

CONFORMED COPY

LOAN NUMBER 4667-BR

Loan Agreement

(Rural Poverty Reduction Project – Rio Grande do Norte)

between

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

and

STATE OF RIO GRANDE DO NORTE

Dated July 4, 2002

LOAN NUMBER 4667-BR

LOAN AGREEMENT

AGREEMENT, dated July 4, 2002 between the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and the STATE OF RIO GRANDE

DO NORTE (the Borrower).

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

(B) by an agreement of even date herewith between the Guarantor and the Bank (the Guarantee Agreement), the Guarantor has agreed to guarantee the payment obligations of the Borrower in respect of the loan provided for in Article II of this Agreement (the Loan); 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 for Single Currency Loans” of the Bank, dated May 30, 1995 (as amended through October 6, 1999) (the General Conditions) constitute an integral part of this Agreement.

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

(a) “Approved POA” means each approved annual operating plan referred to in Section 3.04 (b) of this Agreement;

(b) “Community Association” means a civil association formed by members of a community (*associação civil*) duly established in the Borrower’s territory in accordance with the Guarantor’s laws, and which meets the criteria set forth in the Operational Manual (as hereinafter defined) for participating in the Project;

(c) “Community Subproject” means any investment referred to in Part A of the Project to be carried out by a Community Association utilizing the proceeds of a Grant (as hereinafter defined) and which meets the criteria set forth in the Operational Manual;

(d) “COPES” means *Coordenadoria de Projetos Especiais*, the technical unit within SEAS (as hereinafter defined) in charge of coordinating the Project;

(e) “Council Agreement” means any of the agreements referred to in Section 3.01 (c) (ii) of this Agreement;

(f) “Eligible Categories” means categories (1), (2) and (3) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

(g) “Eligible Expenditures” means the expenditures for goods, works and services referred to in Section 2.02 of this Agreement;

(h) “FUMAC Grant” means a grant approved by a Municipal Council (as hereinafter defined) and made or proposed to be made by SEAS out of the proceeds of the Loan to a Community Association in a Municipality (as hereinafter defined), for the financing of a Community Subproject pursuant to the terms of the Operational Manual;

(i) “FUMAC Pilot Grant” means a grant approved and made or proposed to be made by a Municipal Council, under a FUMAC Pilot Grant Agreement, out of the proceeds of the Loan to a Community Association for the financing of a Community Subproject pursuant to the terms of the Operational Manual;

(j) “FUMAC Pilot Grant Agreement” means any of the agreements to be entered into between a Municipal Council and a Community Association providing for a FUMAC Pilot Grant;

(k) “Grant” means any of a FUMAC Grant or a FUMAC Pilot Grant or a PAC Grant (as hereinafter defined);

(l) “Grant Agreement” means any of the agreements to be entered into between SEAS and a Community Association providing for a PAC Grant or a FUMAC Grant;

(m) “MIS” means the Project monitoring and information system, satisfactory to the Bank, to provide information on Project implementation, including, *inter alia*, information on the Performance Indicators (as hereinafter defined);

(n) “Model Forms” means the set of model draft agreements satisfactory to the Bank, including standard drafts of Council Agreements, Grant Agreements and FUMAC Pilot Grant Agreements, set forth in the Operational Manual;

(o) “Municipal Council” means a municipal council, composed mainly of representatives of communities and local organizations, as provided in the Operational Manual;

(p) “Municipality” means any of the municipalities set forth in Schedule 5 to this Agreement and any other municipality that may be added to such list from time to time by agreement between the Bank and the Borrower;

(q) “Operational Manual” means the manual, for the operation of the Project referred to in Section 3.06 of this Agreement; as the same may be amended from time to time by agreement between the Borrower and the Bank;

(r) “PAC Grant” means a grant approved and made or proposed to be made by SEAS out of the proceeds of the Loan to a Community Association under a Grant Agreement for the financing of a Community Subproject in accordance with the terms of the Operational Manual;

(s) “Performance Indicators” means the set of performance indicators, to be used for purposes of monitoring the progress of the Project, set forth in a supplemental letter of even date herewith from the Borrower to the Bank, and any other additional performance indicator that may be agreed from time to time by the Bank and the Borrower for such purposes;

(t) “Project Management Report” means each report prepared in accordance with Section 4.02 of this Agreement;

(u) “SEAS” means *Secretaria de Estado da Ação Social*, the Borrower’s Secretariat of Social Action;

(v) “SEPLAN” means *Secretaria de Estado do Planejamento e das Finanças*, the Borrower’s Secretariat of Planning and Finance; and

(w) “Special Account” means the account referred to in Part B of Schedule 1 to 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, an amount equal to twenty two million five hundred thousand dollars (\$22,500,000).

Section 2.02. The amount of the Loan may be withdrawn from the Loan Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Bank shall so agree, to be made) in respect of the reasonable cost of goods, works and services required for the Project and to be financed out of the proceeds of the Loan, as well as in respect of the fee referred to in Section 2.04 of this Agreement.

Section 2.03. The Closing Date shall be December 31, 2006 or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower and the Guarantor of such later date.

Section 2.04. The Borrower shall pay to the Bank a fee in an amount equal to one percent (1%) of the amount of the Loan. On or promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of said fee.

Section 2.05. The Borrower shall pay to the Bank a commitment charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Loan not withdrawn from time to time.

Section 2.06. (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 LIBOR

Base Rate plus LIBOR Total Spread.

(b) For the purposes of this Section:

- (i) “Interest Period” means the initial period from and including the date of this Agreement to, but excluding, the first Interest Payment Date occurring thereafter, and after the initial period, each period from and including an Interest Payment Date to, but excluding the next following Interest Payment Date.
- (ii) “Interest Payment Date” means any date specified in Section 2.07 of this Agreement.
- (iii) “LIBOR Base Rate” means, for each Interest Period, the London interbank offered rate for six-month deposits in dollars for value the first day of such Interest Period (or, in the case of the initial Interest Period, for value the Interest Payment Date occurring on or next preceding the first day of such Interest Period), as reasonably determined by the Bank and expressed as a percentage per annum.
- (iv) “LIBOR Total Spread” means, for each Interest Period: (A) three-fourths of one percent ($\frac{3}{4}$ of 1%); (B) minus (or plus) the weighted average margin, for such Interest Period, below (or above) the London interbank offered rates, or other reference rates, for six-month deposits, in respect of the Bank’s outstanding borrowings or portions thereof allocated by the Bank to fund single currency loans or portions thereof made by it that include the Loan; as reasonably determined by the Bank and expressed as a percentage per annum.

(c) The Bank shall notify the Borrower and the Guarantor of LIBOR Base Rate and LIBOR Total Spread for each Interest Period, promptly upon the determination thereof.

(d) Whenever, in light of changes in market practice affecting the determination of the interest rates referred to in this Section 2.06, the Bank determines that it is in the interest of its borrowers as a whole and of the Bank to apply a basis for determining the interest rates applicable to the Loan other than as provided in said Section, the Bank may modify the basis for determining the interest rates applicable to the Loan upon not less than six (6) months’ notice to the Borrower and the Guarantor of the new basis. The new basis shall become effective on the expiry of the notice period unless the Borrower or the Guarantor notifies the Bank during said period of its objection thereto, in which case said modification shall not apply to the Loan.

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

Section 2.08. The Borrower shall repay the principal amount of the Loan in accordance

with the amortization schedule set forth in Schedule 3 to this Agreement.

ARTICLE III

Execution of the Project

Section 3.01. (a) 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, through SEAS, with the assistance of the Municipal Councils, with due diligence and efficiency and in conformity with appropriate social, administrative, agricultural, environmental, financial and engineering practices, and in accordance with the Operational Manual and the Approved POAs, and shall provide or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project. Except as the Bank shall otherwise agree, the Borrower shall not amend, abrogate, suspend, waive or fail to enforce the Operational Manual or any provision thereof. In the case of any conflict between the terms of this Agreement and those of the Operational Manual, the terms of this Agreement shall prevail.

(b) The Borrower shall, for the purposes of carrying out the Project, maintain during Project Implementation COPES with responsibilities, structure and functions satisfactory to the Bank.

(c) The Borrower shall, through SEAS:

- (i) enter into Grant Agreements, whenever appropriate for the carrying out of the Project, such agreements to be made in accordance with the terms of the respective draft set forth in the Model Forms;
- (ii) enter into Council Agreements with Municipal Councils providing for:
 - (A) the terms and conditions for the participation of the relevant Municipal Council in the Project; and
 - (B) the obligation of such Municipal Council:
 - (I) to enter into FUMAC Pilot Grant Agreements with Community Associations which shall be made in accordance with the terms of the respective draft set forth in the Model Forms;

- (II) to exercise its rights and comply with its obligations under the FUMAC Pilot Grant Agreements in such a manner as to protect the interests of the Municipal Council, the Borrower and the Bank and to accomplish the purposes of the Loan; and
 - (III) not to assign, amend, abrogate, waive or fail to enforce the FUMAC Pilot Grant Agreements or any provision thereof; and
- (iii) exercise its rights and comply with its obligations under the Council Agreement and Grant Agreements in such manner as to protect the interests of the Borrower and the Bank and to accomplish the purposes of the Loan, and, except as the Bank shall otherwise agree, the Borrower shall not assign, amend, abrogate, waive or fail to enforce the Council Agreements or the Grant Agreements or any provision thereof.

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. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the Performance Indicators, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, not later than six months after the Effective Date, the baseline evaluation study (*perfil de entrada*) referred to in Part C.4 of the Project;

(c) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, not later than twelve months after the Effective Date and yearly thereafter during the period of Project implementation, a report integrating the results of the evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of such report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and

(d) review with the Bank shortly after such report's preparation, the report referred to in paragraph (c) of this Section, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Bank's views on the matter.

Section 3.04. The Borrower shall:

(a) by October 31 of each year during Project implementation, commencing on October 31, 2002, prepare and furnish to the Bank the proposed annual operating plans and budget, satisfactory to the Bank, detailing the Project activities proposed to be carried out during

the next succeeding year and the respective sources of funding therefor; and

(b) not later than 30 days after the approval of the Borrower's budget by its *Assembléia Legislativa* (Legislative Assembly), furnish to the Bank the approved annual operating plans and respective budget (Approved POA) referred to in paragraph (a) of this Section for each year in question.

Section 3.05. The Borrower shall:

(a) furnish to the Bank, not later than twelve months after the Effective Date and yearly thereafter during the period of Project implementation, the results and recommendations of an assessment, to be carried out under terms of reference satisfactory to the Bank, on the cost structure and effectiveness of Community Subprojects, including an evaluation of the physical performance, and cost comparisons and procurement procedures thereof;

(b) review with the Bank the results and recommendations of such assessments; and

(c) take or cause to be taken all such action which shall have been agreed by the Bank and the Borrower during the review referred to in paragraph (b) above, as shall be necessary for the efficient implementation of Community Subprojects, such action to be taken in a manner and within a timetable agreed upon during such review.

Section 3.06. The Borrower shall carry out the Project in accordance with the Operational Manual, satisfactory to the Bank, said Manual to include, *inter alia*:

(a) the procedures for the carrying out, monitoring and evaluation of the Project (including the procurement and financial requirements thereof);

(b) criteria for selection of Municipal Councils and Community Associations, and Community Subprojects;

(c) requirements for implementation of Community Subprojects, including environmental criteria and procedures for screening and management of Subprojects, in particular for activities that: (i) use wood as fuel; (ii) produce any waste, liquid or solid; (iii) involve the procurement of pesticides; (iv) involve the construction of small dams; and (v) involve fisheries and aquaculture; and

(d) the Model Forms.

Section 3.07. For the purposes of Section 9.08 of the General Conditions, the Borrower shall:

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

(b) afford the Bank a reasonable opportunity to exchange views with the Borrower

on said plan.

ARTICLE IV

Financial Covenants

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

(b) The Borrower shall:

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

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

- (i) maintain or cause to be maintained, in accordance with paragraph (a) of this Section, records and separate accounts reflecting such expenditures;
- (ii) retain, until at least one year after the Bank has received the audit report for the fiscal year in which the last withdrawal from the Loan Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
- (iii) enable the Bank's representatives to examine such records; and
- (iv) ensure that such records and accounts are included in the annual audit

referred to in paragraph (b) of this Section and that the report of such audit contains a separate opinion by said auditors as to whether the Project Management Reports or statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals.

Section 4.02. (a) Without limitation upon the provisions of Section 4.01 of this Agreement, the Borrower shall carry out a time-bound action plan acceptable to the Bank for the strengthening of its financial management system for the Project in order to enable the Borrower, not later than six months after the Effective Date, or such later date as the Bank shall agree, to prepare quarterly Project management reports, acceptable to the Bank, each of which:

- (i) (A) sets forth actual sources and applications of funds for the Project, both cumulatively and for the period covered by said report, and projected sources and applications of funds for the Project for the six-month period following the period covered by said report; and (B) shows separately expenditures financed out of the proceeds of the Loan during the period covered by said report and expenditures proposed to be financed out of the proceeds of the Loan during the six-month period following the period covered by said report;
- (ii) (A) describes physical progress in Project implementation, both cumulatively and for the period covered by said report; and (B) explains variances between the actual and previously forecast implementation targets; and
- (iii) sets forth the status of procurement under the Project and expenditures under contracts financed out of the proceeds of the Loan, as at the end of the period covered by said report.

(b) Upon the completion of the action plan referred to in paragraph (a) of this Section, the Borrower shall prepare, in accordance with guidelines acceptable to the Bank, and furnish to the Bank not later than 45 days after the end of each calendar quarter a Project Management Report for such period.

ARTICLE V

Effective Date; Termination

Section 5.01. The following events are specified as additional conditions to the effectiveness of the Loan Agreement within the meaning of Section 12.01 (c) of the General Conditions:

- (a) the Borrower has adopted the Operational Manual;

(b) the Borrower has prepared an action plan, satisfactory to the Bank, for implementation of the information campaign referred to in Part C.3 of the Project;

(c) the Borrower has established and is operating an MIS;

(d) the Borrower has furnished to the Bank the terms of reference for the baseline evaluation study, and the overall Project evaluation framework, as required for the impact evaluation to be carried out under Part C.4 of the Project; and

(e) the Borrower has strengthened, in form and substance satisfactory to the Bank, the administrative autonomy of COPES.

Section 5.02. 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 Loan provided for in this Agreement has been duly registered by the Guarantor's Central Bank.

Section 5.03. The date October 2, 2002 is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. The Secretary of Planning and Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. 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:

Telex:

Facsimile:

INTBAFRAD
Washington, D.C.

248423 (MCI) or
64145 (MCI)

(202) 477-6391

For the Borrower:

Secretaria de Estado de Planejamento e das Finanças
Km. 0, BR 101 – Lagoa Nova
Centro Administrativo do Estado
59.059-900 Natal, Rio Grande do Norte
Brazil

Facsimile: 55-84-232-1911

With copy to:

SEAIN - Secretaria de Assuntos Internacionais do
Ministério do Planejamento, Orçamento e Gestão
Esplanada dos Ministérios - Bloco K - 5º andar
70040-906 Brasília, DF
Brazil

Facsimile: 55-61-225-4022

SEAS
Km. 0, BR 101 – Lagoa Nova
Centro Administrativo do Estado
59.059-900 Natal, Rio Grande do Norte
Brazil

Facsimile: 55-84-211-7786

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

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Antonio Rocha Magalhães

Authorized Representative

STATE OF RIO GRANDE DO NORTE

By /s/ Fernando Antônio da Câmara Freire

Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Loan

A. General

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

<u>Category</u>	<u>Amount of the Loan Allocated (Expressed in Dollars)</u>	<u>% of Expenditures to be Financed</u>
(1) Grants (Goods, works and services):)	75% of the cost of a Community Subproject financed by a Grant
(a) FUMAC Grants	16,950,000)	
(b) FUMAC Pilot Grants	1,275,000)	
(c) PAC Grants	975,000)	
(2) Consultants' services (including audits) and training for Parts B and C of the Project	1,500,000	100%
(3) Administrative Costs:		
(a) incremental operational costs	140,000	20%
(b) Project supervision and monitoring costs	400,000	50%
(4) Fee	225,000	Amount due under Section 2.04 of this Agreement
(5) Unallocated	<u>1,035,000</u>	
TOTAL	<u>22,500,000</u>	

2. For the purposes of this Schedule the term "Administrative Costs" means the operational costs (which would not have been incurred absent the Project) and the supervision and monitoring costs of the Project incurred by COPEs under Part C of the Project, excluding

expenditures for salaries and related benefits and training.

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 \$2,250,000, may be made on account of payments made within twelve months prior to the date of this Agreement, but in no case prior to May 4, 2001;

(b) payments under a Grant unless the respective Grant Agreement or FUMAC Pilot Grant Agreement, as the case may be, shall have been entered into between the parties thereto; and

(c) payments under a Grant for a Community Subproject costing more than the equivalent of \$50,000, unless the Bank shall have approved such Community Subproject.

4. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditure for expenditures, all under such terms and conditions as the Bank shall specify by notice to the Borrower:

(a) under contracts for goods or works costing less than the equivalent of \$100,000 per contract;

(b) for services of individual consultants under contracts not exceeding \$50,000 equivalent per contract; and

(c) for services of consulting firms under contracts not exceeding \$100,000 equivalent per contract.

B. Special Account

1. The Borrower shall open and maintain in dollars a special deposit account in a commercial bank acceptable to the Bank, on terms and conditions satisfactory to the Bank, including appropriate protection against set-off, seizure and attachment.

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

(a) until the Bank shall have received: (i) the first Project Management Report referred to in Section 4.02 (b) of this Agreement; and (ii) a request from the Borrower for withdrawal on the basis of Project Management Reports, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) upon receipt by the Bank of a Project Management Report pursuant to Section 4.02 (b) of this Agreement, accompanied by a request from the Borrower for withdrawal on the

basis of Project Management Reports, all further withdrawals shall be made in accordance with the provisions of Annex B to this Schedule 1.

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

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

(a) if the Bank determines at any time that any Project Management Report does not adequately provide the information required pursuant to Section 4.02 of this Agreement;

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

(c) if the Borrower shall have failed to furnish to the Bank within the period of time specified in Section 4.01 (b) (ii) of this Agreement, any of the audit reports required to be furnished to the Bank pursuant to said Section in respect of the audit of:(A) the records and accounts for the Special Account; or (B) the records and accounts reflecting expenditures with respect to which withdrawals were made on the basis of Project Management Reports.

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

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

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

refund to the Bank such outstanding amount.

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

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

**Annex A
to
SCHEDULE 1**

**Operation of Special Account
When Withdrawals Are Not Made
On the Basis of Project Management Reports**

1. For the purposes of this Annex the term “Authorized Allocation” means an amount equal to \$2,200,000 to be withdrawn from the Loan Account and deposited into the Special Account pursuant to paragraph 2 of this Annex; provided, however, that unless the Bank shall otherwise agree, the Authorized Allocation shall be limited to an amount equal to \$1,000,000 until the aggregate amount of withdrawals from the Loan Account, plus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General Conditions shall equal or exceed \$3,200,000.

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

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

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

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

Annex B
to
SCHEDULE 1

Operation of Special Account
When Withdrawals Are Made
On the Basis of Project Management Reports

1. Except as the Bank may otherwise specify by notice to the Borrower, all withdrawals from the Loan Account shall be deposited by the Bank into the Special Account in accordance with the provisions of Schedule 1 to this Agreement. Each such deposit into the Special Account shall be withdrawn by the Bank from the Loan Account under one or more of the Special Account's Eligible Categories.

2. Each application for withdrawal from the Loan Account for deposit into the Special Account shall be supported by a Project Management Report.

3. Upon receipt of each application for withdrawal of an amount of the Loan, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account an amount equal to the lesser of: (a) the amount so requested; and (b) the amount which the Bank has determined, based on the Project Management Report accompanying said application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such report; provided, however, that the amount so deposited, when added to the amount indicated by said Project Management Report to be remaining in the Special Account, shall not exceed \$4,400,000.

SCHEDULE 2

Description of the Project

The objectives of the Project are: (a) to increase social and economic opportunities for the Municipalities' rural poor by improving access to basic, social and economic infrastructure through Community Subprojects; (b) to increase the social capital of rural communities to organize collectively and meet their own needs; and (c) to foster local governance and citizenship through creation and strengthening of Municipal Councils, at the same time forging links with governmental and non-governmental agencies, civil society, financial institutions and the private

sector.

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

Part A: Community Subprojects

Financing of small scale community investments consisting, *inter alia*, of: (a) infrastructure investments such as for rural water supply and electrification; (b) social investments such as construction of day care centers and rehabilitation of schools and health posts; and (c) other investments such as for small-scale community agro-processing, purchase of agricultural equipment and minor irrigation schemes (Community Subprojects) through PAC Grants, FUMAC Grants and/or FUMAC Pilot Grants.

Part B: Institutional Development

1. Provision of technical assistance and training for Community Associations in, *inter alia*, community mobilization and organization, preparation of Community Subprojects, and operation and maintenance of such Community Subprojects.
2. Training and equipping of Municipal Councils with respect to the role of Municipal Councils, the contents of the Operational Manual, subproject evaluation and supervision, environmental assessment of subprojects, participatory planning and financial management.
3. Provision of on-the-job training and expert advice for COPES' staff, Municipal Councils, and Community Associations on technical matters regarding the Community Subprojects preparation/execution cycle (such matters to include, for example, technical designs, monitoring techniques and financial management).
4. Provision of technical assistance for SEPLAN's staff in support of the implementation of the Borrower's modernization reforms.
5. Carrying out of workshops and seminars for Municipal Councils and Community Associations to exchange views and disseminate information and experience with respect to the carrying out of the Project.

Part C: Project Administration

Support to the overall Project implementation, coordination and supervision including, *inter alia*:

1. the operation of COPES and its field offices related to Project implementation;
2. the establishment and operation of the MIS;
3. the design, development and carrying out of a statewide information campaign within the Borrower's territory to disseminate information about the Project; and
4. the carrying out of studies to assess the impact of the Project, including, *inter alia*, a

baseline evaluation study, annual physical performance reviews, a mid-term implementation review, and a comprehensive impact evaluation.

* * *

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

SCHEDULE 3

Amortization Schedule

<u>Date Payment Due</u>	<u>Payment of Principal (Expressed in Dollars)*</u>
On each March 15 and September 15 beginning September 15, 2007 through March 15, 2017	1,125,000

* The figures in this column represent the amount in dollars to be repaid, except as provided in Section 4.04 (d) of the General Conditions.

SCHEDULE 4

Procurement

Section I. Procurement of Goods and Works

Part A: General

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

Part B: Procurement Procedures

1. National Competitive Bidding

Except as provided in Parts B.2, B.3 and B.4 hereof, goods and works shall be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines, using standard bidding documents acceptable to the Bank, and the following provisions:

(a) Contracts shall be awarded to the bidder whose bid has been determined to be the lowest evaluated bid, such evaluation to be based on price and, whenever appropriate, to also take into account factors similar to those referred to in paragraph 2.51 of the Guidelines, provided, however, that the bid evaluation shall always be based on factors that can be quantified objectively, and the procedure for such quantification shall be disclosed in the invitation to bid.

(b) Whenever required by the Bank, the invitation to bid shall be advertised for at least three consecutive days in a newspaper of wide circulation in Brazil.

(c) The arrangements, under the invitation to bid, for a joint-venture (*consórcio*) of Brazilian and foreign firms shall be approved in advance by the Bank in each case.

(d) The invitation to bid shall not establish, for purposes of acceptance of bids, minimum or maximum amounts for the contract prices.

(e) The purchaser shall not, without the Bank’s prior approval, issue any change order under a contract which would increase or decrease by more than 15% the quantity of goods (and related services) without any change in the unit prices or other terms and conditions of sale.

2. National Shopping

Except as provided in Part B.4 hereof, goods estimated to cost less than \$100,000 equivalent per contract, up to an aggregate amount not to exceed \$1,100,000 equivalent, may be procured under contracts awarded on the basis of national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

3. Procurement of Small Works

Except as provided in Part B.4 hereof, works estimated to cost less than \$100,000 equivalent per contract, up to an aggregate amount not to exceed \$800,000 equivalent, may be procured under lump-sum, fixed-price contracts awarded on the basis of quotations obtained from three (3) qualified domestic contractors in response to a written invitation. The invitation shall include a detailed description of the works, including basic specifications, the required completion date, a basic form of agreement acceptable to the Bank, and relevant drawings, where applicable. The award shall be made to the contractor who offers the lowest price quotation for the required work, and who has the experience and resources to complete the contract successfully.

4. Community Participation

Goods and works costing \$50,000 equivalent or less per contract under Community Subprojects, may be procured in accordance with procedures acceptable to the Bank as provided in paragraph 3.15 of the Guidelines (including direct contracting in accordance with the provisions of paragraph 3.7 of the Guidelines) all as set forth in the Operational Manual.

Part C: Review by the Bank of Procurement Decisions

1. Procurement Planning

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

2. Prior Review

(a) With respect to each contract to be procured pursuant to the provisions of Part B.1 of this Section, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

(b) With respect to each contract to be procured in accordance with the procedures referred to in Parts B.2 and B.3 hereof, the following procedures shall apply:

(i) prior to the selection of any supplier/execution of any contract under shopping procedures (including small works), the Borrower shall provide to the Bank a report on the comparison and evaluation of quotations received;

(ii) prior to the execution of any contract procured under shopping

procedures, the Borrower shall provide to the Bank a copy of the specifications and the draft contract; and

- (iii) the procedures set forth in paragraph 2 (f), 2 (g) and 3 of Appendix 1 to the Guidelines shall apply.

3. Post Review

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

Section II. Employment of Consultants

Part A: General

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

Part B: Quality- and Cost-based Selection

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

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

Part C: Other Procedures for the Selection of Consultants

1. Least-cost Selection

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

2. Single Source Selection

Services which are estimated to cost less than \$100,000 equivalent per contract may, with the Bank's prior agreement, be procured in accordance with the provisions of paragraphs 3.8 through 3.11 of the Consultant Guidelines.

3. Individual Consultants

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

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

1. Selection Planning

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

2. Prior Review

(a) With respect to each contract for the employment of consulting firms for services estimated to cost the equivalent of \$200,000 or more, the procedures set forth in paragraphs 1, 2 (other than the third subparagraph of paragraph 2 (a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(b) With respect to each contract for the employment of consulting firms for services estimated to cost the equivalent of \$100,000 or more, but less than the equivalent of \$200,000, the procedures set forth in paragraphs 1, 2 (other than the second subparagraph of paragraph 2 (a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(c) With respect to each contract for the employment of individual consultants estimated to cost the equivalent of \$50,000 or more, the qualifications, experience, terms of reference and terms of employment of the consultants shall be furnished to the Bank for its prior review and approval. The contract shall be awarded only after the said approval shall have been given.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set

forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply.

SCHEDULE 5

Municipalities

Água Nova
Acari
Afonso Bezerra
Alexandria
Almino Afonso
Angicos
Antônio Martins
Apodi
Arês
Assu
Baia Formosa
Baraúna
Barcelona
Bento Fernandes
Boa Saúde
Bodó
Bom Jesus
Brejinho
Caiçara do Rio do Vento
Caicó
Caiçara do Norte
Campo Grande
Campo Redondo
Canguaretama
Caraúbas
Carnaúba dos Dantas
Carnaubais
Ceará-Mirim
Cel. João Pessoa
Cerro
Corá
Coronel Ezequiel
Cruzeta
Currais Novos
Dr. Severiano
Encanto
Equador
Espírito Santo
Extremoz
Fernando Pedroza
Florânia
Francisco Dantas

Frutuoso Gomes
Galinhos
Goianinha
Grossos
Ipanguaçu
Ipueira
Itajá
Itaú
Jaçanã
Jandaíra
Janduis
Japi
Jardim de Angicos
Jardim de Piranhas
Jardim do Seridó
João Câmara
João Dias
José da Penha
Jucurutu
Lagoa d'Anta
Lagoa de Pedras
Lagoa de Velhos
Lagoa Nova
Lagoa Salgada
Lajes
Lajes Pintada
Lucrecia
Luiz Gomes
Macaíba
Major Sales
Marcelino Vieira
Martins
Maxaranguape
Messias Targino
Montanhas
Monte das Gameleiras
Monte-Alegre
Nísia Floresta
Nova Cruz
Olho D'Água dos Borges
Ouro Branco
Paraíba
Paraná
Parazinho
Parelhas
Passa e Fica
Passagem
Patu
Pau dos Ferros
Pedra Grande

Pedra Preta
Pedro Avelino
Pedro Velho
Pilões
Poço Branco
Portalegre
Pureza
Rafael Fernandes
Rafael Godeiro
Riacho da Cruz
Riacho de Santana
Riachuelo
Rio do Fogo Rodolfo Fernandes
Rui Barbosa
Santa Maria
São Bento do Norte
São Bento do Trairi
São Fernando
São Francisco do Oeste
São Gonçalo do Amarante
São José do Campestre
São José do Mipibu
São José do Sabugi
São José do Seridó
São Miguel
São Miguel do Gostoso
São Paulo do Potengi
São Pedro
São Rafael
São Tomé
São Vicente Sítio Novo
Santa Cruz
Santana do Seridó
Santana do Matos
Santo Antônio
Sen. Georgino Avelino
Senador Elói de Souza
Serra Caiada
Serra de São Bento
Serra do Mel
Serra Negra do Norte
Serrinha
Serrinha dos Pintos
Severiano Melo
Taboleiro Grande
Taipu
Tangará
Tenente Ananias
Tenente Laurentino
Tibau

Tibau do Sul
Timbaúba dos Batistas
Touros
Triunfo Potiguar
Umarizal
Upanema
Várzea
Venha
Ver
Vera Cruz
Viçosa
Vila Flor
