

CONFORMED COPY

LOAN NUMBER 7080 PH

Guarantee Agreement

(LGU Urban Water and Sanitation Project - Phase II)

between

REPUBLIC OF THE PHILIPPINES

and

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

Dated November 19, 2001

LOAN NUMBER 7080 PH

GUARANTEE AGREEMENT

AGREEMENT, dated November 19, 2001, between REPUBLIC OF THE PHILIPPINES (the Guarantor) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) the Guarantor has developed a program designed to ensure access to sustainable water supply, sanitation and drainage services for the greater portion of the population in approximately two hundred fifty cities and municipalities outside of Metro Manila in the Philippines (the Program), as set forth in the letters to the Bank, dated September 28, 1998, and August 15, 2001 and is committed to the execution of said Program;

(B) the Guarantor has requested that the Bank support the execution of the Program through a series of loans over a period of approximately twelve years to be utilized in the implementation of the Program;

(C) the Guarantor and Development Bank of the Philippines (the Borrower), having been satisfied as to the feasibility and priority of the Project described in Schedule 2 to the Loan Agreement, which Project forms the second phase of the Program, have requested the Bank to assist in the financing of the Project;

(D) the Borrower has obtained from the Nordic Development Fund a loan in amount equivalent to five million Special Drawing Rights (SDR 5,000,000) (the NDF Loan), a portion of which is to be used to assist in the financing of Parts A(2) and B(1) and B(3) of the Project, on terms and conditions set forth in an agreement dated December 28, 1998, (the NDF Loan Agreement) between the Nordic Development Fund and the Borrower; and

(E) by the Loan Agreement of even date herewith between the Bank and the Borrower, the Bank has agreed to extend to the Borrower a loan in the amount of three billion, seven hundred and seventeen million, nine hundred thousand Yen (JPY 3,717,900,000), on the terms and conditions set forth in the Loan Agreement, but only on condition that the Guarantor agree to guarantee the obligations of the Borrower in respect of such loan as provided in this Agreement; and

WHEREAS the Guarantor, in consideration of the Bank's entering into the Loan Agreement with the Borrower, has agreed to guarantee such obligations of the Borrower;

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 Fixed-Spread Loans" of the Bank, dated September 1, 1999, with the modifications set forth in Section 1.01 of the Loan 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, in the Preamble to this Agreement and in the Preamble to and Section 1.02 of the Loan Agreement have the respective meanings therein set forth.

ARTICLE II

Guarantee; Provision of Funds; Execution of the Project

Section 2.01. The Guarantor declares its commitment to the objectives of the Project as set forth in Schedule 2 to the Loan Agreement, and, to this end, without limitation or restriction upon any of its other obligations under the Guarantee Agreement, the Guarantor hereby unconditionally guarantees, as primary obligor and not as surety merely, the due and punctual payment of the principal of, and interest and other charges on, the Loan, and the premium, if any, on the prepayment of the Loan, and the punctual performance of all the other obligations of the Borrower, all as set forth in the Loan Agreement.

Section 2.02. Without limitation or restriction upon the provisions of Section 2.01 of this Agreement, the Guarantor specifically undertakes, whenever there is reasonable cause to believe that funds available for the Project will be inadequate to meet the estimated expenditures required for the carrying out of the Project, to make arrangements, satisfactory to the Bank, to provide or cause to be provided such funds as are needed to meet such expenditures.

Section 2.03. Without limitation or restriction upon the provisions of Section 2.01 of this Agreement, the Guarantor shall:

(a) Carry out Part B(3)(b) and the relevant part of Part B(3)(a) of the Project through DILG and with the participation of the Borrower, with due diligence and efficiency and in conformity with appropriate administrative, economic, environmental, social, financial and management practices and shall provide, promptly as needed the funds, facilities, services and other resources required for said Parts of the Project.

(b) Carry out, through DILG, project preparation, monitoring and evaluation and training under the relevant part of Part B(3)(a) of the Project in accordance with the time-bound action plan dated August 16, 2001.

(c) Cause DILG to maintain, during the duration of the Project, the Water Supply and Sanitation Project Management Office, with functions and resources satisfactory to the Bank, managed and staffed with experienced personnel in adequate number, to provide support to LGUs in the evaluation and preparation of Sub-projects and in the implementation of the LGUs' institutional strengthening programs under Part A(2) of the Project.

(d) Cause DILG in collaboration with the Borrower, to:

(i) maintain the Technical Working Committee, which was set up pursuant to the Memorandum of Agreement, to be responsible for the overall coordination and supervision of all components of the Project; and

(ii) not amend, delete, suspend or waive the Operational Manual or any provision thereof without the prior consent of the Bank.

(e) Cause DILG, with respect to Part B(3) of the Project, to:

(i) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators acceptable to the Bank, the carrying out of Part B(3) the Project and the achievement of the objectives thereof;

(ii) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank: (A) a semi-annual report on or about June 30 and December 31 of each year, commencing June 30, 2002, and (B) a mid-term report on or about December 31, 2003, in each case integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (e)(i) of this Section, on the progress achieved in the carrying out of Part B(3) of the Project during the period preceding the date of each such report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and

(iii) review with the Bank, by January 31, 2004, or such later date as the Bank shall request, the report referred to in paragraph (e)(2)(ii) of this Section, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Bank views on the matter.

ARTICLE III

Implementation of the Program

Section 3.01. (a) The Guarantor and the Bank shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program.

(b) Prior to each such exchange of views, the Guarantor shall furnish to the Bank for its review and comment a report on the progress achieved in the implementation of actions and policies embodied in the Program, in such detail as the Bank shall reasonably request.

ARTICLE IV

Other Covenants

Section 4.01. For purposes of enabling the Borrower to comply with the provisions in Section 4.03 of the Loan Agreement, the Guarantor shall enter into an agreement with the Borrower under which the Guarantor shall assume the foreign exchange risk between the Yen and the Peso in respect of the Loan to the Borrower. To that end, the Guarantor shall charge the Borrower a fee therefor under arrangements acceptable to the Borrower.

Section 4.02. The Guarantor shall take all actions necessary under existing laws to cause the Borrower to distribute annual dividends on its common shares in accordance with the provisions of Section 4.04 of the Loan Agreement, including, but not limited to: (a) adjusting the percentage of the annual net earnings required to be paid as dividends; and (b) developing a policy for the systematic treatment and transparency of guarantees within the context of fiscal risk management.

Section 4.03. The Guarantor shall take, and cause to be taken, all actions necessary to: (a) cause LGUs to facilitate review by the Commission on Audit of Sub-project performance in its Annual Audit Program, which review shall include LGUs' compliance with Administrative Order No. 129; and (b) propose the Water Regulatory Commission Bill for enactment by its Congress.

ARTICLE V

Representative of the Guarantor; Addresses

Section 5.01. The Secretary of Finance of the Guarantor is designated as representative of the Guarantor for the purposes of Section 11.03 of the General Conditions.

Section 5.02. The following addresses are specified for the purposes of Section

11.01 of the General Conditions:

For the Guarantor:

Department of Finance
Department of Finance Building
Roxas Blvd.
Manila
Republic of the Philippines

| | | |
|------------------|----------------------|------------|
| Cable address: | Telex: | Facsimile: |
| SECFIN Manila | 40268 CB-CONF (63-2) | 526-9990 |

For the Bank:

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

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

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

REPUBLIC OF THE PHILIPPINES

By /s/ Jose Isidro Camacho

Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Jemal-ud-din Kassum

Authorized Representative

