

CONFORMED COPY

LOAN NUMBER 3102 BR

Loan Agreement

(Water Sector Project in the State of Sao Paulo)

between

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE
SAO PAULO-SABESP

Dated February 16, 1990

LOAN NUMBER 3102 BR

LOAN AGREEMENT

AGREEMENT, dated February 16, 1990 between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE SAO PAULO-SABESP (the Borrower).

WHEREAS (A) The Federative Republic of Brazil (the Guarantor), the State of Sao Paulo (the State), the Departamento de Aguas e Energia Eletrica (DAEE) 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;

(C) by an agreement (the Shareholders Agreement) of even date herewith between the Bank and the State and DAEE, the State and DAEE have agreed to undertake certain obligations with regard to the execution of the Project and the performance by the Borrower of its obligations under the Loan Agreement; and

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

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Loan and Guarantee Agreements" of the Bank, dated January 1, 1985, with the last sentence of Section 3.02 deleted (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) "Special Account" means the account referred to in Section 2.02 (b) of this Agreement;

(b) "Tariff Law" means Law No. 6,528 of the Guarantor, dated May 11, 1978, published in Diario Oficial of May 12, 1978, as amended to the date of this Agreement;

(c) "Subproject" means a specific water supply or sewerage project consisting of one or more of the following: (i) construction, expansion or improvement of water supply or sewerage systems for urban areas; (ii) construction of sewerage treatment plants in selected cities; (iii) construction of water and sewerage house connections and acquisition and installation of water meters; (iv) installation of production metering equipment and execution of leak detection programs; (v) acquisition of operational equipment; and (vi) designing of water supply or sewerage systems, including provision of recruiting engineering and consulting services;

(d) "free-limit Subproject" means a Subproject to be carried out in a city with a population smaller than 200,000, as so defined, the estimated total investment cost of which shall not exceed the sum of \$4,000,000 equivalent, which fully meets the Eligibility Criteria set forth in Schedule 6 to this Agreement and which shall be subject to review and approval by the Bank on an ex post basis;

(e) "Eligible Subproject" means a Subproject which has been approved by the Bank after reviewing the information to be provided by the Borrower on such Subproject pursuant to Section 3.03 (a) of this Agreement or a free-limit Subproject for which the Bank has authorized withdrawals from the Loan Account on the basis of the information provided by the Borrower pursuant to Section 3.03 (b) of this Agreement;

(f) "FSRMM" means Adicional ao Frete Para a Renovacao da Marinha Mercante - AFRMM, the Borrower's Freight Surcharge for the Renewal of the Merchant Marine established by Decree Law 1,142 of December 30, 1970, as amended to December 31, 1987, or any other tax, levy or charge that, in the reasonable opinion of the Bank, may substitute it, in whole or part, after January 1, 1988;

(g) "Letter of Agreement" means the Agreement between the State and the Borrower, referred to in Section 7.01 of this Agreement, which sets forth the Borrower's rolling five year investment program ("Plano Minimo") and the respective financial and technical obligations of the State and the Borrower in the carrying out of such investment program, as such agreement may be amended from time to time in agreement with the Bank; and

(h) "LRMC Study" means the study referred to in Section 3.05 of this Agreement.

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 two hundred eighty million dollars (\$280,000,000), being the sum 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 described in Schedule 2 to this Agreement 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 account in Banco Central do Brasil on terms and conditions satisfactory to the Bank. 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 June 30, 1994 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 per annum for each Interest Period equal to one-half of one percent per annum above the Cost of Qualified Borrowings for the last Semester ending prior to the commencement of such Interest Period.

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

(c) For purposes of this Section:

(i) "Interest Period" means the six-month period commencing on each date specified in Section 2.06 of this Agreement, including the Interest Period in which this Agreement is signed.

(ii) "Cost of Qualified Borrowings" means the cost of the outstanding borrowings of the Bank drawn down after June 30, 1982, expressed as a percentage per annum, as reasonably determined by the Bank.

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

Section 2.06. Interest and other charges shall be payable semiannually on March 15 and September 15 in each year.

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

ARTICLE III

Execution of the Project

Section 3.01. 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 carry out the Project with due diligence and efficiency and in conformity with appropriate administrative, engineering, ecological, sanitation and public utility practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

Section 3.02. 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.

Section 3.03. (a) When presenting a Subproject (other than a free-limit Subproject) to the Bank for approval, the Borrower shall furnish to the Bank an application, in form and substance satisfactory to the Bank, together with: (i) an appraisal of the Subproject, including the economic evaluation set forth in Schedule 6 to this Agreement and a description of the expenditures proposed to be financed out of the proceeds of the Loan; (ii) a detailed description of how such Subproject meets the Eligibility Criteria set forth in Schedule 6 to this Agreement, including in the case of dams specific safety, ecological and resettlement plans, and (iii) such other information as the Bank shall reasonably request in respect of such Subproject.

(b) Each request by the Borrower for authorization to make withdrawals from the Loan Account in respect of a free-limit Subproject shall contain: (i) a summary description of the Subproject, including the economic evaluation and technical criteria set forth in Schedule 6 to this Agreement and a description of the expenditures proposed to be financed out of the proceeds of the Loan; and (ii) such other information as the Bank shall reasonably request in respect of such Subproject.

Section 3.04. Without limitation to the provisions of Section 3.01 of this Agreement, the Borrower shall: (a) carry out with due diligence and efficiency and in conformity with appropriate practices the dam safety, environmental protection and resettlement plans included in Subprojects which contain the construction, expansion or improvement of dams, reservoirs or other flow control structures; and (b) provide, promptly as needed, the funds, facilities, services and other resources required for the purpose.

Section 3.05. The Borrower shall: (a) not later than March 31, 1990 furnish to the Bank a copy of the findings and recommendations of its study on the structure of its tariffs and the long-run marginal cost of its water supply and sewerage services; (b) allow the Bank a reasonable opportunity to comment on such findings and recommendations; and (c) put into effect such recommendations which are acceptable to the Bank and the Borrower.

Section 3.06. (a) Without limitation to the provisions of Section 9.07 of the General Conditions, the Borrower shall: (i) not later than November 30 each year, starting not later than November 30, 1990, prepare and furnish to the Bank a general financial projection (as required under Article V of this Agreement) for the following five years (including the monitoring of own cash contributions to total investment program, as stipulated in the Letter of Agreement) and the Borrower's detailed investment plan (including but not limited to investments under the Project) for the following calendar year; (ii) prepare and furnish to the Bank not later than September 30 and March 31 of each year, starting not later than September 30, 1990, a report of such scope and detail as the Bank shall reasonably request (including monitoring indicators satisfactory to the Bank) on the execution of the Project and the compliance by the Borrower, the State and DAEE of their respective obligations under this Agreement, the Shareholders Agreement and the Letter of Agreement.

(b) The Borrower shall carry out each investment plan referred to in paragraph (a) (i) of this Section with due diligence and efficiency and, unless the Bank shall otherwise agree, shall not amend any such plan or any part thereof by more than 20% of its total expected cost, as set forth in such plan.

Section 3.07. The Borrower shall: (a) carry out its obligations under the Letter of Agreement with due diligence and efficiency; (b) take all action required on its part to update annually the investment program and other obligations therein contained in terms satisfactory to the Bank; and (c) unless the Bank shall otherwise agree, not amend or concur in any action that would have the effect of amending or abrogating the Letter of Agreement or any provision thereof.

Section 3.08. The Borrower shall: (a) carry out not later than December 31, 1991, a study including a detailed assessment of the degree of treatment required for sewerage effluents in the territories of the State, the benefits and costs thereof, and the sources of revenues to meet the investments recommended thereunder and their operational costs; (b) promptly upon its completion, furnish to the Bank a copy of the findings and recommendations of such study; and (c) allow the Bank a reasonable opportunity to comment on such findings and recommendations.

Section 3.09. Without limiting the generality of Section 9.08 of the General Conditions, the Borrower shall, under arrangements satisfactory to the Bank, cause the dams, reservoirs and water control schemes constructed under the Project to be periodically inspected in accordance with sound engineering practice in order to determine whether there are any deficiencies in the condition of such structures, or in the quality and adequacy of maintenance or methods of operations of the same, which may endanger their safety. To this end, the Borrower shall propose to the Bank appropriate arrangements for the Bank's review no later than one year before the expected completion of such structures.

Section 3.10. Not later than December 15 of each year, the Borrower shall exchange views with the Bank on the execution of the Project, the Borrower's investment program and financial forecasts for the following calendar year and its performance under, and the updating of, the Letter of Agreement.

ARTICLE IV

Management and Operations of the Borrower

Section 4.01. (a) The Borrower shall carry on its operations and conduct its affairs in accordance with sound administrative, financial, engineering, sanitation, public utility and ecological practices under the supervision of qualified and experienced management assisted by competent staff in adequate numbers.

(b) The Borrower shall continue its practice of carrying out economic feasibility studies on the basis of criteria substantially similar to those set forth in paragraph I of Schedule 6 to this Agreement, to select design and carry out investments other than those included in the Project.

Section 4.02. The Borrower shall at all times operate and maintain its plants, machinery, equipment and other property, and from time to time promptly as needed, make all necessary repairs and renewals thereof, all in accordance with sound engineering, financial and public utility practices.

Section 4.03. The Borrower shall take out and maintain with responsible insurers, or make other provisions satisfactory to the Bank for, insurance against such risks and in such amounts as shall be consistent with appropriate practice.

Section 4.04. In order to improve its operational efficiency, the Borrower shall: (a) reduce unaccounted-for water to no more than 22% of total production by December 31, 1993 and thereafter and (b) increase the number of consumers per employee to 235 by December 31, 1993 and thereafter.

ARTICLE V

Financial Covenants

Section 5.01. (a) The Borrower shall maintain records and accounts adequate to reflect in accordance with sound accounting practices its operations and financial condition, including separate accounts to reflect all resources and expenditures in respect of the Project.

(b) The Borrower shall:

(i) have its records, accounts and financial statements (balance sheets, statements of income and expenses and related statements) and the records and accounts for the Special Account for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;

(ii) furnish to the Bank as soon as available, but in any case not later than six months after the end of each such year: (A) certified copies of its financial statements for such year as so audited; and (B) the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

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

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

(i) maintain, in accordance with paragraph (a) of this Section, 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 (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 5.02.(a) Except as the Bank shall otherwise agree, the Borrower shall produce for each of its fiscal years after its fiscal year ending on December 31, 1990, total revenues equivalent to not less than the sum of its: (i) total operating expenses; (ii) dividends; (iii) debt service requirements; and (iv) at least 32% of expenditures incurred and expected to be incurred under, or related to, the Project during such year or a provision for depreciation on a straight-line based on the useful lives of depreciable assets in operation (quotas de depreciacao), or other basis acceptable to the Bank, whichever is greater.

(b) Before November 30 in each of its fiscal years, the Borrower shall, on the basis of forecasts by the Borrower and satisfactory to the Bank, review whether it would meet the requirements set forth in paragraph (a) in respect of such year and the next following fiscal year and shall furnish to the Bank the results of such review upon its completion.

(c) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (a) for the Borrower's fiscal years covered by such review, the Borrower shall take all necessary measures (including, inter alia, adjustments of the structure or levels of its rates) in order to meet such requirements.

(d) For purposes of this Section:

(i) The term "total revenues" means the sum of total operating revenues and net non-operating income.

(ii) The term "total operating revenues" means revenues from all sources related to operations.

(iii) The term "net non-operating income" means the difference between:
operations; and

(A) revenues from all sources other than those related to
incurred in (B) expenses, including taxes and payments in lieu of taxes, the generation of revenues in (A) above.

(iv) The term "total operating expenses" means all expenses related to operations (despesas de exploracao), including administration, adequate maintenance, taxes and payments in lieu of taxes, and provision

for bad debts (provisao Sara devedores duvidosos) and amortization of capitalized operating costs amortizacoes de despesas), but excluding interest and other charges on debt.

(v) The term "debt service requirements" means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest (other than capitalized interest) and other charges on, debt.

(vi) Whenever for the purposes of this Section it shall be necessary to value, in terms of the currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

Section 5.03. (a) Except as the Bank shall otherwise agree, the Borrower shall not incur any debt, if after the incurrence of such debt the ratio of debt to equity shall be greater than 65 to 35 in fiscal year 1990 and than 60 to 40 in fiscal year 1991 and thereafter.

(b) For purposes of this Section:

(i) The term "debt" means any indebtedness of the Borrower maturing by its terms more than one year after the date on which it is originally incurred.

(ii) Debt shall be deemed to be incurred: (A) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment, on the date, and to the extent, the amount of such debt has become outstanding pursuant to such contract, agreement or instrument; (B) under a guarantee agreement on the date the agreement providing for such guarantee has been entered into.

(iii) The term "equity" means the sum of the total unimpaired paid-up capital, retained earnings and reserves of the Borrower not allocated to cover specific liabilities.

(iv) Whenever for the purposes of this Section it shall be necessary to value, in terms of the currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

Section 5.04. (a) Except as the Bank shall otherwise agree, the Borrower shall not incur any debt unless a reasonable forecast of the revenues and expenditures of the Borrower shows that the estimated net revenues of the Borrower for each fiscal year during the term of the debt to be incurred shall be at least 1.5 times the estimated debt service requirements of the Borrower in such year on all debt of the Borrower including the debt to be incurred.

(b) For the purposes of this Section:

(i) The term "debt" means any indebtedness of the Borrower maturing by its terms more than one year after the date on which it is originally incurred.

(ii) Debt shall be deemed to be incurred: (A) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment on the date of such contract, agreement or instrument; and (B) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into.

(iii) The term "net revenues" means the difference between:

and net (A) the sum of revenues from all sources related to operations non-operating income; and

(B) the sum of all expenses related to operations including administration, adequate maintenance, taxes and payments in lieu of taxes, but excluding provision for depreciation, other non-cash operating charges and interest and other charges on debt.

(iv) The term "net non-operating income" means the difference between:

and (A) revenues from all sources other than related to operations;

(B) expenses, including taxes and payments in lieu of taxes, incurred in the generation of revenues in (A) above.

(v) The term "debt service requirements" means the aggregate of repayments (including sinking fund payments, if any) of, and interest other than capitalized interest) and other charges on, debt.

(vi) The term "reasonable forecast" means a forecast prepared by the Borrower not earlier than twelve months prior to the incurrence of the debt in question, which both the Bank and the Borrower accept as reasonable and as to which the Bank has notified the Borrower of its acceptability, provided that no event has occurred since such notification which has, or may reasonably be expected in the future to have, a material adverse effect on the financial condition or future operating results of the Borrower.

(vii) Whenever for the purposes of this Section it shall be necessary to value, in terms of the currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

Section 5.05. (a) The Borrower shall carry out: (i) under terms of reference satisfactory to the Bank and not later than June 30, 1990, a study on the amount and fiscal implications of a fixed assets revaluation on the basis of current replacement costs and useful assets life; and (ii) every year thereafter, similar studies satisfactory to the Bank.

(b) The Borrower shall: (i) in its fiscal year ending on December 31, 1990 revalue its assets in accordance with the methods of valuation recommended by the study carried out pursuant to paragraph (a) (i) of this Section, such methods to be consistently applied in a manner satisfactory to the Bank; and (ii) update in a manner satisfactory to the Bank such asset revaluation as recommended by the studies referred to in paragraph (a) (ii) of this Section, but not less frequently than every four years.

Section 5.06. The Borrower shall take all action necessary to: (a) reduce its accounts receivable comparator to 92, 84, 78 and 70 days by the end of each of the years 1990, 1991, 1992 and 1993, respectively; (b) not later than December 31, 1990, make adjustments in real terms on all overdue bills, or take equivalent or additional measures which may be required, to reduce the financial losses resulting from such overdue bills; and (c) ensure that starting in fiscal year 1991 as a minimum, the average days receivable shown in (a) above apply on an individual basis to all bulk municipal consumers.

For purposes of this Section:

(i) "accounts receivables comparator" means year-end accounts

receivable from operations as measures by overdue bills
multiplied by 365 divided by year-end operating revenues;

(ii) "overdue bills" means bills for water and sewerage operation which are due and unpaid for more than 15 days after the date of issuance;

(iii) "bulk municipal consumers" means all municipal consumers which operate their own water distribution systems, and administer their own consumer services; and

(iv) "real terms" means no less than inflation, as measured by the index of consumers prices (In dice de Precos ao Consumidor - IPC) as published by the Fundacao Getulio Vargas.

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) the State or DAEE shall have failed to perform any of their respective obligations under the Shareholders Agreement; and

(b) the Tariff Law shall have been repealed or amended, or substituted by any other State or Federal law, to an extent which, in the reasonable opinion of the Bank, shall adversely affect the financial condition or the operations of, or the adjustment of the rates for water supply or sewerage services by, the Borrower.

Section 6.02. Pursuant to Section 7.01 (h) of the General Conditions, the following additional events are specified that any of the events specified in paragraphs (a) or (b) of Section 6.01 of this Agreement shall occur and shall continue for a period of 30 days after notice thereof, shall have been given by the Bank to the Borrower.

ARTICLE VII

Effective Date; Termination

Section 7.01. 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) that the Loan Agreement has been duly registered by Banco Central do Brasil; and

(b) that the Letter of Agreement has been executed on behalf of the State and the Borrower.

Section 7.02. 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 Loan Agreement has been duly registered by Banco Central do Brasil;

(b) that the Shareholders Agreement has been duly authorized or ratified on behalf of the State and DAEE and is legally binding upon the State and DAEE in accordance with its terms; and

(c) that the Letter of Agreement has been duly authorized or ratified on behalf of the State and the Borrower and is legally binding upon the State and the Borrower in accordance with its terms.

Section 7.03. The date May 16, 1990 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 President 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:

440098 (ITT)
248423 (RCA) or
64145 (WUI)

For the Borrower:

Companhia de Saneamento Basico de
Sao Paulo - SABESP
Rua Costa Carvalho, 300
Pinheiros, Sao Paulo
CEP 05429
Brazil

Telex:

011-21089

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/ S. Shahid Husain

Regional Vice President
Latin American and the Caribbean

COMPANHIA DE SANEAMENTO BASICO DO ESTADO
DE SAO PAULO-SABESP

By /s/ Lauro Pericles Goncalves
By /s/ Gastao Cesar Bierrenbach

Authorized Representatives

SCHEDULE 1

Withdrawal of the Proceeds

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	Amounts of the Loan Allocated (Expressed in Dollar Equivalent)	% of Expenditures to be Financed
(1) Works	165,400,000	100% of foreign expenditures and 43% of local expenditures
(2) Goods	77,200,000	100% of foreign expenditures, 43% of local expenditures (ex-factory cost) and 43% of local expenditures for other items procured locally
(3) Consultants' services	5,300,000	85% of local expenditures for services of consultants domiciles within the territory of the Guarantor, and 100% of foreign expenditures for services of other consultants
(4) Training	200,000	100% of foreign expenditures
(5) Unallocated	31,900,000	
TOTAL	280,000,000	

2. For the purposes of this Schedule:

(a) the term "foreign expenditures" means expenditures in the currency of any country other than that of the Guarantor for goods or services supplied from the territory of any country other than that of the Guarantor; and

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

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of: (a) payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding the equivalent of \$10,000,000, may be made on account of payments made for expenditures before that date but after January 1, 1989; and (b) expenditures under a Subproject unless it is an Eligible Subproject pursuant to the provisions of this Agreement.

Description of the Project

The objectives of the Project are: (i) to improve environmental and health conditions in urban areas of the State through improved and expanded water service and waste water disposal; (ii) to optimize the allocation of scarce sector resources through better planning, marginal cost analysis and pricing; (iii) to improve the Borrower's operational efficiency and financial condition; (iv) to support Brazil's decentralization efforts by supporting State investments and development; (v) to assist in the development of new investment strategies to implement projects with high social content; and (vi) to develop and improve safety and environmental protection measures in water and sewerage projects.

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: Subprojects

Execution of Eligible Subproject, in the territories of the State.

Part B: Institutional Development

Acquisition and utilization of equipment and materials and provision of technical assistance and training to further the institutional and operational development of the Borrower in the following areas:

1. Macro and micro meeting
2. Customer services and technical and users' cadastre
3. Pitometry
4. Planning and operational control
5. Billing and collection and commercial systems
6. Rehabilitation of water distribution system
7. Sewerage effluent disposal studies.

* * * *

The project is expected to be completed December 31, 1993

SCHEDULE 3

Amortization Schedule

Date Payment Due	Payment of Principal (expressed in dollars)
On each March 15 and September 15	
beginning September 15, 1994 through March 15, 2004	\$14,000,000

Premiums on Prepayment

The following premiums are specified for the purposes of Section 3.04 (b) of the General Conditions:

Time of Prepayment	Premium
	The interest rate (expressed as a percentage per annum) applicable to the balance

outstanding on the Loan on the day of
prepayment multiplied by:

Not more than three years before maturity	0.20
More than three years but not more than six years before maturity	0.40
More than six years but not more than 11 years before maturity	0.73
More than 11 years but not more than 13 years before maturity	0.87
More than 13 years before maturity	1.00

SCHEDULE 4

Procurement and Consultants' Services

Section I. Procurement of Goods and Works

Part A: International Competitive Bidding

1. Except as provided in Part C hereof, goods and works shall be procured under contracts awarded in accordance with procedures consistent with those set forth in Sections I and II of the "Guidelines for Procurement under IBRD Loans and IDA Credits" published by the Bank in May 1985 (the Guidelines).

2. To the extent practicable, contracts for civil works and contracts for goods shall be grouped in bid packages to cost the equivalent of \$5,000,000 or more and \$250,000 or more, respectively.

Part B: Preference for Domestic Manufacturers

In the procurement of goods in accordance with the procedures described in Part A hereof, goods manufactured in Brazil may be granted a margin of preference in accordance with, and subject to, the provisions of paragraphs 2.55 and 2.56 of the Guidelines and paragraphs 1 through 4 of Appendix 2 thereto, provided, however, that:

1. All bidding documents for the procurement of goods shall clearly indicate any preference which would be granted, the information required to establish the eligibility of a bid for such preference and the following methods and stages that will be followed in the evaluation and comparison of bids.

2. After evaluation, responsive bids will be classified in one of the following two groups:

(1) Group A: bids offering goods manufactured in Brazil if the bidder shall have established to the satisfaction of the Borrower and the Bank that such goods contain components manufactured in Brazil equal to at least 50% of the value of the complete goods.

(2) Group B: bids offering any other goods.

3. In order to determine the lowest evaluated bid of each group, all evaluated bids in each group shall first be compared among themselves, without taking into account customs duties and other import taxes levied in connection with the importation, or the sales and similar taxes levied in connection with the sale or delivery of the goods pursuant to the bids. Such lowest evaluated bids shall then be compared with each other, and if, as a result of this comparison, a bid from group A is the lowest,

it shall be selected for the award.

4. If, as result of the comparison under paragraph 3 above, the lowest evaluated bid is a bid from group B, all group B bids shall be further compared with the lowest evaluated bid from group A after adding: (i) to the evaluated bid price of goods to be imported in each group B bid an amount equal to the smaller of: (A) the amount of customs duties and other import taxes which a non-exempt importer would have to pay for the importation of the goods offered in such group B bid; or (B) 15% of the c.i.f. bid price of such goods, and (ii) to the ex-factory bid price of goods supplied domestically offered in each group B bid an amount equal to the smaller of: (A) the amount of customs duties and other import taxes which would be levied on the goods offered in such group B if they originated from the same foreign country as the bid included in group B which enjoys the lowest customs duties and other imported taxes, or (B) 15% of the ex-factory bid price of such goods. If, as result of this comparison, the bid from group A is the lowest, it shall be selected for the award; if not, the lowest evaluated bid from group B, as determined under paragraph 3 above, shall be selected for the award.

Part C: Other Procurement Procedures

Civil works estimated to cost less than the equivalent of \$5,000,000 and goods estimated to cost less than \$250,000 equivalent may be procured under contracts awarded on the basis of competitive bidding, advertised locally, in accordance with procedures satisfactory to the Bank, up to aggregate amounts not to exceed \$230,000,000 equivalent for civil works and \$12,000,000 equivalent for goods respectively.

Part D: Review by the Bank of Procurement Decisions

1. Review of invitations to bid and of proposed awards and final contracts:

(a) With respect to the first two contracts for civil works and the first two contracts for goods to be procured pursuant to Part C of this Schedule and each contract for civil works estimated to cost the equivalent of \$5,000,000 or more and each contract for goods estimated to cost the equivalent of \$250,000 or more, the procedures set forth in paragraphs 2 and 4 of Appendix 1 to the Guidelines shall apply. Where payments for such contract are to be made out of the Special Account, such procedures shall be modified to ensure that the two conformed copies of the contract required to be furnished to the Bank pursuant to said paragraph 2 (d) shall be furnished to the Bank prior to the making of the first payment out of the special Account in respect of such contract.

(b) With respect to each contract not governed by the preceding paragraph, the procedures set forth in paragraphs 3 and 4 of Appendix 1 to the Guidelines shall apply. Where payments for such contract are to be made out of the Special Account, such procedures shall be modified to ensure that the two conformed copies of the contract together with the other information required to be furnished to the Bank pursuant to said paragraph 3 shall be furnished to the Bank as part of the evidence to be furnished pursuant to paragraph 4 of Schedule 5 to this Agreement.

(c) The provisions of the preceding subparagraphs (a) and (b) shall not apply to contracts on account of which the Bank has authorized withdrawals from the Loan Account on the basis of statements of expenditure. Such contracts shall be retained in accordance with Section 5.01 (c) (ii) of this Agreement.

2. The figure of 20% is hereby specified for purposes of paragraph 4 of Appendix 1 to the Guidelines.

Part E: Other

For purposes of this Schedule and the Guidelines, the term "custom duties and other import taxes" includes the FSRMM.

Section II. Employment of Consultants

In order to assist the Borrower in the execution of the Project, the Borrower shall employ consultants whose qualifications, experience and terms and conditions of

employment shall be satisfactory to the Bank. Such consultants shall be selected in accordance with principles and procedures satisfactory to the Bank on the basis of the "Guidelines for the Use of Consultants by World Bank Borrowers and by the World Bank as Executing agency" published by the Bank in August 1981.

SCHEDULE 5

Special Account

1. For the purposes of this Schedule:

(a) the term "eligible Categories" means Categories (1) through (4) set forth in the table in paragraph 1 of Schedule 1 to this Agreement;

(b) the term "eligible expenditures" means expenditures in respect of the reasonable cost of goods and services required for 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 \$15,000,000 to be withdrawn from the Loan Account and deposited into the Special Account pursuant to paragraph 3 (a) of this Schedule.

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 a deposit or deposits 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 in 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 made 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; or

(b) once the total unwithdrawn amount of the Loan allocated to the eligible Categories less the amount of any outstanding special commitment entered into by the Bank pursuant to Section 5.02 of the General Conditions with respect to the Project, shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawal from the Loan Account of the remaining unwithdrawn amount of the Loan allocated to the eligible Categories shall follow such procedures as the Bank shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Bank shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.

6. (a) If the Bank shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; (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.

SCHEDULE 6

Subproject Eligibility Criteria

I. Subprojects shall comply with the following conditions:

(a) Each Subproject must have been included by the Borrower in the updated Letter of Agreement accepted by the Bank.

(b) Subprojects shall be the least-cost solution.

(c) Water supply Subprojects to be carried out in cities with populations greater than 50,000 shall have average water rates equal to or higher than 75% of the long-run average incremental cost of providing services through a minimum diameter water connection.

(d) Sewerage Subprojects, or water supply. Subprojects to be carried out in cities with populations of less than 50,000 shall have average water (or average sewerage) rates equal to or higher than 60% of the long-run average incremental cost of providing services through a minimum diameter connection.

(e) Subprojects or group of Subprojects to be carried out in communities with populations of less than 5,000 shall comply with (d) above for each individual community or for the group.

(f) Subprojects not meeting the criteria set forth herein shall be redesigned to lower acceptable standards or carried out in stages. If the Subproject does not fulfill the criteria after it has been redesigned, it shall be eligible for Bank financing only if a satisfactory social and economic justification is furnished to the Bank.

(g) Calculations of long-run average incremental costs for Subproject acceptability and for least-cost analysis, shall use an annual discount rate equal to the opportunity cost of capital (10%) or another value agreed upon between the Borrower and the Bank.

II. Additional Eligibility Criteria for Subprojects including the construction or expansion of dams, reservoirs or water flow control schemes:

(a) Execution of an environmental impact report acceptable to the Bank and the State.

(b) Execution of relocation studies, including detailed resettlement plans, satisfactory to the Bank and the State.

(c) Execution of safety studies, including specific action plans, satisfactory to the Bank and the State.

(d) Appointment of panel of independent safety and environmental experts, with terms of reference and qualifications and experience satisfactory to the Bank and the State, to be retained until the completion of the Subproject.

