

CONFORMED COPY

CREDIT NUMBER 4096-HO

Development Credit Agreement

(Barrio Ciudad Project)

between

REPUBLIC OF HONDURAS

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated November 16, 2005

CREDIT NUMBER 4096-HO

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated November 16, 2005, between REPUBLIC OF HONDURAS (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, has requested the Association to assist in the financing of the Project; and

WHEREAS (B) 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;

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 May 1, 2004), with the modifications set forth below (the General Conditions), constitute an integral part of this Agreement:

(a) Section 5.08 of the General Conditions is amended to read as follows:

“Section 5.08. *Treatment of Taxes*

Except as otherwise provided in the Development Credit Agreement, the proceeds of the Credit may be withdrawn to pay for taxes levied by, or in the territory of, the Borrower on the goods or services to be financed under the Credit, or on their importation, manufacture, procurement or supply. Financing of such taxes is subject to the Association’s policy of requiring economy and efficiency in the use of the proceeds of its credits. To that end, if the Association shall at any time determine that the amount of any taxes levied on or in respect of any item to be financed out of the proceeds of the Credit is excessive or otherwise unreasonable, the Association may, by notice to the Borrower, adjust the percentage for withdrawal set forth or referred to in respect of such item in the Development Credit Agreement as required to be consistent with such policy of the Association.”; and

(b) Section 6.03 (c) of the General Conditions is amended by replacing the words “corrupt or fraudulent” with the words “corrupt, fraudulent, collusive or coercive”.

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) “AHIBA” means *Asociación Hondureña de Instituciones Bancarias*, a non-profit association organized under Honduran laws on September 24, 1956, and approved by the Borrower’s Legislative Decree No. 8 of December 24, 1964, as it may have been amended to the date of this Agreement;

(b) “AMHON” means *Asociación de Municipios de Honduras*, the Honduran association of municipalities established pursuant to the Borrower’s Executive Resolution No. 16-1962;

(c) “BANHPROVI” means *Banco Hondureño para la Producción y la Vivienda*, a second-tier Honduran credit institution created by the Borrower’s Legislative Decree No. 6-2005 published in the Borrower’s Official Gazette on April 1, 2005;

(d) “BANHPROVI Special Account” means the account for the implementation of Part A of the Project referred to in paragraph 1, Part B of Schedule 1 to this Agreement;

(e) “Community Safety Subproject” means a set of investments covered by Part D.3 of the Project which is eligible for grant financing in accordance with the criteria set forth in the Operational Manual;

(f) “CONASA” means *Consejo Nacional de Agua Potable y Saneamiento*, the Borrower’s national council for water and sanitation, created by the Borrower’s Legislative Decree No. 118-2003 published in the Borrower’s Official Gazette on October 8, 2003;

(g) “Eligible Categories” means Categories (1) through (7) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

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

(i) “Eligible Municipality” means each of the Borrower’s Municipalities with an urban population greater than 15,000, excluding the Municipalities of Tegucigalpa and San Pedro Sula, that meets the criteria set forth in the Operational Manual;

(j) “Environmental Framework” means the Borrower’s framework for the management of environmental aspects of the Project dated April 25, 2005, as may be amended from time to time with the prior approval of the Association;

(k) “ERSAPS” means *Ente Regulador de los Servicios de Agua Potable y Saneamiento*, the Borrower’s regulating entity for potable water and sanitation created by the Borrower’s Legislative Decree No. 118-2003 published in the Borrower’s Official Gazette on October 8, 2003;

(l) “FHIS” means *Fondo Hondureño de Inversión Social*, the Borrower’s Social Investment Fund established pursuant to the Borrower’s Decree No. 12-90 of February 22, 1990, as said Decree may have been amended to the date of this Agreement, and governed by the regulations set forth in the Borrower’s Decree No. 261-91 of April 2, 1991, as said regulations may have been amended to the date of this Agreement;

(m) “FHIS Special Account” means the account for the implementation of Parts B through E of the Project referred to in paragraph 1, Part B of Schedule 1 to this Agreement;

(n) “Financial Intermediary” means a credit institution that meets the criteria set forth in the Operational Manual, which makes Subloans under the Project;

(o) “Financial Monitoring Report” or “FMR” means each report prepared in accordance with Section 4.02 of this Agreement;

(p) “Grant Agreement” means each of the agreements referred to in Section 3.07 (a) of this Agreement, as the same may be amended from time to time, and such term includes all schedules to the Grant Agreement;

(q) “Grant Window Subproject” means a set of investments covered by Part B of the Project which is eligible for grant financing in accordance with the criteria set forth in the Operational Manual;

(r) “Intermediary Loan” means a loan made or proposed to be made by BANHPROVI to a Financial Intermediary: (i) with the proceeds of the Credit; (ii) in an amount equal to up to 25% of the Subloan in question; and (iii) pursuant to an Intermediary Loan Agreement;

(s) “Intermediary Loan Agreement” means an agreement to be entered into by BANHPROVI with a Financial Intermediary pursuant to Section 3.08 (a) of this Agreement, and such term includes all schedules to the Intermediary Loan Agreement;

(t) “Loan Window Subproject” means a set of investments covered by Part A of the Project which is eligible for loan financing in accordance with the criteria set forth in the Operational Manual;

(u) “Municipality” means an autonomous entity established pursuant to the Municipality Law;

(v) “Municipality Framework Agreement” means the agreement to be entered into between FHIS and each Eligible Municipality pursuant to Section 3.06 (a) of this Agreement, as the same may be amended from time to time, and such term includes all schedules to the Municipality Framework Agreement;

(w) “Municipality Law” means the Borrower’s *Ley de Municipalidades*, established by the Borrower’s Decree No. 134-90 of November 19, 1990, as said Decree may have been amended to the date of this Agreement, and including the regulations adopted pursuant to the Borrower’s Accord No. 18-93 of February, 29, 1993, as said regulations may have been amended to the date of this Agreement;

(x) “Operational Manual” means the manual referred to in Section 3.03 (a) of this Agreement;

(y) “Participating Agency” means SOPTRAVI, SEGJ, SANAA, ERSAPS and CONASA and/or any other agency in addition to, or in substitution of, these agencies that the Borrower and the Association deem necessary to carry out the Project;

(z) “Participation Agreement” means the agreement to be entered into between FHIS and each Participating Agency pursuant to Section 3.05 (a) of this Agreement, as the same may be amended from time to time, and such term includes all schedules to the Participation Agreement;

(aa) “Performance Indicators” means the indicators for Project monitoring and evaluation set forth in the Operational Manual;

(ab) “Procurement Plan” means the Borrower’s procurement plan, dated April 22, 2005 covering the initial 18-month period (or longer) of Project implementation, as the same shall be updated from time to time in accordance with the provisions of Section 3.02 to this Agreement, to cover succeeding 18-month periods (or longer) of Project implementation;

(ac) “Project Preparation Advance” means the project preparation advance granted by the Association to the Borrower pursuant to the letter agreement signed on behalf of the Association on March 4, 2005 and on behalf of the Borrower on May 6, 2005;

(ad) “Report-based Disbursements” means the Borrower’s option for withdrawal of funds from the Credit Account referred to in Part A.5 of Schedule 1 to this Agreement;

(ae) “Resettlement Policy Framework” means the Borrower’s resettlement policy framework for the Project dated April 22, 2005, as may be amended from time to time with the prior approval of the Association;

(af) “SANAA” means *Servicio Autónomo Nacional de Acueductos y Alcantarillados*, the Borrower’s national autonomous service for aqueducts and sewerage created by the Borrower’s Legislative Decree No. 91 of April 26, 1961, as it may have been amended to the date of this Agreement;

(ag) “SEFIN” means *Secretaría de Estado en el Despacho de Finanzas*, the Borrower’s Ministry of Finance;

(ah) “SEGJ” means *Secretaría de Estado en el Despacho de Gobernación y Justicia*, the Borrower’s Ministry of the Interior and Justice;

(ai) “SOPTRAVI” means *Secretaría de Estado en los Despachos de Obras Públicas, Transporte y Vivienda*, the Borrower’s Ministry of Public Works, Transport and Housing;

(aj) “Special Accounts” means collectively the BANHPROVI Special Account and the FHIS Special Account;

(ak) “Strategic Framework for Community Participation in Neighborhood Upgrading” means the Borrower’s framework for the management of social aspects of the Project, dated April 22, 2005, as may be amended from time to time with the prior approval of the Association;

(al) “Subprojects” means collectively Loan Window Subprojects, Grant Window Subprojects, and Community Safety Subprojects;

(am) “Subborrower” means an Eligible Municipality to which a Financial Intermediary proposes to make or has made a Subloan;

(an) “Subloan” means a loan made or proposed to be made, with the proceeds of an Intermediary Loan, by a Financial Intermediary to a Subborrower for purposes of Part A of the Project;

(ao) “Subloan Agreement” means an agreement to be entered into by a Financial Intermediary with an Eligible Municipality pursuant to paragraph 3 of Section II of Schedule 4 to this Agreement;

(ap) “Tripartite Subsidiary Agreement” means the agreement to be entered into between the Borrower, FHIS and BANHPROVI 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 Tripartite Subsidiary Agreement; and

(aq) "UTM" means the unit referred in Section 3.04(c) 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 this Agreement, an amount in various currencies equivalent to ten million Special Drawing Rights (SDR 10,000,000).

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) Promptly after the Effective Date, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and pay to itself the amount required to repay the principal amount of the Project Preparation Advance withdrawn and outstanding as of such date and to pay all unpaid charges thereon. The unwithdrawn balance of the authorized amount of the Project Preparation Advance shall thereupon be canceled.

Section 2.03. The Closing Date shall be June 30, 2011 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 June 15 and December 15 in each year.

Section 2.07. The Borrower shall repay the principal amount of the Credit in semiannual installments payable on each June 15 and December 15 commencing December 15, 2015 and ending June 15, 2025. Each installment shall be five percent (5%) of such principal amount.

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.

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 cause FHIS to carry out the Project with the assistance of the Participating Agencies, the Eligible Municipalities, and, for purposes of Parts A and E of the Project, BANHPROVI, all with due diligence and efficiency and in conformity with appropriate administrative, engineering, economic, financial, technical, social and environmental practices, and in accordance with the Operational Manual, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) The Borrower shall enter into an agreement with FHIS and BANHPROVI (the Tripartite Subsidiary Agreement), satisfactory to the Association, providing *inter alia*, for:

- (i) the provision to FHIS of the funds, facilities, services and other resources required to enable FHIS to carry out the Project, including the transfer of the proceeds of the Credit required for Parts B through E of the Project on a grant basis;
- (ii) the provision to BANHPROVI of the funds, facilities, services and other resources required to enable BANHPROVI to carry

out Part A of the Project, including the transfer of the proceeds of the Credit required for Part A of the Project on a grant basis;

(iii) the obligation of FHIS and, with respect to Part A of the Project, BANHPROVI, to carry out the Project in accordance with the terms and conditions set forth in this Agreement and in the Operational Manual, including their respective obligations to:

- (A) comply with the provisions of Sections 4.01 and 4.02 of this Agreement;
- (B) promptly inform the Association of any condition which interferes or threatens to interfere with the progress of the Project or the Subprojects, the accomplishment of the purposes of the Credit, or the performance of their obligations under the Tripartite Subsidiary Agreement;
- (C) prepare the reports referred to in Section 3.13 of this Agreement; and
- (D) in the case of FHIS, enter into Municipality Framework Agreements and Grant Agreements with Eligible Municipalities, and in the case of BANHPROVI, enter into Intermediary Loan Agreements with Financial Intermediaries, all under terms and conditions satisfactory to the Association, including those specified in this Agreement.

(c) The Borrower shall exercise its rights under the Tripartite Subsidiary Agreement in such a 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 change, assign, amend, abrogate, waive or fail to enforce the Tripartite Subsidiary Agreement or any provision thereof.

Section 3.02. (a) Except as the Association shall otherwise agree, procurement of the goods, works and services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 3 to this Agreement, as said provisions may be further elaborated in the Procurement Plan.

(b) The Borrower shall update the Procurement Plan in accordance with guidelines acceptable to the Association, and furnish such update to the Association not later than 12 months after the date of the preceding Procurement Plan, for the Association's approval.

(c) Without limitation to the provisions in paragraphs (a) and (b) above, the Borrower shall ensure that, with the exception of works and consultants' services under Loan Window Subprojects, procurement of works estimated to cost more than \$500,000 per contract and procurement of all consultants' services is carried out by FHIS.

Section 3.03. (a) The Borrower shall cause FHIS and BANHPROVI and cause FHIS to cause each Eligible Municipality to adopt a manual (the Operational Manual), satisfactory to the Association, setting forth rules and procedures for the carrying out of the Project, such manual to include, *inter alia*:

- (i) the procedures for the carrying out, monitoring and evaluation of the Project (including the procurement, financial and environmental requirements thereof);
- (ii) the criteria for the approval, implementation, monitoring and evaluation of Subprojects including the technical, social and economic criteria for the evaluation of such Subprojects;
- (iii) the criteria for eligibility of Municipalities and Subprojects, including without limitation the procedures required for a participatory process during the preparation of Subprojects;
- (iv) a model Municipality Framework Agreement and Grant Agreement;
- (v) the Environmental Framework, the Resettlement Policy Framework, the Strategic Framework for Community Participation in Neighborhood Upgrading, and the procedures to safeguard cultural property;
- (vi) the Performance Indicators;
- (vii) the eligibility criteria for Financial Intermediaries;
- (viii) the procedures to be followed for Intermediary Loans and Subloans; and
- (ix) a model Intermediary Loan Agreement and Subloan Agreement.

(b) The Operational Manual may be amended by FHIS from time to time with the prior approval of the Association. In the case of any conflict between the terms of the Operational Manual and those of this Agreement, the terms of this Agreement shall prevail.

Section 3.04. (a) The Borrower shall cause FHIS, until completion of the Project, to maintain key staff for the Project, including without limitation, a Project coordinator, a procurement specialist, a financial management specialist, an environmental unit specialist, an urban upgrading technical specialist, an urban upgrading social specialist and a crime and violence prevention specialist, all with experience and qualifications that shall be at all times acceptable to the Association, and to agree with the Association with respect to the replacement of key staff of FHIS prior to any such replacement.

(b) The Borrower shall cause BANHPROVI, until completion of the Project, to:

- (i) maintain key staff for the Project, including without limitation a municipal finance specialist and a financial management specialist/administrator, all with experience and qualifications that shall be at all times acceptable to the Association, and to agree with the Association with respect to the replacement of key staff of BANHPROVI prior to any such replacement; and
- (ii) establish and maintain an advisory committee, chaired by representatives of BANHPROVI and including representatives of AHIBA and AHMON, and representatives of any other entity that may be deemed necessary during Project implementation, with functions and responsibilities satisfactory to the Association, including, *inter alia*, providing strategic guidance and oversight for the implementation of Part A of the Project.

(c) The Borrower shall cause FHIS to cause each Eligible Municipality to maintain, during Project implementation, a technical unit (UTM) with duties and responsibilities as set forth in the Operational Manual and staffed with personnel with qualifications and experience satisfactory to the Association, including technical and administrative staff.

Section 3.05. (a) The Borrower shall cause FHIS to enter into an agreement with each Participating Agency (a Participation Agreement), under terms and conditions satisfactory to the Association, such agreement to provide *inter alia*, for:

- (i) coordination mechanisms ensuring consistent approaches and complementarity between the Project and activities implemented by such Participating Agency and to support the decentralization of service delivery; and
- (ii) assistance by such Participating Agency to FHIS on sector specific technical issues, including, *inter alia*, Subproject evaluation, screening criteria, preparation of technical

specifications, and review of technical designs (and also including, in the case of SOPTRAVI, its role in the implementation of the Resettlement Policy Framework and in the implementation of Part C.3 of the Project).

(b) The Borrower shall cause FHIS and each Participating Agency to exercise their respective rights under each Participation Agreement in such a 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, FHIS and each Participating Agency shall not change, assign, amend, abrogate, waive or fail to enforce their respective Participation Agreement or any provision thereof.

Section 3.06. (a) The Borrower shall cause FHIS, before commencing the preparation of any Subproject, to enter into an agreement (a Municipality Framework Agreement), under terms and conditions substantially similar to those of the model form contained in the Operational Manual with the respective Eligible Municipality to provide for:

- (i) the actions required for such Eligible Municipality to access grant and/or loan financing for Subprojects;
- (ii) the technical assistance to be provided and/or coordinated by FHIS for such Eligible Municipality as part of Subproject preparation;
- (iii) the obligations of such Eligible Municipality to follow the requirements of this Agreement and the Operational Manual in respect of such Subprojects, including procurement, reporting and financial management requirements and any actions required from such Eligible Municipality in the implementation of the Environmental Framework, the Resettlement Policy Framework and the Strategic Framework for Community Participation in Neighborhood Upgrading;
- (iv) the supervision arrangements between FHIS and such Eligible Municipality during Subproject preparation and implementation;
- (v) the causes for suspension or cancellation of Subproject preparation; and
- (vi) the distribution of Subproject preparation costs if the Subproject is finally not approved for financing.

(b) The Borrower shall cause FHIS and each Eligible Municipality to exercise their respective rights under each Municipality Framework Agreement in such a 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, FHIS and each Eligible Municipality shall not change, assign, amend, abrogate, waive or fail to enforce their respective Municipality Framework Agreement, or any provision thereof.

Section 3.07. (a) The Borrower shall cause FHIS, before commencing the implementation of any Grant Window Subproject or Community Safety Subproject, to enter into an agreement (a Grant Agreement), under terms and conditions substantially similar to those of the model form contained in the Operational Manual with the respective Eligible Municipality to provide for:

- (i) the provision to such Eligible Municipality by FHIS of the funds, facilities, services and other resources required to carry out the respective Grant Window Subprojects and/or Community Safety Subprojects, including the transfer of the proceeds of the Credit required for such Grant Window Subprojects and/or Community Safety Subprojects on a grant basis, except that the funds required for works estimated to cost more than \$500,000 per contract and all of the funds required for consultants' services shall be retained by FHIS so that the procurement of such works and services shall be carried out by FHIS for the benefit of the Eligible Municipality, and the works shall then be supervised by FHIS and when completed transferred to the Eligible Municipality;
- (ii) the commitment of such Eligible Municipality to contribute in cash or in kind at least fifteen percent of the cost of works and services for Grant Window Subprojects and Community Safety Subprojects being financed with the proceeds of the Credit, as specified in the Operational Manual;
- (iii) the respective roles and responsibilities of FHIS and such Eligible Municipality in the procurement of works and services for Subprojects; and
- (iv) the obligation of the Eligible Municipality to carry out the respective Grant Window Subprojects and/or Community Safety Subprojects in accordance with the terms and conditions set forth in this Agreement and in the Operational Manual, including without limitation its obligation to:
 - (A) comply with the provisions of Sections 4.01 and 4.02 of this Agreement;
 - (B) promptly inform FHIS of any condition which interferes or threatens to interfere with the progress of respective

Grant Window Subprojects and/or Community Safety Subprojects, the accomplishment of the purposes of the Credit or the performance of its obligations under the Grant Agreement or the Municipality Framework Agreement; and

- (C) prepare the reports and plans referred to in the Operational Manual.

(b) The Borrower shall cause FHIS to exercise its rights under each Grant Agreement in such a manner as to: (i) protect the interests of the Association, the Borrower and FHIS; (ii) comply with its obligations under the Tripartite Subsidiary Agreement; and (iii) achieve the purposes of Parts B and D.3 of the Project. Except as the Association shall otherwise agree, the Borrower shall cause FHIS not to change, assign, amend, abrogate, waive or fail to enforce any Grant Agreement or any provision thereof.

Section 3.08. (a) The Borrower shall cause BANHPROVI to relend the proceeds of the Credit for Part A of the Project by making Intermediary Loans to Financial Intermediaries in accordance with the procedures set forth in Schedule 4 to this Agreement and under agreements to be entered into or already entered into between BANHPROVI and each Financial Intermediary, containing terms and conditions satisfactory to the Association which shall include, inter alia:

- (i) rights adequate to protect the interests of the Association, the Borrower and BANHPROVI, including the right to suspend or terminate the right of the Financial Intermediary to the use of the proceeds of the Loan upon failure by such Financial Intermediary to perform its obligations under the Intermediary Loan Agreement; and
- (ii) the applicable terms and conditions set forth or referred to in Schedule 4 to this Agreement.

(b) The Borrower shall cause BANHPROVI to exercise its rights under the Intermediary Loan Agreements in such a manner as to: (i) protect the interests of the Association, the Borrower and BANHPROVI; (ii) comply with its obligations under the Tripartite Subsidiary Agreement; and (iii) achieve the purposes of Part A of the Project. Except as the Association shall otherwise agree, the Borrower shall cause BANHPROVI not to change, assign, amend, abrogate, waive or fail to enforce any Intermediary Loan Agreement or any provision thereof.

Section 3.09. The Borrower undertakes that, unless the Association shall otherwise agree, Subloans under Part A of the Project shall be made by Financial

Intermediaries in accordance with the procedures and on the terms and conditions set forth or referred to in Schedule 4 to this Agreement.

Section 3.10. The Borrower shall cause BANHPROVI to: (a) cause Financial Intermediaries promptly to exercise their rights set forth in Section II, paragraph 3(e) of Schedule 4 to this Agreement; and (b) promptly exercise its suspension or termination rights referred to in Section 3.08 (a) (i) of this Agreement.

Section 3.11. (a) The Borrower shall cause BANHPROVI to use all Intermediary Loan principal repayments received by BANHPROVI until at least four years after the Closing Date from or on behalf of Financial Intermediaries to be used to set up a municipal guarantee fund satisfactory to the Association, which will have as its main objective to serve as a sustainable mechanism to promote lending, with risk sharing, to Municipalities after the full disbursement of the funds under Category 1 in the table in paragraph 1, Part A of Schedule 1 to this Agreement.

(b) The Borrower shall cause BANHPROVI to have the municipal guarantee fund referred to in the preceding paragraph audited each fiscal year by external auditors acceptable to the Association, starting the first fiscal year after the first deposit is made into said fund. Said external auditors shall be hired not later than six months prior to the date when the first audit is due.

Section 3.12. Without limitation to the provisions of Section 3.03 (a) (v) of this Agreement, the Borrower shall cause FHIS and, with respect to Part A of the Project, BANHPROVI, to:

- (a) (i) prior to the implementation of a Subproject in which the Resettlement Policy Framework applies, furnish to the Association for its prior approval, the resettlement plan prepared in accordance with such Resettlement Policy Framework; and
- (ii) thereafter: (A) enter into the inter-institutional agreements that may be necessary; and (B) carry out such resettlement plan in accordance with its terms;

(b) implement the Environmental Framework in accordance with its terms;
and

(c) implement the Strategic Framework for Community Participation in Neighborhood Upgrading in accordance with its terms.

Section 3.13. The Borrower shall cause FHIS and, with respect to Part A of the Project, BANHPROVI, to:

(a) maintain policies and procedures adequate to enable FHIS and BANHPROVI 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 Association, and furnish to the Association, not later than six months after the Effective Date and semestrally thereafter during the period of Project implementation, a report integrating the results of the monitoring and 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 said 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

(c) review with the Association not later than two months after the date of such report, or such later date as the Association shall request, the report referred to in paragraph (b) 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 Association's views on the matter.

Section 3.14. For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the Borrower shall:

(a) prepare, on the basis of guidelines acceptable to the Association, and furnish to the Association 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 Association, a plan for the future operation of the Project; and

(b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

Section 3.15. 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 FHIS.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall cause FHIS and BANHPROVI to maintain, and each Eligible Municipality to establish and maintain, a financial management system, including records and accounts, and prepare financial statements 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 cause FHIS, BANHPROVI and each Eligible Municipality to:

- (i) have the financial statements referred to in paragraph (a) of this Section for each fiscal year in (or other period agreed to by the Association), commencing with the fiscal year in which the first withdrawal under the Project Preparation Advance was made in the case of FHIS, 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 four months after the end of each such year (or such other period agreed to by the Association): (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or other period agreed to by the Association), 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 referred to in Part A.5 of Schedule 1 to this Agreement (Report-based Disbursements) or on the basis of statements of expenditure, the Borrower shall cause FHIS, BANHPROVI and each Eligible Municipality to:

- (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 reports and statements of expenditure 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.

Section 4.02. (a) Without limitation upon the Borrower's progress reporting obligations set out in Section 3.13 of this Agreement, the Borrower shall cause FHIS (with respect to Parts B through E of the Project) and BANHPROVI (with respect to Part A of the Project) to prepare and furnish to the Association a financial monitoring report, in form and substance satisfactory to the Association, which:

- (i) sets forth sources and uses of funds for the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the Credit, and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and explains variances between the actual and planned Project implementation; and
- (iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

(b) The first FMR shall be furnished to the Association not later than 45 days after the end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under the Project through the end of such first calendar quarter; thereafter, each FMR shall be furnished to the Association not later than 45 days after each subsequent calendar quarter, and shall cover such calendar quarter.

ARTICLE V

Remedies of the Association

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

- (i) FHIS shall have failed to perform any of its obligations under the Tripartite Subsidiary Agreement and/or under any Municipality Framework Agreement.
- (ii) BANHPROVI shall have failed to perform any of its obligations under the Tripartite Subsidiary Agreement and/or under any Intermediary Loan Agreement.

- (iii) An Eligible Municipality shall have failed to perform any of its obligations under its respective Municipality Framework Agreement and/or Grant Agreement and/or Subloan Agreement.
 - (iv) A Financial Intermediary shall have failed to perform any of its obligations under its respective Intermediary Loan Agreement and/or Subloan Agreement.
- (b) Notwithstanding the rights contained in Section 6.02 of the General Conditions, it is understood that:
- (i) if any of the events specified in paragraph (a)(iii) of this Section shall have occurred, the Association may, by notice to the Borrower, choose to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account for expenditures solely in respect of the concerned Municipality; and
 - (ii) if any of the events specified in paragraph (a)(iv) of this Section shall have occurred, the Association may, by notice to the Borrower, choose to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account for expenditures solely in respect of the concerned Financial Intermediary.

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

ARTICLE VI

Effective Date; Termination

Section 6.01. The following events are specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 (b) of the General Conditions:

- (a) the Tripartite Subsidiary Agreement has been executed on behalf of the Borrower, FHIS and BANHPROVI;
- (b) FHIS and BANHPROVI have adopted the Operational Manual on terms and in scope acceptable to the Association;

(c) FHIS and BANHPROVI have been staffed as provided in Section 3.04 (a) and Section 3.04 (b) (i) of this Agreement, respectively; and

(d) all Municipalities with an urban population greater than 15,000, excluding the Municipalities of Tegucigalpa and San Pedro Sula, have been thoroughly informed of the Project objectives, components, eligibility criteria, operational mechanisms, and the Environmental Framework and Resettlement Policy Framework.

Section 6.02. The following 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 Tripartite Subsidiary Agreement has been duly authorized or ratified by the Borrower, FHIS and BANHPROVI and is legally binding upon the Borrower, FHIS and BANHPROVI in accordance with its terms.

Section 6.03. The date February 14, 2006 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 Minister of SEFIN 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:

SEFIN
Tegucigalpa, M.D.C.
Honduras

Cable address:

HACIENDA
Tegucigalpa

Facsimile:

(504) 237-4142

For the Association:

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

Cable address:

INDEVAS
Washington, D.C.

Telex:

248423 (MCI) or
64145 (MCI)

Facsimile:

(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 Tegucigalpa, Honduras, as of the day and year first above written.

REPUBLIC OF HONDURAS

By /s/ William Chong Wong

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Jane Armitage

Authorized Representative

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) Loan Window Subprojects	3,200,000	25% of the cost of works and services for Loan Window Subprojects
(2) Grant Window Subprojects	3,200,000	100% of the cost of works and services for Grant Window Subprojects, except for those costs covered by the counterpart contribution cited in Section 3.07(a)(ii) of this Agreement
(3) Community Safety Subprojects	450,000	100% of the cost of works and services for Community Safety Subprojects, except for those costs covered by the counterpart contribution cited in Section 3.07(a)(ii) of this Agreement

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(4) Goods		
(a) for Part C.3 of the Project	24,000	100%
(b) other	82,000	100%
(5) Consultants' Services (other than those included in Categories (1) through (3) above):		
(a) for Part C.3 of the Project	24,800	100%
(b) other	782,000	100%
(6) Training		
(a) for Part C.3 of the Project	16,500	100%
(b) other	169,000	100%
(7) Operating Costs	133,000	100%
(8) Refunding of Project Preparation Advance	1,325,000	Amount due pursuant to Section 2.02 (b) of this Agreement
(9) Unallocated	593,700	
 TOTAL	 <u>10,000,000</u>	

2. For the purposes of this Schedule:

(a) the term “training” means: (i) reasonable travel, room, board and per diem expenditures incurred by trainers and trainees in connection with their training and by non-consultant training facilitators; (ii) course fees; (iii) training facility rentals; and (iv) training material preparation, acquisition, reproduction and distribution expenses not otherwise covered under this paragraph; and

(b) the term “operating costs” means the incremental expenses incurred on account of Project implementation, including office equipment and supplies, vehicle operation and maintenance, communication and insurance costs, office administration costs, utilities, travel, per diem and supervision costs, and salaries of locally contracted employees (none of which would have been incurred absent the Project).

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 SDR 1,000,000 may be made on account of payments made for expenditures covered by disbursement category 1 set forth in the table in paragraph 1 of Part A of this Schedule before that date but after August 1, 2004 (but in no case earlier than twelve months immediately before the date of this Agreement);

(b) payments made for expenditures covered by disbursement categories 1, 2 and 3 set forth in the table in paragraph 1 of Part A of this Schedule in respect of an Eligible Municipality, unless the respective: (i) Municipality Framework Agreement has been entered into by the parties thereto; (ii) UTM for such Eligible Municipality has been properly staffed as provided in Section 3.04 (c) of this Agreement; (iii) financial management arrangements referred to in Section 4.01 (a) of this Agreement for such Eligible Municipality have been established and become operational; and (iv) Grant Agreement in the case of Categories 2 and 3 or Subloan Agreement in the case of Category 1 has been entered into by the parties thereto; and

(c) payments for expenditures covered by disbursement categories 4(a), 5(a) and 6(a) set forth in the table in paragraph 1 of Part A of this Schedule, unless the Participation Agreement between SOPTRAVI and FHIS has been entered into by the parties thereto.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures for: (i) works and services under Loan Window Subprojects, Grant Window Subprojects and Community Safety Subprojects; (ii) training; and (iii) operating costs, all under such terms and conditions as the Association shall specify by notice to the Borrower.

5. 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). In the case of the first such request submitted to the Association before any withdrawal has been made from the Credit Account, the Borrower shall submit to the Association only a statement with the projected sources and applications of funds for the Project for the three-month period following the date of such request.

B. Special Account

1. The Borrower may open and maintain in Dollars, in its Central Bank, and on terms and conditions satisfactory to the Association: (a) a special deposit account for Part A of the Project (the BANHPROVI Special Account); and (b) a special deposit account for Parts B through E of the Project (the FHIS Special Account).

2. After the Association has received evidence satisfactory to it that the Special Accounts have been opened, withdrawals from the Credit Account of amounts to be deposited into any of the Special Accounts 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 respective Special Account shall be made exclusively for Eligible Expenditures. For each payment made by the Borrower out of any of the Special Accounts, 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 any of the Special Accounts:

(a) if the Association, at any time, is not satisfied that the reports referred to in Part A.5 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: (A) the records and accounts for the Special Account; or (B) 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 any of the Special Accounts 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 any of the Special Accounts 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 any of the Special Accounts 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 respective 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 any of the Special Accounts 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 Accounts 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 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 Accounts.

(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 the Credit 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: (a) the amount of \$500,000 to be withdrawn from the Credit Account and deposited into the BANHPROVI Special Account; and (b) the amount of \$800,000 to be withdrawn from the Credit Account and deposited into the FHIS Special Account; all pursuant to paragraph 2 of this Annex.

2. Withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Accounts 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 respective 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 respective Special Account such amount as the Borrower shall have requested.

(b) For replenishment of any of the Special Account, the Borrower shall furnish to the Association requests for deposit into the respective 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 respective 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 respective Special Account for Eligible Expenditures. Each such deposit into the respective 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 any of the Special Accounts, 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 respective Special Account an amount equal to the lesser of: (a) the amount so requested; and (b) the amount which the Association has determined, based on the reports referred to in Part A.5 of this Schedule 1 applicable to such withdrawal application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such reports.

SCHEDULE 2

Description of the Project

The objectives of the Project are: (a) to improve the quality of life for the urban poor in the Borrower's territory; and (b) to enable their municipal governments to continue and sustain such improvements through capacity building and improved access to credit.

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: Urban Services and Infrastructure

Provision of financing to Eligible Municipalities, in the form of Subloans, for the carrying out of Loan Window Subprojects consisting of city-level infrastructure investments (that are revenue generating and permit cost recovery) to:

1. promote urban development and attract new investment, such as markets, transportation terminals and road infrastructure, cemeteries, slaughterhouses and extensions/improvements to the city water and sanitation systems; and
2. help equip cities with basic facilities, such as fire stations, city center improvements and communications services.

Part B: Neighborhood Upgrading

Provision of financing to Eligible Municipalities, in the form of grants, for the carrying out of Grant Window Subprojects consisting of typical urban upgrading interventions such as land titling, water and sanitation connections, drainage, access roads, recreation centers, parks, community facilities, street lighting, child care facilities, risk mitigation works and resettlement costs that are eligible for grant financing according to the criteria set forth in the Operational Manual.

Part C: Technical Assistance

Provision of technical assistance to:

1. build the capacity of Eligible Municipalities and neighborhood organizations within Eligible Municipalities for participatory planning and execution of urban upgrading;

2. improve the capacity of Eligible Municipalities for commercial borrowing and debt management, including technical assistance in selected key areas such as preparing loan financing proposals and financial statements, urban planning, water and sanitation service delivery, financial management, revenue collection, project management, and environmental management and regulation; and
3. strengthen the capacity of the recently created General Directorate for Housing and Urban Development within SOPTRAVI to deliver technical assistance to municipalities, formulate policy and provide sector oversight and regulation in urban development.

Part D: Urban Crime and Violence Prevention

Development of public works and prevention strategies that enhance community security and integration, including:

1. situational prevention, which includes measures that reduce opportunities for particular crime and violence problems through spatial interventions such as “crime prevention through environmental design” and urban renewal;
2. capacity building, training and technical assistance in multi-sectoral crime and violence prevention (excluding police activities), such as community crime mapping and diagnostics, preventing juvenile delinquency and domestic violence, community safety and monitoring and evaluation; and
3. complementary investments and activities, including municipal plans for crime and violence prevention and provision of grants to Eligible Municipalities for complementary infrastructure and programs for community safety (excluding police activities).

Part E: Project Administration

Provision of technical assistance, equipment, training and incremental operational costs as necessary to operate and strengthen FHIS and, with respect to Part A of the Project, BANHPROVI, to enable them to effectively monitor and evaluate the implementation of the Project components (including audit services for purposes of Section 4.01 (b) of this Agreement).

* * *

The Project is expected to be completed by December 30, 2010.

SCHEDULE 3

Procurement

Section I. General

A. (1) All goods, works and services (other than consultants' services) shall be procured in accordance with the provisions of Section I of the "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004 (the Procurement Guidelines), and with the provisions of this Schedule.

(2) Without any limitations to any other provisions set forth in this Schedule or in the Procurement Guidelines, the following shall expressly govern the procurement of goods, works and services (other than consultant services) referred to in Section II of this Schedule:

(a) Contracts shall be awarded to the lowest evaluated bid in accordance with criteria set forth in the bidding documents, and without taking into account, in the evaluation, the financial cost of foreign exchange components.

(b) Foreign bidders shall not, as a condition for submitting bids, be required to:

- (i) be registered in the Borrower's territory;
- (ii) have a representative in the Borrower's territory;
- (iii) be associated with suppliers or contractors of the Borrower's territory; and
- (iv) certify that, in their country of origin, suppliers or contractors of the Borrower's territory are allowed to participate in competitive bidding procedures under equal conditions with other bidders.

(c) Contracts shall not be divided for the sole purpose of reducing contract amounts.

B. (1) All consultants' services shall be procured in accordance with Sections I and IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004 (the Consultant Guidelines), and with the provisions of this Schedule.

(2) Without limitation to any other provisions set forth in this Schedule or the Consultant Guidelines, the following shall expressly govern the procurement of consultants' services referred to in Section III of this Schedule:

(a) Foreign consultants shall be permitted to participate in the selection process even if there is availability of consultants of the Borrower's territory for the services being procured; and

(b) Foreign consultants shall not be required to be registered with associations of the Borrower's territory or to be associated with consulting firms of the Borrower's territory as a condition for participating in any selection process.

C. The capitalized terms used below in this Schedule to describe particular procurement methods or methods of review by the Association of particular contracts, have the meanings ascribed to them in the Procurement Guidelines, or Consultant Guidelines, as the case may be.

Section II. Particular Methods of Procurement of Goods, Works and Services (other than Consultants' Services)

A. International Competitive Bidding. Except as otherwise provided in Part B of this Section, contracts shall be awarded on the basis of International Competitive Bidding. The provisions of paragraphs 2.55 and 2.56 of the Procurement Guidelines, providing for domestic preference in the evaluation of bids, shall apply to goods manufactured in the territory of the Borrower.

B. Other Procurement Procedures

1. National Competitive Bidding. Works estimated to cost less than \$1,500,000 equivalent per contract and goods estimated to cost less than \$150,000 equivalent per contract, may be procured under contracts awarded on the basis of National Competitive Bidding.

2. Shopping. Goods and works estimated to cost less than \$50,000 equivalent per contract, may be procured under contracts awarded on the basis of Shopping.

3. Direct Contracting. Goods and works which the Association agrees meet the requirements for Direct Contracting may be procured in accordance with the provisions of said procurement method.

Section III. Particular Methods of Procurement of Consultants' Services

A. Quality- and Cost-based Selection. Except as otherwise provided in Part B of this Section, consultants' services shall be procured under contracts awarded on the basis of Quality- and Cost-based Selection. For purposes of paragraph 2.7 of the Consultant Guidelines, the short list of consultants for services estimated to cost less than \$150,000 equivalent per contract may comprise entirely national consultants.

B. Other Procedures

1. Selection Under a Fixed Budget. Services for assignments which the Association agrees meet the requirements of paragraph 3.5 of the Consultant Guidelines may be procured under contracts awarded on the basis of a Fixed Budget in accordance with the provisions of paragraphs 3.1 and 3.5 of the Consultant Guidelines.

2. Least-cost Selection. Services for assignments which the Association agrees meet the requirements of paragraph 3.6 of the Consultant Guidelines may be procured under contracts awarded on the basis of Least-cost Selection in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

3. Selection Based on Consultants' Qualifications. Services estimated to cost less than \$50,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1, 3.7 and 3.8 of the Consultant Guidelines.

4. Single Source Selection. Services for tasks in circumstances which meet the requirements of paragraph 3.10 of the Consultant Guidelines for Single Source Selection, may, with the Association's prior agreement, be procured in accordance with the provisions of paragraphs 3.9 through 3.13 of the Consultant Guidelines.

5. Individual Consultants. Services for assignments that meet the requirements set forth in the first sentence of paragraph 5.1 of the Consultant Guidelines may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.2 through 5.3 of the Consultant Guidelines. Under the circumstances described in paragraph 5.4 of the Consultant Guidelines, such contracts may be awarded to individual consultants on a sole-source basis, subject to prior review of the Association.

Section IV. Review by the Association of Procurement Decisions

The Procurement Plan shall set forth those contracts which shall be subject to the Association's Prior Review. If the Procurement Plan provides for prior review of contracts for the employment of individual consultants, the report on the qualifications and experience of all evaluated candidates, the terms of reference and the terms of

employment of the consultants shall be subject to prior approval by the Association. All other contracts shall be subject to Post Review by the Association.

SCHEDULE 4

Procedures for Terms and Conditions of Intermediary Loans Made by BANHPROVI and Subloans Financed by BANHPROVI for Part A of the Project

Section I: Intermediary Loans

1. Except as otherwise provided in this Agreement, the terms and conditions of, and procedures for making, Intermediary Loans shall be as set forth in the Operational Manual.
2. (a) Intermediary Loans shall be denominated, and their interest, principal and other charges be payable, in Honduran lempiras.

(b) Intermediary Loans shall have an interest rate equal to one and one half percent (1 and ½ %) per annum on the principal amount of the Intermediary Loan withdrawn and outstanding from time to time.
3. The principal amount of each Intermediary Loan shall be repaid, irrespective of whether the Subloan or Subloans financed by such Intermediary Loan are repaid, on the same terms and conditions applicable to such Subloans, provided, however, that if a Subloan or any part thereof shall be repaid to the Financial Intermediary in advance of maturity, or, if a Subloan or any part thereof shall be sold, transferred, assigned or otherwise disposed of for value by the Financial Intermediary, the Financial Intermediary shall promptly repay to BANHPROVI the amount of the Intermediary Loan corresponding to such Subloan or any part thereof so repaid in advance or disposed for value.
4. Intermediary Loan Agreements shall, inter alia, contain:
 - (a) the obligation of the Financial Intermediary to abide by the terms of the Operational Manual to the extent consistent with this Agreement including without limitation the obligation of the Financial Intermediary to use the proceeds of such Intermediary Loan to make Subloans to Subborrowers; and
 - (b) the obligation of the Financial Intermediary to: (i) maintain records and accounts adequate to reflect, in accordance with sound accounting practices, its operations and financial condition, including records and separate accounts regarding its activities under Part A of the Project with each Eligible Municipality; (ii) have such records and accounts, together with its financial statements (balance sheets, statements of income and expenses and related statements), for each fiscal year audited, in accordance with generally accepted auditing standards and procedures consistently applied, by independent and qualified auditors; (iii) furnish to BANHPROVI no later than six months

after the end of such year: (A) certified copies of its financial statements for such year as so audited; and (B) the report of such audit by said auditors of such scope and in such detail as the BANHPROVI shall have reasonably requested; and (iv) furnish to BANHPROVI such information and documentation as required to allow BANHPROVI to comply with the obligations referred to in Article IV of this Agreement.

Section II: Subloans

1. Except as otherwise provided in this Agreement, the terms and conditions of, and procedures for making, Subloans shall be as set forth in the Operational Manual.

2. (a) Subloans shall be denominated, and their interest, principal and other charges be payable, in Honduran lempiras.

(b) Subloans shall be in an amount up to 100% of the cost of the Loan Window Subproject being financed.

(c) Subloans shall be repaid in terms which take into account the criteria set forth in the Operational Manual;

(d) Subloans shall have an interest rate equal to no more than the interest rate of the Intermediary Loans plus an intermediation rate approved by BANHPROVI.

3. Each Subloan shall be made on terms whereby the Financial Intermediary shall obtain, by written agreement with the Eligible Municipality, rights adequate to protect the interests of the Association, the Borrower, BANHPROVI and the Financial Intermediary, including the right to:

(a) require that: (i) the services and works to be financed out of the proceeds of the Credit shall be procured in accordance with the provisions of Schedule 3 to this Agreement; and (ii) such goods and services shall be used exclusively in furtherance of the objectives of Part A of the Project;

(b) require that the Loan Window Subprojects are carried out in accordance with the terms of this Agreement and the Operational Manual, including without limitation the Environmental Framework and the Resettlement Policy Framework;

(c) require that: (i) the Eligible Municipality shall take out and maintain with responsible insurers such insurance, against such risks and in such amounts, as shall be consistent with sound business practice; and (ii) without any limitation upon the foregoing, such insurance shall cover hazards incident to the acquisition, transportation and delivery of goods financed out of the proceeds of the Credit and to place the use or installation, any indemnity thereunder to be made payable in a currency freely usable by the Eligible Municipality to replace or repair such goods;

(d) obtain all such information as the Association, the Borrower or BANHPROVI shall reasonably request relating to the foregoing and to the administration, operations and financial condition of the Eligible Municipality and to the benefits to be derived from the Loan Window Subproject; and

(e) suspend or terminate the right of the Eligible Municipality to the use of the proceeds of the Credit, or accelerate maturity of the Subloan, upon failure by the Municipality to perform its obligations under its contract with the Financial Intermediary.