

CONFORMED COPY

LOAN NUMBER 3271 ME

(Water Supply and Sanitation Sector Project)

between

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

and

BANCO NACIONAL DE OBRAS Y
SERVICIOS PUBLICOS, S.N.C.

Dated January 18, 1991

LOAN NUMBER 3271 ME

LOAN AGREEMENT

AGREEMENT, dated January 18, 1991, between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and BANCO NACIONAL DE OBRAS Y SERVICIOS PUBLICOS, S.N.C. (the Borrower).

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

(B) by an agreement (the Guarantee Agreement) of even date herewith between the Guarantor and the Bank, the Guarantor has agreed to guarantee the obligations of the Borrower in respect of the Loan and to undertake such other obligations as set forth in the Guarantee Agreement; and

WHEREAS the Bank has agreed, on the basis, inter alia, of the foregoing, to extend the Loan to the

Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Loan and Guarantee Agreements" of the Bank, dated January 1, 1985, with the modifications set forth in Schedule 4 to this Agreement (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) "CETES" means Certificados de la Tesoreria de la Federacion (Federal Treasury Certificates), as defined in the Diario Oficial, dated November 28, 1977, published by the Guarantor;

(b) "CETES Rate" means the average annual yield, calculated monthly, on CETES with maturities of up to one month, issued during the month in which a CETES Rate is calculated, or such other index reflecting the cost of funds to the Guarantor as shall be acceptable to the Guarantor and the Bank;

(c) "Charter" means the Ley Organica of the Borrower published in the Diario Oficial on January 20, 1986, as amended to the date of this Agreement;

(d) "CNA" means the Guarantor's National Water Commission (Comision Nacional del Agua);

(e) "free-limit Sub-loan" means a Sub-loan, as so defined, which qualifies as a free-limit Sub-loan pursuant to the provisions of paragraph 2 (b) of Schedule 5 to this Agreement;

(f) "IMTA" means the Guarantor's Mexican Institute of Water Technology (Instituto Mexicano de Tecnologia del Agua);

(g) "Marginality Index" means the index, developed by the Guarantor's Consejo Nacional de Poblacion (National Population Council) to measure the level of economic development of individual municipalities. The Marginality Index is higher for less developed areas and lower for more developed areas;

(h) "National Water Quality and Information Program" means the water quality monitoring program presented by CNA to the Bank in a document entitled Programa Nacional de Informacion y Monitoreo de la Calidad del Agua, dated June 26, 1990;

(i) "Normatividad" means the Normatividad para el Ejercicio de Creditos Provenientes de Organismos Financieros Internacionales Destinados a la Banca de Desarrollo y Fondos de Fomento con Apoyos del Gobierno Federal por Diferenciales Negativos en Tasas de Interes (Regulations Governing the Use of Loans from International Finance Institutions to Development Banks and Funds with Assistance from the Federal Government for Negative Differentials in Interest Rates), issued by the

Guarantor's Finance Secretariat (Secretaria de Hacienda y Credito Publico) and Planning and Budgeting Secretariat (Secretaria de Programacion y Presupuesto), by means of Oficio No. 102-B-049, dated November 18, 1988;

(j) "Operating Agency" means a private, state or municipal water supply and sanitation enterprise to which the Borrower proposes to make or has made a Sub-loan;

(k) "Peso" or "pesos" means the currency of the Guarantor;

(l) "Revaluation Guidelines" means the guidelines for revaluing fixed assets of Operating Agencies, prepared by CNA pursuant to Section 3.05 of the Guarantee Agreement;

(m) "SEDUE" means the Guarantor's Urban Development and Ecology Secretariat (Secretaria de Desarrollo Urbano y Ecologia);

(n) "SHCP" means the Guarantor's Finance Secretariat (Secretaria de Hacienda y Credito Publico);

(o) "SPP" means the Guarantor's Planning and Budgeting Secretariat (Secretaria de Programacion y Presupuesto);

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

(q) "Sub-loan" means a loan made or proposed to be made by the Borrower out of the proceeds of the Loan to an Operating Agency for a Sub-project;

(r) "Sub-loan Agreement" means an agreement between the Borrower and an Operating Agency (to which, in the case of a state or municipal Operating Agency, the Guarantor and the government of the state in which the state or municipal Operating Agency operates shall also be parties), which agreement contains the terms and conditions of a Sub-loan;

(s) "Sub-project" means a specific water supply or sanitation development project to be carried out by an Operating Agency utilizing the proceeds of a Sub-loan; and

(t) "SWS" means the State Water Supply and Sanitation Subcommittee (Subcomite Especial de Agua Potable y Alcantarillado) in each of the Guarantor's states.

ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Loan Agreement, various currencies that shall have an aggregate value equivalent to the amount of three hundred million dollars (\$300,000,000), being the sum of withdrawals of the proceeds of the Loan, with each withdrawal valued by the Bank as of the date of such withdrawal.

Section 2.02. (a) The amount of the Loan may be withdrawn from the Loan Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Bank shall so agree, to be made) in respect of the reasonable cost of goods and services required for the Project and to be financed out

of the proceeds of the Loan.

(b) The Borrower shall, for the purposes of the Project, open and maintain in dollars a special deposit account in its Central Bank on terms and conditions satisfactory to the Bank. Deposits into payments out of, the Special Account shall be made in accordance with the provisions of Schedule 7 to this Agreement.

Section 2.03. The Closing Date shall be June 30, 1996 or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower and the Guarantor of such later date.

Section 2.04. The Borrower shall pay to the Bank a commitment charge at the rate of three-fourths of one per cent ($3/4$ of 1%) per annum on the principal amount of the Loan not withdrawn from time to time.

Section 2.05. (a) The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, at a rate for each Interest Period equal to the Cost of Qualified Borrowings determined in respect of the preceding Semester, plus one-half of one percent ($1/2$ of 1%). On each of the dates specified in Section 2.06 of this Agreement, the Borrower shall pay interest accrued on the principal amount outstanding during the preceding Interest Period, calculated at the rate applicable during such Interest Period.

(b) As soon as practicable after the end of each Semester, the Bank shall notify the Borrower and the Guarantor of the Cost of Qualified Borrowings determined in respect of such Semester.

(c) For the purposes of this Section:

(i) "Interest Period" means a six-month period ending on the date immediately preceding each date specified in Section 2.06 of this Agreement, beginning with the Interest Period in which this Agreement is signed.

(ii) "Cost of Qualified Borrowings" means the cost, as reasonably determined by the Bank and expressed as a percentage per annum, of the outstanding borrowings of the Bank drawn down after June 30, 1982, excluding such borrowings or portions thereof as the Bank has allocated to fund: (A) the Bank's investments; and (B) loans which may be made by the Bank after July 1, 1989 bearing interest rates determined otherwise than as provided in paragraph (a) of this Section.

(iii) "Semester" means the first six months or the second six months of a calendar year.

(d) On such date as the Bank may specify by no less than six months' notice to the Borrower, paragraphs (a), (b) and (c) (iii) of this Section shall be amended to read as follows:

"(a) The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, at a rate for each Quarter equal to the Cost of Qualified Borrowings determined in respect of the preceding Quarter,

plus one-half of one percent (1/2 of 1%). On each of the dates specified in Section 2.06 of this Agreement, the Borrower shall pay interest accrued on the principal amount outstanding during the preceding Interest Period, calculated at the rates applicable during such Interest Period."

"(b) As soon as practicable after the end of each Quarter, the Bank shall notify the Borrower and the Guarantor of the Cost of Qualified Borrowings determined in respect of such Quarter."

"(c) (iii) 'Quarter' means a three-month period commencing on January 1, April 1, July 1 or October 1 in a calendar year."

Section 2.06. Interest and other charges shall be payable semi-annually on February 15 and August 15 in each year.

Section 2.07. The Borrower shall repay the principal amount of the Loan in accordance with the amortization schedule set forth in Schedule 3 to this Agreement.

ARTICLE III

Transfer of Loan Proceeds

Section 3.01. (a) The Borrower shall enter into contractual arrangements, satisfactory to the Bank, with the Guarantor, providing, inter alia, for:

- (i) transfer to the Guarantor of the proceeds of the Loan in the same currencies as received from the Bank;
- (ii) onlending by the Guarantor to the Borrower of the proceeds of the Loan to carry out Parts A and B.3 of the Project under terms and conditions which shall include: (A) funds onlent shall be denominated and repayable in pesos; (B) the interest rate charged on funds shall be equal to the CETES Rate and shall be paid on amounts withdrawn and outstanding on a monthly basis; and (C) principal amounts withdrawn and outstanding shall be repaid semi-annually in accordance with the timetable set forth in the Amortization Schedule in Schedule 3 to this Agreement;
- (iii) provision by the Guarantor to the Borrower, in accordance with the Normatividad and by means of specific annual budgetary allocations, of all amounts required to cover: (A) the difference, if any, between the CETES Rate and the interest rate charged by the Borrower on Sub-loans under Part A of the Project; and (B) financial intermediation and operating costs of the Borrower; and
- (iv) payment by the Guarantor to the Borrower of all amounts required by the Borrower to pay to the Bank on account of principal, interest and other charges on the proceeds of the Loan.

(b) Except as the Bank may otherwise agree, the Borrower shall not change or fail to enforce the contractual arrangements referred to in paragraph (a) of

this Section.

ARTICLE IV

Execution of the Project; Management and Operations of the Borrower

Section 4.01. The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall: (i) carry out Parts A and B.3 of the Project and conduct its operations and affairs in accordance with sound financial standards and practices, with qualified management and personnel, and in accordance with the Charter; and (ii) provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for it to carry out Parts A and B.3 of the Project.

Section 4.02. (a) The Borrower undertakes that, unless the Bank shall otherwise agree, Sub-loans will be made in accordance with the procedures and on the terms and conditions set forth or referred to in Schedule 5 to this Agreement and elsewhere in this Agreement. Except as the Bank shall otherwise agree, the Borrower shall not amend, abrogate, waive, or fail to enforce any provision of a Sub-loan Agreement.

(b) The Borrower shall exercise its rights in relation to each Sub-project in such manner as to: (i) protect the interests of the Bank and the Borrower; (ii) comply with its obligations under this Agreement; and (iii) achieve the purposes of the Project.

Section 4.03. 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 6 to this Agreement.

Section 4.04. Except as the Bank shall otherwise agree, the Borrower shall not enter into a Sub-loan Agreement with an Operating Agency unless:

(a) the Operating Agency is directly responsible for operating a water supply or sanitation system, and has its own legal personality (these conditions need not apply to Sub-loan Agreements, for an aggregate amount of Sub-loans equivalent to no more than \$25,000,000 equivalent, entered into before September 1, 1991);

(b) in the case of an Operating Agency receiving an aggregate equivalent to \$1,000,000 or more in Sub-loans, the Operating Agency is collecting water supply and sewerage charges sufficient to produce total operating revenues equivalent to not less than the sum of its total operating expenses. For purposes of this paragraph, the term "total operating revenues" means revenues from all sources related to operations, and the term "total operating expenses" means all expenses related to operations, including administration, adequate maintenance and taxes and payments in lieu of taxes (an Operating Agency which does not meet the conditions set forth in this paragraph shall only be eligible for Sub-loans, aggregating less than the equivalent of \$1,000,000, for institutional development and emergency infrastructure works);

(c) the Operating Agency presents a feasibility study for the relevant Sub-project, approved by CNA and the relevant SWS and satisfactory to the Bank, which shall include, inter alia, (i) an analysis of Sub-project

alternatives which identifies the alternative representing the least cost and specifies that such alternative be the one financed through the proposed Sub-loan; (ii) an environmental impact amelioration action plan for the Sub-project, prepared by CNA, based on a SEDUE environmental impact assessment, with suggested proposals for ameliorating any negative environmental impact specified in the assessment; and (iii) a finding that the proposed Sub-project should yield a rate of return, calculated in a manner satisfactory to the Bank, of at least 12% in the case of water supply Sub-projects or at least 10% in the case of sanitation or water pollution control Sub-projects.

Section 4.05. Each Sub-project shall include a technical assistance and/or training component to strengthen the institutional capabilities of the Operating Agency in question.

Section 4.06. The Borrower shall, by no later than March 31, 1991, present to the Bank a timetable and consultants' terms of reference, satisfactory to the Bank, for carrying out Part B.3 of the Project.

Section 4.07. The Borrower shall participate in the annual reviews, and carry out the annual plans of action, referred to in Section 3.09 of the Guarantee Agreement.

Section 4.08. Throughout the course of Project implementation, and without limitation to the provisions of Section 9.07 of the General Conditions, the Borrower shall present semiannual progress reports to the Bank regarding the Project, no later than each September 30 for semesters ending on each June 30, and no later than each March 31 for semesters ending on each December 31. Such progress reports shall compare Project advances for each semester with the goals and projections set forth in the relevant action plan referred to in Section 3.09 of the Guarantee Agreement. Such progress reports, in the case of unsatisfactory Project advances, shall recommend remedial actions to correct the situation.

Section 4.09. The Borrower shall promptly exercise its rights set forth in paragraph 4 (f) of Schedule 5 to this Agreement.

ARTICLE V

Financial Covenants

Section 5.01. The Borrower shall maintain records and accounts adequate to reflect in accordance with consistently maintained sound accounting practices the operations and financial condition of the Borrower, including separate records and accounts for the Project.

Section 5.02. (a) The Borrower shall:

- (i) have the records referred to in Section 5.01 of this Agreement, its accounts and financial statements (balance sheets, statements of income and expenses and related statements) and records and accounts for the Special Account for each fiscal year audited in accordance with generally accepted auditing standards and procedures, by independent and qualified auditors;
- (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 said financial statements for such year as so audited and (B) the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

- (iii) furnish to the Bank such other information concerning the said records, accounts and financial statements and the audit thereof as the Bank shall from time to time reasonably request.

(b) For all expenditures with respect to which withdrawals from the Loan Account were made on the basis of statements of expenditure, the Borrower shall:

- (i) maintain, in accordance with Section 5.01 of this Agreement, records and accounts reflecting such expenditures;
- (ii) retain, until at least one year after the Bank has received the audit report for the fiscal year in which the last withdrawal from the Loan Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
- (iii) enable the Bank's representatives to examine such records; and
- (iv) ensure that such records and accounts are included in the annual audit referred to in paragraph (a) of this Section and that the report of such audit contains a separate opinion by said auditors as to whether the statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals.

ARTICLE VI

Remedies of the Bank

Section 6.01. Pursuant to Section 6.02 (k) of the General Conditions, the following additional events are specified:

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

(b) that any action shall have been taken for the liquidation, dissolution or disestablishment of the Borrower or for the suspension of its operations.

Section 6.02. Pursuant to Section 7.01 (h) of the General Conditions, the following additional events are specified, namely, the events specified in paragraphs (a) or (b) of Section 6.01 shall occur.

ARTICLE VII

Effective Date; Termination

Section 7.01. The following event is specified as an additional condition to the effectiveness of the Loan Agreement within the meaning of Section 12.01 (c) of the General Conditions, namely that the contractual arrangements referred to in Section 3.01 (a) of this Agreement shall have been entered into.

Section 7.02. The following is specified as an additional matter, within the meaning of Section 12.02 (c) of the General Conditions, to be included in the opinion or opinions to be furnished to the Bank, namely that the contractual arrangements referred to in Section 3.01 (a) of this Agreement have been duly authorized and are legally binding upon the parties thereto.

Section 7.03. The date April 18, 1991 is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VIII

Representative of the Borrower; Addresses

Section 8.01. The Director General of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 8.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Bank:

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

Cable address:

INTBAFRAD
Washington, D.C.

Telex:

197688 (TRT),
248423 (RCA),
64145 (WUI) or
82987 (FTCC)

For the Borrower:

Banco Nacional de Obras y
Servicios Publicos, S.N.C.
Insurgentes Norte 423
06900 Mexico, D.F.
Mexico

Cable address:

BANTECARIO
Mexico City

Telex:

BNOSME 01772619
Mexico City

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

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Shahid Husain
Regional Vice President
Latin America and the Caribbean

BANCO NACIONAL DE OBRAS Y
SERVICIOS PUBLICOS, S.N.C.

By /s/ Gustavo Carvajal Moreno
Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Loan

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Loan, the allocation of the amounts of the Loan to each Category and the percentage of expenditures for items so to be financed in each Category:

Category	Amount of the Loan Allocated (Expressed in Dollar Equivalent)	% of Expenditures to be Financed
(1) Goods and civil works for Part A of the Project	208,000,000	50%
(2) Consultants' services for Part A of the Project	23,000,000	100%
(3) Goods and civil works for Part B of the Project	24,000,000	80%
(4) Consultants' services for Part B of the Project	15,000,000	100%
(5) Unallocated	30,000,000	
TOTAL	300,000,000 =====	

2. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made:

(a) in respect of goods, works or services financed by a Sub-loan unless the Sub-loan has been made in accordance with the procedures and on the terms and conditions set forth or referred to in Schedule 5 to this Agreement; and

(b) in respect of payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding the equivalent of \$30,000,000, may be made in respect of Categories (1) through (4) on account of payments made for expenditures before that date but after May 1, 1990.

SCHEDULE 2

Description of the Project

The objectives of the Project are: (a) to improve the quantity and quality of water supply and sanitation services throughout the territory of the Guarantor (except for the metropolitan areas of Mexico City, Guadalajara and Monterrey); (b) to support the institutional strengthening of CNA, IMTA, Operating Agencies and the Borrower with regard to their activities in the water supply and sanitation sector; (c) to ameliorate the environmental impact of water supply and sanitation sector activities; and (d) to support sound pricing policies and the reduction of subsidization for the water supply and sanitation sector.

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

Part A:

Provision of Sub-loans to Operating Agencies to finance Sub-projects aimed at rehabilitating and expanding water supply and sanitation systems, including sewerage treatment plants, and at strengthening the institutional capabilities of such Operating Agencies.

Part B:

1. Provision of technical assistance and training for CNA with regard to: (a) improving and assisting in Sub-project evaluation and preparation; (b) reviewing and updating technical norms and parameters for the design, construction and maintenance of water supply and sanitation systems; (c) designing and implementing a monitoring system for the water supply and sanitation sector; (d) assisting in the strengthening of institutional and environmental assessment capabilities of Operating Agencies; (e) carrying out a pilot water pollution control effort in the Lerma-Chapala Basin; and (f) preparing for follow-up Bank projects in the water supply and sanitation sector.

2. Strengthening of the IMTA National Training Center through: (a) upgrading its training facilities in Cuernavaca; (b) acquiring and utilizing training materials and equipment; and (c) developing and implementing a management and technical training program for water supply and sanitation sector managers and staff.

3. Strengthening of the capabilities of the Borrower in the areas of Sub-project preparation and evaluation, of procurement, and of monitoring and evaluation with regard to the water supply and sanitation sector.

4. Construction of facilities (including water sampling and analysis laboratories) and provision of materials and equipment for the operation of the National Water Quality and Information Program.

5. Undertaking of studies to: (a) provide or update basic information needed to define medium- and long-term water pollution control strategies and policies; and (b) examine alternative mechanisms for encouraging private sector participation in the provision of water supply and sanitation services.

* * *

The Project is expected to be completed by December

31, 1995.

SCHEDULE 3

Amortization Schedule

Date Payment Due dollars)*	Payment of Principal (expressed in
On each February 15 and August 15	
beginning August 15, 1996 through February 15, 2008	12,500,000.00

