

Public Disclosure Authorized

**CONFORMED COPY**

**LOAN NUMBER 7375-ME**

# **Loan Agreement**

**(Environmental Services Project)**

**between**

**UNITED MEXICAN STATES**

**and**

**INTERNATIONAL BANK FOR RECONSTRUCTION  
AND DEVELOPMENT**

**Dated May 11, 2006**

Public Disclosure Authorized

## LOAN AGREEMENT

AGREEMENT, dated May 11, 2006 between UNITED MEXICAN STATES (the Borrower) acting through 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, has requested the Bank to assist in the financing of the Project;

WHEREAS (C) the Project will be carried out by the Borrower's *Comisión Nacional Forestal* (CONAFOR) with the Borrower's assistance and, as part of such assistance, the Borrower will make the proceeds of the Loan available to CONAFOR, as set forth in this Agreement;

WHEREAS (D) by an agreement of even date herewith between the Borrower, *Nacional Financiera, S.N.C.* and the Bank, acting as implementing agency of the Global Environment Facility established by the Executive Directors of the Bank (the GEF Grant Agreement), the Bank has agreed to make a grant to the Borrower in an amount of fifteen million Dollars (\$15,000,000) (the GEF Trust Fund Grant) to assist in financing the Project on the terms and conditions set forth in the GEF Grant Agreement; and

WHEREAS (E) 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 and in the agreement of even date herewith between the Bank and CONAFOR (the Project 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 (as amended through May 1, 2004), with the modifications set forth below (the General Conditions) constitute an integral part of this Agreement:

- (a) Section 5.08 is amended to read as follows:

“Treatment of Taxes. Except as otherwise provided in the Loan Agreement, the proceeds of the Loan may be withdrawn to pay for taxes levied by, or in the territory of, the Borrower or the Guarantor on the goods or services to be financed under the Loan, or on their importation, manufacture, procurement or supply. Financing of such taxes is subject to the Bank’s policy of requiring economy and efficiency in the use of the proceeds of its loans. To that end, if the Bank shall at any time determine that the amount of any taxes levied on or in respect of any item to be financed out of the proceeds of the Loan is excessive or otherwise unreasonable, the Bank may, by notice to the Borrower, adjust the percentage for withdrawal set forth or referred to in respect of such item in the Loan Agreement as required to be consistent with such policy of the Bank.”

- (b) Section 6.03 (c) of the General Conditions is amended by replacing the words “corrupt or fraudulent” with the words “corrupt, fraudulent, collusive or coercive”.

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

- (a) “Advisory Committee” means the committee referred to in Section 2.01 (b) (i) of the Project Agreement;

(b) “Area Specific Indigenous Action Plan” or “IAP” means any plan developed in accordance with the IPDP;

- (c) “Asset Management Agency” means the agency referred to in Section 2.09 (b) of the Project Agreement;

(d) “Asset Management Contract” means the contract referred to in Section 2.09 (b) of the Project Agreement;

(e) “Biodiversity Environmental Services” means the services generated by forest ecosystems in the conservation of biodiversity which benefit people other than the land users;

(f) “Carbon Sequestration Environmental Services” means the services generated by forest ecosystems in the capture of carbon which benefit people other than the land users;

(g) “CNA” means *Comisión Nacional del Agua*, the Borrower’s National Water Commission;

(h) “Community” means any population and land tenancy unit (*comunidad*), with its own legal personality, governed by Title III, Chapter V of the Borrower’s Agrarian Law (*Ley Agraria*), published in the Official Gazette on February 26, 1992, or a legally established association of Communities, and composed mostly of indigenous peoples represented by duly elected Community officials, which meets the criteria and other requirements set forth in the Operational Manual to participate in the Project;

(i) “CONABIO” means *Comisión Nacional para el Conocimiento y Uso de la Biodiversidad*, the Borrower’s National Commission for Biodiversity Knowledge and Use;

(j) “Cooperation Agreements” means any of the agreements to be entered into pursuant to Section 2.01 (e) of the Project Agreement;

(k) “Disbursed Amount” means in respect of each Interest Period, the aggregate principal amount of the Loan withdrawn from the Loan Account in said Interest Period;

(l) “*Ejido*” means any population and land tenancy unit, with its own legal personality, governed by Title III, Chapters I-IV of the Borrower’s Agrarian Law (*Ley Agraria*), published in the Official Gazette on February 26, 1992, or a legally established association of *Ejidors*, which meets the criteria and other requirements set forth in the Operational Manual to participate in the Project;

(m) “Eligible Categories” means Categories (1) through (3) set forth in the table in Parts A.1 of Schedule 1 to this Agreement, and Schedule 1 to the Grant Agreement, respectively;

(n) “Eligible Expenditures” means the expenditures for items referred to in Section 2.02 of this Agreement (other than the front-end fee and premiums), and for goods, services and Endowment Fund contribution referred to in Section 2.02 of the GEF Grant Agreement;

(o) “Eligible Pilot Area” means any of the pilot areas of the Borrower set forth in the Operational Manual, and any other area as CONAFOR may propose and the Bank may agree;

(p) “Endowment Fund” means the biodiversity endowment fund to be created by CONAFOR with financing from the proceeds of the GEF Trust Fund Grant and other public and private donors to finance the costs associated with biodiversity conservation;

(q) “Endowment Fund Directives” means the directives for the operation of the Endowment Fund, referred to in Section 2.08 of the Project Agreement, as the same may be amended from time to time by agreement between the Bank and CONAFOR;

(r) “Environmental Management Plan” means CONAFOR’s environmental management plan for the Project set forth in the Operational Manual and including provisions intended to prevent negative impacts by: (i) incorporating: (A) eligibility and prioritization criteria for the types of lands and landowners that could sign PES contracts; and (B) review procedures and specific responsibilities within CONAFOR to ensure that all contracts are awarded, administered, and supervised in accordance with the eligibility criteria; (C) provisions preventing the clearing of forests or other natural habitats to establish new agricultural systems; and (ii) requiring: (A) reforestation with species native to the site; and (B) all eligible landowners (whether Communities, *Ejidors* or individuals) to present evidence of legally secure land tenure and long-term residence in the relevant area;

(s) “Environmental Services” means collectively the Water Environmental Services, the Carbon Sequestration Environmental Services and the Biodiversity Environmental Services;

(t) “Federal Agencies” means SEMARNAT, SAGARPA and SECTUR;

(u) “Financing Agreements” means any of the agreements referred to in Section 2.01 (f) of the Project Agreement;

(v) “FMR” means each report prepared in accordance with Section 4.02 of the Project Agreement;

(w) “GEF Subsidiary Contract” means the contract to be entered into between NAFIN, acting on behalf of the Borrower, and CONAFOR pursuant to Section 3.01 (b) of the GEF Grant Agreement; as the same may be amended from time to time; and such term includes all schedules to the GEF Subsidiary Contract;

(x) “GEF Special Account” means the amount referred to in Part B.1 of Schedule 1 to the GEF Grant Agreement;

(y) “Implementation Agreement” means any of the agreements referred to in Section 2.01 (c) of the Project Agreement;

(z) “IMTA” means *Instituto Mexicano de Tecnología del Agua*, the Borrower’s Water Technology Institute;

(aa) “Indigenous Peoples Development Plan” or “IPDP” means CONAFOR’s plan for benefiting indigenous peoples under all Parts of the Project, which also includes the requirements for the preparation of IAPs in respect of Part D.4 of the Project, all as set forth in the Operational Manual;

(bb) “INE” means *Instituto Nacional de Ecología*, the Borrower’s National Ecology Institute;

(cc) “Local Financing Grant” means a grant provided by CONAFOR to a provider of Environmental Services to complement the payments for such services made to such provider by a private purchaser of Environmental Services in the Eligible Pilot Areas;

(dd) “MANDATO Contract” means the contract to be entered into among the Borrower, NAFIN and CONAFOR pursuant to Section 3.01 (b) of this Agreement, as the same may be amended from time to time; and such term includes all schedules to the MANDATO Contract;

(ee) “Maturity Fixing Date” means for each Disbursed Amount, the date on which the amortization schedule for said Disbursed Amount is established, such date being the first day of the Interest Period next following the Interest Period in which said Disbursed Amount is withdrawn;

(ff) “Municipalities” means any of the Borrower’s municipalities;

(gg) “NAFIN” means *Nacional Financiera, S.N.C.* a Mexican development bank serving as the Borrower’s financial agent for purposes of the Loan and as the Recipient’s financial agent for purposes of the GEF Trust Fund Grant;

(hh) “Official Gazette” means the Borrower’s *Diario Oficial de la Federación*;

(ii) “Operational Manual” means the manual approved by the Bank on February 27, 2006 as the same may be amended from time to time by agreement between CONAFOR and the Bank;

(jj) “Operational Rules” means the operational rules of the Borrower’s program to develop environmental services markets for carbon capture and biodiversity and to establish and improve agro-forestry systems (CABSA), dated November 24, 2004,

and the Borrower's payment for hydrological environmental services program (PSAH), dated October 3, 2003, as amended on June 18, 2004, as the same may be amended from time to time by agreement with the Bank;

(kk) "Performance Indicators" means the indicators included in the Operational Manual;

(ll) "PES" means the Programs of Environmental Services set forth in the Operational Rules;

(mm) "PES Contract" means the contract between CONAFOR and an *Ejido*, a Community or other land user, for the provision of Environmental Services which meet the environmental, social and other requirements of the Operational Manual for financing out of the proceeds of the Loan and the GEF Trust Fund Grant;

(nn) "PES Contract Payments" means the payments made by CONAFOR to land users pursuant to the terms of PES Contracts which meet the environmental, social and other requirements of the Operational Manual for financing out of the proceeds of the Loan and the GEF Trust Fund Grant;

(oo) "Procurement Plan" means CONAFOR's procurement plan, dated February 8, 2006 covering the initial 18 month period (or longer) of Project implementation, as the same shall be updated from time to time in accordance with the provisions of Section 3.02 to this Agreement, to cover succeeding 18 month periods (or longer) of Project implementation;

(pp) "Project Agreement" means the agreement between the Bank and CONAFOR of even date herewith, as the same may be amended from time to time, and such term includes all schedules and agreements supplemental to the Project Agreement;

(qq) "Project Team" means the team referred to in Section 2.01 (b) (ii) of the Project Agreement;

(rr) "Report-based Disbursements" means the Borrower's option for withdrawal of funds from the Loan and the GEF Trust Fund Grant referred to in Part A.5 of Schedule 1 to this Agreement and the GEF Grant Agreement;

(ss) "SAGARPA" means *Secretaría de Agricultura, Ganadería, Desarrollo Rural, Pesca y Alimentación*, the Borrower's Secretariat of Agriculture, Livestock, Rural Development, Fisheries and Food;

(tt) "SECTUR" means *Secretaría de Turismo*, the Borrower's Secretariat of Tourism;

(uu) “SEMARNAT” means *Secretaría de Medio Ambiente y Recursos Naturales*, the Borrower’s Secretariat for Environment and Natural Resources;

(vv) “SHCP” means *Secretaría de Hacienda y Crédito Público*, the Borrower’s Secretariat of Finance and Public Credit;

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

(xx) “States” means any of the Borrower’s states;

(yy) “Technical Strengthening Activity” means a technical assistance or training activity or activities to be carried out by a Community and/or *Ejido* for the improvement of the capacity of such Community and/or *Ejido* for the delivery of Environmental Services, which activity or activities are eligible for financing out of the proceeds of the Loan and the GEF Trust Fund Grant under Part C.4 (b) of the Project in accordance with the criteria and other requirements set forth in the Operational Manual;

(zz) “Technical Support Agency” means CONABIO, INE, IMTA and/or any other agency that may provide technical and monitoring support to CONAFOR in the implementation of the Project; and

(AA) “Water Environmental Services” means the services generated by forest ecosystems in the provision of water, the prevention of disasters, and the protection of infrastructure from damages caused by hydrological phenomena which benefit people other than the land users.

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

## ARTICLE II

### The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, an amount equal to forty five million Dollars (\$45,000,000), as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.09 of this Agreement.



Section 2.02. The amount of the Loan may be withdrawn from the Loan Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Bank shall so agree, to be made) in respect of the reasonable cost of the items listed in the table in Part A.1 of Schedule 1 to this Agreement and to be financed out of the proceeds of the Loan, including in respect of the front-end fee referred to in Section 2.04 of this Agreement, and in respect of any premiums 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.

Section 2.03. The Closing Date shall be June 30, 2011 or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a front-end fee in an amount equal to one percent (1%) of the amount of the Loan, subject to any waiver of a portion of such fee as may be determined by the Bank from time to time. 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: (a) eighty five one-hundredths of one per cent (0.85%) per annum from the date on which such charge commences to accrue in accordance with the provisions of Section 3.02 of the General Conditions to, but not including, the fourth anniversary of such date; and (b) seventy five one-hundredths of one per cent (0.75%) per annum thereafter.

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

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

Section 2.08. (a) Subject to the provisions of paragraph (b) of this Section, the Borrower shall repay each Disbursed Amount in semiannual installments payable on each February 15 and August 15, the first such installment to be payable on the ninth (9th) Interest Payment Date following the Maturity Fixing Date for said Disbursed Amount and the last such installment to be payable on the eighteenth (18th) Interest Payment Date following the Maturity Fixing Date for said Disbursed Amount. Each installment except for the last one shall be equal to one tenth (1/10th) of said Disbursed Amount. The last installment shall be equal to the remaining outstanding amount of said Disbursed Amount.

(b) Notwithstanding the provision of paragraph (a) of this Section, if any one or more installments of principal of any Disbursed Amount would, pursuant to the provision of such paragraph (a), be payable after August 15, 2020, the Borrower shall also pay on such date the aggregate amount of all such installments.

(c) The Bank shall notify the Borrower of the amortization schedule for each Disbursed Amount promptly after the Maturity Fixing Date for said Disbursed Amount.

(d) Notwithstanding the provisions of paragraph (a) through (c) of this Section in the event of a Currency Conversion of all or any portion of a Disbursed Amount 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.

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 Internacional* of NAFIN, and any person or persons whom he or she shall designate in writing are designated as representatives 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, Other Covenants

Section 3.01. (a) The Borrower declares its commitment to the objective of the Project, and, to this end, without any limitation or restriction upon any of its other obligations under the Loan Agreement, shall cause CONAFOR to perform in accordance with the provisions of the Project Agreement all the obligations of CONAFOR therein set forth, shall take or cause to be taken all actions, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable CONAFOR to perform such obligations, and shall not take or permit to be taken any action which would prevent or interfere with such performance.

(b) The Borrower, through SHCP, shall enter into a contract (the *MANDATO* Contract) with NAFIN and CONAFOR, 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;
- (ii) CONAFOR agrees to carry out the Project; and
- (iii) the Borrower agrees that, through SHCP and NAFIN as financial agent, the Borrower shall cooperate fully with CONAFOR to ensure that CONAFOR is able to comply with all of CONAFOR's obligations referred to in the Project Agreement.

(c) The Borrower shall exercise its rights and carry out its obligations under the *MANDATO* Contract in such a manner as to protect the interests of the Borrower and 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 *MANDATO* Contract. In case of any conflict between the terms of: (i) the *MANDATO* Contract; and (ii) those of this Agreement, the terms of this Agreement shall prevail.

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

(b) The Borrower shall cause CONAFOR to: (i) update the Procurement Plan in accordance with guidelines acceptable to the Bank; and (ii) furnish such update to the

Bank not later than 12 months after the date of the preceding Procurement Plan, for the Bank's approval.

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

Section 3.04. The Borrower shall participate and cause NAFIN to participate in the reviews referred to in Section 2.06 (c) of the Project Agreement.

## **ARTICLE IV**

### **Financial Covenants**

Section 4.01. (a) The Borrower shall cause NAFIN: (i) to maintain a financial management system, including records and accounts; and (ii) to prepare financial statements, all in accordance with consistently applied accounting standards acceptable to the Bank, adequate to reflect its operations, resources and expenditures related to the Project.

- (b) The Borrower shall cause NAFIN:
- (i) to have the financial statements referred to in paragraph (a) of this Section for each fiscal year (or other period agreed to by the Bank) audited, in accordance with consistently applied auditing standards acceptable to the Bank, by independent auditors acceptable to the Bank;
  - (ii) to furnish to the Bank as soon as available, but in any case not later than six months after the end of each such year (or such other period agreed to by the Bank): (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or such other period agreed to by the Bank), as so audited; and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Bank; and
  - (iii) to furnish to the Bank such other information concerning such records, accounts and the audit of such financial statements, and concerning said auditors, as the Bank may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Loan Account were made on the basis of Report-based Disbursements or statements of expenditure, the Borrower shall cause NAFIN to:

- (i) ensure that all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures are retained until at least one year after the Bank has received the audit report for, or covering, the fiscal year in which the last withdrawal from the Loan Account was made;
- (ii) enable the Bank's representatives to examine such records; and
- (iii) ensure that such statements of expenditure are included in any audit that the Bank may have requested pursuant to paragraph (b) of this Section.

## **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) CONAFOR shall have failed to perform any of its obligations under the Project Agreement or the *MANDATO* Contract or NAFIN shall have failed to perform any of its obligations under the *MANDATO* Contract.

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

- (c)
  - (i) Subject to subparagraph (ii) of this paragraph, the right of the Borrower to withdraw the proceeds of the GEF Trust Fund Grant for the financing of the Project shall have been suspended, canceled or terminated in whole or in part, pursuant to the terms of the agreement providing therefor, or
  - (ii) Subparagraph (i) of this paragraph shall not apply if the Borrower establishes to the satisfaction of the Bank that: (A) such suspension, cancellation or termination is not caused by the failure of the Borrower to perform any of its obligations under such agreement; and (B) adequate funds for the Project are available to the Borrower from other sources on terms and

conditions consistent with the obligations of the Borrower under this Agreement.

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

## 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 *MANDATO* Contract has been executed on behalf of the Borrower, NAFIN and CONAFOR; and

(b) the GEF Trust Fund Grant Agreement has been executed and delivered and all conditions precedent to its effectiveness or to the right of the Borrower to make withdrawals thereunder, except only the effectiveness of the Loan Agreement, have been fulfilled.

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, by counsel to each of the parties to the respective agreements:

(a) that the Project Agreement has been duly authorized or ratified by CONAFOR, and is legally binding upon CONAFOR in accordance with its terms; and

(b) that the *MANDATO* Contract has been duly authorized or ratified by the Borrower, NAFIN and CONAFOR and is legally binding upon the Borrower, NAFIN and CONAFOR in accordance with its terms.

Section 6.03. Without prejudice to the provisions of the General Conditions, the date specified for the purposes of Section 12.04 of the General Conditions is the date ninety (90) days after the date of this Agreement, but in no case later than the eighteen (18) months after the Bank's approval of the Loan which expires on September 29, 2007.

## ARTICLE VII

### Representative of the Borrower; Addresses

Section 7.01. Except as provided in Section 2.10 of this Agreement, the *Titular de la Unidad de Crédito Público* of SHCP 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  
Unidad de Crédito Público  
Palacio Nacional  
Patio Central  
3er piso, oficina 3010  
Colonia Centro  
06000 México, D.F.

Facsímile: 011-52-559158-1156

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:

INTBAFRAD  
Washington, D.C.

248423 (MCI),  
64145 (MCI),

Facsimile: (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 Mexico City, Mexico, as of the day and year first above written.

UNITED MEXICAN STATES

By /s/ Gerardo Rodríguez Regordosa  
Authorized Representative

INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

By /s/ Isabel Guerrero  
Authorized Representative

## SCHEDULE 1

### Withdrawal of the Proceeds of the Loan

#### A. General

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Loan and the GEF Trust Fund Grant, the allocation of the amounts of the Loan and the GEF Trust Fund Grant to each Category and the percentage of expenditures for items so to be financed by the Loan or the GEF Trust Fund Grant in each Category (with the proviso that no item can receive more than 100% total financing):

<u>Category</u>	<u>Amount of the Loan Allocated (Expressed in US Dollars)</u>	<u>Amount of the GEF Trust Fund Grant Allocated (Expressed in US Dollars)</u>	<u>% of Expenditures to be Financed by the Loan</u>	<u>% of Expenditures to be Financed by the GEF Trust Fund Grant</u>
(1) Goods, Training, Operating Costs and consultants' services for all Parts of the Project and Technical Strengthening Activities and Stipends	10,674,000	8,450,000	100%	100%
(2) Endowment Fund contribution	0	5,000,000	0%	100%
(3) (a) PES Contract Payments	25,938,500	750,000	100%	100%
(b) Local Financing Grants	8,275,000	800,000	100%	100%
(4) Front-end fee	112,500	0	Amount due under Section 2.04 of this Agreement	0

<u>Category</u>	<u>Amount of the Loan Allocated (Expressed in US Dollars)</u>	<u>Amount of the GEF Trust Fund Grant Allocated (Expressed in US Dollars)</u>	<u>% of Expenditures to be Financed by the Loan</u>	<u>% of Expenditures to be Financed by the GEF Trust Fund Grant</u>
(5) Premia for Interest Rate Caps and Interest Rate Collars	0	0	Amount due under Section 2.09 (c) of this Agreement	0
<b>TOTAL</b>	<u>45,000,000</u>	<u>15,000,000</u>		

2. For the purposes of this Schedule:

(a) the term “Training” means expenditures incurred in connection with the provision of training and in connection with meetings of the Advisory Committee (including trainers’ fees, logistics, materials, and the reasonable recurrent travel costs and per diem of participants);

(b) “Operating Costs” means reasonable recurrent expenditures to carry out the Project such as travel and per diem cost for supervision activities, preparation of promotion materials, communications services, rental of facilities, maintenance of Project facilities, equipment, vehicles, fuel, utilities, and consumable material and supplies; and

(c) “Stipends” means payments to the community technicians referred to in Part C.2 of the Project for operating expenses associated with carrying out their activities under the Project, all in the amounts eligible for financing in accordance with the 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 \$4,500,000, may be made on account of payments made for expenditures incurred within twelve months before that date, but in no case incurred before December 16, 2005; and

(b) payments covered by Category (3) (b) above for a Local Financing Grant, unless: (i) the Operational Rules have been revised to the satisfaction of the Bank to incorporate the procedures and eligibility for financing of Local Financing Grants; and

(ii) for those requiring an IAP as per the terms of the IPDP, the respective IAP has been approved by the Bank.

4. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditure for expenditures under contracts for: (a) goods estimated to cost less than the equivalent of \$300,000 per contract; (b) consulting firms estimated to cost less than the equivalent of \$200,000 per contract; (c) individual consultants estimated to cost less than the equivalent of \$50,000 per contract; and (d) Operating Costs, Stipends, PES Contract Payments, Local Financing Grants and Technical Assistance Activities, all under such terms and conditions as the Bank shall specify by notice to the Borrower.

5. The Borrower, through NAFIN as financial agent, may request withdrawals from the Loan Account to be made on the basis of reports to be submitted to the Bank in form and substance satisfactory to the Bank, such reports to include the FMR and any other information as the Bank shall specify by notice to the Borrower (Report-based Disbursements). In the case of the first such request submitted to the Bank before any withdrawal has been made from the Loan Account, the Borrower shall cause NAFIN to submit to the Bank only a statement with the projected sources and applications of funds for the Project for the six-month period following the date of such request.

B. Special Account

1. The Borrower may, for the purposes of the Project, 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 or attachment.

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

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

(b) if the Borrower, through NAFIN, is making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex B to this Schedule 1.

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

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

(a) if the Bank, at any time, is not satisfied that the reports referred to in Part A.5 of this Schedule 1 adequately provide the information required for Report-based Disbursements;

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

(c) if the Borrower, through NAFIN shall have failed to furnish to the Bank, within the period of time specified in Section 4.01 (b) (ii) of this Agreement, any of the audit reports required to be furnished to the Bank pursuant to said Section in respect of the audit of: (A) the records and accounts for the Special Account; or (B) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based Disbursements or were made on the basis of statements of expenditure, as the case may be.

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

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

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

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

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

**Annex A**

**to**

**SCHEDULE 1**

**Operation of Special Account  
When Withdrawals Are Not  
Report-based Disbursements**

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

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

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

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

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

**Annex B**

**to**

**SCHEDULE 1**

**Operation of Special Account  
When Withdrawals Are  
Report-based Disbursements**

1. Withdrawals from the Loan Account shall be deposited by the Bank into the Special Account in accordance with the provisions of Schedule 1 to this Agreement. Each such deposit into the Special Account shall be withdrawn by the Bank from the Loan Account under one or more of the Eligible Categories.
  
2. Upon receipt of each application for withdrawal of an amount of the Loan, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account an amount equal to the lesser of: (a) the amount so requested; and (b) the amount which the Bank has determined, based on the reports referred to in Part A.5 of this Schedule 1 applicable to such withdrawal application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such reports.



## **SCHEDULE 2**

### **Description of the Project**

The objective of the Project is to enhance the provision in the Borrower's territory of Environmental Services of national and global significance and secure their long term sustainability.

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 objective:

#### Part A: Development of Sustainable PES Financing Mechanisms

Development of new financing mechanisms for PES in the Eligible Pilot Areas, and replication strategies for such mechanisms to expand their use to other areas, all with respect to environmental services which would be derived from:

1. water users;
2. biodiversity users, in which case the mechanisms would include: (a) development of local programs; and (b) (i) development; (ii) establishment; and (iii) capitalization of the Endowment Fund; and
3. carbon users.

The development of all such mechanisms will include diagnosis of land uses, relevant technical studies, promotional efforts, and capacity building of the agencies concerned and could be channeled either through existing environmental services programs or through new, stand-alone local mechanisms.

#### Part B: Development and Strengthening of PES Delivery Mechanisms

Strengthening and improvement of the efficiency in the delivery of existing PES through:

1. strengthening of existing delivery mechanisms including: (a) capacity building of institutions relevant to the implementation of the Project; (b) development of improved Operational Rules; and (c) improvement of enforcement and impact monitoring; and
2. development of local delivery mechanisms in the Eligible Pilot Areas.

Part C: Supporting Environmental Services Providers

1. Carrying out of diagnostics of the organizational structure and capacity of the Communities and *Ejidos*.
2. Provision of community technicians to work with Communities and *Ejidos* in developing customized capacity building strategies, and act as liaisons among Communities, *Ejidos* and/or CONAFOR as required for the Project.
3. Strengthening of the organizational capacity of Communities and *Ejidos*.
4. (a) Provision of technical assistance to improve the capacity of Communities and *Ejidos* to deliver Environmental Services; and/or  
(b) carrying out of Technical Strengthening Activities.

Part D: Financing of Environmental Services

Financing of:

1. Water Environmental Services.
2. Biodiversity Environmental Services.
3. Carbon Sequestration Environmental Services.
4. Local Financing Grants in the Eligible Pilot Areas.

Part E: Project Management

Establishment and operation of the Project Team, and provision of the technical assistance, equipment and training required therefor.

\* \* \*

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