

CONFORMED COPY

LOAN NUMBER 4228 PH

Loan Agreement

(Water Districts Development Project)

between

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

and

LAND BANK OF THE PHILIPPINES

Dated May 15, 1999

LOAN NUMBER 4228 PH

LOAN AGREEMENT

AGREEMENT, dated May 15, 1999, between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and Land Bank of the Philippines (the Borrower).

WHEREAS (A) the Republic of the Philippines (the Guarantor) and the Borrower, having been satisfied as to the feasibility and priority of the Project described in Schedule 2 to this Agreement, have requested the Bank to assist in the financing of Part B 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 obligations of the Borrower in respect of the LBP Loan (as hereinafter defined) and to undertake such other obligations as set forth in the Guarantee Agreement;

(C) the Republic of the Philippines has requested additional financial assistance toward financing Part A of the Project, and the Bank has agreed to extend a loan in the amount of two million three hundred thousand dollars (\$2,300,000) to the Republic of the Philippines (the Republic Loan) pursuant to a loan agreement of even date herewith between the Republic of the Philippines and the Bank (the Republic 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, with the modifications set forth below (the General Conditions) constitute an integral part of this Agreement:

"Section 6.03 is modified to read: "Section 6.03. Cancellation by the Bank. If (a) the right of the Borrower to make withdrawals from the Loan Account shall have been suspended with respect to any amount of the Loan for a continuous period of thirty days, or (b) at any time the Bank determines, after consultation with the Borrower, that an amount of the Loan will not be required to finance the Project's costs to be financed out of the proceeds of the Loan, or (c) at any time the Bank determines, with respect to any contract to be financed out of the proceeds of the Loan, that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement or the execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation, and establishes the amount of expenditures in respect of such contract which would otherwise have been eligible for financing out of the proceeds of the Loan, or (d) at any time the Bank determines that the procurement of any contract to be financed out of the proceeds of the Loan is inconsistent with the procedures set forth or referred to in the Loan Agreement and establishes the amount of expenditures in respect of such contract which would otherwise have been eligible for financing out of the proceeds of the Loan, or (e) after the Closing Date, an amount of the Loan shall remain unwithdrawn from the Loan Account, or (f) the Bank shall have received notice from the Guarantor pursuant to Section 6.07 with respect to an amount of the Loan, the Bank may, by notice to the Borrower and the Guarantor, terminate the right of the Borrower to make withdrawals with respect to such amount. Upon the giving of such notice, such amount of the Loan shall be canceled."

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions, the Preamble to this Agreement, the Guarantee Agreement and the Republic Loan Agreement have the respective meanings therein set forth and the following additional terms, wherever used in this Agreement, have the following meanings:

(a) "Affected Person" means a person who on account of the execution of the Project had or would have his or her: (i) standard of living adversely affected; or (ii) right, title or interest in any house, or interest in or right to use any land (including premises, agricultural and grazing land) or right in annual or perennial crops and trees or any other fixed or movable asset, acquired or possessed, temporarily or permanently; or (iii) business, occupation, work or place of residence or habitat adversely affected, temporarily or permanently, and "Affected Persons" means, collectively, all persons who qualify as an Affected Person;

(b) "Categories" means the categories set forth in the table in paragraph 1 of Schedule 1 to this Agreement, and "Category" means any of such Categories;

(c) "Charter" means the charter of the Borrower dated August 8, 1963, as amended on February 23, 1995;

(d) "LBP Loan" means the loan extended to the Borrower under this Agreement;

(e) "Local Government Unit" and "LGU" mean a political subdivision of the Guarantor, at the barangay, municipal, city or provincial level;

(f) "Operations Manual" means the manual dated April 27, 1999, specifying the managerial, financial, administrative, engineering and environmental policies and procedures for the execution of the Project and the eligibility criteria for selection of Sub-projects;

(g) "Participating LGUs" means LGUs outside Metro Manila area that have entered into a Subsidiary Loan Agreement with the Borrower;

(h) "Participating Water Districts" means the Water Districts with which the Participating LGUs shall have entered into memoranda of agreement in accordance with Paragraph 3 (e) of Schedule 6 to this Agreement, for the operation and maintenance of the sewerage and sanitation facilities within the jurisdiction of such Participating LGUs, and "Participating Water District" means any of such Participating Water Districts;

(i) "Policy Framework on Resettlement and Compensation of Affected Persons" means the policy, satisfactory to the Bank, approved by the Guarantor, for carrying out the compensation, resettlement and rehabilitation of each Affected Person pursuant to paragraph 3 (b) of Schedule 5 to this Agreement, as such Policy Framework may be amended from time to time by agreement between the Borrower, the Guarantor and the Bank;

(j) "Procedural Guidelines" mean the guidelines acceptable to the Bank, referred to in paragraphs 2 and 3 of Schedule 5 and paragraph 3 (c) of Schedule 6 to this Agreement, and established by the Borrower to ensure that in the design and implementation of its respective Sub-project each Participating LGU shall take all necessary action to avoid or mitigate the involuntary dislocation or temporary dismantling of existing structures due to the alignment of sewer lines to be constructed under Part B.1 of the Project, and take appropriate measures to resettle or relocate, and to rehabilitate persons affected by such involuntary dislocation or temporary dismantling of structures;

(k) "Project Management Office" and "PMO" mean the office to be established and maintained by the Borrower in accordance with paragraph 1 of Schedule 5 to this Agreement;

(l) "Project Management Unit" and "PMU" mean the unit to be established and maintained by each Participating LGU in accordance with paragraph 3 (a) of Schedule 6 to this Agreement, to undertake the implementation of its respective Sub-project;

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

(n) "Subsidiary Loan" means a loan made or proposed to be made by the Borrower to a Participating LGU, under the provisions of a Subsidiary Loan Agreement, for the carrying out of Part B.1 of the Project;

(o) "Subsidiary Loan Agreements" means the agreements to be entered between the Borrower and the Participating LGUs, pursuant to Section 3.02 (a) of this Agreement, and "Subsidiary Loan Agreement" means any of such Subsidiary Loan Agreements;

(p) "Sub-project" in respect of each Participating LGU means the specific investment project which includes the construction of any combination of water and sanitation facilities, sewerage facilities and drainage systems, for which an environmental management plan, satisfactory to the Borrower and the Bank, has been prepared; such project to be carried out by such Participating LGU under Part B.1 of the Project, utilizing the proceeds of its respective Subsidiary Loan; and

(q) "Water District" means a local agency of the Guarantor established pursuant to Title II of the Provincial Water Utilities Act of 1973, as amended to the date of this Agreement, to provide, operate and maintain wastewater collection, treatment and disposal facilities within a designated geographical area.

ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Loan Agreement, an amount equal to thirty six million three hundred thousand dollars (\$36,300,000).

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 and services required for Part B of the Project and to be financed out of the proceeds of the Loan, and in respect of interest and other charges on the Loan.

(b) The Borrower may, for the purposes of Part B of the Project, open and maintain in dollars a special deposit account in a commercial bank specifically authorized for this purpose by the Bangko Sentral ng Pilipinas, on terms and conditions satisfactory to the Bank, including appropriate protection against set-off, seizure or attachment. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Schedule 7 to this Agreement.

(c) On each of the semiannual interest payment dates specified in Section 2.06 of this Agreement, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amounts required to pay, on such date, interest and other charges on the Loan accrued and payable on or before the date set forth, and up to the amount allocated in Schedule 1 to this Agreement, as such Schedule may be amended from time to time by agreement between the Borrower and the Bank.

Section 2.03. The Closing Date shall be June 30, 2004 or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower and the Guarantor of such later date.

Section 2.04. 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 2.05. (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 2.06 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 percentage per annum.

(iv) "LIBOR Total Spread" means, for each Interest Period: (A) one half of one percent (1/2 of 1%); (B) minus (or plus) the weighted average margin, for such Interest Period, below (or above) the London interbank offered rates, for 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 Guarantor and Borrower of the LIBOR Base Rate and the 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 2.05, 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 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 2.06. Interest and other charges shall be payable March 15 and September 15 in each year.

Section 2.07. 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; Management and Operations of the Borrower

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 Part B of the Project and conduct its operations and affairs in accordance with sound financial standards and practices and ensure that Participating LGUs comply with appropriate resettlement practices and compensation of Affected Persons, with qualified management and personnel, and in accordance with the Charter.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Bank and the Borrower shall otherwise agree, the Borrower shall carry out Part B of the Project in accordance with the Implementation Program set forth in Schedule 5 to this Agreement.

Section 3.02. (a) For purposes of carrying out Part B of the Project, the Borrower shall onlend to each Participating LGU out of the proceeds of the Loan the amounts allocated from time to time to Categories (1), (2), and (3), under subsidiary loan agreements satisfactory to the Bank, on terms and conditions satisfactory to the Bank, including those set out in paragraph 3 of Schedule 6 to this Agreement.

(b) Except as the Bank shall otherwise agree, the Borrower shall not take, or concur in, any action which shall have the effect of assigning, amending, abrogating or waiving any Subsidiary Loan Agreement or any provision thereof.

(c) The Borrower shall exercise its rights in relation to each Subsidiary Loan and each Sub-project in such manner as to: (i) protect the interests of the Bank and the Borrower; (ii) comply with its obligations under this Agreement; and (iii) achieve the purposes of the Project. Section 3.03. Except as the Bank shall otherwise agree, procurement of the goods, works and consultants' services required for Part B of the Project and to be financed out of the proceeds of the Loan shall be governed by the provisions of Schedule 4 to this Agreement.

Section 3.04. For the purposes of Section 9.08 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 Bank and the Borrower, a plan designed to ensure the continued achievement of the objectives of Part B 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. The Borrower shall maintain procedures and records adequate to monitor and record the progress of Part B of the Project and of each Sub-project (including its cost and the benefits to be derived from it) and to reflect in accordance with consistently maintained sound accounting practices the operations and

financial condition of the Borrower.

Section 4.02. (a) The Borrower shall:

(i) have its records, accounts and financial statements (balance sheets, statements of income and expenses and related statements), including the records and accounts referred to in Section 4.01 of this Agreement, and those for the Special Account, for each fiscal year audited in accordance with sound auditing principles 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 (6) months after the end of each such year, (A) certified copies of said financial statements for such year as so audited and (B) the 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 said records, accounts and financial statements and the audit thereof as the Bank shall from time to time reasonably request.

(b) 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) maintain, in accordance with Section 4.01 of this Agreement, records and accounts reflecting such expenditures;

(ii) 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 (a) 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 4.03. The Borrower shall take such steps satisfactory to the Bank as shall be necessary to protect itself against risk of loss resulting from changes in the rates of exchange between the currencies (including the currency of the Guarantor) used in its operations.

ARTICLE V

Remedies of the Bank

Section 5.01. Pursuant to Section 6.02 (1) of the General Conditions, the following additional events are specified:

(a) the Charter shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the operations or the financial condition of the Borrower or its ability to carry out Part B of the Project or to perform any of its obligations under this Agreement;

(b) the Guarantor or any other authority having jurisdiction shall have taken any action for the dissolution or disestablishment of the Borrower.

Section 5.02. Pursuant to Section 7.01 (h) of the General Conditions, the following additional event is specified, namely, that any event specified in Section

5.01 of this Agreement shall occur.

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 Borrower shall have established the Project Management Office and appointed the management and staff thereof in accordance with the provisions of paragraph 1 of Schedule 5 to this Agreement;

(b) at least two of the Participating LGUs shall have: (i) established their respective Project Management Units and appointed the management and staff thereof in accordance with the provisions of paragraph 3 (a) of Schedule 6 to this Agreement; (ii) entered into Subsidiary Loan Agreements with the Borrower in accordance with Section 3.02 (a) of this Agreement.

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) that the provisions of the Policy Framework on Resettlement and Compensation of Affected Persons are legally valid and enforceable in accordance with their terms; and

(b) that each of the Subsidiary Loan Agreements referred to in Section 6.01 (b) (ii) has been duly authorized or ratified by the Borrower and the respective Participating LGU, and is legally binding and enforceable upon the Borrower and such Participating LGU in accordance with its terms.

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 President and Chief Executive Officer 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:

INTBAFRAD
Washington, D.C.

Telex:

248423 (MCI) or
64145 (MCI)

For the Borrower:

Land Bank of the Philippines
#319 Sen. Gil Puyat Ave.
Makati City, Philippines

Cable address:

Telex:

LBP PN
Makati City

64045; 62806
(EasternTelecoms) or
22679 (PhilCom)

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

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Aloysius Ordu

Authorized Representative

LAND BANK OF THE PHILIPPINES

By /s/ Jesus F. Diaz

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:

Category	Amount of the Loan Allocated (Expressed in Dollars)	% of Expenditures to be Financed
(1) Works for Sub-projects of Participating LGUs	19,000,000	100% of foreign expenditures, and 79% of local expenditures
(2) Goods for Sub-projects of Participating LGUs	4,200,000	100% of foreign expenditures, 100% of local expenditures (ex-factory cost), and 65% of local expenditures for other items procured locally
(3) Consultants' services and training under Part B of the Project	6,100,000	100%
(4) Interest and other charges on the Loan accrued on or before March 14, 2003	7,000,000	Amounts due pursuant to Section 2.02 (c) of this Agreement
TOTAL	36,300,000	

2. For the purposes of this Schedule:

(a) the term "foreign expenditures" means expenditures in the currency of any

country other than that of the Guarantor for goods or 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 goods or services supplied from the territory of the Guarantor.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of Categories 1 and 2 in respect of Sub-projects for Participating LGUs unless, in each case, the respective Participating LGU shall have met all the conditions for the disbursement of its Subsidiary Loan in accordance with paragraph 4 of Schedule 6 to this Agreement.

4. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditure for expenditures for:

(a) goods under contracts costing less than \$1,000,000 equivalent;

(b) works under contracts costing less than \$500,000 equivalent;

(c) consultants' services under contracts with firms or individuals costing less than \$100,000 equivalent and \$50,000 equivalent, respectively; and

(d) training; 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 assist the Republic of the Philippines in: (i) creating an institutional environment which would encourage the participation of the private sector in water utilities; and (ii) supporting the Participating LGUs in improving water sewerage, sanitation and drainage services within the areas of their jurisdiction.

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 objectives:

Part A: Public Performance Audit

Development and piloting of a public performance audit system to measure the performance of concessionaires for water and sewerage services, through the provision of technical assistance.

Part B: Water, Sewerage, Sanitation and Drainage Services

1. Improvement in the water, sewerage, sanitation and drainage services in Participating LGUs through the construction of: (i) water, sewerage and drainage systems in barangays, (ii) on-site and communal sanitation facilities for residents of such LGUs, (iii) a sewerage system consisting of house connections, feeder and trunk sewers; (iv) a sewage treatment plant; and (v) drainage facilities.

2. Strengthening the capability of the Project Management Office to support the Participating LGUs in the design of their respective Sub-projects and to manage the overall implementation of the Project, through the provision of consultants' services.

The Project is expected to be completed by June 30, 2004.

SCHEDULE 3

Amortization Schedule

Payment of Principal

Date Payment Due	(expressed in Dollars)*
March 15, 2003	765,000.00
September 15, 2003	785,000.00
March 15, 2004	810,000.00
September 15, 2004	835,000.00
March 15, 2005	860,000.00
September 15, 2005	885,000.00
March 15, 2006	910,000.00
September 15, 2006	940,000.00
March 15, 2007	965,000.00
September 15, 2007	995,000.00
March 15, 2008	1,025,000.00
September 15, 2008	1,055,000.00
March 15, 2009	1,090,000.00
September 15, 2009	1,120,000.00
March 15, 2010	1,155,000.00
September 15, 2010	1,190,000.00
March 15, 2011	1,225,000.00
September 15, 2011	1,260,000.00
March 15, 2012	1,300,000.00
September 15, 2012	1,340,000.00
March 15, 2013	1,380,000.00
September 15, 2013	1,420,000.00
March 15, 2014	1,460,000.00
September 15, 2014	1,505,000.00
March 15, 2015	1,550,000.00
September 15, 2015	1,600,000.00
March 15, 2016	1,645,000.00
September 15, 2016	1,695,000.00
March 15, 2017	1,745,000.00
September 15, 2017	1,790,000.00

* 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 and Consultants' Services

Section I. Procurement of Goods and Works

Part A: General

Goods and works for Part B of the Project 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, and September 1997 (the Guidelines) and the following provisions of this Section, as applicable.

Part B: International Competitive Bidding

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

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

- (a) 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.

- (b) Notification and Advertising

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

Part C: Other Procurement Procedures

1. National Competitive Bidding

Except as provided in paragraph 2 of this Part C: (a) works under Part B.1 of the Project estimated to cost more than \$50,000 and less than \$1,000,000 equivalent per contract, up to an aggregate amount not to exceed \$14,300,000; and (b) goods estimated to cost more than \$100,000 and less than \$1,000,000 equivalent per contract, up to an aggregate amount not to exceed \$4,600,000 may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines.

2. Procurement of Small Works

Works under Part B.1 of the Project estimated to cost less than \$50,000 per contract up to an aggregate amount not to exceed \$4,500,000 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.

3. National Shopping

Goods estimated to cost less than \$100,000 equivalent per contract, up to an aggregate amount not to exceed \$2,600,000 equivalent, may be procured under contracts awarded on the basis of national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

4. Community Participation

Works required for Part B of the Project estimated to cost less than \$100,000 shall be procured in accordance with procedures acceptable to the Bank

Part D: Review by the Bank of Procurement Decisions

1. Procurement Planning

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

2. Prior Review

The procedures set forth in paragraphs 2 and 3 of Appendix 1 of the Guidelines shall apply to:

(a) the first three contracts for works, and each contract for works estimated to cost the equivalent of \$500,000 or more;

(b) each contract for goods estimated to cost the equivalent of \$1,000,000 or more; and

(c) the first contracts for works and for goods respectively, for each of the Participating LGUs regardless of their estimated costs.

3. Post Review

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

Section II. Employment of Consultants

Part A: General

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

Part B: Procedures for the Selection of Consultants

1. Quality-based Selection

Except as provided under paragraph 2 of this Part B, consultants' services for Part B of the Project shall be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 through 3.4 of the Consultant Guidelines.

2. Individual Consultants

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

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

1. Selection Planning

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

2. Prior Review

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

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

3. Post Review

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

SCHEDULE 5

Implementation Program

1. The Borrower shall establish and maintain a Project Management Office managed and staffed with qualified personnel in adequate numbers, with functions and responsibilities satisfactory to the Bank, which shall be responsible for coordinating and managing overall Project activities, including providing technical assistance to:

(a) the Participating LGUs in the conduct of their consultation with the service users; the detailed design of their respective water, sewerage, sanitation and drainage systems; and procurement and supervision of works; and

(b) the Participating Water Districts in the implementation of their respective memoranda of agreement with the Participating LGUs.

2. (a) The Project shall be carried out in accordance with the Operations Manual, as such manual may be updated from time to time by agreement among the Borrower, the Guarantor and the Bank.

(b) The Borrower shall furnish any proposed revision to the Operations Manual and to the Procedural Guidelines to the Bank for its prior approval.

3. The Borrower shall ensure that Participating LGUs shall, prior to commencing work on their respective Sub-projects under Part B.1 of the Project:

(a) undertake the acquisition of all necessary land and other property, compensation therefor and resettlement in accordance with the principles and institutional procedures established in the Policy Framework on Resettlement and Compensation of Affected Persons;

(b) for each Sub-project where the number of Affected Persons is higher than 200, to prepare and furnish to the Bank a detailed resettlement action plan acceptable to the Bank documenting the implementation arrangements for resettlement, including compensation, relocation and rehabilitation; and

(c) to complete the implementation of such resettlement action plan in a manner satisfactory to the Bank.

(d) to submit environmental impact assessments, including environmental management plans, satisfactory to the Bank, in respect of the construction, operation and maintenance of their respective water, sewerage and sanitation facilities and drainage systems.

4. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators satisfactory to the Bank, the carrying out of Part B of the Project and the achievement of the objectives thereof;

(b) ensure that Affected Persons shall be compensated, resettled and rehabilitated in accordance with the Policy Framework on Resettlement and Compensation of Affected Persons. To that end, the Borrower shall cause each of the Participating LGU to comply fully with the Procedural Guidelines as described under paragraph 3 (c) (i) of Schedule 6.

(c) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, by March 31 and September 30 of each year, beginning on March 31, 2000, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of Part B 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 Part B of the Project and the achievement of the objectives thereof during the period following such date; and

(d) review with the Bank, by such later date as the Bank shall request, each report referred to in subparagraph (b) of this Section, and, thereafter, take all measures required to ensure the efficient implementation of Part B 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.

SCHEDULE 6

Terms and Conditions of Subsidiary Loans

1. Except as the Borrower and the Bank may otherwise agree, the Subsidiary Loan to each Participating LGU shall include the following terms and conditions:

(a) a term of nineteen (19) years with a grace period no later than March 15, 2003;

(b) a rate of interest of fourteen percent (14%) per annum;

(c) repayment in the currency of the Guarantor of the equivalent, at the time of withdrawal, of: the respective amounts withdrawn from time to time in respect of such Participating LGU under Categories (1), (2), and (3), in accordance with Section 3.02 (a) of this Agreement; and

(d) repayment in the currency of the Guarantor of the amounts withdrawn from time to time, under the Subsidiary Loan of such Participating LGU, by the Borrower to pay to itself the amount of interest and other charges on such Subsidiary Loan accrued and payable on or before the date set forth in Category (4).

2. Each Subsidiary Loan to a Participating LGU shall be made pursuant to a Subsidiary Loan Agreement in accordance with Section 3.02 (a) of this Agreement, whereby the Borrower shall obtain rights adequate to protect the interest of the Bank and the Borrower, including the rights to:

(a) require the Participating LGU to provide adequate resources for and to carry out and operate its Sub-project with due diligence and efficiency and in accordance with sound technical, financial, managerial and environmental standards and practices, including the provisions of its environmental management plan referred to in paragraph 3 (d) below, and to maintain adequate records;

(b) require that: (i) the goods, works and consultants' services to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 4 to this Agreement; and (ii) such goods, works and services shall be used exclusively in the carrying out of the Sub-project;

(c) inspect, by itself or jointly with representatives of the Bank if the Bank shall so request, such goods and the sites, works, plants and construction included in the Sub-project, the operation thereof, and any relevant records and documents;

(d) require that: (i) the Participating LGU shall take out and maintain with responsible insurers such insurance, against such risks and in such amounts, as shall be consistent with sound business practice; and (ii) without any limitation upon the foregoing, such insurance shall cover hazards incident to the acquisition, transportation and delivery of goods financed out of the proceeds of the Loan to the place of use or installation, any indemnity thereunder to be made payable in a currency freely usable by the Participating LGU to replace or repair such goods;

(e) obtain all such information as the Bank or the Borrower shall reasonably request relating to the foregoing, to the benefits to be derived from the Sub-project, and to the administration, operations and financial condition of the Participating LGU, including its audited financial statements and, by March 31 of each year beginning in 2000 the annual budget appropriations of such Participating LGU; and

(f) suspend or terminate the right of the Participating LGU to the use of the proceeds of the Loan upon failure by such Participating LGU to perform its obligations under its Subsidiary Loan Agreement with the Borrower.

3. Under each Subsidiary Loan Agreement with a Participating LGU, such Participating LGU shall undertake the obligations to:

(a) establish and maintain a Project Management Unit managed and staffed with qualified personnel in adequate numbers, including the city engineer, representatives from city planning, the city budget office and an operator, which will be a representative of the relevant Participating Water District for those Sub-projects that will be operated by the Water District, to supervise the implementation of its Sub-project and carry out the functions of liaison and coordination with the PMO;

(b) complete the acquisition of all land necessary for its sewage treatment plant(s), pump stations and obtain clear title thereto;

(c) (i) comply fully with the Procedural Guidelines and Resettlement Action Plan prior to commencing work on its respective Sub-project; and (ii) provide evidence satisfactory to the Bank of its compliance with said Guidelines and Resettlement Action Plan;

(d) (i) prior to commencing work on its respective Sub-project, submit an environmental impact assessment, including an environmental management plan, satisfactory to the Borrower and the Bank; and (ii) thereafter, implement such environmental management plan in a manner satisfactory to the Borrower and the Bank, and obtain all environmental compliance certificates required under Philippine laws and regulations for the operation and maintenance of its sewerage and sanitation facilities;

(e) enter into and thereafter implement a memorandum of agreement with the relevant Participating Water District or operator, satisfactory to the Borrower and the Bank, whereby such Water District agrees, inter alia to: (i) assume the operation and maintenance of the water, sewerage and sanitation facilities within the jurisdiction of the Participating LGU after their completion; (ii) apply and collect an agreed sewerage surcharge to defray the costs of operating and maintaining such facilities and an agreed amortization charge to amortize the costs of sewer connections constructed by the Participating LGU; and (iii) transfer to the Participating LGU the amount of agreed amortization charge.

4. Each Subsidiary Loan Agreement shall further provide that no disbursement shall occur until: (i) the Loan shall have been declared effective and (ii) the Bank shall have been provided with an opinion or opinions satisfactory to the Bank of counsel acceptable to the Bank showing that such Subsidiary Loan Agreement has been duly authorized or ratified by the Borrower and the respective Participating LGU and is legally binding and enforceable upon the Borrower and such Participating LGU in accordance with its terms. In addition, no disbursements under the Subsidiary Loan Agreements under Categories (1) and (2) shall occur until the Participating LGU shall have taken the actions specified under subparagraphs (a), (b), (c), (d) and (e) of paragraph 3 above.

SCHEDULE 7

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 and services required for Part B of 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 an amount equal to \$2,000,000 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 an amount equal to \$1,000,000 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 be equal to or exceed the amount of \$8,000,000.

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 4.02 (a) (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 with respect to Part B of the Project, 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 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.

