Loan Agreement


(Programa de Desenvolvimento Sustentável e Convivência com o Semi-árido Potiguar)

between

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

and

STATE OF RIO GRANDE DO NORTE

Dated June 20, 2008
LOAN AGREEMENT

AGREEMENT, dated June 20, 2008, between the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and the STATE OF RIO GRANDE DO NORTE (the Borrower).

WHEREAS (A) the Federative Republic of Brazil (the Guarantor) and the Borrower, having been satisfied as to the feasibility and priority of the Borrower’s Integrated Water Resources Management Project as such project is described in Schedule 2 to this Agreement (the Project), have requested the Bank to assist in the financing of the Project, which is an integral part of the Borrower’s development strategy;

(B) by an agreement of even date herewith between the Guarantor and the Bank (the Guarantee Agreement), the Guarantor has agreed to guarantee the payment obligations of the Borrower in respect of the loan provided for in Article II of this Agreement (the Loan); and

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. (a) Except as otherwise provided in (b) below, the “General Conditions Applicable to Loan and Guarantee Agreements for Fixed-Spread Loans” of the Bank dated September 1, 1999 (as amended through May 1, 2004) with the modifications set forth below (the General Conditions) constitute an integral part of this Agreement:

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

“Section 5.08. Treatment of Taxes
Except as otherwise provided in the Loan Agreement, the proceeds of the Loan may be withdrawn to pay for taxes levied by, or in the territory of, the Borrower or the Guarantor on the goods or services to be financed under the Loan, or on their importation, manufacture, procurement or supply. Financing of such taxes is subject to the Bank’s policy of requiring economy and efficiency in the use of the proceeds of its loans. To that end, if the Bank shall at any time determine that the amount of any taxes levied on or in respect of any item to be financed out of the proceeds of the Loan is excessive or otherwise unreasonable, the Bank may, by notice to the Borrower, adjust the percentage for withdrawal set forth or referred to in respect of such item in the Loan Agreement as required to be consistent with such policy of the Bank.”

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

(b) Notwithstanding the provisions of Section 1.01. (a) of this Agreement, Articles III and IV of the “General Conditions for Loans” of the Bank dated July 1, 2005 (as amended through October 17, 2007) (the 2007 General Conditions), as well as the definitions set forth in the Appendix of the 2007 General Conditions of the terms used in said Articles III and IV, constitute an integral part of this Agreement with respect to Article II and Schedule III 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) “ADESE” means Agência de Desenvolvimento do Seridó, a public interest civil society organization, operating in the territory of the Borrower, to promote the development of the Seridó region;

(b) “CAERN” means Companhia de Aguas e Esgotos do Rio Grande do Norte, the Borrower’s water and sewerage company;

(c) “DIG&R” means the Bank-approved Dam Inspection Guidelines dated July, 2002 and the reports prepared by and between the Borrower and the Bank dated November 8, 2005 with respect to the rehabilitation and maintenance of dams under Part C.1 of the Project, which are included in the Environmental Assessment;

(d) “ECM” means the Borrower’s Environmental Construction Manual dated 2005, containing the appropriate environmental practices, including guidelines, procedures and technical specifications to be adopted in all stages of the construction and operation of water infrastructure;
(e) “Eligible Categories” means categories (1) through (4) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

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

(g) “EMATER” means Instituto de Assistência Técnica e Extensão Rural do Estado do Rio Grande do Norte, the Borrower’s Institute for Technical Assistance and Rural Extension;

(h) “EMP for Water Pipes” means the Bank-approved Environmental Manual for the Construction of Water Pipes dated 2005;

(i) “EMPARN” means Empresa de Pesquisa Agropecuaria do Rio Grande do Norte, the Borrower’s Company for Agricultural Research;

(j) “Environmental Assessment” means the Borrower’s assessment, dated November 8, 2005, of the Project environmental impact, which identifies the existing environmental conditions and the potential direct and indirect environmental impact from the carrying out of the Project, and recommends mitigation measures for each negative impact identified, as well as measures for enhancing each identified positive impact;

(k) “FMR” means each financial monitoring report prepared in accordance with Section 4.02 of this Agreement;

(l) “IGARN” means Instituto de Gestão das Águas do Rio Grande do Norte, the Borrower’s Institute for Water Management;

(m) “Management Council” means the council referred to in Section 3.03 (a) of this Agreement, as established and operating under Decree No. 19.905 dated July 13, 2007 adopted by the Borrower’s Governor;

(n) "Operational Manual" means the manual of even date herewith, referred to in Section 3.01 (b) (ii) of this Agreement, as the same may be amended from time to time with the agreement of the Bank;

(o) “Partner Agencies” means collectively EMATER, EMPARN, CAERN, IGARN and SEPLAN (as hereinafter defined);
(p) “PMU” means the Project management unit referred to in Section 3.03 (a) of this Agreement, as established and operating under Decree No. 19.905 dated July 13, 2007 adopted by the Borrower’s Governor;

(q) “Procurement Plan” means the Borrower’s procurement plan, dated May 18, 2007, covering the initial 18 month period of implementation of the Project, as the same shall be updated from time to time in accordance with the provisions of Section 3.02 of this Agreement, to cover succeeding 18 month periods (or longer) of implementation of the Project;

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

(s) “Resettlement Framework” means the Borrower’s document, dated November 8, 2005, specifying the population resettlement policies, planning principles, institutional arrangements, procurement arrangements and design criteria that shall apply to the preparation and carrying out of activities in case resettlement of population under the Project is needed, which is included in the Environmental Assessment;

(t) “SAPE” means Secretaria de Estado da Agricultura, da Pecuária e da Pesca, the Borrower’s Secretariat for Agriculture, Livestock and Fisheries;

(u) “Secretariat of National Treasury” means the Secretaria do Tesouro Nacional, the Guarantor’s Secretariat of National Treasury;

(v) “SEMARH” means Secretaria de Estado do Meio Ambiente e dos Recursos Hídricos, the Borrower’s Secretariat of Environment and Water Resources;

(w) “SEPLAN” means Secretaria de Estado do Planejamento e das Finanças, the Borrower’s Secretariat of Finance and Planning; and

(x) “Special Account” means the account referred to in Part B of Schedule 1 to this Agreement.
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 this Agreement, an amount equal to thirty five million nine hundred thousand Dollars ($35,900,000), as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.08 of this Agreement.

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 expenditures made (or, if the Bank shall so agree, to be made) in respect of the reasonable cost of goods, works and services required for the Project and to be financed out of the proceeds of the Loan, as well as in respect of the front-end fee referred to in Section 2.04 of this Agreement and any premium in respect of an Interest Rate Cap or Interest Rate Collar payable by the Borrower in accordance with Section 4.04 (c) of the 2007 General Conditions.

(b) If, at any time, after consultation with SEMARH, the Bank determines that any amount of the Loan withdrawn from the Loan Account was used to make a payment for an expenditure that is not eligible for financing pursuant to the Loan Agreement, the Borrower shall, upon notice from the Bank to the Borrower and the Guarantor, promptly refund such amount to the Bank.

Section 2.03. The Closing Date shall be November 30, 2012, or such later date as the Bank shall establish, after having received evidence that the Guarantor has authorized the extension of the Closing Date. The Bank shall promptly notify the Borrower and the Guarantor of such later date, which shall not be a date beyond the date authorized by the Guarantor.

Section 2.04. The Borrower shall pay to the Bank a front-end fee in an amount equal to one quarter of one per cent (0.25%) 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 interest on the principal amount of the Loan withdrawn and outstanding from time to time, in respect of each Interest Period, at the Variable Rate; provided that, upon a Conversion of all or any portion of the principal amount of the Loan, the Borrower shall, during the Conversion Period, pay interest on such amount in accordance with the relevant provisions of Article IV of the 2007 General Conditions.
Section 2.06. Interest and other charges shall be payable semiannually in arrears on May 15 and November 15 in each year.

Section 2.07. The Borrower shall repay the principal amount of the Loan in accordance with the provisions of Schedule 3 to this Agreement.

Section 2.08. (a) The Borrower may at any time, in each case with the prior no-objection of the Guarantor and through the Secretariat of National Treasury, request any of the following Conversions of the terms of the Loan in order to facilitate prudent debt management:

(i) a change of the Loan Currency of all or any portion of the principal amount of the Loan, withdrawn or unwithdrawn, to an Approved Currency;

(ii) a change of the interest rate basis applicable to all or any portion of the principal amount of the Loan from a Variable Rate to a Fixed Rate, or vice versa; and

(iii) the setting of limits on the Variable Rate applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding by the establishment of an Interest Rate Cap or Interest Rate Collar on said Variable Rate.

(b) Any conversion requested pursuant to paragraph (a) of this Section that is accepted by the Bank shall be considered a “Conversion”, as defined in the Appendix of the 2007 General Conditions, and shall be effected in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.

(c) Promptly following the Execution Date for an Interest Rate Cap or Interest Rate Collar in respect of which the Borrower has requested that the premium be paid out of the proceeds of the Loan, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amounts required to pay any premium payable in accordance with Section 4.04 (c) of the 2007 General Conditions up to the amount allocated from time to time for such purpose in the table in Part A.1 of Schedule 1 to this Agreement.

Section 2.09. The Borrower’s Secretary of Environment and Water Resources is designated as representative of the Borrower for the purposes of taking any action required or permitted to be taken under the provisions of Section 2.02 of this Agreement and Article V of the General Conditions, including the opening and management of the Special Account.
ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objective of the Project as set forth in Schedule 2 to this Agreement, and, to this end shall:

(i) carry out the Project (except Parts B.3 and C.2 (c) thereof) through SEMARH and SEPLAN (the latter to carry out solely Part A.5 (b) of the Project), with the overall assistance of the Partner Agencies; and

(ii) cause CAERN to carry out Parts B.3 and C.2 (c) of the Project; all with due diligence and efficiency and in conformity with appropriate social, environmental, administrative, financial, engineering, and integrated urban development practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation to the provisions of Section 3.01 (a) of this Agreement, the Borrower shall cause the Project to be carried out:

(i) in accordance with the provisions and recommendations of the Environmental Assessment, the Resettlement Framework, the ECM, the DIG&R and the EMP for Water Pipes, when applicable; and

(ii) in accordance with the provisions of a manual, satisfactory to the Bank (the Operational Manual), which shall contain the policies and procedures for the carrying out, monitoring and evaluation of the Project, including, inter alia: (A) the organizational structure of the Project, including the role of the Management Council and the Partner Agencies; (B) the Project procurement and financial management requirements and procedures; (C) the indicators to be used for Project monitoring and evaluation; and (D) the functions, responsibilities, structure and key staff composition of the Management Council and the PMU. In case of any inconsistency between a provision of the Operational Manual and this Agreement, the provision of this Agreement will prevail.
Section 3.02. (a) Except as the Bank shall otherwise agree, procurement of the goods, works, and 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, as said provisions may be further elaborated in the Procurement Plan.

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

(c) The Borrower shall ensure that every contract for the procurement of civil works under the Project shall contain an annex with environmental technical specifications acceptable to the Bank, to be applied by the contractors in the carrying out of civil works under the Project.

Section 3.03. The Borrower shall, for purposes of Project implementation:

(a) through a decree issued by the Borrower’s Governor, assign and thereafter maintain until completion of the Project, a council to be responsible for overall guidance with respect to Project execution (the Management Council), and a unit within SEMARH to be responsible for the general management of the Project (the PMU), such Management Council and PMU to have the composition, structure, responsibilities and functions as set out in the Operational Manual;

(b) enter into institutional arrangements (Convênios) with each of EMATER, EMPARN, both agreements with the intervention of SAPE, IGARN and CAERN, and a cooperation agreement (Acordo de Cooperação) with SEPLAN, all under terms and conditions satisfactory to the Bank, setting forth their respective responsibilities for the implementation of those Parts of the Project in which each of the agencies mentioned above participates; and

(c) exercise its rights and comply with its obligations under each of the Convênios referred in paragraph (b) above, in such manner as to protect the interests of the Borrower and the Bank and to accomplish the purposes of the Loan, and, except as the Bank shall otherwise agree, the Borrower shall not assign, amend, abrogate, waive or fail to enforce its rights under such agreements or any provision thereof.

Section 3.04. The Borrower shall:

(a) maintain a Project monitoring and information system in SEMARH, satisfactory to the Bank, to enable it to monitor and evaluate on an on-going basis, in accordance with the performance indicators set forth in the Operational Manual, the carrying out of the Project and the achievement of the objective thereof;
(b) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, not later than twelve months after the Effective Date and yearly thereafter during Project implementation, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of such report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objective thereof during the period following such date; and

(c) review each such report with the Bank promptly after its preparation, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objective thereof, based on the conclusions and recommendations of the said report and the Bank’s views on the matter.

Section 3.05. For the purposes of Section 9.07 (c) of the General Conditions, the Borrower shall:

(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.

ARTICLE IV

Financial Covenants

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

(b) The Borrower, through SEMARH, shall:

(i) have the financial statements referred to in paragraph (a) of this Section for each fiscal year (or other period agreed to by the Bank) audited, in accordance with consistently applied auditing standards acceptable to the Bank, 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 (or such other period agreed to by the Bank), certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or such other period agreed to by the Bank), as so audited; and

(iii) furnish to the Bank such other information concerning such records and accounts, and the audit of such financial statements, 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 Report-based Disbursements or were made on the basis of statements of expenditure, the Borrower shall:

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

(ii) enable the Bank’s representatives to examine such records; and

(iii) ensure that the relevant statements of expenditure and reports referred to in Part A.4 and A.5 of Schedule 1 to this Agreement, as the case may be, are included in the audit for each fiscal year (or other period agreed to by the Bank), referred to in paragraph (b) of this Section.

Section 4.02. (a) Without limitation upon the Borrower’s reporting obligations set out in Section 3.04 of this Agreement, the Borrower shall prepare and furnish to the Bank a financial monitoring report, in form and substance satisfactory to the Bank (the FMR), which:

(i) sets forth sources and uses of funds for the Project, both cumulatively and for the period covered by said report, showing separately funds provided by the Loan, and explains variances between the actual and planned uses of such funds;

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

(iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

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

ARTICLE V

Effective Date; Termination

Section 5.01. The following events are specified as conditions to the effectiveness of the Loan within the meaning of Section 12.01 (c) of the General Conditions, namely that each of the institutional arrangements (Convênios) and the cooperation agreement (Acordo de Cooperação), referred to in paragraph (b) of Section 3.03 of this Agreement, have been entered into between the respective parties thereto in a manner satisfactory to the Bank.

Section 5.02. The following is specified as an additional matter, 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, namely that the Loan has been duly registered by the Guarantor’s Central Bank.

Section 5.03. Without prejudice to the provisions of the General Conditions, the Effective Date is the date ninety (90) days after the date of this Agreement, but in no case later than the eighteen (18) months after the Bank’s approval of the Loan which expire on March 18, 2009.
ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. Except as provided in Section 2.09 of this Agreement, the Borrower’s Governor is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

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
Telex: 248423 (MCI) or (202) 477-6391
Facsimile: 64145 (MCI)

For the Borrower:

Secretariat of Planning and Finance – Secretaria de Estado do Planejamento e das Finanças
Centro Administrativo do Estado
BR 101 – Lagoa Nova
59.059-900 Natal, RN
Brazil

Facsimile: (55-84) 3232-1911

Secretariat of Environment and Water Resources - Secretaria de Estado do Meio Ambiente e dos Recursos Hídricos
Rua Dona Maria Câmara, nº 1884, Bairro Capim Macio
59082-430 Natal, RN
Brazil

Facsimile: (55-84) 3232-2411
IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Brasília, Federative Republic of Brazil as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By/s/ John Briscoe
Authorized Representative

STATE OF RIO GRANDE DO NORTE

By/s/ Wilma Maria de Faria
Authorized Representative
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 Loan to each Category and the percentage of expenditures for items so to be financed in each Category:

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount of the Loan Allocated (Expressed in Dollars)</th>
<th>% of Expenditures to be Financed</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Goods and non-consultants’ services</td>
<td>9,600,000</td>
<td>100%</td>
</tr>
<tr>
<td>(2) Works</td>
<td>11,100,000</td>
<td>66%</td>
</tr>
<tr>
<td>(3) Consultants’ services</td>
<td>10,050,000</td>
<td>100%</td>
</tr>
<tr>
<td>(4) Operating Costs</td>
<td>1,250,000</td>
<td>75%</td>
</tr>
<tr>
<td>(5) Front-end fee</td>
<td>89,750</td>
<td>Amount due under Section 2.04 of this Agreement</td>
</tr>
<tr>
<td>(6) Premia for Interest Rate Caps and Interest Rate Collars</td>
<td>0</td>
<td>Amount due under Section 2.08 (c) of this Agreement</td>
</tr>
<tr>
<td>(7) Unallocated</td>
<td>3,810,250</td>
<td>TOTAL 35,900,000</td>
</tr>
</tbody>
</table>

2. For the purposes of this Schedule the term “Operating Costs” means the reasonable costs of salaries, communications, office supply, small refurbishing (as
necessary), travel and *per diem* directly related to the performance of the Project activities, which would not have been incurred absent the Project.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of Categories (1) to (4) set forth in the table in paragraph 1 above on account of payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding $5,900,000, may be made on account of payments made for expenditures within twelve months before that date.

4. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditure for expenditures for: (a) works costing less than the equivalent of $10,000,000 per contract; (b) goods or non-consultants’ services costing less than the equivalent of $500,000 per contract; (c) consulting firms’ services costing less than the equivalent of $500,000 per contract; (d) individual consultants’ services; and (e) operating costs.

5. The Borrower may request withdrawals from the Loan Account to be made on the basis of reports to be submitted to the Bank in form and substance satisfactory to the Bank, such reports to include the FMR and any other information as the Bank shall specify by notice to the Borrower (Report-based Disbursements). In the case of the first such request submitted to the Bank before any withdrawal has been made from the Loan Account, the Borrower shall submit to the Bank only a statement with the projected sources and applications of funds for the Project for the six-month period following the date of such request.

B. Special Account

1. The Borrower may open and maintain in Reais, a special deposit account in a commercial bank acceptable to the 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 to be deposited into the Special Account shall be made as follows:

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

   (b) if the Borrower is making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex B to this Schedule 1.

3. Payments out of the Special Account shall be made exclusively for Eligible Expenditures. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the 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 at any time is not satisfied that the reports referred to in Part A.5 of this Schedule 1 adequately provide the information required for Report-based Disbursements;

   (b) if the Bank determines at any time that all further withdrawals for payment of Eligible Expenditures 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: (i) the records and accounts for the Special Account; or (ii) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based Disbursements or were made on the basis of statements of expenditure, as the case may be.

5. The 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 and the Guarantor 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 and the Guarantor 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 subparagraph (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
Report-based Disbursements

1. For the purposes of this Annex, the term “Authorized Allocation” means an amount in R$9,000,000 to be withdrawn from the Loan Account and deposited into the Special Account pursuant to paragraph 2 of this Annex.

2. Withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

   (a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the 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
Report-based Disbursements

1. 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 Eligible Categories.

2. 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 reports referred to in Part A.5 of this Schedule 1 applicable to such withdrawal application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such reports.
SCHEDULE 2

Description of the Project

The objective of the Project is to promote economic, social and environmentally sustainable development in the Borrower’s territory through the implementation of an integrated water resources management system, including the preparation of a water sector strategy and a long-term investment program to promote an efficient use and adequate supply of water resources.

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 objective:

Part A: Institutional Development

1. Improvement of the legal and institutional water resources management framework of the Borrower through, *inter alia*: (a) review of the existing legal framework for the water resources management sector, and preparation of potential reforms, including the development and improvement of a water rights system; (b) the institutional strengthening, including appropriate staffing, of SEMARH and IGARN; (c) the strengthening of the Borrower’s policies and development strategies in the water resources and irrigation sectors; (d) the establishment of new water users associations and provision of support to existing ones; (e) the establishment of watershed management committees; and (f) the development of a training program, including environmental education programs.

2. Design and implementation of: (a) an updated water resources management and emergency plans; and (b) hydrological studies for aquifer management and protection (including completion of an atlas of the Borrower’s water resources).

3. Design and implementation of a water resources monitoring and evaluation network, as well as maintenance and updating of the Borrower’s integral water resources information system.

4. Development and improvement of: (a) a water rights system, including a cadastral survey of water users and their respective water rights; (b) an efficient water tariff system; (c) an operational model for a Borrower-operated water supply infrastructure; and (d) a framework for the operation of water supply systems for small communities within the Borrower’s territory.

5. Carrying out of studies aimed at: (a) the identification and analysis of different options for the proper treatment of solid waste in the Borrower’s territory; and (b) the design of a monitoring and evaluation system for the Borrower’s management programs.
Part B: Conservation and Protection of Natural Resources

1. Provision of support for the preservation of water quality and improved water use efficiency though, *inter alia*, the preparation and implementation of two pilot schemes to be carried out respectively in: (a) the watershed of the Borrower’s *Cobra* River in the *Seridó* region; and (b) the watershed of the Borrower’s *Salto e Una* River. Both schemes shall consist of, *inter alia*, the carrying out of participatory diagnostic of micro-watersheds, the design and implementation of management plans to promote soil conservation, the recovery of native vegetation and the adoption of a regulated use of agrochemicals.

2. Carrying out of maintenance works of the Borrower’s water transmission pipeline network, including the implementation of a macro-measurement system.

3. Establishment of measures to overcome water losses in the public distribution systems including, *inter alia*, the implementation of: (a) an information-processing technology for billing and collection purposes; and (b) installation of micro- and macro-measurement equipment.

4. Carrying out pilot projects for the use of treated wastewater to promote appropriate water use.

5. Construction of small soil-retention schemes to control sedimentation and improve water quality.

Part C: Water Infrastructure

1. Provision of support for improved water availability through, *inter alia*, the carrying out of rehabilitation and maintenance works of the Borrower’s existing water infrastructure, including updating technical information on all dams operated by the Borrower.

2. Carrying out improvement and expansion works of the Borrower’s *Monsenhor Expedito* water distribution system, including (a) strengthening of the productive system; (b) automation of pipeline operation and the implementation of macro-measurement systems; and (c) offshoot to support the water provision to new municipalities.

3. Carrying out construction, rehabilitation and maintenance works with respect to selected desalinization systems and small water supply systems, including the installation of equipment and training of operators.

4. Carrying out the participatory design, implementation and operation of pilot interventions for the rehabilitation of irrigation schemes located in the Borrower’s *Seridó*
region, including the implementation of improved water management systems and technology.

**Part D: Project Management**

1. Provision of support for the establishment and operation of the PMU, as well as for the overall Project administration, supervision, auditing activities and monitoring and evaluation.

2. Design and implementation of a long-term water sector program for the Borrower and a Project information program, including an informational campaign aimed at increasing public awareness on water constraints, as well as on Project activities.

* * *

The Project is expected to be completed by May 31, 2012.
SCHEDULE 3

Amortization Schedule

1. The following table sets forth the Principal Payment Dates of the Loan and the percentage of the total principal amount of the Loan payable on each Principal Payment Date (Installment Share). If the proceeds of the Loan shall have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined by the Bank by multiplying: (a) the total principal amount of the Loan withdrawn and outstanding as of the first Principal Payment Date; by (b) the Installment Share for each Principal Payment Date, such repayment amount to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

<table>
<thead>
<tr>
<th>Payment Date</th>
<th>Installment Share (Expressed as a %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>On each May 15 and November 15</td>
<td></td>
</tr>
<tr>
<td>Beginning November 15, 2011 through November 15, 2023</td>
<td>3.85%</td>
</tr>
<tr>
<td>On May 15, 2024</td>
<td>3.75%</td>
</tr>
</tbody>
</table>

2. If the proceeds of the Loan shall not have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined as follows:

(a) To the extent that any proceeds of the Loan shall have been withdrawn as of the first Principal Payment Date, the Borrower shall repay the amount withdrawn and outstanding as of such date in accordance with paragraph 1 of this Schedule.

(b) Any withdrawal made after the first Principal Payment Date shall be repaid on each Principal Payment Date falling after the date of such withdrawal in amounts determined by the Bank by multiplying the amount of each such withdrawal by a fraction, the numerator of which shall be the original Installment Share specified in the table in paragraph 1 of this Schedule for said Principal Payment Date (the Original Installment Share) and the denominator of which shall be the sum of all remaining Original Installment Shares for Principal Payment Dates falling on or after such date, such repayment amounts to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.
3. (a) Withdrawals made within two calendar months prior to any Principal Payment Date shall, for the purposes solely of calculating the principal amounts payable on any Principal Payment Date, be treated as withdrawn and outstanding on the second Principal Payment Date following the date of withdrawal and shall be repayable on each Principal Payment Date commencing with the second Principal Payment Date following the date of withdrawal.

(b) Notwithstanding the provisions of subparagraph (a) of this paragraph 3, if at any time the Bank shall adopt a due date billing system under which invoices are issued on or after the respective Principal Payment Date, the provisions of such subparagraph shall no longer apply to any withdrawals made after the adoption of such billing system.

4. Notwithstanding the provisions of paragraphs 1 and 2 of this Schedule, upon a Currency Conversion of all or any portion of the withdrawn principal amount of the Loan to an Approved Currency, the amount so converted in said Approved Currency that shall be repayable on any Principal Payment Date occurring during the Conversion Period, shall be determined by the Bank by multiplying such amount in its currency of denomination immediately prior to said Conversion by either: (i) the exchange rate that reflects the amounts of principal in said Approved Currency payable by the Bank under the Currency Hedge Transaction relating to said Conversion; or (ii) if the Bank so determines in accordance with the Conversion Guidelines, the exchange rate component of the Screen Rate.

5. If the principal amount of the Loan withdrawn and outstanding from time to time shall be denominated in more than one Loan Currency, the provisions of this Schedule shall apply separately to the amount denominated in each Loan Currency, so as to produce a separate amortization schedule for each such amount.
SCHEDULE 4

Procurement

Section I. General

A. All goods, works and non-consultant services shall be procured in accordance with the provisions of Section I of the “Guidelines for Procurement under IBRD Loans and IDA Credits” dated May 2004 (the Procurement Guidelines), and with the provisions of this Schedule.

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

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

Section II. Particular Methods of Procurement of Goods and Works

A. International Competitive Bidding

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

B. Other Procurement Procedures

1. National Competitive Bidding

Goods estimated to cost $100,000 or more but less than $500,000 equivalent per contract, and works estimated to cost $500,000 or more but less than $10,000,000 equivalent per contract may be procured under contracts awarded on the basis of National Competitive Bidding and the following additional provisions, using bidding documents, satisfactory to the Bank, in a standardized form for the Project:

(a) contracts shall be awarded to the bidder whose bid has been determined to be the lowest evaluated bid, such evaluation to be based on price and, whenever appropriate, to also take into account factors similar to those referred to in paragraph 2.52 of the Guidelines, provided, however, that the bid evaluation shall always be based on
factors that can be quantified objectively, and the procedure for such quantification shall be disclosed in the invitation to bid;

(b) whenever required by the Bank, the invitation to bid shall be advertised in at least one newspaper of national circulation in Brazil;

(c) the arrangements, under the invitation to bid, for joint-ventures (consórcios) of Brazilian and foreign firms shall be approved in advance by the Bank in each case;

(d) the invitation to bid shall not establish, for purposes of acceptance of bids, minimum or maximum amounts for the contract prices; and

(e) the purchaser shall not, without the Bank’s prior approval, issue any change order under a contract which would increase or decrease by more than 15% the quantity of goods (and related services) without any change in the unit prices or other terms and conditions of sale.

2. **Shopping**

Goods estimated to cost less than $100,000 equivalent per contract and works estimated to cost less than $500,000 equivalent per contract may be procured under contracts awarded on the basis of shopping procedures and a standard request for quotations acceptable to the Bank.

3. **Direct Contracting**

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

**Section III. Particular Methods of Procurement of Consultants’ Services**

A. **Quality- and Cost-based Selection.** Except as otherwise provided in Part B of this Section, consultants’ services shall be procured under contracts awarded on the basis of Quality- and Cost-based Selection. For purposes of paragraph 2.7 of the Consultant Guidelines, the short list of consultants for services estimated to cost less than $500,000 equivalent per contract may comprise entirely national consultants.

B. **Other Procurement Procedures**

1. **Selection Based on Consultants’ Qualifications.** Services for assignments costing less than $100,000 equivalent per contract and which the Bank agrees meet the requirements of paragraphs 3.7 and 3.8 of the Consultant Guidelines may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1, 3.7 and 3.8 of the Consultant Guidelines.
2. Least-cost Selection. Services for assignments costing less than $200,000 equivalent per contract and which the Bank agrees meet the requirements of paragraph 3.6 of the Consultant Guidelines may be procured under contracts awarded on the basis of Least-cost Selection in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

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

Section IV. Review by the Bank of Procurement Decisions

The Procurement Plan shall set forth those contracts which shall be subject to the Bank’s Prior Review. All other contracts shall be subject to Post Review by the Bank.