

Public Disclosure Authorized

CONFORMED COPY

LOAN NUMBER 4852-CHA
GEF GRANT NUMBER TF056948

Project Agreement

(Second Shandong Environment Project)

between

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

acting on its own behalf and acting as Implementing Agency
of the Global Environment Facility

and

SHANDONG PROVINCE

Dated March 30, 2007

PROJECT AGREEMENT

Agreement dated March 30, 2007, entered into between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (“Bank”) and SHANDONG PROVINCE (“Project Implementing Entity”) (“Project Agreement”) in connection with:

- (1) the Loan Agreement (“Loan Agreement”) of the same date between PEOPLE’S REPUBLIC OF CHINA (“Borrower”) and the Bank; and
- (2) the Global Environment Facility Grant Agreement (“Co-financing Agreement”) of the same date between the People’s Republic of China (“Recipient”) and the Bank, acting as an implementing agency of the Global Environment Facility (“Co-financier”), for the Co-financing (hereinafter defined).

The Bank and the Project Implementing Entity hereby agree as follows:

ARTICLE I – GENERAL CONDITIONS; DEFINITIONS

- 1.01. The General Conditions (as defined in the Appendix to the Loan Agreement), with the modifications set forth below, constitute an integral part of this Agreement:
 - (a) Whenever used in the General Conditions, the term “Borrower” shall include the term “Recipient” and the term “Loan” shall include the term “Grant” except in Article III, Article IV and Sections 7.02(a), 7.05, 7.07 and 7.08 of the General Conditions.
 - (b) Whenever used in the provisions of Sections 5.01, 5.02, 5.09 and 5.11, the term “Legal Agreement” means any of the Loan Agreement, the Co-financing Agreement or the Project Agreement. “Legal Agreements” means collectively, all of such agreements.
 - (c) Whenever used in the provisions of Sections 5.04 and 5.11, the term “Loan” means the Loan or the Co-financing.
 - (d) Section 5.07(c) is modified to read as follows:
 - “(c) The Borrower and the Project Implementing Entity shall retain all records (contracts, orders, invoices, bills, receipts and other documents) evidencing expenditures under their Respective Parts of the Project until at least the latest of:
 - (i) one (1) year after the Bank has received the audited Financial Statements covering the period during which the last withdrawal from the Loan Account was made;

- (ii) one (1) year after the Bank has received the audited Financial Statements covering the period during which the last withdrawal from the Grant Account (as defined in Section 1.02(b) of the Project Agreement) was made;
- (iii) two (2) years after the Closing Date specified in Section IV of Schedule 2 to the Loan Agreement; or
- (iv) two (2) years after the Closing Date specified in Section IV of Schedule 2 to the Co-financing Agreement.

The Borrower and the Project Implementing Entity shall enable the Bank's representatives to examine such records.

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

“(c) The Borrower shall prepare, or cause to be prepared, and furnish to the Bank not later than six (6) months after the Closing Date specified in Section IV of Schedule 2 to the Co-financing Agreement or the Closing Date specified in Section IV of Schedule 2 to the Loan Agreement, whichever is later: (i) a report of such scope and in such detail as the Bank shall reasonably request, on the execution of the Project, the performance by the Loan Parties, the parties to the Co-financing Agreement, the Project Implementing Entity and the Bank of their respective obligations under the Loan Agreement, Co-Financing Agreement and the Project Agreement and the accomplishment of the purposes of the Loan and the Co-financing; and (ii) a plan designed to ensure the sustainability of the Project's achievements.”

- (f) Section 5.10 is modified to read as follows:

“The Bank, the Loan Parties, the parties to the Co-financing Agreement and the Implementing Entity shall cooperate fully to assure that the purposes of the Loan and the Co-financing and the objectives of the Project will be accomplished. To that end, the Bank, the Loan Parties, the parties to the Co-financing Agreement and the Implementing Entity, throughout the implementation of the Project and for a period of ten (10) years thereafter, shall:

- (a) from time to time, at the request of any one of them, exchange views on the Project, the Loan, the Co-financing and the performance of their respective obligations under the Loan Agreement, the Co-Financing Agreement and the Project Agreement, and furnish to the other party all

such information related to such matters as it shall reasonably request; and

(b) promptly inform each other of any condition which interferes with, or threatens to interfere with, such matters.”

(g) Section 9.05 of the General Conditions is amended to read as follows:

“Section 9.05. Termination of the Project Agreement

The Project Agreement and all obligations of the parties under the Project Agreement shall forthwith terminate upon: (i) full payment of the Withdrawn Loan Balance and all other Loan Payments due; or (ii) when all obligations of the Co-financing Agreement have been fully performed, whichever is later.”

1.02. Unless the context requires otherwise, the capitalized terms used in the Project Agreement have the meanings ascribed to them in the Loan Agreement or the General Conditions and the following terms have the following meanings:

(a) “Co-financing” means an amount of five million dollars (\$5,000,000) to be provided by the Co-financier to the Borrower to assist in the financing of Part A.2 of the Project.

(b) “Grant Account” means the account opened in the books of the Co-financier in the name of the Borrower and into which the amount of the Co-financing is credited pursuant to the provisions of the Co-financing Agreement.

ARTICLE II – PROJECT

2.01. The Project Implementing Entity declares its commitment to the objectives of the Project. To this end, the Project Implementing Entity shall: (a) carry out, and cause the Project Municipalities, Project Counties/Cities and Project Companies to carry out, the Project in accordance with the provisions of Article V of the General Conditions; and (b) provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.

2.02. Without limitation upon the provisions of Section 2.01 of this Agreement, and except as the Bank and the Project Implementing Entity shall otherwise agree, the Project Implementing Entity shall carry out, and shall cause to be carried out, the Project in accordance with the provisions of the Schedule to this Agreement.

ARTICLE III – REPRESENTATIVE; ADDRESSES

3.01. The Project Implementing Entity’s Representative is Governor or a Vice Governor or such other person or persons as said Governor or a Vice Governor shall designate in writing, and the Project Implementing Entity shall furnish to the Bank sufficient evidence of the authority and the authenticated specimen signature of each such person.

3.02. The Bank’s Address is:

International Bank for Reconstruction and Development
1818 H Street, NW
Washington, DC 20433
United States of America

Cable:	Telex:	Facsimile:
INTBAFRAD Washington, D.C.	248423(MCI) or 64145(MCI)	1-202-477-6391

3.03. The Project Implementing Entity’s Address is:

Shandong Provincial Finance Bureau
No. 3 Jida Road
Jinan, Shandong Province
People’s Republic of China

Facsimile:
86-531-82920751

AGREED at Beijing, People's Republic of China, as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By: /s/ David Dollar

Authorized Representative

SHANDONG PROVINCE

By: /s/ Mr. Cal Limin

Authorized Representative

SCHEDULE

Execution Of The Project

Section I. Institutional and Other Arrangements

Project Management.

1. The Project Implementing Entity shall maintain, and cause to be maintained, for purposes of carrying out the Project, the following organizations, with terms of reference, staffing and other resources acceptable to the Bank, throughout the period of implementation of the Project:

(a) The Provincial Project Leading Group, chaired by a Vice Governor of the Project Implementing Entity, which group is responsible for providing overall policy guidance and support for Project implementation.

(b) The Provincial Project Management Office, which is responsible for overall Project coordination, management and monitoring; annual budget preparation; Project-wide quality assurance; Project progress reporting; interagency coordination and provision of procurement support; and facilitation of training and technical assistance.

(c) Each Leading Group established at the Project Municipality and Project County/City levels, which is responsible for provision of policy guidance on and coordination for the implementation of Project activities within its respective jurisdiction.

(d) Each Project Management Office established by a Project Municipality and Project County/City, which is responsible for the coordination of technical assistance and management of Project implementation within its respective jurisdiction.

Resettlement, Environment Protection, and Dam Safety.

2. The Project Implementing Entity shall:

(a) take, and shall cause the Project Municipalities, Project Counties/Cities, and Project Companies to take, all necessary actions to minimize to the extent possible any involuntary loss by persons of shelter, productive assets or access to productive assets or income or means of livelihood, temporarily or permanently in carrying out the Project;

(b) for this purpose and prior to the commencement of any works under the Project, implement, and cause the Project Municipalities, Project Counties/Cities and Project Companies to implement the Resettlement Action Plan, in a manner satisfactory to the Bank; and

(c) provide, and cause the Project Municipalities, Project Counties/Cities, and Project Companies to provide, to the Bank for its prior concurrence any proposed modification or waiver of the Resettlement Action Plan, prior to putting into effect such modification or waiver.

3. The Project Implementing Entity shall implement, and shall cause the Project Municipalities, Project Counties/Cities, and Project Companies to implement, the Environmental Management Plan in a manner satisfactory to the Bank and designed to ensure that the Project is implemented in accordance with sound environmental practices and standards.

4. The Project Implementing Entity shall, and shall cause the Project Municipalities, Project Counties/Cities, and Project Companies to:

(a) maintain policies and procedures adequate to enable them to monitor and evaluate, in accordance with guidelines acceptable to the Bank, the implementation of the Environmental Management Plan and the Resettlement Action Plan and the achievement of the objectives of said plans, including the engagement of experienced and qualified independent monitoring agencies acceptable to the Bank;

(b) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank by: (i) February 28 and August 31 of each year, commencing on February 28, 2008, semi-annual reports of the results of the monitoring and evaluation activities with respect to the Environmental Management Plan and Resettlement Action Plan referred to in sub-paragraph (a) above, together with any revisions proposed to be introduced into said plans in order to achieve their respective objectives; and (ii) by February 28 of each year commencing on February 28, 2008, annual reports of the results of the monitoring and evaluation activities to be carried out by independent monitoring agencies referred to in sub-paragraph (a) above; and

(c) introduce such revisions into said plans as shall have been agreed with the Bank.

5. (a) The Project Implementing Entity shall cause Weifang and Yantai Municipalities, each to establish an independent panel of dam safety experts ("Panel"), with qualifications and experience, satisfactory to the Bank. The Panel shall be responsible for monitoring and evaluating the safety of the Related Dams and providing to the Bank by each February 28 (with the exception of the first annual report which is due on August 31, 2007) annual reports of said monitoring and evaluation, prepared under terms of reference satisfactory to the Bank, together with any recommendations for remedial works being carried out or to be carried out.

(b) The Project Implementing Entity shall cause each of Weifang Municipality and Gaomi and Qixia Counties to carry out in a timely manner any remedial works that are identified or recommended in any report prepared pursuant to the

provisions of sub-paragraph (a) of this paragraph as being appropriate to be implemented at their respective Related Dam.

(c) Without limitation to the provisions of sub-paragraph (b) of this paragraph 5, the Project Implementing Entity shall cause Weifang Municipality and Gaomi and Qixia Counties:

- (i) to complete remedial works at the Related Dams by December 31, 2007, in accordance with the plans set forth in the documents entitled “Construction Design for Remedial and Reinforcement of Anli Reservoir” for Qixia City; “Preliminary Design for Remedial and Reinforcement of Bailanghe Reservoir” for Weifang Municipality; and “Construction Design for Remedial and Reinforcement of Wangwu Reservoir”; and “Construction Design for Remedial and Reinforcement of Xiashan Reservoir” both for Gaomi City; and
- (ii) thereafter, furnish to the Bank: (A) confirmation by the Panel of the satisfactory completion of the remedial works; and (B) operational plans of the Related Dams to the Bank.

Financial Arrangements.

6. The Project Implementing Entity shall allocate to each Project Municipality and Project County/City an amount of the Loan under arrangements satisfactory to the Bank, which shall include, without limitation, the following principal terms:

(a) the Project Implementing Entity shall make available the principal amount, which has been allocated to each Project Municipality and Project County/City, in Dollars (on the date, or respective dates, of withdrawal from the Loan Account) of the value of the currency or currencies so withdrawn on account of the Project (in whole or part) to be implemented within the jurisdiction of the Project Municipality or Project County/City, as the case may be;

(b) the Project Implementing Entity shall recover: (i) such principal amount so made available; and (ii) an amount equal to one percent (1%), or such other percentage as may be determined by the Bank from time to time pursuant to Section 2.04 of the Loan Agreement, of such principal amount, over a period of twenty (20) years, inclusive of a grace period of five (5) years;

(c) the Project Implementing Entity shall charge interest on such principal amount, withdrawn and outstanding from time to time at a rate equal to the rate of interest applicable from time to time to the Loan pursuant to Section 2.05 of the Loan Agreement plus two tenths of one percent (2/10 of 1%) per annum; and

(d) the Project Implementing Entity shall charge a commitment charge on such principal amount, not withdrawn from time to time at a rate equal to three-fourths of one percent (3/4 of 1%) per annum.

7. The Project Implementing Entity shall, for purposes of Part A.2 of the Project, allocate to Yantai Municipality an amount of the Grant under arrangements satisfactory to the Bank.

Subsidiary Loan Agreements.

8. The Project Implementing Entity shall cause each Project Municipality (except Zaozhuang Municipality) and Project County/City to relend the portions of the proceeds of the Loan, which was allocated to it pursuant to Section I, paragraph 6 of this Schedule for the purposes of carrying out its Respective Project Company's Respective Parts of the Project, to each of the Respective Project Company under a subsidiary loan agreement to be entered into between said Project Municipality (directly or through a Project County/City) or Project County/City, as the case may be, and its Respective Project Company: (i) on the principal terms set forth in paragraphs 1 through 4 of Annex A to this Schedule; and (ii) under conditions which shall have been approved by the Bank, and which shall include, without limitation, those set forth in paragraphs 5 through 15 of the Annex A to this Schedule.

Section II. Project Monitoring, Reporting, and Evaluation

A. Project Reports.

1. The Project Implementing Entity shall monitor and evaluate the progress of the Project and prepare Project Reports for the Project in accordance with the provisions of Section 5.08(b) of the General Conditions and on the basis of the indicators set forth in Annex B to this Schedule. Each such Project Report shall cover the period of one (1) calendar semester, and shall be furnished to the Bank by February 28 and August 31 each year, starting February 28, 2008.

B. Financial Management, Financial Reports and Audits.

1. The Project Implementing Entity shall maintain a financial management system and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Bank, both in a manner adequate to reflect the operations and financial condition of the Project Implementing Entity, including the operations, resources and expenditures related to the Project.

2. The Project Implementing Entity shall have its financial statements referred to above audited by independent auditors acceptable to the Bank, in accordance with consistently applied auditing standards acceptable to the Bank. Each audit of these financial statements shall cover the period of one (1) fiscal year of the Project

Implementing Entity. The audited financial statements for each period shall be furnished to the Borrower and the Bank not later than six (6) months after the end of the period.

Section III. Procurement

All goods, works and services required for the Project: (a) to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 2 to the Loan Agreement; and (b) to be financed out of the proceeds of the Co-financing shall be procured in accordance with the provisions of Schedule 2 to the Co-financing Agreement.

Section IV. Other Undertakings

1. The Project Implementing Entity shall cause Heze and Rizhao Municipalities to:
 - (a) carry out, in accordance with terms of reference satisfactory to the Bank, a study of fees and user charges to be levied for the provision of solid waste management services (including, proposals for improved collections, and a detailed action plan for the full recovery of costs beginning on January 1, 2011); and
 - (b) furnish the results of said study to the Bank by June 30, 2009, and thereafter, implement the recommendations of said study, taking into account the Bank's comments thereon.
2. The Project Implementing Entity shall cause Huantai County, within one (1) year from the commissioning of the water supply facilities constructed under Part C of the Project in Huantai County, promptly to take all action necessary to: (a) ensure that industries located within the water supply service area of Huantai Company cease using groundwater as a source of water supply; and (b) connect such industries to the Huantai Company water supply system.
3. The Project Implementing Entity shall cause each of Qixia City and Weifang and Zaozhuang Municipalities to prepare and furnish to the Bank by February 28, 2008, an operations and maintenance plan (including financing), prepared in accordance with terms of reference satisfactory to the Bank, for the river embankment and wastewater investments carried out under Part A of the Project within their respective jurisdiction.
4. The Project Implementing Entity shall cause each of the Project Municipalities (excluding Heze and Rizhao Municipalities) and Project Counties/Cities, through their relevant environmental protection bureaus and other government agencies or bodies, with regard to wastewater discharged into sewers within their respective jurisdiction: (a) to complete by February 28, 2008, a plan for measures, satisfactory to the Bank, for the effective monitoring and enforcement of wastewater quality standards; and (b) to record and report such monitoring and enforcement activities in the Project Reports.

**ANNEX A
to
SCHEDULE**

**Principal Terms and Conditions of the
Subsidiary Loan Agreements**

For the purposes of Section I, paragraph 8 of the Schedule to this Agreement: (a) the terms of availability of the Loan proceeds shall be those set forth in paragraphs 1 through 4 of this Annex; and (b) the Subsidiary Loan Agreements shall be entered into on the conditions set forth in paragraphs 5 through 15 of this Annex.

Terms of Availability

1. The principal amount of each Subsidiary Loan made by a Project Municipality or Project County/City, as the case may be, to each of the Respective Project Company, shall be the amount equivalent in Dollars (on the respective dates of withdrawal from the Loan Account) of the value of the currency or currencies so withdrawn on account of its Project Company's Respective Parts of the Project.
2. Each Project Company shall repay: (a) such principal amount; and (b) an amount equal to one percent (1%), or such other percentage as may be determined by the Bank from time to time pursuant to Section 2.04 of the Loan Agreement, of such principal amount, over a period of not more than twenty (20) years, inclusive of a grace period of five (5) years.
3. Each Project Company shall pay interest on the principal amount thereof withdrawn and outstanding from time to time at a rate not less than the rate of interest applicable from time to time to the Loan pursuant to Section 2.05 of the Loan Agreement plus two-tenths of one percent (2/10 of 1%).
4. Each Project Company shall pay a commitment charge on such principal amount, not withdrawn from time to time at a rate equal to three-fourths of one percent (3/4 of 1%) per annum.

Conditions

The Subsidiary Loan Agreements shall include the following principal conditions:

5. Each Project Company shall undertake to: (a) carry out its Respective Parts of the Project with due diligence and efficiency and in accordance with appropriate management, financial, engineering and public utility practices and social and environmental standards acceptable to the Bank, and provide, promptly as needed, the funds, facilities and other resources required for the purpose; and (b) without limitation

on the foregoing, take all measures necessary to ensure that its Respective Parts of the Project shall be implemented in accordance with the Resettlement Action Plan and the Environmental Management Plan.

6. Each Project Company shall undertake to procure the goods, works and consultants' services to be financed out of the proceeds of the Loan in accordance with the provisions of Section III of Schedule 2 to the Loan Agreement, and utilize such goods, works and consultants' services exclusively in the carrying out of their Respective Parts of the Project.

7. Each Project Company shall undertake to enable the Bank, the Project Implementing Entity and the Project Municipality or Project County/City concerned to inspect such goods and the sites and works included in the Respective Parts of the Project, the operation thereof, and any relevant records and documents.

8. Each Project Company shall undertake to take out and maintain with responsible insurers such insurance, against such risks and in such amounts, as shall be consistent with sound business practice, including, without limitation, such insurance to cover hazards incident to the acquisition, transportation and delivery of goods financed out of the proceeds of the Loan to the place of use or installation, any indemnity thereunder to be made payable in a currency freely usable to replace or repair such goods.

9. Each Project Company shall undertake to:

(a) Maintain records and accounts adequate to reflect in accordance with sound accounting practices its operations and financial condition.

(b) Have its financial statements (balance sheets, statements of income and expenses and related statements) for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank.

(c) Furnish to the Bank, the Project Implementing Entity and the Project Municipality or Project County/City concerned, as soon as available, but in any case not later than six (6) months after the end of each such year: (i) certified copies of said financial statements and accounts for such year as so audited; and (ii) an opinion on such statements by said auditors in such scope and detail as the Bank, Project Implementing Entity and the Project Municipality or Project County/City concerned shall have reasonably requested.

(d) Prepare and furnish to the Bank, Project Implementing Entity and the Project Municipality or Project County/City concerned all such other information concerning said records, accounts and financial statements, as well as the audit thereof, as the Bank, Project Implementing Entity, and Project Municipality or Project County/City concerned shall reasonably request.

- (e) Each Respective Project Company shall undertake to:
 - (i) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators set forth in Annex B of the Schedule to this Agreement the carrying out of its Respective Parts of the Project and the achievement of the objectives thereof; and
 - (ii) prepare, under terms of reference satisfactory to the Bank, and furnish to Project Implementing Entity for its review, consolidation in the Project Reports and submission to the Bank, semi-annual reports integrating the results of the monitoring and evaluation activities performed pursuant to clause (i) of this sub-paragraph (e) on the progress achieved in the carrying out of its Respective Parts of the Project during the period preceding the date of each such report.

10. (a) Except as the Bank shall otherwise agree, each of the following Project Companies shall undertake to produce for each of its fiscal years commencing with the fiscal year beginning on:

- (i) January 1, 2008, for Gaomi Company (with respect to its water supply operations only); and
- (ii) January 1, 2011, or such later date agreed by the Bank, for Huantai Company (with respect to its water supply operations only),

total revenues, equivalent to not less than the sum of: (A) its total operating expenses; and (B) increases in working capital other than cash, debt service requirements and twenty percent (20%) of the annual average of its capital expenditures incurred, or expected to be incurred, for the current year, the previous fiscal year and the next following fiscal year.

(b) Before September 30 in each of its fiscal years, the Project Company shall, on the basis of forecasts prepared by said Project Company and satisfactory to the Bank, review whether it would meet the requirements set forth in sub-paragraph (a) of this paragraph 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 Project Company would not meet the requirements set forth in sub-paragraph (a) of this paragraph for said Project Company's fiscal years covered by such review, the Project Company shall promptly take all necessary measures (including, without limitation, adjustments of the structure or levels of its rates) in order to meet such requirements.

11. (a) Except as the Bank shall otherwise agree, each of the following Project Companies shall undertake to produce for each of its fiscal years commencing with its fiscal year beginning on:

- (i) January 1, 2008, for each of Gaomi Company (with respect to its wastewater operations only), Rizhao Company, Weihai Company and Yantai Company; and
- (ii) January 1, 2011, or such later date agreed by the Bank, for Huantai Company (with respect to its wastewater operations only), and Qixia Company,

total revenues equivalent to not less than the sum of its: (A) total operating expenses; and (B) the amount by which debt service requirements exceed the provision for depreciation.

(b) Before September 30 in each of its fiscal years, the Project Company shall, on the basis of forecasts prepared by said Project Company and satisfactory to the Bank, review whether it would meet the requirements set forth in sub-paragraph (a) of this paragraph 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 Project Company would not meet the requirements set forth in sub-paragraph (a) of this paragraph for said Project Company's fiscal years covered by such review, the Project Company shall promptly take all necessary measures (including, without limitation, adjustments of the structure or levels of its rates) in order to meet such requirements.

12. (a) For purposes of paragraphs 10 and 11 of this Annex, the following terms have the following meanings; and in addition, for purposes of paragraph 10 of this Annex, all terms defined below relate only to the water supply operations of each Project Company and for purposes of paragraph 11 of this Annex, for Gaomi Company and Huantai Company, all terms defined below relate only to the wastewater operations of each said company:

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

- (B) expenses, including taxes and payments in lieu of taxes, incurred in the generation of revenues in (A) above.
 - (iv) The term “total operating expenses” means all expenses related to operations, including administration, adequate maintenance, taxes and payments in lieu of taxes, and provision for depreciation on a straight-line basis at a rate of not less than 3.3% per annum of the average current gross value of the Project Company’s fixed assets in operation, or other basis acceptable to the Bank, but excluding interest and other charges on debt.
 - (v) The average current gross value of the Project Company’s fixed assets in operation shall be calculated as one half of the sum of the gross value of the Project Company’s fixed assets in operation at the beginning and at the end of the fiscal year, as valued from time to time in accordance with sound and consistently maintained methods of valuation satisfactory to the Bank.
 - (vi) The term “debt service requirements” means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest and other charges on, debt.
13. (a) Except as the Bank shall otherwise agree, each Project Company shall not incur any debt unless a reasonable forecast of the revenues and expenditures of the Project Company shows that the estimated net revenues of the Project Company for each fiscal year during the term of the debt to be incurred shall be at least 1.3 times the estimated debt service requirements of the Project Company in such year on all debt of the Project Company including the debt to be incurred.
- (b) For the purposes of sub-paragraph (a) of this paragraph:
 - (i) The term “debt” means any indebtedness of the Project Company maturing by its terms more than one (1) 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:

- (A) the sum of revenues from all sources related to operations and net 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:
- (A) revenues from all sources other than those related to operations; and
 - (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 amount of repayments (including sinking fund payments, if any) of, and interest and other charges on, debt.
- (vi) The term “reasonable forecast” means a forecast prepared by the Project Company not earlier than twelve (12) months prior to the incurrence of the debt in question, which both the Bank and the Project Company accept as reasonable and as to which the Bank has notified the Project Company 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 Project Company.

14. Whenever for the purposes of paragraphs 10, 11, 12, and 13 of this Annex it shall be necessary to value, in terms of the currency of the Borrower, 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.

15. Each Project Municipality or Project County/City, as the case may be, shall have the right to suspend or terminate the right of its Project Company to the use of the proceeds of the Loan made available under the Subsidiary Loan Agreement with said Project Company upon failure by such Project Company to perform its obligations under the agreement.

**ANNEX B
to
SCHEDULE**

Indicators

Results Framework

PDO	Outcome Indicators*	Use of Outcome Information
The development objective of the project is to improve the environmental conditions in participating municipalities/counties through a package of priority interventions, including upgrading and development of wastewater collection and treatment facilities, river embankment rehabilitation, solid waste management, water supply improvements, industrial pollution monitoring, and enhancement of the financial performance and efficiency of key urban environmental service agencies.	<ul style="list-style-type: none"> -Citizens' satisfaction with wastewater, solid waste and water supply services in participating cities/counties -Improvement of water quality within participating cities/counties -Percentage of population connected to WWTPs -Percentage of treated effluent reuse -Rate of compliance of connected industries with the discharge standards -Percentage of population provided with solid waste services 	Benchmarking the performance and efficiency of public services satisfactory for citizens
<p>GEF Global Environment Objective: The Global Environmental Objective of the GEF activity is to reduce land-based pollution through demonstration and dissemination of the Yantai model in Shandong Province</p>	<p>GEF Component: Pollution discharge to Bohai Sea reduced</p>	Benchmarking the performance of the septic tanks management and efficiency of reduction of pollution
Intermediate Results One per Component	Results Indicators for Each Component	Use of Results Monitoring
<p>Wastewater Component: Expanded wastewater services in participating cities/counties of Shandong Province would (a) substantially improve the local environment; and (b) reduce the pollution load reaching recipient rivers and the Bohai Sea.</p>	<p>Wastewater Component: -Volume of wastewater treated in the cities/counties -Rate of wastewater treated in the cities/counties -Reduction of pollution load reaching the recipient rivers</p>	<p>Wastewater Component: -Key performance data in management information system of wastewater companies -Input in provincial data base for defining sector policies and planning further expansion of wastewater services in participating cities/counties and elsewhere in Shandong Province</p>
<p>Solid Waste Component: Expanded solid waste services in participating cities/counties of Shandong Province would improve local environment</p>	<p>Solid Waste Component: -Weight of municipal solid waste collected and transferred to sanitary landfills -Rate of municipal solid waste collected and transferred to landfill</p>	<p>Solid Waste Component: -Key performance data in management information system of solid waste companies -Input in provincial data base for defining sector policies and planning further expansion of solid waste services in participating cities/counties and elsewhere in Shandong Province</p>

* Via reports from independent technical and social audit teams.

Results Framework (Continued)

Intermediate Results One per Component	Results Indicators for Each Component	Use of Results Monitoring
<p>Water Supply Component: Substantial reduction of groundwater mining and improved water supply services in participating cities/counties of Shandong Province.</p>	<p>Water Supply Component: -Population access to water supply services -Water production from ground and surface sources -Non-revenue water as percent of water produced</p>	<p>Water Supply Component: -Key performance data in management information system of water supply companies -Input in provincial data base for defining sector policies, with regard to protection of groundwater in particular, and planning further expansion of water supply services in participating cities/counties and elsewhere in Shandong Province</p>
<p>Sector Development and Capacity Building Component: -Improvement of the financial performance and efficiency of key urban environmental services under the control of participating cities/counties in Shandong Province.</p> <p>-Improvement of the capacity of the EPB in monitoring of industrial pollution control.</p>	<p>Sector Development and Capacity Building Component: -Cost recovery ratio of wastewater management operations -Cost recovery ratio of solid waste management operations -Cost recovery ratio of water supply management operations</p> <p>-Numbers of installation of online automatic monitoring stations at industrial discharge sites -Public disclosure of the status of compliance of major pollution enterprises</p>	<p>Sector Development and Capacity Building Component: -Key performance data in management information system of wastewater, solid waste, and water supply companies</p> <p>-EPB key performance data in management information system</p>
<p>GEF Component: Pilot demonstration of (a) impact of serviced septic tanks on reduction of pollution in recipient rivers; and (b) dissemination experiment in Shandong cities.</p>	<p>GEF Component: -Volume of septage collected in Yantai -Volume of septage jointly treated with wastewater in Yantai</p>	<p>GEF Component: -Evaluation of achievement of pilot demonstration objectives, inputs and outputs -Dissemination plan of pilot demonstration achievements in Shandong Province and in China</p>

Arrangements for Results Monitoring

Outcome Indicators	Target Values			Data Collection and Reporting		
	Baseline Dec 2005	Mid-Term Review Dec 2009	Implement Completion Dec 2013	Frequency and Reports	Data Collection Instruments	Responsibility for Data Collection
-Citizens' satisfaction with wastewater, solid waste and water supply services in participating cities/counties	(a) 66%	(a) 75%	(a) 92%	Consolidated Semi-annual PPR	SPPMO Reports, Independent audits	SPPMO, participating cities/counties
-Improvement of water quality in cities/counties from Class V to Class VI	0	148 km	148 km			
-Percentage of population connected to WWTPs	58%	80%	85%			
-Percentage of treated effluent reuse	0.2%	15%	21%			
-Rate of compliance of connected industries with the discharge standards	60%	70%	90%			
-Percentage of population provided with solid waste services	84%	90%	95%			
GEF Component: -Pollution discharge to Bohai Sea reduced (BOD ton/year)	0	680	1700	Consolidated Semi-annual PPR	Independent audits	SPPMO, Yantai municipality
Results Indicators for Each Component						
Wastewater Component: -Volume of wastewater treated (million m ³ /year)	103	197	226	Consolidated Semi-annual PPR	SPPMO, Supervision Reports	SPPMO, participating cities/counties
-Rate of wastewater treated in the cities/counties (%)	65%	70%	80%			
-Reduction of pollution load reaching the recipient rivers (ton COD/year)	9,400	20,000	28,000			

(a) Summary Social Assessment of the Second Shandong Environment Project, February 2006.

Arrangements for Results Monitoring (Continued)

Outcome Indicators	Target Values			Data Collection and Reporting		
	Baseline Dec 2005	Mid-Term Review Dec 2009	Implement Completion Dec 2013	Frequency and Reports	Data Collection Instruments	Responsibility for Data Collection
Solid Waste Component: -Municipal solid waste collected and transferred to sanitary landfill (ton/year)	293,460	387,265	450,775	Consolidated Semi-annual PPR	SPPMO, Supervision reports	SPPMO, participating cities/counties
Water Supply Component: -Population access to water supply services (%) -Water production a) Total million m ³ /year b) Groundwater/total water production (%) c) Liters/capita/day -Non-revenue water in % of water produced (%)	84% 46.72 85% 101 25%	97% 75.55 39% 115 22%	97% 104.03 39% 127 20%	Consolidated Semi-annual PPR	SPPMO, Supervision reports	SPPMO, participating cities/towns
Sector Development and Capacity Building Component: -Cost recovery ratio of wastewater management operations (%) -Cost recovery ratio of solid waste management operations (%) -Cost recovery ratio of water supply management operations (%) -Numbers of installation of online automatic monitoring stations at industrial discharge sites -Public disclosure of the status of compliance of major pollution enterprises	2.5% 1.0% 1.6% 366 Annual Report	1.5% 1.3% 1.5% 600 Quarterly Report	1.2% 1.4% 1.2% 800 Monthly Report	Consolidated Semi-annual PPR	SPPMO, Supervision reports;	SPPMO, participating cities/counties;
GEF Component: -Volume of septage collected in Yantai (1,000 tons/year) -Volume of septage jointly treated with wastewater in Yantai (1,000 tons/year)	0 0	50 50	150 150	Consolidated Semi-annual PPR	SPPMO, Supervision reports, GEF monitoring and evaluation program	SPPMO, Yantai Municipality