

CONFORMED COPY

LOAN NUMBER 7133-ME

Loan Agreement

(Municipal Development in Rural Areas Project)

between

UNITED MEXICAN STATES

and

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

Dated September 30, 2002

LOAN NUMBER 7133-ME

LOAN AGREEMENT

AGREEMENT, dated September 30, 2002, between UNITED MEXICAN STATES (the Borrower), represented by its signatory on page 15 of this Agreement, and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) the Borrower is a signatory of the *Articles of Agreement of the International Bank for Reconstruction and Development* (the international treaty by which the Bank was created), which *Articles of Agreement* contain, *inter alia*, general provisions relating to loans extended by the Bank;

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

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

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

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

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

(a) “Eligible Municipality” means each of the Project State municipalities listed in the Implementation Letter (as hereinafter defined), as well as any other

municipality in a Project State as may be agreed in writing by the Borrower and the Bank;

(b) “Fiscal Coordination Law” means the Borrower’s *Ley de Coordinación Fiscal* published in the Borrower’s *Diario Oficial de la Federación* (Official Gazette) on December 27, 1978, as amended through April 1, 2002;

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

(d) “Implementation Letter” means the letter of even date herewith, from the Borrower to the Bank, containing the performance indicators for Project monitoring and evaluation, the list of Eligible Municipalities and the IPDP (as hereinafter defined);

(e) “INAFED” means the Borrower’s *Instituto Nacional para el Federalismo y el Desarrollo Municipal* (National Institute for Federalism and Municipal Development);

(f) “IPDP” means the indigenous peoples’ development plan for the Project (*Programa para Promover la Participación en el Proyecto de los Pueblos Indígenas*) set forth in an attachment to the Implementation Letter;

(g) “Municipal Funds Program” means the Borrower’s program for funding small municipal investments, which program is identified in the Fiscal Coordination Law as the *Fondo de Aportaciones para la Infraestructura Social Municipal* (Municipal Social Infrastructure Fund);

(h) “Municipality Contract” means a contract referred to in Section 3.04 (a) (v) of this Agreement;

(i) “NAFIN” means *Nacional Financiera S.N.C.*, a Mexican development bank serving as the Borrower’s financial agent for purposes of the Loan;

(j) “NAFIN Contract” means the contract referred to in Section 3.02 (a) of this Agreement;

(k) “Project Operational Manual” means the manual referred to in Section 3.03 (a) of this Agreement;

(l) “Project State” means each of the Borrower’s states of Puebla, Guanajuato, Veracruz and Zacatecas, as well as any other Borrower state as may be agreed in writing by the Borrower and the Bank;

(m) “Project State Contract” means a contract, between the Borrower (through INAFED) and a Project State, referred to in Section 3.04 (a) of this Agreement;

(n) “SHCP” means the Borrower’s *Secretaría de Hacienda y Crédito Público* (Secretariat of Finance);

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

(p) “STU” means a unit referred to in Section 3.04 (a) (ii) of this Agreement; and

(q) “Subproject” means a set of activities constituting the carrying out of an individual investment covered by Part A of the Project.

Section 1.03. Each reference in the General Conditions to the Project implementation entity shall be deemed as a reference to INAFED.

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 four hundred million Dollars (\$400,000,000), as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.09 of this Agreement.

Section 2.02. (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 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 and any premium in respect of an Interest Rate Cap or Interest Rate Collar payable by the Borrower in accordance with Section 4.04 (c) of the General Conditions.

(b) The Borrower may, for the purposes of the Project, cause NAFIN to open and maintain in Dollars a special deposit account on the Borrower's behalf either: (i) in the Borrower's Central Bank on terms and conditions satisfactory to the Bank; (ii) in NAFIN on terms and conditions satisfactory to the Bank, including appropriate protection against set-off, seizure and attachment; or (iii) 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 December 31, 2006 or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a front-end fee in an amount equal to one percent of the amount of the Loan. The Borrower agrees that on or promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of such fee.

Section 2.05. The Borrower shall pay to the Bank a commitment charge on the principal amount of the Loan not withdrawn from time to time, at a rate equal to: (i) eighty five one-hundredths of one per cent (0.85%) per annum from the date on which such charge commences to accrue in accordance with the provisions of Section 3.02 of the General Conditions to but not including the fourth anniversary of such date; and (ii) seventy five one-hundredths of one per cent (0.75%) per annum thereafter.

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

Section 2.07. Interest and other charges shall be payable semiannually in arrears on March 15 and September 15 in each year.

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

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

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

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

(c) Promptly following the Execution Date for an Interest Rate Cap or Interest Rate Collar in respect of which the Borrower has requested that the premium be paid out of the proceeds of the Loan, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amounts required to pay any premium payable in accordance with Section 4.04 (c) of the General Conditions up to the amount allocated from time to time for such purpose in the table in paragraph 1 of Schedule 1 to this Agreement.

Section 2.10. The *Director de Financiamientos Internacionales* of NAFIN and any person or persons whom he or she shall designate in writing is designated as representative of the Borrower for the purposes of taking any action required or permitted to be taken under the provisions of Section 2.02 of this Agreement and Article V of the General Conditions.

ARTICLE III

Execution of the Project

Section 3.01. The Borrower declares its commitment to the objectives of the Project, and, to this end, shall carry out the Project through INAFED (with the assistance of NAFIN and Project States) with due diligence and efficiency and in conformity with appropriate administrative, financial, environmental and technical practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

Section 3.02. (a) The Borrower, through SHCP and INAFED, shall enter into a contract (*Contrato de Mandato*) with NAFIN, satisfactory to the Bank, whereby:

- (i) NAFIN agrees to act as financial agent of the Borrower with regard to the Loan, meaning that, *inter alia*, NAFIN agrees to represent the Borrower vis-à-vis the Bank for purposes of submitting Loan withdrawal applications to the Bank in form and substance sufficient to justify disbursement by the Bank to the Borrower of Loan proceeds, agrees to maintain and operate the Special Account in compliance with the terms of this Agreement, agrees to ensure that the obligations set forth in Article IV of this Agreement are complied with as pertain to the Special Account and agrees to participate in the periodic reviews referred to in Section 3.08 (c) of this Agreement; and
- (ii) the Borrower agrees that, through INAFED, the Borrower shall cooperate fully with NAFIN to ensure that NAFIN is able to comply with all of NAFIN's obligations referred to in paragraph (a) of this Section.

(b) The Borrower shall exercise its rights and carry out its obligations under the NAFIN Contract in such a manner as to protect the interests of the Bank and to accomplish the purposes of the Loan. Except as the Bank may otherwise agree, the Borrower shall not amend or fail to enforce any provision of the NAFIN Contract. In case of any conflict between the terms of the NAFIN Contract and those of this Agreement, the terms of this Agreement shall prevail.

Section 3.03. (a) The Borrower, through INAFED, shall issue an operational manual, satisfactory to the Bank, setting forth rules and procedures for the carrying out of Part A of the Project, such manual to include, *inter alia*:

- (i) detailed rules and procedures for the selection, design, environmental screening, assessment and mitigation, approval, implementation, auditing, monitoring and evaluation of Subprojects, and record-keeping and procurement pertaining thereto, using a community-driven development approach whereby Subproject proposals emanate from community groups in Eligible Municipalities and those Subprojects are financed up to a minimum of ten percent (10%) of their cost, in cash or in kind, by the community group in question;

- (ii) a provision limiting the cost of any individual Subproject to no more than \$50,000 equivalent (\$100,000 equivalent in the case of a potable water, sewerage or drainage Subproject); and
- (iii) a negative list containing types of investment activities that cannot be considered to fall under Part A of the Project.

(b) The Project Operational Manual may be amended by INAFED from time to time with the approval of the Bank. In case of any conflict between the terms of the Project Operational Manual and those of this Agreement, the terms of this Agreement shall prevail.

Section 3.04. (a) The Borrower, through INAFED, shall enter into, and comply with the terms of, separate contracts, one with each of the Project States and satisfactory to the Bank, whereby, in exchange for receiving INAFED support for the institutional development of the Project State and its municipalities under Parts B.1, B.2, C.1 and C.2 of the Project, the Project State in question agrees to:

- (i) cause Part A of the Project to be carried out in the Project State in conformity with the terms of the Project Operational Manual (which shall constitute an integral part of the Project State Contract);
- (ii) maintain, within the Project State's executive branch ministry responsible for coordination of the Municipal Funds Program in the Project State, a technical unit (*unidad coordinadora estatal*), with staff in numbers and with qualifications and experience satisfactory to the Bank (including an environmental expert for the review of Subprojects and an expert on procurement of works), to support the Project State's Eligible Municipalities in the Subproject processing, implementation and evaluation cycle on the terms set forth in the Project Operational Manual (said support shall include the carrying out by the STU of an action plan, satisfactory to the Bank, for implementing a Project State-wide dissemination campaign designed to convey to all potential Subproject beneficiaries, via culturally appropriate media, information regarding procedures and benefits relating to Part A of the Project);
- (iii) participate in the periodic reviews referred to in Section 3.08 (c) of this Agreement;

- (iv) (A) comply with the terms of Schedule 4 to this Agreement whenever carrying out any procurement under Parts B.1, B.2, C.1 and C.2 of the Project; and (B) cooperate fully with INAFED so that the Borrower can comply with all Borrower obligations set forth or referred to in Article IV of this Agreement as pertain to Parts B.1, B.2, C.1 and C.2 of the Project;
- (v) enter into a separate contract, satisfactory to the Bank, with each Project State municipality (or set of municipalities) that wishes to benefit under Parts B.1, B.2, C.1 and C.2 of the Project, whereby, in exchange for receiving Project State approval of municipal institutional development activities as required by the Fiscal Coordination Law, the municipality (or set of municipalities) agrees to: (A) fund such activities with its own municipal funds and, optionally, those of other willing Project State municipalities; (B) comply with the terms of Schedule 4 to this Agreement whenever carrying out any procurement under Parts B.1, B.2, C.1 and C.2 of the Project; and (C) cooperate fully with the Project State so as to allow the Project State to in turn collaborate fully with INAFED so that the Borrower can comply with all Borrower obligations set forth or referred to in Article IV of this Agreement as pertain to Parts B.1, B.2, C.1 and C.2 of the Project; and
- (vi) carry out the Project State's obligations under the IPDP and cause the municipal obligations under the IPDP to be carried out by Eligible Municipalities in the Project State.

(b) The Borrower shall exercise its rights and carry out its obligations under each Project State Contract in such a manner as to protect the interests of the Bank and to accomplish the purposes of the Loan. Except as the Bank may otherwise agree, the Borrower shall not amend or fail to enforce any provision of any Project State Contract. In case of any conflict between the terms of any Project State Contract and those of this Agreement, the terms of this Agreement shall prevail.

Section 3.05. The Borrower, through INAFED, shall maintain, throughout the course of Project implementation, a management information system for the Project, consisting of the following three modules: (a) an information module containing physical and financial information regarding each Subproject; (b) a financial management module compliant with the terms of Article IV of this Agreement; and (c) a module dedicated to the generation of project reports in a manner compliant with the terms of Section 3.08 of this Agreement.

Section 3.06. (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. Procurement under Parts B.3 and C.3 of the Project shall be carried out exclusively by the Borrower through INAFED.

(b) The Borrower shall, throughout the course of Project implementation, maintain within INAFED a project implementation unit, to be staffed with, *inter alia*, an expert on Bank-financed procurement of consultant services, as well as other personnel, in numbers and with qualifications and experience satisfactory to the Bank, to coordinate Project implementation.

Section 3.07. For the purposes of Section 9.07 of the General Conditions and without limitation thereto, the Borrower shall, through INAFED:

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

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

Section 3.08. The Borrower, through INAFED, shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the performance indicators specified in the Implementation Letter (and consistently using, *inter alia*, periodic Subproject beneficiary consultations and self-diagnostics), the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, not later than each April 30 during the period of Project implementation (beginning on April 30, 2003), reports integrating the results of the evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of such reports and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date (said reports shall, *inter alia*, contain a chapter in which the results of the Subproject beneficiary consultations and self-diagnostics are separately compiled, which chapter shall be publicly disseminated by INAFED promptly after the relevant review referred to in paragraph (c) of this Section);

(c) review with the Bank shortly after such reports' preparation, the reports referred to in paragraph (b) of this Section, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said reports and taking into account the Bank's views on the matter (the review to take place in 2004 shall be deemed a Project mid-term review); and

(d) carry out INAFED's obligations under the IPDP.

ARTICLE IV

Financial Covenants

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

(b) The Borrower shall through INAFED, and also cause NAFIN 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 Accounts for each fiscal year audited, in accordance with auditing standards acceptable to the Bank, consistently applied, by independent auditors acceptable to the Bank;
- (ii) furnish to the Bank as soon as available, but in any case not later than six months after the end of each such year: (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year as so audited; and (B) an opinion on such statements, records and accounts and report of such audit, by said auditors, of such scope and in such detail as the Bank shall have reasonably requested (including, as part of the information to be provided in the first such report, a management letter concerning INAFED's and NAFIN's internal controls); and
- (iii) furnish to the Bank such other information concerning such records and accounts, and the audit thereof, and concerning said auditors, as the Bank may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Loan Account were made on the basis of statements of expenditure, the Borrower shall through INAFED, and also cause NAFIN to:

- (i) maintain, in accordance with paragraph (a) of this Section, records and separate 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 (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 3.08 of this Agreement, the Borrower shall prepare in accordance with guidelines acceptable to the Bank 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 planned and actual 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 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 semester 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 semester; and thereafter, each FMR shall be furnished to the Bank not later than 45 days after each subsequent calendar semester, and shall cover such calendar semester.

Section 4.03. As part of its obligations set forth in Sections 4.01 and 4.02 of this Agreement, the Borrower, through INAFED, shall enhance INAFED's existing financial management system, within no less than six months after the Effective Date, in a manner satisfactory to the Bank.

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) that any Project State, or any municipality where a Subproject is carried out, shall have failed to perform any of its obligations (regarding the Municipal Funds Program) under the Fiscal Coordination Law or shall have failed to comply with the terms of the Project Operational Manual for that Project State so as to affect, in the opinion of the Bank, materially and adversely the carrying out of the Project. In such a case, the Bank may, after consultation with and by notice to the Borrower, only suspend in whole or in part the right of the Borrower to make withdrawals from the Loan Account for expenditures incurred by the Project State and/or any municipality in question;

(b) that the Fiscal Coordination Law or any part thereof shall have been amended, suspended, abrogated, repealed, waived or not enforced so as to affect, in the opinion of the Bank, materially and adversely the carrying out of the Project;

(c) that a Project State or any of its municipalities shall have failed to comply with any of its obligations under a Municipality Contract or shall have amended, abrogated, repealed, waived or failed to enforce any provision of said Municipality Contract. In such a case, the Bank may, after consultation with and by notice to the Borrower, only suspend in whole or in part the right of the Borrower to make withdrawals from the Loan Account for expenditures incurred by the Project State and/or the municipality in question; and

(d) NAFIN shall have failed to comply with any of its obligations under the NAFIN Contract.

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 (b) 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) an action plan, referred to in Section 3.04 (a) (ii) of this Agreement, has been prepared by the STU for each of the Project States for which a Project State Contract has been entered into in compliance with the condition set forth in paragraph (b) of this Section;

(b) a separate Project State Contract has been entered into between the Borrower, through INAFED, and at least one of the Project States;

(c) an STU, staffed as referred to in Section 3.04 (a) (ii) of this Agreement, is operational for each of the Project States for which a Project State Contract has been entered into in compliance with the condition set forth in paragraph (b) of this Section; and

(d) the NAFIN Contract has been entered into by the Borrower and NAFIN.

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 Borrower (in its legal opinion) and each of the Project States (in a separate legal opinion satisfactory to the Bank for each such Project State, issued by Project State counsel acceptable to the Bank), for which a Project State Contract has been entered into in compliance with the condition set forth in Section 6.01 (b) of this Agreement, indicate that the relevant Project State Contract has been duly authorized or ratified by, and executed and delivered on behalf of, the Borrower and said Project State and is legally binding upon the Borrower and said Project State in accordance with the Project State Contract's terms; and

(b) that the Borrower (in its legal opinion) and NAFIN (in a separate legal opinion satisfactory to the Bank, issued by NAFIN counsel acceptable to the Bank), indicate that the NAFIN Contract has been duly authorized or ratified by, and executed and delivered on behalf of, the Borrower and NAFIN and is legally binding upon the Borrower and NAFIN in accordance with the NAFIN Contract's terms.

Section 6.03. The date December 30, 2002 is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VII

Representative of the Borrower; Addresses

Section 7.01. Except as provided in Section 2.10 of this Agreement, the *Director General de Crédito Público* of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

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

For the Borrower:

Secretaría de Hacienda y Crédito Público
Dirección General de Crédito Público
Palacio Nacional
Patio Central
3er piso, oficina 3010
Colonia Centro
06000 México, D.F.

Facsimile:

011-525-228-1156

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

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.

UNITED MEXICAN STATES

By /s/ Francisco Gil Díaz

Authorized Representative
Secretariat of Finance and Public Credit

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ James D. Wolfensohn

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) Goods and works for completed Subprojects in Project States	320,000,000	65%
(2) Consultants' services under Parts A, B.1, B.2, C.1 and C.2 of the Project for the benefit of, or in connection with completed Subprojects in, Project States or their municipalities	15,700,000	83%
(3) Consultants' services under Parts B.3 and C.3 of the Project	4,000,000	83%
(4) Training expenses under Parts B.1, B.2, C.1 and C.2 of the Project for the benefit of Project States or their municipalities	16,200,000	83%
(5) Training expenses under Parts B.3 and C.3 of the Project	5,000,000	83%
(6) (a) Incremental recurrent costs under Parts B.1, B.2, C.1 and C.2 of the Project for the benefit of Project States or their municipalities	10,100,000	20%
(b) Incremental recurrent costs Part C.3 of the Project	500,000	20%

<u>Category</u>	<u>Amount of the Loan Allocated (Expressed in Dollars)</u>	<u>% of Expenditures to be Financed</u>
(7) Goods under Part B.3 of the Project	4,500,000	65%
(8) Goods under Part C.3 of the Project	500,000	65%
(9) Premia for Interest Rate Caps and Interest Rate Collars	0	Amount due under Section 2.09 (c) of this Agreement
(10) Fee	4,000,000	Amount due under Section 2.04 of this Agreement
(11) Unallocated	19,500,000	
TOTAL	<u>400,000,000</u>	

2. For the purposes of this Schedule:

(a) the term “Training” includes only: (i) reasonable travel, room, board and *per diem* expenditures incurred by trainees in connection with their training and by non-consultant training facilitators; (ii) course fees charged by academic institutions; (iii) training facility rentals; and (iv) training material preparation, acquisition, reproduction and distribution expenses not otherwise covered under this paragraph, all as incorporated in Project annual training plans, satisfactory to the Bank, prepared by INAFED (and excluding any expenses under Part B.1 of the Project for study tours);

(b) the term “Incremental recurrent costs” includes reasonable recurrent expenditures incurred in connection with operation of INAFED and the STUs for rentals, travel, room, board and *per diem* expenditures, maintenance, consumable materials and supplies and utilities (but not including any salaries), which would not have been incurred absent the Project; and

(c) the term “completed Subprojects” means Subprojects for which completion has been evidenced through the issuance at the relevant municipal level of a document of completion (*acta de entrega y/o recepción de obra*) according to the terms of the Project Operational Manual.

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 \$40,000,000, may be made on account of payments made for expenditures incurred after March 1, 2002 (but in no case incurred earlier than the twelve months immediately before the date of this Agreement);

(b) payments for expenditures covered by disbursement categories (1), (2), (4) and (6) (a) set forth in the table in paragraph 1 of this Schedule with regard to a Project State (other than a Project State for which a Project State Contract has been entered into in compliance with the condition set forth in Section 6.01 (b) of this Agreement), unless: (i) a Project State Contract has been entered into for the Project State in question and both the Borrower and the Project State in question have each furnished to the Bank a separate legal opinion satisfactory to the Bank, of counsel acceptable to the Bank, showing that, on behalf of the Borrower and said Project State, the relevant Project State Contract has been duly authorized or ratified by, and executed and delivered on behalf of, the Borrower and said Project State and is legally binding upon the Borrower and said Project State in accordance with the Project State Contract’s terms; (ii) an action plan, referred to in Section 3.04 (a) (ii) of this Agreement, has been prepared by the relevant STU for the Project State in question; and (iii) an STU, staffed as referred to in Section 3.04 (a) (ii) of this Agreement, is operational for the Project State in question;

(c) payments for expenditures covered by disbursement categories (2), (4) and (6) (a) set forth in the table in paragraph 1 of this Schedule, under Parts B and C of the Project and pertaining to a particular municipality or set of municipalities but not to a specific Subproject, unless a Municipality Contract has been entered into for said municipality or set of municipalities; and

(d) payments for expenditures covered by disbursement categories (2), (4) and (6) (a) set forth in the table in paragraph 1 of this Schedule, under Parts B and C of the Project and pertaining to a particular municipality but not to a specific Subproject, unless said municipality is either an Eligible Municipality or has pooled resources with other municipalities as set forth in Section 3.04 (a) (v) (A) of 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 training, for incremental recurrent costs, for goods, for works (except works covered by Part C.2 of Section I of Schedule 4 to this Agreement), for consultants' services provided by firms under contracts costing less than \$100,000 equivalent each and for consultants' services provided by individuals under contracts costing less than \$50,000 equivalent 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 reduce the incidence of rural poverty in the territory of the Borrower by: (a) supporting investments in basic small-scale social and productive infrastructure in rural areas of the Project States, using a community-driven development approach; (b) strengthening the administrative and technical capacity of rural municipalities to increase the efficiency of municipal investments; and (c) deepening the ongoing decentralization of governmental functions from the federal to the state and municipal levels.

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

Part A: Municipal Subprojects

Carrying out investments, according to the terms of the Project Operational Manual, to construct or rehabilitate basic small-scale social and productive infrastructure in Eligible Municipalities, such as with regard to potable water, sewerage, drainage, latrine, urbanization, rural and poor neighborhood electrification, basic health services, basic educational services, productive rural and other such infrastructure, all financed in part with proceeds of the Municipal Funds Program.

Part B: Municipal Institutional Development and Support for Decentralization

1. Supporting Project State municipal institutional development -- at the level of an individual municipality using its own resources -- through the carrying out of activities such as: (a) training of municipal government personnel; (b) provision of technical assistance to improve municipal government performance in the investment subproject cycle (from the design through the implementation and monitoring of subprojects) and to prepare municipal development plans; (c) provision of technical assistance to improve municipal organizations and processes (such as through the drafting of new municipal regulations or other such legal instruments); (d) carrying out of studies to diagnose municipal government problems and propose and carry out solutions such as through the use of maps and cadasters; (e) drafting of manuals, guidelines and other materials to disseminate municipal regulations; (f) provision of technical assistance to enhance municipal government financial management and reporting; (g) identification and dissemination of good practices in the delivery of municipal services; (h) carrying out of capacity building activities to assist community groups in enhancing their participation in said investment subproject cycle; (i) carrying out studies to diagnose, monitor and/or evaluate performance of municipal programs; (j) provision of technical assistance to design and implement indicators aimed at measuring progress in the improvement of

municipal life; and (k) provision of technical assistance to strengthen municipal capacity to carry out environmental screening, assessment and enforcement actions regarding subprojects.

2. Supporting municipal institutional development, through activities using resources either pooled by a Project State and a number of its municipalities or by such municipalities among themselves, which activities: (a) can focus either on an individual municipality or be collectively applied to a number of collaborating municipalities; and (b) are intended to be standardized in nature (such as standardized training accessible to those municipalities that wish to benefit from it, central hot line assistance provided by the Project State and development of uniform municipal administrative performance indicators).

3. Supporting municipal institutional development, through activities carried out by INAFED in collaboration with Project States (or other states) aimed at improving the macro-level framework relevant to the entire municipal sector (such as the constitutional and other legal provisions that regulate municipalities, municipal human resource administration approaches, certification of municipal competencies, decentralization measures aimed at transferring added responsibilities to municipalities, municipal financial practices, e-government at the municipal level and promotion of citizenry participation in municipal affairs), as well as through the provision by INAFED, to municipalities, of computer equipment and software to support the municipalities' institutional development.

Part C: Project Support, Supervision, Monitoring and Evaluation

1. Carrying out of investment related activities -- at the municipal level -- not covered by direct Subproject costs but essential for Subproject implementation, such as technical designs, field support, supervision of Subproject execution (including physical inspections).

2. Carrying out of activities at the Project State level to monitor, supervise, evaluate and audit Subprojects, support the operation of the STUs and upgrade Project State management information systems applicable to the Municipal Funds Program.

3. Carrying out of activities at the INAFED level to monitor, supervise, evaluate and audit the Project and upgrade INAFED's management information system applicable to the Municipal Funds Program (including the provision of computer hardware and software to INAFED in support of such activities).

* * *

The Project is expected to be completed by June 30, 2006.

SCHEDULE 3

Amortization Schedule

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

<u>Payment Date</u>	<u>Installment Share (Expressed as a %)</u>
On each March 15 and September 15	
Beginning March 15, 2008 through September 15, 2017	5%

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

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

(b) Any withdrawal made after the first Principal Payment Date shall be repaid on each Principal Payment Date falling after the date of such withdrawal in amounts determined by the Bank by multiplying the amount of each such withdrawal by a fraction, the numerator of which shall be the original Installment Share specified in the table in paragraph 1 of this Schedule for said Principal Payment Date (the Original Installment Share) and the denominator of which shall be the sum of all remaining Original Installment Shares for Principal Payment Dates falling on or after such date, such repayment amounts to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

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

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

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

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

SCHEDULE 4

Procurement

Section I. Procurement of Goods and Works

Part A: General

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

Part B: Procurement Procedures

1. National Competitive Bidding

Computer hardware and software under Parts B.3 and C.3 of the Project, as well as goods not covered by Part B.2 of this Section I, shall be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines, using standard bidding documents acceptable to the Bank.

2. International or National Shopping

Goods (other than computer hardware and software), estimated to cost \$100,000 equivalent or less per contract, shall 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.

3. Procurement of Small Works

Works estimated to cost \$100,000 equivalent or less per contract 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. Works estimated to cost more than \$100,000 equivalent may not be procured by any procurement method.

Part C: Review by the Bank of Procurement Decisions

1. Procurement Planning

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

2. Prior Review

(a) With respect to the first two contracts for the Project procured under Part B.1 of this Section I, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

(b) With respect to the first contract to be procured, in each calendar year during Project implementation in each Project State, in accordance with the procedures referred to in Part B.3 above, the following procedures shall apply:

- (i) prior to the execution of any such contract, the Borrower shall provide to the Bank a report on the comparison and evaluation of quotations received;
- (ii) prior to the execution of any such contract, the Borrower shall provide to the Bank a copy of the specifications and the draft contract; and
- (iii) the procedures set forth in paragraphs 2 (f), 2 (g) and 3 of Appendix 1 to the Guidelines shall apply.

3. Post Review

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

Section II. Employment of Consultants

Part A: General

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

Part B: Quality- and Cost-based Selection

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

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

Part C: Least-cost Selection

Services of a standard or routine nature, estimated to cost less than \$200,000 equivalent per contract, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

Part D: Individual Consultants

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

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

1. Selection Planning

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

2. Prior Review

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

(b) With respect to each contract for the employment of 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

Special Account

1. For the purposes of this Schedule:
 - (a) the term “eligible Categories” means Categories (1) through (8) 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 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 an amount equivalent to \$40,000,000, 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 equivalent to \$15,000,000 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 equivalent of \$25,000,000.
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, 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.