

CONFORMED COPY

CREDIT NUMBER 3689 PAK

Development Credit Agreement

(AJK Community Infrastructure and Services Project)

between

ISLAMIC REPUBLIC OF PAKISTAN

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated August 24, 2002

CREDIT NUMBER 3689 PAK

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated August 24, 2002, between the ISLAMIC REPUBLIC OF

PAKISTAN, acting by its President (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Borrower, having satisfied itself as to the feasibility and priority of the project described in Schedule 2 to this Agreement (the Project), has requested the Association to assist in the financing of the Project; and

(B) the Project will be carried out by Azad Jammu and Kashmir (AJK) with the Borrower's assistance and, as part of such assistance, the Borrower will make the proceeds of the credit provided for in Article II of this Agreement (the Credit) available to AJK, as set forth in this Agreement; and

WHEREAS the Association has agreed, on the basis, *inter alia*, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement and in the agreement of even date herewith between the Association and AJK (the Project Agreement);

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Development Credit Agreements" of the Association, dated January 1, 1985 (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 and the following additional terms have the following meanings:

(a) "AJK" means the territory of Azad Jammu and Kashmir and any successor thereto;

(b) "CAP" means a community action plan formulated by and for each community participating in the Project to serve as a comprehensive framework for the planning, designing, financing, implementing, operating and maintaining, and monitoring and evaluating of such community's CD and CI schemes consistently with the policies, principles and procedures set out in the Operational Manual;

(c) "CBO" means a community-based organization or association, including a village or a women's or a mohalla (low-income urban neighborhood) group or committee or self-help organization, established and operating in the territory of the Borrower;

(d) "CD scheme" means a Community Development scheme to be carried out under Part B.1 of the Project;

(e) "CI scheme" means a Community Infrastructure scheme to be carried out under Part C.1 of the Project;

(f) “Environmental Management Framework” or “EMF” means the environmental management framework dated October 2001, satisfactory to the Association, setting out the principles, policies and procedures for assessing and mitigating the environmental and social impacts of CI schemes, as the same may be amended from time to time with the agreement of the Association;

(g) “Financial Management Manual” or “FMM” means the financial management manual prepared by AJK dated April 30, 2002, satisfactory to the Association, setting out the principles, policies and procedures for the financial management of the Project;

(h) “Financial Monitoring Report” or “FMR” means each report prepared in accordance with Section 3.02 of the Project Agreement;

(i) “Fiscal Year” means the fiscal year of the Borrower commencing July 1 and ending June 30 of each year;

(j) “LGRDD” means the Local Government and Rural Development Department of AJK;

(k) “NGOs” means non-governmental organizations established and operating in the territory of the Borrower;

(l) “PMCC” means the Program Management and Coordination Committee referred to in paragraph 2 of Schedule 2 to the Project Agreement;

(m) “Project Agreement” means the agreement between the Association and AJK of even date herewith, as the same may be amended from time to time, and such term includes all schedules and agreements supplemental to the Project Agreement;

(n) “PSC” means the Project Steering Committee established and maintained pursuant to paragraph 3 of Schedule 2 to the Project Agreement;

(o) “Operational Manual” or “OM” means the operational manual prepared by AJK dated March 15, 2002, satisfactory to the Association, setting out the principles, policies and procedures for the identification, selection, preparation, approval and implementation of CD schemes and CI schemes, as the same may be amended from time to time with the agreement of the Association; and

(p) “Special Account” means the account referred to in Section 2.02 (b) of this Agreement.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to sixteen million one hundred thousand Special Drawing Rights (SDR 16,100,000).

Section 2.02. (a) The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Association 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 Credit.

(b) The Borrower may, for the purposes of the Project open and maintain in the National Bank of Pakistan a special deposit account on terms and conditions satisfactory to the Association, including appropriate protection against set-off, seizure and attachment. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Schedule 3 to this Agreement.

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

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent ($3/4$ of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on January 15 and July 15 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each January 15 and July 15 commencing July 15, 2012 and ending January 15, 2037. Each installment to and including the installment payable on January 15, 2022 shall be one and one-fourth percent (1-1/4%) of such principal amount, and each installment thereafter shall be two and one-half percent (2-1/2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level

established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

- (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and
- (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

Section 2.09. The Additional Chief Secretary, Planning and Development Department, AJK, is designated as representative of the Borrower for the purposes of taking any action required or permitted to be taken under the provisions of Section 2.02 of this Agreement and Article V of the General Conditions.

ARTICLE III

Execution of the Project

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, without any limitation or restriction upon any of its other obligations under the Development Credit Agreement, shall cause AJK to perform in accordance with the provisions of the Project Agreement all the obligations of AJK therein set forth, shall take and cause to be taken all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable AJK to perform such obligations, and shall not take or permit to be taken any action which would prevent or interfere with such performance.

(b) The Borrower shall make available to AJK the proceeds of the Credit in accordance with the Borrower's standard budgetary procedures.

Section 3.02. Except as the Association 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 Credit shall be governed by the provisions of Schedule 1 to the Project Agreement.

Section 3.03. The Borrower and the Association hereby agree that the obligations set forth in Sections 9.03, 9.04, 9.05, 9.06, 9.07 and 9.08 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition, respectively) shall be carried out by AJK pursuant to Section 2.03 of the Project Agreement.

ARTICLE IV

Financial Covenants

Section 4.01. (a) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of statements of expenditure, the Borrower shall:

- (i) maintain or cause to be maintained in accordance with sound accounting practices, records and separate accounts reflecting such expenditures;
- (ii) ensure that all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures are retained until at least one year after the Association has received the audit report for the fiscal year in which the last withdrawal from the Credit Account was made; and
- (iii) enable the Association's representatives to examine such records.

(b) The Borrower shall:

- (i) have the records and accounts referred to in paragraph (a)(i) of this Section and those for the Special Account for each fiscal year audited, in

accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association;

- (ii) furnish to the Association as soon as available, but in any case not later than six months after the end of each such year the report of such audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested, including a separate opinion by said auditors as to whether 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; and
- (iii) furnish to the Association such other information concerning said records and accounts and the audit thereof as the Association shall from time to time reasonably request.

ARTICLE V

Remedies of the Association

Section 5.01. Pursuant to Section 6.02(l) of the General Conditions, the following additional events are specified:

(a) AJK shall have failed to perform any of its obligations under the Project Agreement.

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

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

ARTICLE VI

Effective Date; Termination

Section 6.01. The following event is specified as an additional matter, within the meaning of Section 12.02 (b) of the General Conditions, to be included in the opinion or opinions to be furnished to the Association, namely, that the Project Agreement has been duly authorized or ratified by AJK, and is legally binding upon AJK in accordance with its terms.

Section 6.02. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

Section 6.03. The provisions of Section 5.02 of this Agreement shall cease and determine on the date on which the Development Credit Agreement shall terminate or on the date twenty (20) years after the date of this Agreement, whichever shall be the earlier.

ARTICLE VII

Representative of the Borrower; Addresses

Section 7.01. Except as provided in Section 2.09 of this Agreement, the Secretary to the Government of Pakistan, Economic Affairs Division, or any Additional Secretary, Joint Secretary, Deputy Secretary or Section Officer in that Division is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

The Secretary to the Government of Pakistan
Economic Affairs Division
Islamabad, Pakistan

Cable address:	Telex:
ECONOMIC Islamabad	ECDIV-05-634

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

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

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

ISLAMIC REPUBLIC OF PAKISTAN

By /s/ Waqar Masood Khan

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Abid Hasan

Acting Country Director, Pakistan

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

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

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(1) Civil works	7,150,000	75%
(2) Equipment, materials, office furniture and vehicles	6,100,000	100% of foreign expenditures, 100% of local expenditures (ex factory cost) and 80% of local expenditures for other items procured locally
(3) Consultants' services	650,000	85%
(4) Training	1,100,000	100%
(5) Incremental operating costs	900,000	80% until June 30, 2003, 75% until June 30, 2004, 50% until June 30, 2005 and 40% until June 30, 2006
(6) Unallocated	200,000	
TOTAL	16,100,000	

2. For the purposes of this Schedule:

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

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

(c) the term "consultants' services" includes the services provided by NGOs, in

addition to firms, individuals and training institutions; and

(d) the term “incremental operating costs” means the salaries and travel and daily allowances and other emoluments of LGRDD staff, appointed to posts created after September 30, 2001, and recruited in accordance with a project staffing plan acceptable to the Association for purposes of the Project, and the operating and maintenance costs of vehicles, equipment and offices acquired under and/or used in carrying out the Project.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures prior to the date of this Agreement except that withdrawals in an aggregate amount not exceeding the equivalent of \$2,000,000 may be made in respect of Categories (1), (2), (3), (4) and (5) on account of payments made for expenditures before that date but after July 1, 2001.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures for: (a) goods and works under contracts costing less than \$100,000 equivalent each; (b) consultants’ services under contracts costing less than \$100,000 equivalent each, in the case of firms; (c) consultants’ services under contracts costing less than \$50,000 equivalent each, in the case of individuals; (d) training, workshops and study tours; and (e) incremental operating costs, all under such terms and conditions as the Association shall specify by notice to the Borrower.

SCHEDULE 2

Description of the Project

The objective of the Project is to assist in delivering cost effective and sustainable community development programs and basic infrastructure services to under-served rural, urban and peri-urban communities (the communities) in AJK, using participatory community-based approaches, and, to that end: (a) to support an increase in the number and capacity of community representative organizations; (b) to enhance the capacity of the territorial, district and municipal governments to extend technical, financial and management support to community representative organizations; and (c) to generally enhance accountability and transparency through the establishment of improved operational, financial and budgeting procedures and monitoring and evaluation systems.

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

Part A: Decentralized Planning and Implementation Assistance

1. Development of capacity in at the territory, district and municipal levels, in CBOs and in the communities for developing and using community-driven development approaches and techniques, particularly in such areas as program development, community participation, awareness campaigns and other promotional activities.

2. Strengthening of LGRDD at the territory, district and municipal levels in terms of project implementation, monitoring and evaluation, through the provision of technical assistance, training, equipment and vehicles and recurrent and operating costs.

3. Carrying out of: (a) water quality testing in selected communities to assess the impact of the Project; (b) surveys to determine whether the specified initial viability criteria established for community infrastructure schemes under the Project will be met; and (c) such other community infrastructure-related studies as may be needed from time to time.

Part B: Community Development

1. Carrying out of community development schemes, each consisting of:

(a) community mobilization and capacity building activities such as: (i) raising community awareness through training, media campaigns and other promotional activities; (ii) forming, organizing and strengthening of CBOs; (iii) fostering community participation, *inter alia*, through the preparation of community action plans (CAPs) to form the basis of active participation by community members in planning, developing and implementing their own development schemes; and (iv) systematic orientation and training in survey design, construction technology, and, with respect to CBOs, management, accounting, resource mobilization and operation and maintenance (O&M);

(b) health and environmental sanitation (HESA) development activities such as: (i) improving environmental sanitation, and personal and domestic hygiene; (ii) reducing morbidity by generating demand for safe water and sanitation and other basic infrastructure; and (iii) improving the overall environment; and

(c) women and children's development activities which shall enable them, *inter alia*, to: (i) develop skills required to realize the benefits of improved community infrastructure, particularly water supply, and to participate in community education (or functional literacy); (ii) obtain improved access to the formal credit system; (iii) play a greater role in planning and implementing community infrastructure, water supply and sanitation schemes, and other environmental management initiatives, and (iv) participate in resource mobilization activities, such as collection of user charges, operation and maintenance (O&M) and project monitoring and evaluation.

2. Carrying out of studies, pilots, field testing and dissemination activities centering round particular themes such as women and children's participation in water and sanitation services, environmental management, operation and maintenance and organizing approaches to community infrastructure schemes, including special studies such as beneficiary satisfaction/report card activities.

Part C: Community Infrastructure and Services

1. Carrying out of schemes for construction and/or upgrading of basic community infrastructure and services, including: (a) water supply; (b) community latrines; (c) regular and storm-water drainage; (d) street pavements; (e) street lighting; (f) solid waste management; (g) internal pathways; (h) foot bridges; and (i) street tagging and numbering; and supported by the necessary trunk infrastructure and other specialized community facilities.

* * *

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

SCHEDULE 3

Special Account

1. For the purposes of this Schedule:

(a) the term “eligible Categories” means Categories (1) (2), (3) (4) and (5) set forth in the table in paragraph 1 of Schedule 1 to this Agreement;

(b) the term “eligible expenditures” means expenditures in respect of the reasonable cost of goods and services required for the Project and to be financed out of the proceeds of the Credit allocated from time to time to the eligible Categories in accordance with the provisions of Schedule 1 to this Agreement; and

(c) the term “Authorized Allocation” means an amount equivalent to \$1,500,000 to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 3(a) of this Schedule, provided, however, that unless the Association shall otherwise agree, the Authorized Allocation shall be limited to an amount equivalent to \$750,000 until the aggregate amount of withdrawals from the Credit Account plus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions shall be equal to or exceed the equivalent of SDR 3,000,000.

2. Payments out of the Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Schedule.

3. After the Association has received evidence satisfactory to it that the Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

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

(b) (i) For replenishment of the Account, the Borrower shall furnish to the Association requests for deposits into the Special Account at such intervals as the Association shall specify.

(ii) Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to paragraph 4 of this Schedule for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit 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. All such deposits shall be withdrawn by the Association from the Credit Account under the respective eligible Categories,

and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for eligible expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Association shall not be required to make further deposits into the Special Account:

(a) if, at any time, the Association shall have determined that all further withdrawals should be made by the Borrower directly from the Credit Account in accordance with the provisions of Article V of the General Conditions and paragraph (a) of Section 2.02 of this Agreement;

(b) if the Borrower shall have failed to furnish to the Association, 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 Association pursuant to that provision in respect of the audit of the records and accounts for the Special Account;

(c) if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to the provisions of Section 6.02 of the General Conditions; or

(d) once the total unwithdrawn amount of the Credit allocated to the eligible Categories, minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions with respect to the Project, shall equal the equivalent of twice the amount of the Authorized Allocation. Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit allocated to the eligible Categories shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.

6. (a) If the Association shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association: (A) provide such additional evidence as the Association may request; or (B) deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless the Association shall otherwise agree, no further deposit by the Association 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 Association shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for eligible expenditures, the Borrower shall, promptly upon notice from the Association, refund to the Association such

outstanding amount.

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

(d) Refunds to the Association made pursuant to paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.

