

CONFORMED COPY

LOAN NUMBER 4601 RU

Loan Agreement

(Municipal Heating Project)

between

RUSSIAN FEDERATION

and

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

Dated February 8, 2002

LOAN NUMBER 4601 RU

LOAN AGREEMENT

AGREEMENT, dated February 8, 2002, between the RUSSIAN FEDERATION (the Borrower) and the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS 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;

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;

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 October 6, 1999) (the General Conditions), constitute an integral part of this Agreement.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) "Gosstroj" means the Borrower's State Committee for Construction and Housing and Communal Complex, or any successor or successors thereto;

(b) "Local Project Account" means the account to be opened by each Participating City and referred to in paragraph 3 (i) of Part C of Schedule 7 to this Agreement;

(c) "LPMU" means the local sub-project management unit to be opened by each Participating City and referred to in paragraph 3 (k) of Part C of Schedule 7 to this Agreement;

(d) "MOF" means the Borrower's Ministry of Finance, or any successor or successors thereto;

(e) "NFHR" means the National Foundation of Housing Reform, a legal entity organized and established in the form of a noncommercial foundation, pursuant to the Borrower's law 'On Non-Commercial Organizations', dated January 12, 1996, and operating on the basis of its charter, as revised on September 13, 1999, registered by Moscow City Government on July 6, 1995 (Registration No. 2385-1), and having a Board of Supervisors whose members include representatives of the MOF, Ministry of Economic Development and Trade and Gosstroj;

(f) "Operational Manual" means a manual, satisfactory to the Bank, adopted by the NFHR on November 9, 2000, setting forth procedures and rules related to Project

implementation, as the same may be amended from time to time;

(g) "Participating City" means any city or municipality of the Borrower which may from time to time have been selected by the Borrower pursuant to Part B of Schedule 7 to this Agreement;

(h) "Participating Subject of the Borrower" means any administrative subdivision of the Borrower which is a subject of the Russian Federation, to which any Participating City is legally subject under the laws of the Borrower, which may from time to time have been selected by the Borrower pursuant to Part B of Schedule 7 to this Agreement;

(i) "Participating District Heating Enterprise" means the municipal unitary enterprise or enterprise of another legal form providing district heating services in the Participating City, owned and operated by the Participating City;

(j) "Project Implementation Agreement" means the agreement between the MOF and Gosstroi, and the NFHR, referred to in Section 3.03 of this Agreement, and such term includes all schedules and agreements supplemental to the Project Implementation Agreement;

(k) "Project Monitoring Indicators" means the indicators developed by the Borrower, and satisfactory to the Bank, to monitor and evaluate, on ongoing basis, the carrying out of the Project and the achievement of Project objectives, referred to in paragraph 1 of Schedule 5 to this Agreement, and set forth in the Annex to Schedule 5 to this Agreement;

(l) "PMR" means the project management report referred to in Section 4.01 (d) (ii) of this Agreement, and prepared in accordance with Section 4.02 of this Agreement;

(m) "Special Account" means the account referred to in Section 2.02 (b) of this Agreement;

(n) "Sub-projects" means specific projects designed to rehabilitate and improve the operating efficiency of existing municipal district heating networks, and which are to be carried out by the Participating Cities, with the involvement of the Participating District Heating Enterprises, utilizing the proceeds of the Subsidiary Loans; and "Sub-project" means each and any such sub-project;

(o) "Sub-Project Implementation Agreements" means the agreements between the Participating Cities and the respective Participating District Heating Enterprises, approved by Gosstroi, referred to in paragraph 2 (c) of Part A of Schedule 7 to this Agreement, as the same may be amended from time to time, and such term includes all schedules and agreements supplemental to the Sub-Project Implementation Agreements; and Sub-Project Implementation Agreement means each and any such agreement;

(p) "Subsidiary Loans" means loans made or proposed to be made by the Borrower out of the proceeds of the Loan to the Participating Cities for the Sub-projects, and referred to in Section 3.02 (a) of this Agreement; and "Subsidiary Loan" means each and any such loan; and

(q) "Subsidiary Loan and Guarantee Agreements" means the agreements to be entered into between the Borrower, Participating Subjects of the Borrower and Participating

Cities pursuant to Section 3.02 (a) of this Agreement, as the same may be amended from time to time, and such term includes all schedules and agreements supplemental to the Subsidiary Loan and Guarantee Agreements; and "Subsidiary Loan and Guarantee Agreement" means each and any such agreement.

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

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 eighty five million Dollars (\$85,000,000).

Section 2.02. (a) 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 withdrawals made by a Participating City under a Subsidiary Loan to meet the reasonable cost of goods, works and services required for the Sub-project in respect of which the withdrawal from the Loan Account is requested; and (ii) expenditures made (or, if the Bank shall so agree, to be made) in respect of the reasonable cost of goods, services and incremental operating costs required for Parts B and C of the Project.

(b) The Borrower may, for the purposes of the Project, open and maintain in Dollars a special deposit account on terms and conditions satisfactory to the Bank, including appropriate protection against set-off, seizure or attachment. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Schedule 6 to this Agreement.

Section 2.03. The Closing Date shall be June 30, 2006, 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 the 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.
(i i)	"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 Dollars 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.
(i v)	"LIBOR Total Spread" means, for each Interest Period: (A) three fourth 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 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 on May 15 and November 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 as set forth in Schedule 2 to this Agreement, and, to this end, shall carry out the Project with due diligence and efficiency and in conformity with appropriate administrative, financial, commercial, engineering, district heating, environmental, and other technical practices, shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project, and shall, except as the Bank and the Borrower shall otherwise agree, carry out the Project in accordance with the Implementation Program set forth in Schedule 5 to this Agreement .

Section 3.02. Without limitation upon the provisions of Section 3.01 of this Agreement, and except as the Bank and the Borrower shall otherwise agree, the Borrower shall, for purposes of Part A of the Project:

(a) relend, out of the proceeds of the Loan allocated from time to time to Categories (1), (2) and (3)(a) of the table set forth in paragraph 1 of Schedule 1 to this Agreement, to the Participating Cities the amount of financing (the Subsidiary Loans) required by the Participating Cities in respect of their respective Sub-projects, under loan agreements (the Subsidiary Loan and Guarantee Agreements) to be entered into among the Borrower, represented by the MOF and Gosstroï, and each such Participating City, with the guarantee of a Participating Subject of the Borrower, in accordance with the procedures, eligibility criteria, and on terms and conditions satisfactory to the Bank, including, without limitation, the procedures, eligibility criteria, and terms and conditions set forth or referred to in Schedule 7 to this Agreement; and

(b) exercise its rights under the Subsidiary Loan and Guarantee Agreements in such a manner as to protect the interests of the Borrower and the Bank, and to accomplish the purposes of the Project, and, shall not assign, amend, abrogate or waive any Subsidiary Loan and Guarantee Agreement or any provision thereof.

Section 3.03. Without limitation upon the provisions of Section 3.01 of this Agreement, and except as the Bank and the Borrower shall otherwise agree, the MOF and Gosstroï shall, in order to facilitate the efficient carrying out of the Project, enter into a project implementation agreement (the Project Implementation Agreement) with the NFHR, under terms and conditions which shall have been approved by the Bank, which shall include, but not be limited to, the following:

(a) scope of responsibilities and description of activities to be carried out by the NFHR during the execution of the Project, consistent with paragraph 4 of Schedule 5 to this Agreement;

(b) obligation of the NFHR during the execution of the Project to provide resources and appoint qualified staff and engage consultants, under terms of reference satisfactory to the MOF and Gosstroï and Bank;

(c) basis of payments to the NFHR; and

- (d) reporting, accounting and auditing requirements.

Section 3.04. Except as the Bank shall otherwise agree, the procurement of 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 3.05. For the purposes of Section 9.07 of the General Conditions and without limitation thereto, the Borrower shall:

- (a) prepare, on the basis of guidelines acceptable to the Bank and furnish to 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 designed to ensure the continued achievement of the Project objectives; and

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

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall cause the NFHR 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 its operations and financial position and to register separately the operations, resources and expenditures related to the Project.

- (b) The Borrower shall cause the NFHR to:

- (i) have its records, accounts and financial statements (balance sheet, statements of sources and uses of funds, and related statements) 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 (6) 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 so audited, and (B) an opinion on such statements, records and accounts, 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 and accounts, and the audit thereof, and concerning said auditors, as the Bank shall 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 statements of expenditure, the Borrower shall cause the NFHR 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 twelve (12) months following Project completion; and
 - (iii) enable the Bank's representatives to examine such records.
- (d) The Borrower shall cause the NFHR to:
- (i) have the records and accounts referred to in paragraph (c) (i) of this Section and those for the Special Account for each fiscal year audited, in accordance with 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 (6) 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 on the project management reports (the PMRs) submitted during such fiscal year, and as to whether the 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 such records and accounts, and the audit thereof as the Bank shall from time to time reasonably request.

Section 4.02. The Borrower shall cause the NFHR to prepare, in accordance with guidelines acceptable to the Bank, and furnish to the Bank not later than forty five (45) days after the end of each calendar quarter, a PMR for such period, which:

- (a) (i) sets forth actual sources and uses 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 (ii) 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;
- (b) (i) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and (ii) explains variances between the actual and previously forecast implementation targets; and
- (c) 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.

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 Project Implementation Agreement shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of the NFHR to carry out the Project; or

(b) the NFHR shall have failed to perform any of its obligations under the Project Implementation Agreement.

Section 5.02. Pursuant to Section 7.01 (k) of the General Conditions, the following additional events are specified, namely the events specified in Section 5.01 (a) or (b) 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.

ARTICLE VI

Effective Date; Termination

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

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

(b) the Borrower, Participating Cities and Participating Subjects of the Borrower, and Participating District Heating Enterprises have executed Subsidiary Loan and Guarantee Agreements, and related Sub-Project Implementation Agreements in respect of a minimum of four (4) Sub-projects, and all conditions to the effectiveness of such Subsidiary Loan and Guarantee Agreements and Sub-Project Implementation Agreements have been fulfilled.

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 Implementation Agreement has been duly authorized or ratified by the MOF and Gosstroj, and NFHR, and is legally binding upon the MOF and Gosstroj, and NFHR in accordance with its terms; and

(b) that the Subsidiary Loan and Guarantee Agreements and related Sub-Project Implementation Agreements referred to in Section 6.01 (b) of this Agreement have been duly authorized or ratified by the Participating City and respective Participating District Heating Enterprises.

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 or Deputy Minister of Finance of the Borrower responsible for international economic affairs 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
Ilyinka Street, 9
103009 Moscow
Russian Federation

Telex:

112008

Facsimile:

(7-095) 915-5887

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)

Facsimile:

(1 202) 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.

RUSSIAN FEDERATION

By /s/ Yuri Ushakov

Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Johannes F. Linn

Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Loan

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 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 Dollars)	% of Expenditures To be Financed
(1) Works	300,000	75%
(2) Goods, including local transportation and related insurance	67,550,000	100% of foreign expenditures, 100% of local expenditures (ex- factory cost) and 80% of local expenditures for other items procured locally
(3) Consultants' services:		
(a) for Part A of the Project	4,100,000	100%
(b) for Part B of the Project	2,500,000	100%
(4) Incremental Operating Costs	2,900,000	100%
(5) Fee	850,000	Amount due pursuant to Section 2.04 of this Agreement

(6)	Unallocated	<u>6,800,000</u>
	TOTAL	85,000,000

2. For the purposes of this Schedule:

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

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

(c) the term "Incremental Operating Costs" means reasonable incremental expenses incurred by the NFHR under Part C of the Project on account of Project implementation, management and monitoring, including the cost of: (a) transportation and travel; (b) training and attendance of study tours, workshops, conferences and seminars; (c) communication; (d) office goods and supplies; (e) maintenance of office equipment and facilities; (f) rent and utilities; (g) NFHR consultants' services and auditing services; and (h) NFHR staff salaries; provided, however, that the above expenditures shall be set forth in approved annual budgets of the NFHR, adopted pursuant to the Project Implementation Agreement and the Operating Manual.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding the equivalent of \$500,000 may be made in respect of Category (4) set forth in the table in paragraph 1 of this Schedule on account of payments made for expenditures before that date but after May 1, 2000.

4. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditure for expenditures for: (i) works under contracts not exceeding \$100,000 equivalent; (ii) goods under contracts not exceeding \$100,000 equivalent; (iii) services provided by consulting firms under contracts not exceeding \$100,000 equivalent; (iv) services provided by individual consultants under contracts not exceeding \$50,000 equivalent; and (v) incremental operating costs, all under such terms and conditions as the Bank shall specify by notice to the Borrower.

SCHEDULE 2

Description of the Project

The objective of the Project is to alleviate financial burden on selected municipal authorities of the Borrower associated with their supply of district heating to local population by (a) improving the operating efficiency of the district heating networks, (b) promoting sound cost recovery policies and commercial practices, and (c) supporting government efforts to improve the cost-effectiveness of subsidy programs.

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: District Heating System Rehabilitation

The carrying out of Sub-projects for the rehabilitation of the existing district heating systems owned by the Participating Cities and operated by the Participating District Heating Enterprises, through the financing of goods, works and services.

Part B: Sector Development Support

Development of the district heating and communal services sector policies and strategies through the financing of services and research in the areas such as pricing and regulation, sector restructuring, needed infrastructure investment, and improvement of the effectiveness and efficiency of social support programs in the housing and communal services area.

Part C: Project Management and Implementation Support

Assistance in the management and implementation of the Project, including procurement related activities, design and implementation of a system of financial management and accounting, preparation of the accounts and financial statements referred to in Section 4.01 of this Agreement, audit of the accounts and financial statements referred to above, and institutional strengthening of the NFHR to manage and implement the Project, through the financing of incremental operating costs, including external auditing services.

* * *

The Project is expected to be completed by December 31, 2005.

SCHEDULE 3

Amortization Schedule

<u>Date Payment Due</u>	<u>Payment of Principal (expressed in Dollars)*</u>
On each May 15 and November 15 beginning November 15, 2006 through November 15, 2017	3,540,000
On May 15, 2018	3,580,000

* The figures in this column represent the amount in Dollars to be repaid, except as provided in Sections 4.04 (d) of the General Conditions.

SCHEDULE 4

Procurement

Section I. Procurement of Goods and Works

Part A: General

Goods and works, including those under supply and install contracts, 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 this Section.

Part B: International Competitive Bidding

1. Goods, including those under supply and install contracts, 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.

2. The following provision shall apply to goods and works to be procured under contracts awarded in accordance with the provisions of paragraph 1 of this Part B.

(a) Prequalification

Bidders for civil works and supply and installation contracts estimated to cost \$5,000,000 equivalent or more shall be prequalified in accordance with the provisions of paragraphs 2.9 and 2.10 of the Guidelines.

(b) Preference for domestically manufactured goods

The provisions of paragraphs 2.54 and 2.55 of the Guidelines and Appendix 2 thereto shall apply to goods manufactured in the territory of the Borrower.

(c) Notification and Advertising

The invitation to prequalify or bid for each contract estimated to cost \$10,000,000 equivalent or more shall be advertised in accordance with the procedures applicable to large contracts under paragraph 2.8 of the Guidelines.

Part C: Other Procurement Procedures

1. National Competitive Bidding

Works estimated to cost less than \$200,000 equivalent per contract, up to an aggregate amount not to exceed \$600,000 equivalent, 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 \$100,000 equivalent per contract, up to an aggregate amount not to exceed \$500,000 equivalent, 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 \$50,000 equivalent per contract, up to an aggregate amount not to exceed \$300,000, may be procured under contracts awarded on the basis of national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

Part D: Review by the Bank of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations to prequalify for bidding or to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Bank for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Guidelines. Procurement of all goods and works shall be undertaken in accordance with such procurement plan as shall have been approved by the Bank, and with the provisions of said paragraph 1.

2. Prior Review

With respect to each contract procured under the International Competitive Bidding procedures under Part B hereof and National Competitive Bidding procedures under Part C.1 hereof, the first two contracts procured under the International Shopping procedures under Part C.2 hereof, and the first two contracts procured under the National Shopping Procedures under Part C.3 hereof, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

3. Post Review

With respect to each contract not governed by paragraph 2 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 Sections I and 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 Consultants Guidelines), and the following provisions of Section II of this Schedule.

Part B: Quality- and Cost-based Selection

1. Except as otherwise provided in Part C of this Section, consultants' services shall be procured under contracts awarded in accordance with the provisions of Section II of the Consultants 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.
2. The provisions of paragraph 2.7 of the Consultants Guidelines shall apply to contracts for consultants' services estimated to cost less than \$100,000 equivalent per contract.

Part C: Other Procedures for the Selection of Consultants

1. Least-cost Selection

Services for auditors, design and preparation of bidding documents, and supervision of building construction or equipment installation contracts, estimated to cost less than \$100,000 equivalent per contract, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultants Guidelines.

2. Individual Consultants

Services related to activities under Parts B and C of the Project that meet the requirements set forth in paragraph 5.1 of the Consultants Guidelines, may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultants Guidelines.

Part D: Review by the Bank of the Selection of Consultants

1. Selection Planning

Prior to the issuance to consultants of any requests for proposals, the proposed plan for the selection of consultants under the Project shall be furnished to the Bank for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Consultants Guidelines. Selection of all consultants' services shall be undertaken in accordance with such selection plan as shall have been approved by the Bank, and with the provisions of said

paragraph 1.

2. Prior Review

(a) With respect to each contract for the employment of consulting firms estimated to cost the equivalent of \$100,000 or more, the procedures set forth in paragraphs 1, 2 (other than the third subparagraph of paragraph 2(a)) and 5 of Appendix 1 to the Consultants Guidelines shall apply.

(b) With respect to each contract for the employment of individual consultants estimated to cost the equivalent of \$50,000 or more, the qualifications, experience, terms of reference and terms of employment of the consultants shall be furnished to the Bank for its prior review and approval. The contract shall be awarded only after said approval shall have been given.

3. 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 Consultants Guidelines shall apply.

SCHEDULE 5

Implementation Program

1. Project Monitoring and Evaluation. (a) The Borrower shall monitor and evaluate on an ongoing basis, in accordance with the indicators (the Project Monitoring and Evaluation Indicators) set forth in the Annex to this Schedule 5, the carrying out of the Project and the achievement of the objectives thereof.

(b) For each year of Project implementation, the Borrower shall, through the NFHR, prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, on or about April 30, a report integrating the results of the monitoring and evaluation activities performed pursuant to subparagraph (a) of this paragraph 1, on the progress achieved in the carrying out of the Project during the preceding year, and setting out the measures recommended to ensure the efficient carrying out of the Project and the Program and the achievement of the objectives thereof during the period following such date.

(c) For each year of Project implementation, the Borrower shall review with the Bank, by May 30, or such later date as the Bank shall request, the report referred to in subparagraph (b) of this paragraph 1, 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 reports and the Bank views on the matter.

2. Gosstroj. Gosstroj shall, with the assistance of the NFHR, be responsible for the overall direction and strategic oversight of the Project, monitoring the carrying out of the Project and achievement of Project objectives.

3. MOF. The MOF shall be responsible for the financial aspects of the Subsidiary Loan and Guarantee Agreements.

4. NFHR. The NFHR shall be responsible for day-to-day Project administration, management and coordination, including Project-related financial management, accounting, procurement, disbursement, engagement of outside auditors and preparation of appropriate auditing reports and their dissemination, and preparation of progress reports and annual reports with respect to the Project.

5. Participating Subjects of the Borrower and Participating Cities. The Borrower shall ensure that the Participating Subjects of the Borrower and Participating Cities shall be responsible for setting appropriate tariff policies related to the Participating District Heating Enterprises, and otherwise ensuring that the Participating District Heating Enterprises' financial positions are satisfactory, and for providing financial and other guarantees related to the Sub-projects.

**Annex
to
SCHEDULE 5**

Project Monitoring and Evaluation Indicators

1. During each year of Project implementation, district heating charges are established and maintained at levels which: (a) allow each Participating District Heating Enterprise to cover all prudently incurred costs of operations, including local costs of the Sub-project and a reasonable level of profitability; (b) fully cover depreciation on revalued assets. During each year of Project implementation, the transfers from the Participating Cities to the Participating District Heating Enterprises take into account amounts not invoiced by the Participating District Heating Enterprise to its household customers.

2. The percentage of full cost recovery district heating charges paid by households in each Participating City are not less than 80% in year 2001, 90% in year 2002, and 100% in year 2003 and thereafter.

3. The average collection ratio in the communal heating sector of the Participating Cities (i.e., the ratio of collected operating revenues to total billings) increase from a minimum level of seventy percent (70%) in year 2000 to seventy five percent (75%) in year 2001, eighty percent (80%) in year 2002, eighty five percent (85%) in year 2003, and ninety five percent (95%) in year 2004.

4. The average cash collection ratio in the communal heating sector of the Participating Cities (i.e., the cash collection ratio of cash collections to total collected operating revenues) increase to at least sixty percent (60%) in year 2001, seventy percent (70%) in year 2002, eighty five percent (85%) in year 2003, and one hundred percent (100%) in year 2004 and thereafter.

5. At the completion of the Project, quality of heat and hot water services has increased significantly, and the energy efficiency of the Participating District Heating Enterprise has improved significantly compared to base-line figures prior to Project implementation.

6. By the time of Project completion, the operating costs of the Participating District Heating Enterprises have decreased, in comparable inflation-adjusted prices and under comparable conditions, and such cost decrease will be reflected in the related district heating charges.

7. During the Project, the Participating Cities will significantly improve targeting of heating subsidies to the low-income households, as a part of their housing allowance programs or successor programs.

8. At the completion of the Project, funds spent by each Participating City to support municipal heating services (including operating losses of the Participating District heating Enterprises and subsidies with respect to the heating costs of low income households) will decrease, in comparable inflation-adjusted prices and under comparable conditions.

SCHEDULE 6

Special Account

1. For the purposes of this Schedule:

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

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

(c) the term "Authorized Allocation" means an amount equivalent to \$4,000,000 to be withdrawn from the Loan Account and deposited into the Special Account pursuant to paragraph 3 (a) of this Schedule, provided, however, that unless the Bank shall otherwise agree, the Authorized Allocation shall be limited to an amount equivalent to \$2,000,000 until the aggregate amount of withdrawals from the Loan Account plus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General Conditions shall be equal to or exceed the equivalent of \$7,000,000.

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

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

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

- (b) (i) For replenishment of the Special Account, the Borrower shall furnish to the Bank requests for deposits into the Special Account at such intervals as the Bank shall specify.
- (ii) 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 paragraph 4 of this Schedule for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the 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. All such deposits shall be withdrawn by the Bank from the Loan Account under the respective eligible Categories, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

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

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

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

(b) if the Borrower shall have failed to furnish to the 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 the records and accounts for the Special Account;

(c) 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 the provisions of Section 6.02 of the General Conditions; or

(d) once the total unwithdrawn amount of the Loan allocated to the eligible Categories, minus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General Conditions with respect to the Project, shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawal from the Loan Account of the remaining unwithdrawn amount of the Loan allocated to the eligible Categories 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.

6. (a) If the Bank shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Bank, the Borrower shall, promptly upon notice from the Bank: (A) provide such additional evidence as the Bank may request; or (B) 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 or the portion thereof not so eligible or justified. 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 shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for eligible expenditures, the Borrower shall, promptly upon notice from the 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 paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Loan Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.

SCHEDULE 7

Procedures, Eligibility Criteria and Terms and Conditions of Subsidiary Loans

Part A: Procedures

1. No expenditures for goods, works and services required for a Sub-project shall be eligible for financing out of the proceeds of the Loan unless the Sub-project and related Subsidiary Loan shall have been approved by the Bank, and a Subsidiary Loan and Guarantee Agreement has been executed among the MOF and Gosstroj, Participating Subject of the Borrower and Participating City in accordance with the terms and conditions of this Schedule 7.

2. When presenting a proposed Subsidiary Loan to the Bank for approval, the Borrower, through the MOF and Gosstroj, shall furnish to the Bank, in a form satisfactory to the Bank:

(a) a draft Subsidiary Loan and Guarantee Agreement;

(b) an independent assessment of the credit-worthiness of the Participating City, prepared in accordance with the terms of reference satisfactory to the MOF and Bank;

(c) a draft Sub-Project Implementation Agreement, which shall define the technical and operational rights and responsibilities of the Participating City and Participating District Heating Enterprise under the proposed Sub-Project;

(d) a description of the proposed Participating District Heating Enterprise which would be involved in the proposed Sub-project implementation, including its legal status and ownership information, and a description of the existing service agreement or any other operational agreement between the Participating City and the Participating District Heating Enterprise governing the Participating District Heating Enterprise's district heating system operational responsibilities;

(e) a feasibility and appraisal report describing the institutional, legal and regulatory, technical, economic, financial, operational, procurement, and environmental aspects of the proposed Sub-project;

(f) draft procurement (tender) documents covering the first year of planned procurement activities; and

(g) such other information as the Bank shall reasonably request.

3. The MOF and Gosstroj, Participating Subject of the Borrower, and Participating City may execute the draft Subsidiary Loan and Guarantee Agreement referred to in paragraph 2 (a) of Part A of this Schedule 7, and giving the MOF and Gosstroj rights adequate to protect the interests of the Bank and the Borrower, and containing, *inter alia*, the terms and conditions set forth in Part C of this Schedule 7, following the Bank's positive appraisal of the technical, economic and financial aspects of the proposed Sub-Projects. The right of the Sub-borrower to make withdrawals for Sub-loans, and, respectively, the right of the Borrower to make withdrawals from the Loan Account shall be contingent upon the Bank's final approval of the Sub-Project, which shall be issued only upon the receipt by the Bank of satisfactory procurement documents for the Sub-project, referred to in paragraph 2 (f) above.

4. Sub-loan and Guarantee Agreements and all related documents with respect to at least \$64,000,000 of Sub-Loans shall be executed on or before December 31, 2001, and all Sub-Loan and Guarantee Agreements and all related documents with respect to all remaining Sub-Loans shall be executed on or before March 31, 2002.

Part B: Eligibility and Selection Criteria

1. The Participating Subjects of the Borrower and Participating Cities shall be selected based on the receipt by the MOF and Gosstroj of:

(a) a letter of commitment satisfactory to the MOF and Gosstroj, and the Bank, and executed by an authorized official of the proposed Participating Subject of the Borrower and Participating City;

(b) satisfactory feasibility and appraisal report covering institutional, legal and regulatory, technical, economic, financial, operational, procurement, and environmental aspects of the proposed Sub-project;

(c) satisfactory report on the credit-worthiness of the Participating City, including confirmation that there are no legal barriers to its borrowing for the proposed Sub-Project; and

(d) confirmation that the Participating City is in compliance with the minimum financial criteria established as prior conditions of participation, including:

- (i) compliance with current federal standards regarding the share of district heating service charges to be paid by the population;
- (ii) average district heating service charges established at a level that is satisfactory to the Bank; and
- (iii) collections in cash and/or direct offsets sufficient to cover the full costs of personnel, fuel and heat purchases of the heating enterprises.

2. Sub-projects shall be selected based on their expected impact on the rehabilitation of and operating efficiency of existing district heating systems (and, if appropriate, their impact on energy efficiency of apartment buildings connected to such systems), and their technical, economic, financial and commercial viability.

Part C: Terms and Conditions of the Subsidiary Loan and Guarantee Agreements

1. Each Subsidiary Loan shall be made under a Subsidiary Loan and Guarantee Agreement entered into by the MOF and Gosstroj, Participating City and Participating Subject of the Borrower, and shall include a repayment guarantee by the Participating Subject of the Borrower.

2. Each Subsidiary Loan and Guarantee Agreement shall provide that the Subsidiary Loan shall:

- (a) be denominated and be repayable (principal and interest) in Dollars equivalent;
- (b) be repayable in fifteen (15) years, including a grace period of up to five (5) years;
- (c) carry an interest rate on the principal amount of the Subsidiary Loan withdrawn and outstanding from time to time equal to the interest rate specified in Section 2.06 of this Agreement, plus a spread of two percent (2%), a commitment charge on the amount of the Subsidiary Loan not withdrawn from time to time equal to the percentage of the commitment charge paid by the Borrower to the Bank pursuant to Section 2.05 of this Agreement, and a fee equal to the fee specified in Section 2.04 of this Agreement; and
- (d) be equal to not less than \$3,000,000.

3. Each Subsidiary Loan and Guarantee Agreement shall require, inter alia, that the Participating City and Participating Subject of the Borrower, as applicable, and, when appropriate, that the Participating District Heating Enterprise, under the terms of a Sub-Project Implementation Agreement with the Participating City:

- (a) furnish evidence acceptable to the MOF and Gosstroj that the Subsidiary Loan and Guarantee Agreement has been executed, and is valid and legally binding upon, the Participating Subject of the Borrower and Participating City, as applicable;
- (b) carry out and operate the Sub-project with due diligence and efficiency under the supervision of qualified and experienced management assisted by competent staff in adequate numbers, and in accordance with sound technical, economic, financial, environmental,

commercial and managerial standards;

(c) implement, within a specifically described time frame, financial, accounting and commercial systems to allow the Participating City to maintain records and accounts adequate to reflect in accordance with sound accounting practices the operations and financial status of the Participating City and the Participating District Heating Enterprise, and to register separately the operations, resources and expenditures related to the Sub-project;

(d) have the records, accounts and financial statements related to the Sub-project for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors satisfactory to the MOF and Gosstroï, and the Bank, and furnish to the MOF and Gosstroï not later than six (6) months after the end of each such year certified copies of the financial statements for such year so audited and the report of such audit by the auditors of such scope and such detail as the MOF and Gosstroï, and the Bank shall have reasonably requested;

(e) procure the goods, works and services to be financed by the Subsidiary Loan in accordance with the provisions of Schedule 4 to this Agreement, and to use such goods, works and services exclusively in the carrying out of the Sub-project;

(f) allow the MOF and Gosstroï, by itself or jointly with representatives of the Bank, if the Bank shall so request, and/or the NFHR, to inspect such goods and the sites, works, plants and construction included in the Sub-project, the operation thereof, and any relevant records and documents related to the Sub-project;

(g) take out and maintain, or, when applicable, ensure that third parties receiving goods financed out of the proceeds of the Subsidiary Loan maintain, with responsible insurers such insurance, against such risks and in such amounts, as shall be consistent with sound business practice, including insurance covering hazards incident to the acquisition, transportation and delivery of goods financed out of the proceeds of the Subsidiary Loan to the place of use or installation, any indemnity thereunder to be made to replace or repair such goods;

(h) assume the foreign exchange risk between the currency of the Sub-loan and currency of the Borrower;

(i) open, by the date on which the Participating City shall enter into the Subsidiary Loan and Guarantee Agreement, and thereafter maintain, a separate account (the Local Project Account) in a commercial bank under terms and conditions satisfactory to the MOF and Gosstroï, including protection against set-off, seizure, or attachment, and deposit and maintain in such Local Project Account, during the life of the Sub-project, an amount sufficient to pay for the Participating City's co-financing share of the total Sub-project related expenditures estimated to be required during the following three (3) months;

(j) utilize the amounts deposited into the said Local Project Account exclusively to finance the Sub-project;

(k) establish and maintain, with adequate membership, staff and other resources, a local project management unit (the LPMU) with the responsibilities for the day-to-day coordination and execution of the Sub-project;

- (1)
 - (i) ensure that for each of the Participating District Heating Enterprise's fiscal years during Sub-project implementation, the Participating District Heating Enterprise's collected operating revenues are sufficient to meet the Participating District Heating Enterprise's operational expenses, adequate maintenance expenses, and other Sub-project related expenses for that fiscal year, and provide a reasonable level of return on investment;
 - (ii) ensure that for each of the Participating District Heating Enterprise, the average ratio of collected operating revenues to total billings is not less than seventy five percent (75%) in year 2001, eighty percent (80%) in year 2002, eighty five percent (85%) in year 2003, ninety percent (90%) in year 2004, and ninety five (95%) percent in year 2005, and thereafter;
 - (iii) ensure that each Participating District Heating Enterprise's cash collection ratio is not less than sixty percent (60%) in year 2001, seventy percent (70%) in year 2002, eighty five percent (85%) in year 2003, and one hundred percent (100%) in year 2004, and thereafter;
 - (iv) by or before April 15 of each year during Sub-project implementation, the concerned Participating City and Participating Subject of the Borrower, and the Participating District Heating Enterprise shall review, on the basis of forecasts prepared by the Participating District Heating Enterprise and satisfactory to the Bank, whether the Participating District Heating Enterprise would be able to meet the requirements set forth in subparagraphs (1) (i), (ii) and (iii) above in respect of such year and the next following fiscal year, and shall furnish to the NFHR and the Bank a copy of such review upon its completion;
 - (v) if any such review shows that the Participating District Heating Enterprise would not meet the requirements set forth in subparagraphs (1) (i), (ii) and (iii) for the Participating District Heating Enterprise's fiscal years covered by such review, the concerned Participating City and Participating Subject of the Borrower shall promptly take, and ensure that the Participating District Heating Enterprise shall promptly take, all necessary measures in order to meet such requirements; and
 - (vi) for the purposes of this subparagraph (1):
 - (A) the term "collected operating revenues" means the sum of collected revenues from all sources related to operations, consumer deposits, and operational subsidies received by the Participating District Heating Enterprise, but excluding instruments of deferred payment unless there is a liquid market for such instruments;
 - (B) the term "operational subsidies" means all subsidies received by the Participating District Heating Enterprise in lieu of charges to consumers for services provided by the Participating District Heating Enterprise;

- (C) the term "operational expenses" means all expenses, as determined under the accrual method of accounting, related to adequate operation of the Participating District Heating Enterprise, including expenditures for personnel, energy and other utilities, chemicals and materials, social payments, taxes and payments in lieu of taxes, and depreciation;
- (D) the term "other Sub-project related expenses" means the sum of:
 - (i) the Participating City contribution to the Sub-project, as specified in the Subsidiary Loan and Guarantee Agreement; and
 - (ii) payments required to be made for the repayment of interest and other fees related to the Sub-loan and other debt service requirements;
- (E) the term "cash collection" means the collected operating revenues as defined in subparagraph (I) (vi) (A) above, received in cash by the Participating District Heating Enterprise;
- (F) the term "cash collection ratio" means the ratio between the cash collection as defined in sub-paragraph (I) (vi) (E) above and the collected operating revenues, as defined in subparagraph (I) (vi) (A) above, received in either cash or barter, off-sets and other non-cash transactions;
- (G) the term "total billings" means the sum of all moneys, including subsidies, due to the Participating District Heating Enterprise for the supply of heating services during the given year; and
- (H) whenever for the purposes of this paragraph (I) it shall be necessary to value, in terms of the currency of the Borrower, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

(m) ensure that the Participating District Heating Enterprise is compensated by the Participating City or Participating Subject of the Borrower for providing mandated benefits to preferred customers;

(n) ensure that the setting and collection of district heating charges during Sub-project implementation is done in an effective manner, which shall mean, among other things, that:

- (i) district heating charges shall be established and maintained at levels which: (A) allow the Participating District Heating Enterprise to cover all prudently-incurred costs of operations, including local costs of the project and a reasonable level of profit; (B) fully cover depreciation on

revalued assets. The Participating City will further ensure that tariffs are adjusted in a timely manner to reflect changes in operating costs. District heating charges will be adjusted at a minimum on an annual basis, and will be further adjusted if the prices for any single major input (fuel, wages, electricity, water, purchased heat) increase by twenty five percent (25%) and/or if the weighted average cost of supply increases by ten percent (10%);

- (ii) district heating charges payable to the Participating District Heating Enterprise by municipal or oblast owned or controlled entities (budgetary organizations) and overdue by more than thirty (30) days, shall be paid by the Participating City and Participating Subject of the Borrower through direct budgetary transfers to the Participating District Heating Enterprise, and with respect to amounts payable and overdue by more than thirty (30) days from federally owned or controlled entities, reasonable efforts and actions will be made by the Participating City and Participating Subject of the Borrower to ensure that arrears will be paid;
 - (iii) district heating charges payable by residential, budgetary and industrial consumers shall be collected in a timely and efficient manner and, when payments are not made on time, district heating services can be and are legally terminated in accordance with established policies and procedures; and
 - (iv) district heating charges payable by residential consumers in each fiscal year during Sub-project implementation shall be set at a level not less than eighty percent (80%) of average costs of heating services supplied by the Participating District Heating Enterprise in year 2001, not less than ninety percent (90%) of average cost of heating services supplied by the Participating District Heating Enterprise in year 2002, and one hundred percent (100%) of average costs of heating services supplied by the Participating District Heating Enterprise in year 2003;
- (o) prepare and promptly furnish to the MOF and Gosstroï all such information as the MOF and Gosstroï or the Bank shall reasonably request relating to the administration, operations and financial position of the Participating District Heating Enterprise, and to the benefits to be derived from the Sub-project;
- (p) maintain the Participating District Heating Enterprise in a satisfactory legal form;
- (q) carry out an environmental management plan satisfactory to the MOF and Gosstroï, and the Bank;
- (r) require that the Participating City not submit for approval any new procurement packages unless and until it is in full compliance with its obligations under the Subsidiary Loan and Guarantee Agreement, and give the Borrower the right to suspend or terminate the right of the Participating City to the use of the proceeds of the Subsidiary Loan upon failure by the Participating City or Participating Subject of the Borrower to perform its obligations under the Subsidiary Loan and Guarantee Agreement; and

(s) at the conclusion of the Sub-project, submit to the MOF and Gosstroj, in a manner and by date satisfactory to the MOF and Gosstroj, and the Bank, a Sub-project completion report.

4. Each Subsidiary Loan and Guarantee Agreement shall be subject to the following conditions of effectiveness:

(a) a corresponding LPMU shall have been established;

(b) a Local Project Account shall have been opened and an amount equivalent to the Participating City's co-financing contribution for Sub-project related expenditures projected to be required during the following three (3) months and due from the Participating City shall have been deposited into the Local Project Account;

(c) a corresponding Sub-Project Implementation Agreement has been executed; and

(d) the MOF and Gosstroj shall have received a satisfactory legal opinion or a written official confirmation from the Participating City, Participating Subject of the Borrower and Participating District Heating Enterprise confirming that the Subsidiary Loan and Guarantee Agreement and Sub-Project Implementation Agreement have been duly executed, delivered and authorized or ratified by all necessary governmental and corporate action of the concerned Participating City, Participating Subject of the Borrower, and Participating District Heating Enterprise, and that such agreements are legally valid and binding on the parties thereto in accordance with their terms.

5. Each Subsidiary Loan and Guarantee Agreement shall include a Sub-project description, Sub-loan amortization schedule and procurement terms and conditions.

