008	
through November 15, 2017	2,300,000

* 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. 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 this Section I.

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 provision shall apply to goods to be procured under contracts awarded in accordance with the provisions of paragraph 1 of this Part B:

Preference for domestically manufactured goods

The provisions of paragraphs 2.54 and 2.55 of the Guidelines and Appendix 2 thereto shall apply to goods manufactured in the territory of the Guarantor.

Part C: Other Procurement Procedures

1. National Competitive Bidding

Works estimated to cost less than \$5,000,000 equivalent per contract, but not exceeding an amount equivalent to \$49,120,000 in the aggregate, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines. The standard bidding documents set forth in the Operational Manual shall be used for the procurement of works under this Part C.

Without limitation to any other provisions set forth in this Schedule or the Guidelines, the following shall apply to the procurement of works to be undertaken pursuant to this Part C:

(a) contracts shall be awarded to the bidder whose bid has been determined to be the lowest evaluated bid, such evaluation to be based on price and, whenever appropriate, to also take into account factors similar to those referred to in paragraph 2.51 of the Guidelines, provided, however, that the bid evaluation shall always be based on factors that can be quantified objectively, and the procedure for such quantification shall be disclosed in the invitation to bid;

(b) whenever required by the Bank, the invitation to bid shall be advertised for at least three consecutive days in a newspaper of wide circulation in Brazil;

(c) the arrangements, under the invitation to bid, for joint-ventures (*consórcios*) of Brazilian and foreign firms shall be approved in advance by the Bank in each case; and

(d) the invitation to bid shall not establish, for purposes of acceptance of bids, minimum or maximum amounts for the contract prices.

2. Procurement of Small Works

Works estimated to cost less than \$50,000 equivalent per contract, up to an aggregate amount not to exceed \$1,000,000 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.

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. Such plan shall be updated every six months during the execution of the Project, and each such updating shall be furnished to the Bank for its review and approval. Procurement of all goods and works shall be undertaken in accordance with such procurement plan (as updated from time to time) as shall have been approved by the Bank, and with the provisions of said paragraph 1.

2. Prior Review

The procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply to: (a) each contract to be awarded in accordance with the procedures referred to in Part B of this Section; (b) all contracts to be awarded by Olinda in accordance with the procedures set forth in Part C of this Section; (c) the first two contracts to be awarded each by the Borrower and Recife in accordance with the procedures set forth in Part C of this Section; and (d) all contracts to be awarded by COMPESA in accordance with the procedures set forth in Part C of this Section.

3. Post Review

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

Section II. Employment of Consultants

Part A: General

Consultants' services shall be procured in accordance with the provisions of the Sections I and 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, January 1999 and May 2002 (the Consultant Guidelines), paragraph 1 of Appendix 1 thereto, appendix 2 thereto, and the following provisions of this Section II.

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, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

2. The short list of consultants for services estimated to cost less than \$250,000 equivalent per contract may comprise entirely national consultants in accordance with the provisions of paragraph 2.7 and footnote 8 of the Consultant Guidelines.

Part C: Individual Consultants

Services of individual consultants for tasks that meet the requirements set forth in paragraph 5.1 of the Consultant Guidelines shall be procured under contracts awarded 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

A plan for the selection of consultants, which shall include contract cost estimates, contract packaging, and applicable selection criteria and procedures, shall be furnished to the Bank, for its review and approval, prior to the issuance to consultants of any requests for proposals. Such plan shall be updated every six__ months during the execution of the Project, and each such updating shall be furnished to the Bank for its review and approval. Selection of all consultants' services shall be undertaken in accordance with such selection plan (as updated from time to time) as shall have been approved by the Bank.

2. Prior Review

(a) The procedures set forth in paragraphs 2, 3 and 5 of Appendix 1 to the Consultant Guidelines shall apply to each contract for the employment of consulting firms estimated to cost the equivalent of \$100,000 or more.

(b) With respect to each contract for the employment of consulting firms estimated to cost less than the equivalent of \$100,000 the terms of reference of the consulting services and terms of employment of the consulting firms 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.

(c) With respect to each contract for the employment of individual consultants estimated to cost the equivalent of \$50,000 or more, the report on the comparison of the qualifications and experience of the candidates, and the 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. The provisions of paragraph 3 of Appendix 1 to the Consultant Guidelines shall also apply to such contracts.

3. Post Review

The procedures set forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply to each contract not governed by paragraph 2 (a) and (c) of this Part.

SCHEDULE 5

Special Account

1. For the purposes of this Schedule:
 - (a) the term “eligible Categories” means Categories (1), (2) and (3) set forth in the table in paragraph 1 of Schedule 1 to this Agreement;
 - (b) the term “eligible expenditures” means expenditures in respect of the reasonable cost of goods, works and consultants’ services required for the Project and to be financed out of the proceeds of the Loan allocated from time to time to the eligible Categories in accordance with the provisions of Schedule 1 to this Agreement; and
 - (c) the term “Authorized Allocation” means the amount of \$4,000,000 to be withdrawn from the Loan Account and deposited into the Special Account pursuant to paragraph 3 (a) of this Schedule; provided, however, that unless the Bank shall otherwise agree, the Authorized Allocation shall be limited to the amount of \$2,000,000 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 amount of \$15,000,000.
2. Payments out of the Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Schedule.
3. After the Bank has received evidence satisfactory to it that the Special Account has been duly opened, 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 do not exceed the aggregate amount of the Authorized Allocation. On the basis of such request or requests, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account such amount or amounts as the Borrower shall have requested.
 - (b)
 - (i) For replenishment of the Special Account, the Borrower shall furnish to the Bank requests for deposits into the Special Account at such intervals as the Bank shall specify.

(ii) 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 4 of this Schedule 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. All such deposits shall be withdrawn by the Bank from the Loan Account under the respective eligible Categories, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. 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.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Bank shall not be required to make further deposits into the Special Account:

(a) if, at any time, the Bank shall have determined that all further withdrawals should be made by the Borrower directly from the Loan Account in accordance with the provisions of Article V of the General Conditions and paragraph (a) of Section 2.02 of this Agreement;

(b) 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 the records and accounts for the Special Account;

(c) 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 the provisions of Section 6.02 of the General Conditions; or

(d) 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, withdrawals from the Loan Account of the remaining unwithdrawn amount of the Loan allocated to the eligible Categories 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.

6. (a) If the Bank shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Bank, the Borrower shall, promptly upon notice from the Bank: (A) provide such additional evidence as the Bank may request; or (B) 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 or the portion thereof not so eligible or justified. 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 shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for eligible expenditures, 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 paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Loan Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.