

CONFORMED COPY

LOAN NUMBER 4481 LT

Loan Agreement

(Municipal Development Project)

between

REPUBLIC OF LITHUANIA

and

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Dated December 7, 1999

LOAN NUMBER 4481 LT

LOAN AGREEMENT

AGREEMENT, dated December 7, 1999, between REPUBLIC OF LITHUANIA (the Borrower) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) In order to encourage the sound economic development of municipal infrastructure on the territory of the Borrower, the Government of the Borrower has adopted a program (the Municipal Development Program) designed to support the construction and rehabilitation of municipal infrastructure facilities through the carrying out, by Participating Municipalities and Entities (as hereinafter defined), of qualifying municipal sub-projects approved by the relevant municipal administrative bodies for purposes consistent with each Participating Municipality's public investment plan, and consisting of specific measures, including the measures described in Schedule 2 to this Agreement, to facilitate such municipal infrastructure development;

(B) 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 Bank to assist in the financing of the Project as part of the Municipal Development Program;

(C) the Project will be carried out by the Borrower with the assistance of the Housing and Urban Development Foundation (HUDF), and with the participation of the Participating Municipalities and Entities, all in accordance with the provisions of the Implementation Agreement (as hereinafter defined) to be entered into between the Borrower and HUDF, as provided in this Agreement;

(D) the Borrower intends to contract from European Investment Bank (EIB) a

loan (the EIB Loan) to assist in financing part of the Municipal Development Program on the terms and conditions set forth in an agreement to be entered into between the Borrower and EIB (the EIB Loan Agreement);

(E) by an agreement dated January 19, 1998, as amended, between the Borrower and Nordic Investment Bank (the NIB Loan Agreement), NIB has agreed to make a loan to the Borrower in a principal amount of 20 million ECU (the NIB Loan) to assist in financing part of the Municipal Development Program on the terms and conditions set forth in the NIB Loan Agreement;

WHEREAS the Bank has agreed, on the basis, inter alia, of the foregoing, to extend the Loan to the Borrower upon the terms and conditions set forth in this Agreement and in the agreement of even date herewith between the Bank and HUDF (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 Loan and Guarantee Agreements for Single Currency Loans" of the Bank, dated May 30, 1995 (as amended through December 2, 1997), with the modifications set forth in Schedule 6 to this Agreement (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) "ALAL" means the Association of Local Authorities of Lithuania, a public association established and operating pursuant to Law No. I-833 of the Borrower approving the Basic Regulations of ALAL, dated March 28, 1995;

(b) "Eligible Categories" means Category (1) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

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

(d) "Euro" means the lawful currency of the member states of the European Union that adopt the single currency in accordance with the Treaty establishing the European Community, as amended by the Treaty on European Union;

(e) "HUDF" means the public institution Housing and Urban Development Foundation operating pursuant to its by-laws approved by Resolution No. 202 of the Minister of Finance of the Borrower, dated July 29, 1999 and registered in the City of Vilnius on August 5, 1999, (Registration No. VS97-138);

(f) "Implementation Agreement" means the agreement governing the relationship between the Borrower and HUDF, to be entered into between the Borrower and HUDF pursuant to Section 3.02 of this Agreement, and such term shall include any amendments to such agreement as may be made from time to time;

(g) "MOF" means the Ministry of Finance of the Borrower;

(h) "Municipal Infrastructure Grants" means grants made pursuant to Part B of Schedule 2 and Annex 2 to Schedule 5 to this Agreement;

(i) "Operational Manual" means the operational manual satisfactory to the Bank and the Borrower adopted by HUDF and setting forth the policies and procedures for implementation of the Project;

(j) "Participating Entity" means legal entities established by municipalities under the Borrower's law on enterprises; and other entities providing municipal services under the authority of a Participating Municipality;

(k) "Participating Municipality" means a municipality selected by the Borrower to participate in the Municipal Development Program in accordance with the provisions of Section I of Annex I to Schedule 5 to this Agreement;

(l) "Participating Municipalities and Entities" means Participating Municipalities and Participating Entities;

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

(n) "Project Management Report" means each report prepared in accordance with Section 4.02 of this Agreement;

(o) "Qualifying Sub-project Expenditures" means the reasonable cost of goods, works, services, working capital and other specific expenditures required for the carrying out of a Sub-project approved in accordance with the procedures referred to in Part A of Annex 1 to Schedule 5 to this Agreement, provided that such expenditures are actually made or incurred by the Participating Municipality or Entity and are for items qualifying according to the eligibility criteria set forth or referred to in the Operational Manual;

(p) "Special Accounts" means the accounts referred to in Part B of Schedule 1 to this Agreement;

(q) "Statutes" means the charter, statutes, articles of incorporation, founders' agreement, license, regulations, or special laws or decrees relating to the establishment, or governing the operations of HUDF;

(r) "Sub-loan" means a loan, made or proposed to be made by the Borrower, out of the proceeds of the Loan, to a Participating Municipality or Entity for purposes of financing all or a portion of the costs required for the carrying out of a Sub-project;

(s) "Sub-loan Agreement" means the agreement entered into between the Borrower, through HUDF, and a Participating Municipality or Entity, providing for a Sub-loan, as referred to in Section 3.05 of this Agreement; and

(t) "Sub-Project" means a specific infrastructure project meeting the criteria applicable to the Project, which has been selected by HUDF pursuant to the provisions of the Implementation Agreement and is proposed to be carried out by a Participating Municipality or Entity in whole or in part through the utilization of the proceeds of a Sub-loan.

Section 1.03. Each reference in the General Conditions to the Project implementation entity shall be deemed as a reference to HUDF.

## ARTICLE II

### The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Loan Agreement an amount equal to eighteen million eight hundred ninety thousand Euro (EUR 18,890,000).

Section 2.02. The amount of the Loan may be withdrawn from the Loan Account in accordance with the provisions of Schedule 1 to this Agreement for: (i) amounts paid (or, if the Bank shall so agree, to be paid) by the Borrower on account of a withdrawal made by a Participating Municipality or Entity under a Sub-loan under Part A of the Project, to meet the costs of Qualifying Sub-project Expenditures reasonably incurred under a Sub-project; and (ii) expenditures incurred in respect of the fee referred to in Section 2.04 of this Agreement.

Section 2.03. The Closing Date shall be June 30, 2005, or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a fee in an amount equal to one

percent (1%) of the amount of the Loan. On or promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of said fee.

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

Section 2.06. (a) The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, at a rate for each Interest Period equal to LIBOR Base Rate plus LIBOR Total Spread.

(b) For the purposes of this Section:

(i) "Interest Period" means the initial period from and including the date of this Agreement to, but excluding, the first Interest Payment Date occurring thereafter, and after the initial period, each period from and including an Interest Payment Date to, but excluding the next following Interest Payment Date.

(ii) "Interest Payment Date" means any date specified in Section 2.07 of this Agreement.

(iii) "LIBOR Base Rate" means, for each Interest Period, the London interbank offered rate for six-month deposits in Euro for value the first day of such Interest Period (or, in the case of the initial Interest Period, for value the Interest Payment Date occurring on or next preceding the first day of such Interest Period), as reasonably determined by the Bank and expressed as a percentage per annum.

(iv) "LIBOR Total Spread" means, for each Interest Period: (A) three-fourths of one percent (3/4 of 1%); (B) minus (or plus) the weighted average margin, for such Interest Period, below (or above) the London interbank offered rates, or other reference rates, for six-month deposits, in respect of the Bank's outstanding borrowings or portions thereof allocated by the Bank to fund single currency loans or portions thereof made by it that include the Loan; as reasonably determined by the Bank and expressed as a percentage per annum.

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

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

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

Section 2.08. The Borrower shall repay the principal amount of the Loan in accordance with the amortization schedule set forth in Schedule 3 to this Agreement.

### ARTICLE III

#### Execution of the Project

Section 3.01. The Borrower declares its commitment to the objectives of the Project, and, to this end, shall carry out the Project, with the assistance of HUDF as set forth in Schedule 5 to this Agreement, with due diligence and efficiency and in conformity with appropriate administrative, financial, engineering and environmental

protection practices, and shall provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.

Section 3.02. The Borrower shall, for the purposes of implementing the Project, enter into an implementation agreement with HUDF satisfactory to the Bank (the Implementation Agreement), whereby HUDF shall be appointed executing agent of the Borrower for carrying out such activities under the Project and obligations of the Borrower as shall have been specified therein and in respect of which the Borrower shall have made all necessary provision, including, inter alia:

(a) the carrying out by HUDF of Parts A and B of the Project with due diligence and efficiency and in conformity with appropriate practices and in accordance with the applicable provisions of the Project Agreement;

(b) the carrying out by HUDF of the procurement and related accounting for the goods, works, and consultants' services required for the Project and to be financed out of the proceeds of the Loan; and

(c) the establishment and continuous operation by HUDF of all facilities necessary for the appropriate administration of Project activities and related management functions undertaken by HUDF in accordance with sub-paragraphs (a) and (b) of this Section.

Section 3.03. Without limitation upon the provisions of Section 3.02 of this Agreement, and except as the Borrower and the Bank shall otherwise agree, the Borrower shall carry out, or cause to be carried out, the Project in accordance with the Implementation Program set forth in Schedule 5 to this Agreement.

Section 3.04. Without limitation or restriction upon any of its other obligations under the Loan Agreement, the Borrower shall:

(a) cause HUDF to perform in accordance with the applicable provisions of this Agreement, the Project Agreement, the Implementation Agreement, the Operational Manual, and its Statutes, all the obligations and activities of HUDF therein set forth which may pertain to the Project; and take or cause to be taken all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable HUDF to perform such obligations; and not take or permit to be taken any action which would prevent or interfere with such performance; and

(b) exercise its rights under the Implementation Agreement in such a manner as to protect the interests of the Borrower and the Bank, to comply with the provisions of this Agreement, and to accomplish the purposes of the Loan, and, except as the Bank shall otherwise agree, not assign, amend, abrogate or waive the Implementation Agreement or any provision thereof.

Section 3.05. For the purposes of Parts A and B of the Project, the Borrower shall:

(a) relend to the Participating Municipal Entities the equivalent of the proceeds of the Loan allocated from time to time to Category 1 of the table set forth in paragraph 1 of Part B of Schedule 1 to this Agreement, under agreements to be entered into between the Borrower (acting in coordination with HUDF in accordance with the provisions of the Implementation Agreement) and each such Participating Municipality or Entity (the Sub-loan Agreements), under terms and conditions which shall have been approved by the Bank which shall include, without limitation, those set forth in Part B of Annex 1 to Schedule 5 to this Agreement;

(b) exercise its rights under the Sub-loan Agreements in such manner as to protect the interests of the Bank and the Borrower and to achieve the purposes of the Project, and, except as the Bank shall otherwise agree, the Borrower shall not assign, amend, abrogate or waive any Sub-loan Agreement or any provision thereof;

(c) coordinate the overall implementation of the Municipal Infrastructure Development Credit Facility and monitor the carrying out by the Participating Municipalities and Entities of their respective obligations under the Sub-loan Agreements in accordance with policies and procedures satisfactory to the Bank; and

(d) exercise due oversight over the selection and award of Municipal Infrastructure Grants under Part B of the Project to the respective Participating Municipalities and Entities in accordance with appropriate policy guidelines, eligibility criteria and approval procedures acceptable to the Bank, and cause the Participating Municipalities and Entities to carry out their respective obligations under the Municipal Infrastructure Grants in accordance with terms and conditions satisfactory to the Bank, including the eligibility criteria, procedures, and terms and conditions set forth or referred to in Annex 2 to Schedule 5 to this Agreement.

Section 3.06. Except as the Bank shall otherwise agree, procurement of the goods, works and consultants' services required for the Project and to be financed out of the proceeds of the Loan shall be governed by the provisions of Schedule 4 to this Agreement.

Section 3.07. For the purposes of Section 9.08 of the General Conditions and without limitation thereto, the Borrower shall, with the assistance of HUDF:

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

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

Section 3.08. The Bank and the Borrower hereby agree that the obligations set forth in Sections 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, and maintenance respectively) relating to Sub-projects under Parts A and B of the Project, shall be carried out by HUDF pursuant to Section 2.03 of the Project Agreement.

#### ARTICLE IV

##### Financial Covenants

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

(b) The Borrower shall cause HUDF to:

(i) have the records, accounts and financial statements referred to in paragraph (a) of this Section and the records and accounts for the Special Accounts for each fiscal year audited, in accordance with auditing standards acceptable to the Bank, consistently applied, by independent auditors acceptable to the Bank;

(ii) furnish to the Bank as soon as available, but in any case not later than six months after the end of each such year, (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year as so audited, and (B) an opinion on such statements and report of such audit, by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

(iii) furnish to the Bank such other information concerning such records, accounts and financial statements, and the audit thereof, and concerning said auditors, as the Bank may from time to time reasonably request.

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

(i) maintain in accordance with paragraph (a) of this Section records

and separate accounts reflecting such expenditures;

(ii) ensure that all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures are retained until at least one year after the Bank has received the audit report for the fiscal year in which the last withdrawal from the Loan Account was made; and

(iii) enable the Bank's representatives to examine such records.

(d) The Borrower shall:

(i) have the records and accounts referred to in paragraph (c) (i) of this Section and those for the Special Accounts for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;

(ii) furnish to the Bank as soon as available, but in any case not later than six months after the end of each such year the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested, including a separate opinion by said auditors as to whether the Project Management Reports or statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals; and

(iii) furnish to the Bank such other information concerning said records and accounts and the audit thereof and concerning said auditors, as the Bank may from time to time reasonably request.

Section 4.02. (a) Without limitation upon the provisions of Section 4.01 of this Agreement, the Borrower shall cause HUDF to carry out a time-bound action plan acceptable to the Bank for the strengthening of the financial management system referred to in paragraph (a) of said Section 4.01 in order to enable HUDF, not later than June 30, 2000, or such later date as the Bank shall agree, to prepare quarterly Project Management Reports, acceptable to the Bank, each of which:

(i) (A) sets forth actual sources and applications of funds for the Project, both cumulatively and for the period covered by said report, and projected sources and applications of funds for the Project for the six-month period following the period covered by said report, and (B) shows separately expenditures financed out of the proceeds of the Loan during the period covered by said report and expenditures proposed to be financed out of the proceeds of the Loan during the six-month period following the period covered by said report;

(ii) (A) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and (B) explains variances between the actual and previously forecast implementation targets; and

(iii) sets forth the status of procurement under the Project and expenditures under contracts financed out of the proceeds of the Loan, as at the end of the period covered by said report.

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

#### ARTICLE V

##### Remedies of the Bank

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

(a) The Municipal Development Program shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of the Borrower to carry out the Project or to perform any of its obligations under this Agreement;

(b) HUDF shall have failed to perform any of its obligations under the Project Agreement or the Implementation Agreement;

(c) As a result of events which have occurred after the date of the Loan Agreement, an extraordinary situation shall have arisen which shall make it improbable that HUDF will be able to perform its obligations under the Project Agreement or the Implementation Agreement;

(d) The Statutes of HUDF shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of HUDF to perform any of its obligations under the Project Agreement or the Implementation Agreement; and

(e) (i) Subject to subparagraph (ii) of this paragraph:

(A) the right of the Borrower to withdraw the proceeds of any grant or loan made to the Borrower for the financing of the Project shall have been suspended, canceled or terminated in whole or in part, pursuant to the terms of the agreement providing therefor, or

(B) any such grant or loan shall have become due and payable prior to the agreed maturity thereof.

(ii) Subparagraph (i) of this paragraph shall not apply if the Borrower establishes to the satisfaction of the Bank that: (A) such suspension, cancellation, termination or prematuring is not caused by the failure of the Borrower to perform any of its obligations under such 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 (k) of the General Conditions, the following additional events are specified:

(a) Any event specified in paragraph (b) 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 Bank to the Borrower.

(b) Any event specified in paragraphs (a) or (d) of Section 5.01 of this Agreement shall occur.

(c) The event specified in paragraph (e) (i) (B) of Section 5.01 of this Agreement shall occur, subject to the proviso of paragraph (e) (ii) of that Section.

## ARTICLE VI

### Effective Date; Termination

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

(a) the Implementation Agreement has been executed on behalf of the Borrower and HUDF;

(b) the Borrower has furnished notice to the Bank that the HUDF Operational Manual has been adopted by HUDF satisfactory to the Borrower;

(c) a Sub-loan Agreement satisfactory to the Bank has been entered into



between the Borrower and the Participating Municipality or Entity for a Sub-loan approved in conformity with the procedures described in Annex 1 to Schedule 5 to this Agreement; and

(d) a financial management system, satisfactory to the Bank, shall have been established.

Section 6.02. The following are specified as additional matters, within the meaning of Section 12.02 (c) of the General Conditions, to be included in the opinion or opinions to be furnished to the Bank:

(a) that the Project Agreement has been duly authorized or ratified by HUDF, and is legally binding upon HUDF in accordance with its terms; and

(b) that the Implementation Agreement has been duly authorized or ratified by the Borrower and HUDF is legally binding upon the Borrower and HUDF 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 Minister 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  
J. Tumo-Vaizganto 8a/2  
Vilnius, 2600  
Lithuania

For the Bank:

International Bank for  
Reconstruction and Development  
1818 H Street, N.W.  
Washington, D.C. 20433  
United States of America

Cable address:

INTBAFRAD  
Washington, D.C.

Telex:

248423 (MCI) or  
64145 (MCI)

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

REPUBLIC OF LITHUANIA

By /s/ Vytautas Dudenas

Authorized Representative

INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

By /s/ Basil G. Kavalsky

Acting Regional Vice President  
Europe and Central Asia

SCHEDULE 1

Withdrawal of the Proceeds of the Loan

A. General

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

Category	Amount of the Loan Allocated (Expressed in Euro)	% of Expenditures to be Financed
(1) Sub-loans extended under Sub-projects	16,901,100	100%
(2) Fee	188,900	Amount due under Section 2.04 of this Agreement
(3) Unallocated	1,800,000	
TOTAL	18,890,000	

2. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made:

(a) in respect of a Sub-loan unless the Sub-loan has been made in accordance with the procedures set forth in the Operational Manual and on the terms and conditions set forth or referred to in Annex I to Schedule 5 to this Agreement; and

(b) in respect of payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding and EUR 1,800,000 may be made in respect of Category (1) set forth in the table in paragraph 1 of Part A of this Schedule on account of payments made for expenditures before that date but after March 30, 1999.

3. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditure for expenditures for: (i) goods under contracts costing less than \$200,000 equivalent each; (ii) works under contracts costing less than \$500,000 equivalent each; and (iii) for services, under contracts costing less than \$100,000 equivalent for firms and \$50,000 for equivalent for individuals, under such terms and conditions as the Bank shall specify by notice to the Borrower.

B. Special Account

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

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

(a) until the Bank shall have received: (i) the first Project Management Report referred to in Section 4.02 (b) of this Agreement; and (ii) a request from the

Borrower for withdrawal on the basis of Project Management Reports, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) upon receipt by the Bank of a Project Management Report pursuant to Section 4.02 (b) of this Agreement, accompanied by a request from the Borrower for withdrawal on the basis of Project Management Reports, all further withdrawals shall be made in accordance with the provisions of Annex B to this Schedule 1.

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

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

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

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

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

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

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

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

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

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

#### ANNEX A TO SCHEDULE 1

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

1. For the purposes of this Annex: the term "Authorized Allocation" means an amount equivalent to EUR 1,840,000 to be withdrawn from the Loan Account in respect of the Loan and deposited into the Special Account pursuant to paragraph 2 of this Annex; provided, however, that unless the Bank shall otherwise agree, the Authorized Allocation shall be limited to an amount equivalent to EUR 920,000 until the aggregate amount of withdrawals from the Loan, plus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General Conditions in respect of the Loan, shall equal or exceed the equivalent of EUR 3,500,000.

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

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

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

#### ANNEX B TO SCHEDULE 1

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

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

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

3. Upon receipt of each application for withdrawal of an amount of the Loan, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account an amount equal to the lesser of: (a) the amount so requested; and (b) the amount which the Bank has determined, based on the Project Management Report accompanying said application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such report; provided, however, that the amount so deposited, when added to the amount indicated by said Project Management Report to be remaining in the Special Account, shall not exceed the equivalent of EUR 2,000,000.

SCHEDULE 2

Description of the Project

The objective of the Project is to support the Borrower's reforms of local government management and finance through: (i) capacity building at the municipal level; and (ii) development of a viable system of financing local government infrastructure investments.

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

Part A: Credit for Municipal Investment Projects

Establishment and operation of a credit facility for the financing of loans to Participating Municipalities and Entities, enabling such Participating Municipalities and Entities to finance part of the costs related to the carrying out of qualifying infrastructure sub-projects.

Part B: Municipal Infrastructure Grants

Grants for the financing of qualifying infrastructure sub-projects by Participating Municipalities and Entities.

Part C: Institutional Development

Provision of technical assistance to enable HUDF, ALAL, and the Participating Municipalities and Entities to develop capacity to prepare, appraise, finance and manage municipal investments, including financing of audit costs.

\* \* \*

The Project is expected to be completed by December 31, 2004.

SCHEDULE 3

Amortization Schedule

Date Payment Due	Payment of Principal Euro)*
On each October 15 and April 15 beginning October 15, 2004, through October 15, 2015	785,000
On April 15, 2016	835,000

SCHEDULE 4

Procurement

Section I. Procurement of Goods and Works

Part A: General

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

Part B: International Competitive Bidding

Except as otherwise provided in Part C of this Section, goods and works shall be

procured under contracts awarded in accordance with the provisions of Section II of the Guidelines and paragraph 5 of Appendix 1 thereto.

Part C: Other Procurement Procedures

1. National Competitive Bidding

Works estimated to cost less than \$800,000 equivalent per contract, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines.

2. International Shopping

Goods estimated to cost less than \$200,000 equivalent per contract may be procured under contracts awarded on the basis of international shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

3. National Shopping

Goods estimated to cost less than \$75,000 equivalent per contract may be procured under contracts awarded on the basis of national shopping procedures in accordance with paragraphs 3.5 and 3.6 of the Guidelines.

4. Procurement of Small Works

Works estimated to cost less than \$200,000 equivalent per contract, may be procured under lump-sum, fixed-price contracts awarded on the basis of quotations obtained from three (3) qualified domestic contractors in response to a written invitation. The invitation shall include a detailed description of the works, including basic specifications, the required completion date, a basic form of agreement acceptable to the Bank, and relevant drawings, where applicable. The award shall be made to the contractor who offers the lowest price quotation for the required work, and who has the experience and resources to complete the contract successfully.

Part D: Review by the Bank of Procurement Decisions

1. Prior Review

With respect to each contract for: (i) goods estimated to cost the equivalent of \$200,000 or more; and (ii) works estimated to cost the equivalent of \$500,000 or more, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

2. Post Review

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

Section II. Employment of Consultants

Part A: General

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

Part B: Quality- and Cost-based Selection

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

## Implementation Program

The provisions of this Schedule shall apply for the purposes of Section 3.03 of this Agreement:

### A. Overall Coordination and Management of the Project

The MOF shall be responsible for coordinating and monitoring the overall implementation of the Project in accordance with the objectives of the Municipal Development Program.

### B. Implementation of Municipal Development Credit Facility

1. The eligibility of municipalities and municipal entities for participation in the Project shall be determined in accordance with guidelines to be set forth in an Operational Manual adopted by HUDF satisfactory to the Borrower and the Bank. HUDF shall maintain the Operational Manual in form and content satisfactory to the Borrower and the Bank, shall duly perform its obligations under the Operational Manual and shall not amend or waive the guidelines, conditions and procedures set forth in the Operational Manual without obtaining the prior approval of the Bank.

2. Responsibility for specific administrative and supervision functions relating to the Municipal Development Credit Facility, including specific matters relating to the coordination and support of Sub-project preparation, the administration of Sub-loans, procurement, disbursements, financial and other reporting and auditing, shall be delegated to the HUDF pursuant to the provisions of an agreement (the Implementation Agreement) to be entered into between the MOF on the one hand, and the HUDF on the other, satisfactory to the Bank.

3. The Borrower shall select the commercial bank in which any Special Account is to be opened.

4. Procedures for the accounting of obligations under Sub-loans, and for the transfers to, and receipt of payment from, the respective Participating Municipal Entities, shall be established by MOF using practices and arrangements satisfactory to the Bank.

### C. Implementation of Part C of the Project

1. Specific programs and activities shall be carried out in accordance with a budget, schedule and work plan satisfactory to the Bank.

2. The qualifications, experience and terms of reference for any consultants engaged to perform activities under Part C of the Project shall be satisfactory to the Bank.

## ANNEX 1 TO SCHEDULE 5

### Municipal Development Credit Facility: Eligibility, Approval Procedures and Terms and Conditions of Sub-loans

#### Part A: Eligibility and Approval Procedures

1. No expenditures under any Sub-Project shall be eligible for financing out of the proceeds of the Loan unless the Sub-loan for such Sub-project shall have been approved by the Bank and such expenditures shall have been made not earlier than one hundred twenty (120) days prior to the date on which the Bank shall have received the application and information required under paragraph 3 (a) of this Annex I to Schedule 5 in respect of such Sub-loan.

2. Eligibility of specific Sub-project expenditures for financing out of the Municipal Development Credit Facility described under Part A of the Project shall be determined in accordance with specific criteria for selection and appraisal of the proposed Sub-project and following such procedures as shall have been established by the HUDF for such purpose as set forth in the Operational Manual, satisfactory to the Borrower and the Bank, which shall include without limitation, the selection and appraisal criteria and procedures set forth or referred to in paragraph 4 of this Part

A of this Schedule.

3. (a) When presenting a Sub-loan to the Bank for approval, HUDF shall furnish to the Bank the application of the Participating Municipality or Entity concerned, in form satisfactory to the Bank, together with: (i) a description of the Participating Municipality or Entity and the proposed Sub-project, including a description of the goods, works and services proposed to be financed out of the proceeds of the Sub-loan and the specific manner in which the costs of such goods, works and services are to be determined; (ii) the draft Sub-loan Agreement containing the proposed terms and conditions of the Sub-loan, including the schedule of amortization of the Sub-loan; (iii) the appraisal report and recommendation of the HUDF concerning the Sub-project; and (iv) such other information as the Bank shall reasonably request.

(b) Applications made pursuant to the provisions of subparagraph (a) of this paragraph shall be presented to the Bank on or before June 30, 2003.

4. In addition to the procedures set forth in paragraphs 1 through 3 of Part A of this Annex to Schedule 5, the following procedures shall be followed in connection with the selection and appraisal of the Sub-projects:

(a) The prospective Participating Municipality or Entity shall first prepare an application in form satisfactory to HUDF, together with a description of the proposed Sub-project, in accordance with guidelines satisfactory to the Borrower and the Bank.

(b) HUDF shall appraise the proposed Sub-project, on the basis of the evaluation criteria as set forth in the Operational Manual.

(c) Until at least two Sub-loans shall have been made to Participating Municipal Entities, in each of the following sectors: water/sanitation, solid waste, district heating, street lighting and urban infrastructure, urban transport, and energy insulation in schools and municipal buildings, and at any time thereafter, whenever a Sub-loan is proposed to be made in an amount greater than EUR 1,200,000, HUDF shall ensure that each qualifying Sub-Project for which a Sub-loan is proposed to be made is submitted in advance to the Bank for approval, such approval to be based on a review and appraisal of the proposed Sub-project in such manner and of such scope as the Bank shall determine to be reasonably necessary. The Borrower shall conclude the Sub-loan Agreement with the Participating Municipality or Entity only after the Bank has expressed its concurrence with respect to the financing of the Sub-project.

(d) Once the first two Sub-loans shall have been made to Participating Municipal Entities in a given sector, and unless otherwise specified by the Bank, HUDF shall enter into the respective Sub-loan Agreement with the Participating Municipal Entities within a reasonable period following the approval of the Sub-loan by HUDF.

(e) The Sub-loan Agreement with the Participating Municipal Entities shall give the MOF legal rights adequate to protect the interests of the Bank and the Borrower, and shall contain, inter alia, the terms and conditions enumerated in Part B of this Annex 1 to Schedule 5.

Part B: Terms and Conditions of Sub-loans

1. The principal amount of each Sub-loan made out of the proceeds of the Loan allocated from time to time to Category (1) of the table set forth in paragraph 1 of Part A of Schedule 1 to this Agreement shall: (a) be denominated Euro; and (b) be valued as the equivalent, in Euro as of the date or respective dates of withdrawal from the Loan Account or payment out of the Special Account, of the value of the currency or currencies so withdrawn or paid out on account of the Qualifying Sub-project Expenditures made or incurred by the Participating Municipality or Entity for the goods, works and services under the Sub-project, to the extent that such amounts are eligible for financing out of the proceeds of the Sub-loan in accordance with the provisions of paragraph 2 of this Part B of this Annex 1 to Schedule 5.

2. The maximum amount of any Sub-loan shall be determined by the HUDF in accordance with the particular financing plan submitted as part of each Participating Municipality or Entity's Sub-loan application. Such amount may not exceed the total costs of goods, works and services under the Sub-project excluding amounts payable by



the Participating Municipality or Entity on account of taxes for such goods, works and services; provided, however, that the amount of expenditures to be financed under a Sub-loan shall not in any event exceed ninety percent (0%) of the total costs of such Sub-project; and provided that the amount of any Sub-loan shall not under any circumstances exceed EUR 2,800,000 equivalent.

3. Each Sub-loan shall be charged interest, on the principal amount thereof withdrawn and outstanding from time to time, at the rate determined as the sum of an index rate (representing the rate determined pursuant to Section 2.06 of the Loan Agreement), plus a margin determined by the Borrower in accordance with practices and policies satisfactory to the Bank.

4. Sub-loans shall be repayable over a term and grace period determined according to the nature of the Sub-project and in the currencies of the Sub-loan (Dollars and Euro) at the rate of exchange, established by the Central Bank of the Borrower for interbank transactions at the time of the respective due date of each such repayment.

5. Sub-loans shall be made on terms whereby the Borrower shall obtain, by written contract with the Participating Municipality or Entity or by other appropriate legal means, rights adequate to protect the interests of the Bank and the Borrower, including:

(a) the right to require the Participating Municipality or Entity to carry out the Sub-Project with due diligence and efficiency and in accordance with sound technical, financial, managerial and environmental standards and practices, and to maintain adequate records;

(b) the right to require that: (i) the goods and services to be financed out of the proceeds of the Loan shall be procured under the supervision of HUDF in accordance with the provisions of the Implementation Agreement and in accordance with the provisions of Schedule 4 to this Agreement; and (ii) such goods and services shall be used exclusively in the carrying out of the Sub-Project;

(c) the right to inspect, by itself or jointly with representatives of the Bank if the Bank shall so request, the sites included in the Sub-Project, the operation thereof, and any relevant records and documents;

(d) the right to obtain all such information as the Bank or the Borrower shall reasonably request relating to the foregoing and to the administration, operations and financial condition of the Participating Municipality or Entity and to the benefits to be derived from the Sub-Project;

(e) the right to suspend or terminate the right of the Participating Municipality or Entity to the use of the proceeds of the Loan upon failure by such Participating Municipality or Entity to perform its obligations under the Sub-loan Agreement; and

(f) in the case of a Sub-loan to a Participating Entity, the guarantee of the Participating Municipality; and in the case of a Sub-loan to a Participating Municipality, adequate collateral securing the repayment of the Sub-loan.

ANNEX 2  
TO  
SCHEDULE 5

Municipal Infrastructure Grants

1. The purpose of the Municipal Infrastructure Grants is to reduce the share of the total Sub-project cost financed by a Sub-loan, where justified. Hence, Municipal Infrastructure Grants shall be made on the condition that the share of the costs of the Sub-project which are determined to be eligible to be financed out of a Sub-loan shall be proportionately reduced in accordance with a methodology and procedures satisfactory to the Bank.

2. Municipal Infrastructure Grants may be made to Participating Municipalities and Entities which shall have established to the satisfaction of the Borrower that they meet the eligibility criteria for municipal infrastructure grants set forth in the

Operational Manual.

3. No expenditures for a Sub-project shall be eligible for financing out of the proceeds of the Loan unless the Municipal Infrastructure Grant for such Sub-project shall have been approved by the Borrower and such expenditures shall have been made not earlier than one hundred twenty (120) days prior to the date on which the Borrower shall have received the application and information required in respect of such Municipal Infrastructure Grant.

#### SCHEDULE 6

##### Modifications of General Conditions

For the purposes of this Agreement, the provisions of the General Conditions are modified as follows:

Section 6.03 is modified to read:

"Section 6.03. Cancellation by the Bank. If (a) the right of the Borrower to make withdrawals from the Loan Account shall have been suspended with respect to any amount of the Loan for a continuous period of thirty (30) days, or (b) at any time, the Bank determines, after consultation with the Borrower, that an amount of the Loan will not be required to finance the Project's costs to be financed out of the proceeds of the Loan, or (c) at any time the Bank determines, with respect to any contract to be financed out of the proceeds of the Loan, that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement or the execution of such contract, without the Borrower having taken timely and appropriate actions satisfactory to the Bank to remedy the situation, and establishes the amount of expenditures in respect of such contract which would otherwise have been eligible for financing out of the proceeds of the Loan, or (d) at any time, the Bank determines that the procurement of any contract to be financed out of the proceeds of the Loan is inconsistent with the procedures set forth or referred to in the Loan Agreement and establishes the amount of expenditures in respect of such contract which would otherwise have been eligible for financing out of the proceeds of the Loan, or (e) after the Closing Date, an amount of the Loan shall remain unwithdrawn from the Loan Account, or (f) by the date specified in paragraph 3 (b) of Section I of the Annex 1 to Schedule 5 to the Loan Agreement, the Bank shall, in respect of any portion of the Loan: (i) have received no applications or requests under subparagraphs (a) or (b) of said paragraph 3; or (ii) have denied any such applications or requests, the Bank may, by notice to the Borrower, terminate the right of the Borrower to submit such applications or requests or to make withdrawals from the Loan Account, as the case may be, with respect to such amount or portion of the Loan. Upon the giving of such notice, such amount or portion of the Loan shall be cancelled.

