

Public Disclosure Authorized

CONFIRMED COPY

CREDIT NUMBER 3911-NEP

Development Credit Agreement

(Second Rural Water Supply and Sanitation Project)

between

KINGDOM OF NEPAL

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated September 14, 2004

Public Disclosure Authorized



CREDIT NUMBER 3911-NEP

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated September 14, 2004, between KINGDOM OF NEPAL (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;

(B) the Project will be carried out by the Rural Water Supply and Sanitation Fund Development Board (the "Board") 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 the Board, as set forth in this Agreement;

(C) the Borrower intends to obtain from the United Kingdom of Great Britain and Northern Ireland (United Kingdom), acting through the Department for International Development (DFID) a grant (the DFID Grant), in an approximate amount of Pound Sterling two million seven hundred thirty seven thousand (£2,737,000) to assist in financing part of the Project on the terms and conditions set forth in an agreement (the DFID Grant Agreement) to be entered into between the Borrower and DFID; 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 the Board (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) “Batches” means the forth, fifth, sixth, seventh, eighth and any subsequent batches in which implementation of Parts B of the Project shall take place, and the term “Batch” refers to each and any of those batches;
- (b) “Board” means the Rural Water Supply and Sanitation Fund Development Board established by the Formation Order (as hereinafter defined), issued pursuant to Section 3 of the Borrower’s Development Board Act, 2013 (1956), as amended from time to time;
- (c) “Development Phase” means the phase in which social mobilization takes place and Schemes under Part B.2 (ii) of the Project are selected, planned and designed;
- (d) “Environmental Assessment” means the Borrower’s environmental assessment, in form and substance satisfactory to the Association, dated January 28, 2003, including, *inter alia*: (i) the identification and assessment of potential environmental impact of activities to be carried out under the Project; (ii) an evaluation of alternative measures; and (iii) the Environmental Management Plan (EMP), all detailing the appropriate environmental mitigation, monitoring, institutional and management measures required for the implementation of the Project;
- (e) “EMAP” means the Borrower’s Environmental Management Action Plan which sets out, *inter alia*, procedures to screen and process each scheme under the Project for significant environmental impacts, and to assist in mitigating impacts;
- (f) “Financial Monitoring Report” means each report prepared in accordance with Section 4.02 of the Project Agreement;
- (g) “Fiscal Year” or “FY” means the twelve month period corresponding to any of the Borrower’s fiscal years, commencing and ending in mid July of each calendar year;
- (h) “Formation Order” means the Borrower's Formation Order dated March 14, 1996 establishing the Board, as amended;
- (i) “Implementation Manuals” means the Board’s Operations Manual, Project Implementation Plan, Training Manual, Monitoring and Evaluation Manual, Technical Manual, Management Information System (MIS) Manual, Board Accounting Manual, Support Organization Accounting Manual, and Standard Unit Price System Manual adopted by the Board, as amended from time to time in agreement with the Association;
- (j) “Implementation Phase” means the phase in which the construction of Schemes under Part B.2 (iii) selected, planned and designed under the Development Phase is carried out and completed;
- (k) “IPDP” means Indigenous People’s Development Plan for Rural Water Supply and Sanitation dated December 27, 2002, prepared by the Borrower in consultation with the local communities, describing a program of actions, measures and policies designed to maximize the benefits accruing to indigenous people under the Project;

- (l) “MPPW” means the Borrower’s Ministry of Physical Planning and Works, or any successor thereto;
- (m) “Nepal Rastra Bank” means the central bank of the Borrower established and operating pursuant to the provisions of the Borrower’s Nepal Rastra Bank Act, 2058 (2001);
- (n) “Performance Indicators” means indicators referred to in paragraph 5 of Schedule 2 to the Project Agreement;
- (o) “Project Agreement” means the agreement between the Association and the Board 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;
- (p) “Rules” means the Rules framed by the Board under the Formation Order;
- (q) “RWSS” means Rural Water Supply and Sanitation, as defined in the Borrower’s Water Supply and Sanitation Sector Policy dated January 29, 2004;
- (r) “Scheme” or “Schemes” means improvements of water supply and sanitation services for selected communities to be implemented under the Project;
- (s) “Service Agency” or “SA” means any non-governmental agency, established or recognized under the prevalent laws of the Borrower, including consultant and academicians selected by the Board to provide training, monitoring and evaluation, SO (as hereinafter defined) field assessments, Scheme site appraisals, water quality testing, auditing support and services and other specialized services to the Board under the Project;
- (t) “Special Account” means the account referred to in Part B of Schedule 1 to this Agreement;
- (u) “Support Organization” or “SO” means a Non-governmental Organization (NGO), Community Based Organizations (CBO) or private sector institution or entity, established or recognized under the prevalent laws of the Borrower, and selected by the Board to provide necessary support to WSUG (as hereinafter defined) for planning and implementing their respective part of the Project and/or to mobilize such other organizations with such objective;
- (v) “Subsidiary Grant Agreement” means the agreement to be entered into between the Borrower and the Board pursuant to Section 3.01(b) of this Agreement, as the same may be amended from time to time, and such term includes all schedules to the Subsidiary Grant Agreement;
- (w) “WSUC” means a Water Supply and Sanitation User Committee of people elected by the WSUG (as hereinafter defined) from amongst its members to be

accountable to it and to act on its behalf for planning, implementing and maintaining of a Scheme; and

(x) “WSUG” means any Water Supply and Sanitation User Group registered under the Borrower’s Water Resources Act, 2049 (1992), and Water Resources Regulations, 2050 (1993), consisting of local people willing voluntarily to contribute necessary support for planning, implementation and operation of a Scheme and deriving water supply and sanitation benefits therefrom.

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 this Agreement, an amount in various currencies equivalent to seventeen million Special Drawing Rights (SDR 17,000,000).

Section 2.02. 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.

Section 2.03. The Closing Date shall be August 31, 2009 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 (60) 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 charge and service charge shall be payable semiannually on May 15 and November 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 May 15 and November 15, commencing November 15, 2014 and ending May 15, 2044. Each installment to and including the installment payable on May 15, 2024 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (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 (3) 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 (6) 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 (5) 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 Executive Director of the Board 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, excluding Sections 5.02, 5.04 and 5.05 thereof.

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 the Board to perform in accordance with the provisions of the Project Agreement all the obligations of the Board 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 the Board 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 the proceeds of the Credit available to the Board under a subsidiary grant agreement to be entered into between the Borrower and the Board, under terms and conditions satisfactory to the Association which shall include, *inter alia*, the release of the Board's budget as block grants in three (3) tranches under a separate budget head in the Borrower's budget (Red Book) to the Rural Water Supply and Sanitation Fund Development Board.

(c) The Borrower shall exercise its rights under the Subsidiary Grant Agreement in such manner as to protect the interests of the Borrower and the Association and to accomplish the purposes of the Credit, and, except as the Association shall otherwise agree, the Borrower shall not assign, amend, abrogate or waive the Subsidiary Grant Agreement or any provision thereof.

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, and 9.07 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, and

maintenance, respectively) shall be carried out by the Board pursuant to Section 2.03 of the Project Agreement.

Section 3.04. The Borrower shall maintain, in form and substance satisfactory to the Association, the IPDP, and implement it in accordance with the objectives, policies, procedures, time schedules and other provisions set forth therein, to ensure that indigenous people in the Project area shall benefit fully from the activities financed under the Project.

Section 3.05. The Borrower shall allocate, from its own resources, adequate operating budget to the RWSS Monitoring and Evaluation Unit within MPPW to carry out RWSS sector monitoring.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall maintain a financial management system, including records and accounts, and prepare financial statements, all in accordance with consistently applied accounting standards, acceptable to the Association, adequate to reflect the operations, resources and expenditures related to the Project.

(b) The Borrower shall:

- (i) commencing with the fiscal year in which the Effective Date falls, to and including the fiscal year in which the last withdrawal from the Credit Account is made, have the financial statements referred to in paragraph (a) of this Section for each Fiscal Year, audited, in accordance with consistently applied auditing standards acceptable to the Association, 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, (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 by said auditors, in scope and detail satisfactory to the Association; and
- (iii) furnish to the Association such other information concerning such records and accounts, and the audit of such financial statements, and concerning said auditors, as the Association may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of reports (FMRs), the Borrower shall:

- (i) retain, until at least one year after the Association has received the audit report for, or covering, the fiscal year in which the last withdrawal from the Credit Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
- (ii) enable the Association's representatives to examine such records; and
- (iii) ensure that such FMRs are included in the audit for each fiscal year or other period agreed to by the Association, referred to in paragraph (b) of this Section.

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) The Board 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 the Board will be able to perform its obligations under the Project Agreement.

(c) The Formation Order shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of the Board to perform any of its obligations under the Project Agreement.

(d) The Borrower shall have failed to submit the Bill establishing the Rural Water Supply & Sanitation Fund Development Board as an autonomous and regular sector institution in Parliament within six (6) months of its being convened.

(e) the Borrower shall have failed to establish in operational manner the RWSS Sector monitoring and evaluation system by July 16, 2005, or such later date as agreed with the Association.

(f) The DFID Grant Agreement shall have failed to become effective by July 31, 2005, or such later date as the Association may agree; provided, however, that the provisions of this paragraph shall not apply if the Borrower establishes to the satisfaction of the Association that adequate funds for the Project are available to the Borrower from other sources on terms and conditions consistent with the obligations of the Borrower under this Agreement.

- (g) (i) Subject to subparagraph (ii) of this paragraph, the right of the Borrower to withdraw the proceeds of the DFID Grant shall have been suspended, canceled or terminated in whole or in part, pursuant to the terms of the DFID Grant Agreement; or
- (ii) Subparagraph (i) of this paragraph shall not apply if the Borrower establishes to the satisfaction of the Association that: (A) such suspension, cancellation or termination is not caused by the failure of the Borrower to perform any of its obligations under the DFID Grant Agreement; and (B) adequate funds for the Project are available to the Borrower from other sources on terms and conditions consistent with the obligations of the Borrower under this Agreement.

Section 5.02. Pursuant to Section 7.01(h) of the General Conditions, the following additional events are specified:

- (a) 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;
- (b) the events specified in paragraph (c) of Section 5.01 of this Agreement shall occur; and
- (c) the event specified in paragraph (g) (i) of Section 5.01 of this Agreement shall occur, subject to the proviso of paragraph (g) (ii) of that Section.

ARTICLE VI

Effective Date; Termination

Section 6.01. The following event is specified as an additional condition to the effectiveness of this Agreement within the meaning of Section 12.01 (b) of the General Conditions, namely, that the Subsidiary Grant Agreement has been executed on behalf of the Borrower and the Board.

Section 6.02. The following are specified as additional matters 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:

- (a) that the Project Agreement has been duly authorized or ratified by the Board, and is legally binding upon the Board in accordance with its terms; and
- (b) that the Subsidiary Grant Agreement has been duly authorized or ratified by the Borrower and the Board and is legally binding upon the Borrower and the Board in accordance with its terms.

Section 6.03. 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.

ARTICLE VII

Representative of the Borrower; Addresses

Section 7.01. The Secretary of the Ministry of Finance of the Borrower 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:

Ministry of Finance
Singha Durbar
Kathmandu
Nepal

Facsimile:

(977-1) 4259-891

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 Kathmandu, Kingdom of Nepal, as of the day and year first above written.

KINGDOM OF NEPAL

By /s/ Bhanu Prasad Acharya
Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Kenichi Ohashi
Country Director, Nepal
South Asia Region

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

A. General

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) Goods, works, and services for the Schemes:		
(a) Development Phase	1,410,000	100% of grants under Part B of the Project
(b) Implementation Phase	10,970,000	100% of grants under Part B of the Project
(2) Goods	210,000	100% of foreign expenditures, and 85% of local expenditures
(3) Consultants' services and studies	410,000	85%
(4) Training	670,000	100%
(5) Monitoring and Evaluation and Publicity	1,340,000	100%
(6) Incremental Operating Cost	410,000	60% during the first year; 45% during the second year; 30% during the third year; 15% during the fourth year; and 0% thereafter.
(7) Unallocated	1,580,000	
TOTAL	<u>17,000,000</u>	

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 “Incremental Operating Costs” means, salaries, per diem, and fringe benefits of staff appointed to posts in the Board and engaged on a full-time basis for the purposes of the Project, including conveyance, travel and boarding/lodging allowances when on tour, and operating and maintenance costs of vehicles, fuels, equipment and offices acquired under and used in the carrying out of the Project, including the costs of advertising, media projections, newspaper subscriptions, periodicals, insurance, printing, stationery, rent and utilities.

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 SDR 190,000, may be made in respect of Categories 1 and 5 on account of payments made for expenditures before that date but after January 1, 2004.

4. The Borrower may request withdrawals from the Credit Account to be made on the basis of reports to be submitted to the Association in form and substance satisfactory to the Association, such reports to include the FMR and any other information as the Association shall specify by notice to the Borrower (Report-based Disbursements).

B. Special Account

1. The Borrower may open and maintain in Dollars a special deposit account in Nepal Rastra Bank acceptable to the Association, on terms and conditions satisfactory to the Association.

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

(a) if the Borrower is not making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) if the Borrower is making Report-based Disbursements, 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 Association shall reasonably request, furnish to the Association 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 Association shall not be required to make further deposits into the Special Account:

(a) if the Association, at any time, is not satisfied that the reports referred to in Part A.4 of this Schedule 1 adequately provide the information required for Report-based Disbursements;

(b) if the Association determines at any time that all further withdrawals for payment of Eligible Expenditures should be made by the Borrower directly from the Credit Account; or

(c) 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 said Section in respect of the audit of: (i) the records and accounts for the Special Account; or (ii) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based Disbursements or were made on the basis of statements of expenditure, as the case may be.

5. The Association 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 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 Section 6.02 of the General Conditions. Upon such notification, the Association 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 of its determination.

6. (a) If the Association 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 Association, the Borrower shall, promptly upon notice from the Association, provide such additional evidence as the Association may request, or 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. 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 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 (6) month period following such determination, 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 subparagraph (a), (b) or (c) of this paragraph 6 shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the provisions of this Agreement.

Annex A
to
SCHEDULE 1

Operation of Special Account
When Withdrawals Are Not
Report-based Disbursements

1. For the purposes of this Annex, the term “Authorized Allocation” means the amount of \$2,000,000 to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 2 of this Annex, provided, however, that unless the Association shall otherwise agree, the Authorized Allocation shall be limited to an amount equivalent to \$1,000,000 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 \$10,000,000.

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 Association 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 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.

(b) For replenishment of the Special Account, the Borrower shall furnish to the Association requests for deposit into the Special Account at such intervals as the Association shall specify. 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 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 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. Each such deposit into the Special Account shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.

3. The Association shall not be required to make further deposits into the Special Account, once the total unwithdrawn amount of the Credit minus the total amount of all outstanding special commitments entered into by the Association 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 Credit Account of the remaining unwithdrawn amount of the Credit 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.

**Annex B
to
SCHEDULE 1**

**Operation of Special Account
When Withdrawals Are
Report-based Disbursements**

1. Withdrawals from the Credit Account shall be deposited by the Association 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 Association from the Credit Account under one or more of the Eligible Categories.
2. Upon receipt of each application for withdrawal of an amount of the Credit, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account an amount equal to the amount so requested.

SCHEDULE 2

Description of the Project

The objectives of the Project are to: (a) improve rural water supply and sanitation sector institutional performance and mainstream the Rural Water Supply and Sanitation Fund Development Board approach within the Borrower's governmental system; and (b) support communities to form inclusive local WSUGs that can plan, implement and operate drinking water and sanitation infrastructure that delivers sustainable health, hygiene and productivity benefits to rural households.

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: Rural Water Supply and Sanitation Fund Development Board

Strengthening of the Board through the provision of equipment and materials, technical assistance, training, monitoring and evaluation, and administrative and operating costs.

Part B: Development of Schemes

The carrying out of a program of selection and construction of Schemes through:

(i) the promotion of participation of communities in the planning, construction and management of their Schemes, including: (a) community mobilization activities; (b) conducting of information campaigns; (c) provision of non-formal education (focused on dalits and women); (d) health hygiene and sanitation activities; and (e) technical support services for women to improve access to formal credit systems;

(ii) the carrying out of work and provision of technical advisory services for the construction of Schemes, including gravity flow systems, installation of shallow and deep tube wells, dug wells, rainwater harvesting, and catchment protection; and

(iii) the carrying out of work for the construction of sanitation facilities, including provision of grants to WSUGs for making loans to households for domestic latrine construction; and construction of institutional latrines in selected schools and health facilities for demonstration effects.

Part C: Institutional Development and Studies

Provision of technical assistance to: (i) refine and improve MPPW's monitoring and evaluation system; (ii) introduce performance based budget allocations; and (iii) conduct action research, institutional development studies and independent

evaluations to generate improved information needed to design sector policies and test improved methods and techniques for community development.

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The Project is expected to be completed by February 28, 2009.