Project Agreement

(Second Ulaanbaatar Services Improvement Project)

between

INTERNATIONAL DEVELOPMENT ASSOCIATION

and

MUNICIPALITY OF ULAANBAATAR

Dated July 23, 2004
PROJECT AGREEMENT

AGREEMENT, dated July 23, 2004, between the INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association) and the Municipality of Ulaanbaatar (MUB).

WHEREAS (A) by the Development Credit Agreement of even date herewith between Mongolia (the Borrower) and the Association, the Association has agreed to make available to the Borrower an amount in various currencies equivalent to twelve million one hundred thousand Special Drawing Rights (SDR12,100,000), on the terms and conditions set forth in the Development Credit Agreement, but only on the condition that the MUB agrees to undertake such obligations toward the Association as are set forth in this Agreement;

(B) by a subsidiary loan agreement to be entered into between the Borrower and the MUB, the proceeds of the credit provided for under the Development Credit Agreement will be made available to the MUB on the terms and conditions set forth in the MUB Subsidiary Loan Agreement; and

WHEREAS the MUB, in consideration of the Association’s entering into the Development Credit Agreement with the Borrower, has agreed to undertake the obligations set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

Definitions

Section 1.01. Unless the context otherwise requires, the several terms defined in the Development Credit Agreement, the Preamble to this Agreement and in the General Conditions (as so defined) have the respective meanings therein set forth.
ARTICLE II

Execution of the Project

Section 2.01. (a) MUB declares its commitment to the objectives of the Project as set forth in Schedule 2 to the Development Credit Agreement, and, to this end, shall carry out, or cause to be carried out, the Project with due diligence and efficiency and in conformity with appropriate administrative, financial, economic, engineering, public utilities, and technical practices and environmental and social standards, acceptable to the Association, and shall provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Association and the MUB shall otherwise agree, the MUB shall carry out, or cause to be carried out, the Project in accordance with the Implementation Program set forth in Schedule 2 to this Agreement.

Section 2.02. Except as the Association shall otherwise agree, procurement of the goods, works and consultants’ services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 1 to this Agreement.

Section 2.03. (a) The MUB shall carry out the obligations set forth in Sections 9.03, 9.04, 9.05, 9.06, 9.07 and 9.08 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition, respectively) in respect of the Project Agreement.

(b) For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the MUB shall:

(i) prepare, on the basis of guidelines acceptable to the Association and furnish to the Association not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Association and the MUB, a plan designed to ensure the continued achievement of the Project’s objectives; and

(ii) afford the Association a reasonable opportunity to exchange views with the MUB on said plan.
Section 2.04. The MUB shall duly perform all its obligations under the MUB Subsidiary Loan Agreement. Except as the Association shall otherwise agree, the MUB shall not take or concur in any action which would have the effect of amending, abrogating, assigning, suspending, repealing, or waiving the MUB Subsidiary Loan Agreement or any provision thereof.

Section 2.05. (a) The MUB shall, at the request of the Association, exchange views with the Association with regard to the progress of the Project, the performance of its obligations under this Agreement, the MUB Subsidiary Loan Agreement, and the USAG Subsidiary Loan Agreement, and other matters relating to the purposes of the Credit.

(b) The MUB shall promptly inform the Association of any condition which interferes or threatens to interfere with the progress of the Project, the accomplishment of the purposes of the Credit, or the performance by the MUB of its obligations under this Agreement and under the MUB Subsidiary Loan Agreement.

ARTICLE III

Financial Covenants

Section 3.01. (a) The MUB shall establish and maintain a financial management system, including records and accounts, and prepare financial statements, all in accordance with consistently applied accounting standards acceptable to the Association, adequate to reflect the operations, and to register separately the operations, resources and expenditures related to the Project.

(b) The MUB shall:

(i) have the financial statements (balance sheets, statements of income and expenses and related statements) related to the Project for each fiscal year (or other period agreed to by the Association) audited, in accordance with consistently applied auditing standards acceptable to the Association, by independent auditors acceptable to the Association;

(ii) furnish to the Association as soon as available, but in any case not later than six (6) months after the end of each such year (or such other period agreed to by the Association), (A) certified copies of the financial statements referred to in paragraph (a) of
this Section, for such year (or such other period agreed to by the Association), as so audited, and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Association; and

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

Section 3.02. (a) Without limitation upon the MUB’s progress reporting obligations set out in paragraph 13 of Schedule 2 to this Agreement, the MUB shall, prepare and furnish to the Association a Financial Monitoring Report, in form and substance satisfactory to the Association, which:

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

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

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

(b) The first FMR shall be furnished to the Association not later than forty-five (45) days after the end of the first fiscal year 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 fiscal quarter; thereafter, each FMR shall be furnished to the Association not later than six (6) months after each subsequent half-year period, and shall cover such half-year period.
ARTICLE IV

Effective Date; Termination; Cancellation and Suspension

Section 4.01. This Agreement shall come into force and effect on the date upon which the Development Credit Agreement becomes effective.

Section 4.02. This Agreement and all obligations of the Association and of the MUB thereunder shall terminate on the date on which the Development Credit Agreement shall terminate in accordance with its terms, and the Association shall promptly notify the MUB thereof.

Section 4.03. All the provisions of this Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the General Conditions.

ARTICLE V

Miscellaneous Provisions

Section 5.01. Any notice or request required or permitted to be given or made under this Agreement and any agreement between the parties contemplated by this Agreement shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand or by mail, telex or facsimile to the party to which it is required or permitted to be given or made at such party’s address hereinafter specified or at such other address as such party shall have designated by notice to the party giving such notice or making such request. Deliveries made by facsimile transmission shall also be confirmed by mail. The addresses so specified are:
Section 5.02. Any action required or permitted to be taken, and any document required or permitted to be executed, under this Agreement on behalf of the MUB or by the MUB on behalf of the Borrower under the Development Credit Agreement, may be taken or executed by its Mayor or such other person or persons as said Mayor shall designate in writing, and the MUB shall furnish to the Association sufficient evidence of the authority and the authenticated specimen signature of each such person.

Section 5.03. This Agreement may be executed in several counterparts, each of which shall be an original, and all collectively but one instrument.
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 Ulaanbaatar, Mongolia, as of the day and year first above written.

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Dhevan Meyanathan

Authorized Representative

MUNICIPALITY OF ULAANBAATAR

By /s/ Miyegombo Enkhbold

Authorized Representative
SCHEDULE 1

Procurement

Section I. Procurement of Goods and Works

Part A: General

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

Part B: International Competitive Bidding

1. Except as otherwise provided in Part C of this Section, goods and works shall be procured under contracts awarded in accordance with the provisions of Section II of the Guidelines and paragraph 5 of Appendix 1 thereto.

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

   (b) Grouping of contracts

       To the extent practicable, contracts for pumps with associated equipment, steel, ductile iron and high density polyethylene pipes and specials, and water meters shall be grouped in bid packages estimated to cost $100,000 equivalent or more each.

   (c) Preference for domestically manufactured goods and domestic contractors

       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 and works to be carried out by domestic contractors.
Part C: Other Procurement Procedures

National Competitive Bidding

(a) Works estimated to cost less than $700,000 equivalent per contract, up to an aggregate amount not to exceed $3,500,000 equivalent, and goods estimated to cost less than $100,000 equivalent, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines.

(b) The procedures to be followed for the procurement of goods and works under national competitive bidding, advertised locally, under the provisions of sub-paragraph (a), Part C, of this Section I shall be as set forth in the Annex to this Schedule 1.

Part D: Review by the Association of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Association 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 Association, and with the provisions of said paragraph 1.

2. Prior Review

With respect to: (a) the first contract for goods, all contracts for goods estimated to cost $500,000 equivalent or more, and all contracts for works, all to be procured in accordance with the provisions of Part B.1 of this Section; and (b) the first contract for goods and the first two contracts for works to be procured in accordance with the provisions of Part C(a) of this Section; 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, January 1999 and May 2002 (the Consultant Guidelines), paragraph 1 of Appendix 1 thereto, Appendix 2 thereto and the following provisions of Section II of this Schedule.

Part B: Quality- and Cost-based Selection

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 Consultant Guidelines, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

Part C: Other Procedures for the Selection of Consultants

1. Selection Based on Consultants’ Qualifications

   Services for Project monitoring and independent audit activities 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 3.7 of the Consultant Guidelines.

2. Single Source Selection

   Services for detailed engineering designs and Project management under Part D of the Project may, with the Association’s prior agreement, be procured in accordance with the provisions of paragraphs 3.8 through 3.11 of the Consultant Guidelines.

3. Individual Consultants

   Services of individual consultants for monitoring compliance with the Environmental Management Plan and Resettlement Action Plan may be procured under contracts awarded in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultant Guidelines.
Part D: Review by the Association of the Selection of Consultants

1. Selection Planning

A plan for the selection of consultants, which shall include contract cost estimates, contract packaging, and applicable selection criteria and procedures, shall be furnished to the Association for its review and approval prior to the issuance to consultants of any requests for proposals. Such plan shall be updated every eighteen (18) months during the execution of the Project, and each such updating shall be furnished to the Association for its review and approval. Selection of all consultants’ services shall be undertaken in accordance with such selection plan, as updated from time to time, and as shall have been approved by the Association.

2. Prior Review

With respect to: (a) all contracts for the employment of consulting firms estimated to cost the equivalent of $100,000 or more; (b) the first two contracts for consulting firms to be procured in accordance with the provisions set forth in Part C.1 of this Section; (c) all contracts for individual consultants estimated to cost the equivalent of $50,000 or more; and (d) the first contract to be procured in accordance with the provisions set forth in paragraph C.2 of this Section; the procedures set forth in paragraphs 2, 3 and 5 of Appendix 1 to the Consultant 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 Consultant Guidelines shall apply.
ANNEX TO SCHEDULE 1

National Competitive Bidding

I. Advertising

(a) The Invitation for Bids shall be advertised in a newspaper of national circulation in Mongolia. In addition, the Invitation for Bids shall be posted at the relevant public venue or such other place or places as shall be appropriate.

(b) The Invitation for Bids may be in the Mongolian language and in such other language that may be deemed appropriate by the Borrower’s department or agency concerned, and shall include the information referred to in the model Invitation for Bids set forth in the *Standard Bidding Documents for Procurement of Works* published by the International Bank for Reconstruction and Development on May 2000, revised March 2002 and March 2003 and in the model Invitation for Bids set forth in the *Standard Bidding Documents for Procurement of Goods* published by the International Bank for Reconstruction and Development in January 1995, as revised in March 2000, January 2001, March 2002, and March 2003.

(c) In the case of procurement of works, the time period for bid submission after issue of the Invitation for Bids shall be sufficient to allow potential bidders a reasonable time to prepare and submit bids. It shall be no less than 30 calendar days, unless otherwise agreed with the Association.

II. Eligibility

(a) The eligibility of bidders shall be as defined under the Bank’s 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).

(b) Foreign bidders shall be allowed to bid if they wish to do so.

(c) The formation of joint ventures between foreign and local firms shall not be a condition of eligibility. Foreign bidders shall be allowed to bid alone. Nevertheless, foreign bidders may be required to appoint a local agent or intermediary in Mongolia as a condition of award of contract.
(d) The Borrower shall not require bidders or potential bidders to be registered with an authority of the Borrower as a condition of bidding.

III. Bidding

(a) In addition to the Invitation for Bids, the bidding documents shall include the following:

(i) Instructions to Bidders including the bid evaluation criteria.

(ii) Conditions of Contract.

(iii) Technical Specifications.

(iv) Bid Form and Price Schedules.

(v) Performance Security (optional for contracts estimated to cost less than $50,000 equivalent per contract).

(vi) Bills of Quantities or breakdown of lump sum pricing as the case may be.

(b) Bids may be expressed in Togrog or in foreign currency as set forth in the Invitation for Bids. If the currency of payment set forth in the Invitation for Bids Togrog, the Invitation for Bids may indicate that there is no obligation on the part of the Borrower’s department or agency soliciting the bids to convert the amounts to be paid into foreign currency.

(c) Bidding documents may be in the Mongolian language or in such other language that may be deemed appropriate by the Borrower’s department or agency soliciting the bids.

(d) Bids may be delivered by mail or by hand at the place set forth for such purpose in the Invitation for Bids.

(e) Bids shall be opened publicly immediately following the bid closing time specified in the Invitation for Bids, allowing representatives of the bidders to attend if they so desire. Bids shall not be modified after bid opening except to correct arithmetical errors. All bids shall be opened at the same time and
Minutes of Bid Opening shall be prepared by the Borrower’s representative supervising the opening and signed by all bidders who chose to attend.

IV. Evaluation of Bids

(a) Award of goods and works contracts shall be made to the lowest evaluated responsive bid and any bid award based on a point system, or any other criteria other than the lowest evaluated responsive bid, shall be deemed invalid.

(b) Price negotiations with bidders shall not be undertaken before award of contract except as provided in paragraphs 2.59 to 2.62 of the Guidelines.

(c) No preference whatsoever shall be given to a domestic bidder over foreign bidders or to a State Owned Enterprise (SOE) over a non-SOE. Bids shall be compared on delivered price inclusive of any prevailing duties.

(d) An SOE in the Borrower’s country may be awarded a contract only if it can establish that it: (i) is legally and financially autonomous, and (ii) operates under commercial law. No dependent agency of the Borrower or Sub-borrower shall be awarded a contract for goods, works or services under the Project.

(e) Bids shall not be automatically rejected for lack of effective competition solely on the basis of the number of bidders or because all bid prices substantially exceed the budget allocated. The provisions of Article 23 of the Public Procurement Law of Mongolia published on April 14, 2000, shall apply only as modified by the provisions on rejections of bids set forth in paragraphs 2.59 to 2.62 of the Guidelines.

(f) Award of a contract shall be made within the period specified in the bidding documents, which shall be determined in each case based on the complexity of the contract and the approval.

(g) A bid evaluation report shall be prepared by the Borrower’s department or agency soliciting the bids, setting out a record of all bids submitted, the reasons for disqualification of any bids, the evaluation criteria, weighting and evaluation of all responsive bids, the recommendation of award and, if award is recommended to other than the lowest responsive bidder, the reasons therefor. The Borrower’s department or agency soliciting the bids shall furnish to the Association an English translation of such bid evaluation report pursuant to paragraphs 2 and 3 of Appendix 1 of the Guidelines.
V. Right to Inspect/Audit

A provision shall be included in all National Competitive Bidding Contracts for works and goods financed by the Association requiring suppliers and contractors to permit the Association to inspect their accounts and records relating to the performance of the contract, and to have them audited by auditors appointed by the Association.
SCHEDULE 2

Implementation Program

For purposes of Section 2.01 (b) of this Agreement, the Implementation Program shall consist of the provisions set forth below.

Project Management

1. The MUB shall maintain throughout the implementation of the Project, the Project Steering Committee, established on November 20, 2002, chaired by the MUB General Manager, to provide oversight and guidance to the MUB for Project implementation, and consisting of senior official and representatives of the MUB, with functions, responsibilities and resources satisfactory to the Association.

2. The MUB shall maintain throughout the implementation of the Project, the PMU, under the direction of a qualified and experienced Director, and provided with qualified staff in adequate numbers and with functions and responsibilities acceptable to the Association, including responsibility for the overall coordination and supervision of Project execution, procurement, resettlement and environmental management activities, and provided with adequate funds and resources as shall be necessary to enable the PMU to coordinate and supervise the carrying out of the Project, satisfactory to the Association.

3. The MUB shall establish and thereafter maintain throughout Project implementation, a Project financial management system in the PMU, in a manner and substance acceptable to the Association.

Ger Area Water Supply

4. In carrying out Part A of the Project, the MUB shall cause USAG to prepare and furnish to the Association for its review and comments by June 30, 2005, or such later date as the Association may otherwise agree, a time bound action plan to extend the city-piped water system to the ger areas of Bayankhoshuu, Chingeltei, Dambadarjaa, Dari-Ekh, Naran, and Uliastai, under terms of reference satisfactory to the Association, thereafter taking into account the Association’s views and comments thereon, implement said action plan, in a manner and substance satisfactory to the Association.
City Water Supply

5. In carrying out Part B of the Project, the MUB shall cause the USAG to prepare and furnish to the Association for its review and comments by June 30, 2005, or such later date as the Association may otherwise agree, a time bound action plan to rehabilitate and upgrade the city water supply network, under terms of reference satisfactory to the Association, thereafter taking into account the Association’s views and comments thereon, implement said action plan, in a manner and substance satisfactory to the Association.

Energy Efficiency Improvement

6. In carrying out Part C of the Project, the MUB shall cause the USAG to prepare and furnish to the Association for its review and comments by December 31, 2005, or such later date as the Association may otherwise agree, a time bound action plan to reduce energy consumption through the replacement of selected, high energy-consuming electrical equipment with energy-efficient equipment, under terms of reference satisfactory to the Association, thereafter taking into account the Association’s views and comments thereon, implement said action plan, in a manner and substance satisfactory to the Association.

Project Management and Detailed Engineering Designs

7. The MUB shall execute an agreement with a consultancy firm for the provision of technical advisory assistance to the PMU for Project management and detailed engineering designs under Part D of the Project, with said consultancy firm possessing qualifications and experience under terms of reference acceptable to the Association, to be selected in accordance with Part C.2, Section II of Schedule 1 to this Agreement, and provided with adequate resources, all in a manner and substance acceptable to the Association.

USAG Subsidiary Loan Agreement

8. (a) The MUB shall relend the proceeds of the Credit allocated from time to time to Categories 1, 2, 3, and 4 of the table in paragraph 1 of Schedule 1 to the Development Credit Agreement, to USAG under a subsidiary loan agreement to be entered into between MUB and USAG (the USAG Subsidiary Loan Agreement) under terms and conditions which shall have been approved by the Association, and which shall include, without limitation, those set forth in Schedule 3 to this Agreement.
(b) Pursuant to the provisions of the USAG Subsidiary Loan Agreement and immediately upon the commissioning of the assets provided and installed through the carrying out of Parts A, B, and C of the Project, satisfactory to the Association, the MUB shall undertake all necessary actions to facilitate and complete the lawful transfer to USAG the legal title of, and the physical and operational control over, the assets acquired by the MUB under such Parts of the Project out of the proceeds of the Credit, with said transfer to include the transfer to USAG from the MUB of any and all associated outstanding liabilities resulting from said acquisition.

9. (a) The MUB shall cause USAG to:

(i) perform, in accordance with the provisions of the USAG Subsidiary Loan Agreement, all of the obligations of USAG therein set forth;

(ii) take or cause to be taken all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable USAG to perform such obligations; and

(iii) not take or permit to be taken any action which would prevent or interfere with such performance; and

(b) The MUB shall exercise its rights under the USAG Subsidiary Loan Agreement in such manner as to protect the interests of the Borrower, the Association and the MUB and to accomplish the purposes of the Credit, and except as the Association shall otherwise agree, not assign, amend, abrogate, suspend, repeal, or waive the USAG Subsidiary Loan Agreement or any provision thereof.

Environment and Resettlement

10. The MUB shall:

(a) take, or cause to be taken, all necessary actions to minimize to the extent possible, any involuntary loss by persons of shelter, productive assets or access to productive assets or of income or means of livelihood, temporarily or permanently;

(b) carry out, or cause to be carried out, the Environmental Management Plan and Resettlement Action Plan in a manner satisfactory to the Association; and
(c) furnish any proposed revision to the Environmental Management Plan or Resettlement Action Plan referred to in sub-paragraph (b) above to the Association for its prior approval.

11. In carrying out the Project, and without limitation to the provisions of paragraph 10 of this Schedule, the MUB shall, prior to commencing work on any Project activity in areas not covered by the Resettlement Action Plan and which requires the acquisition of land, temporarily or permanently, prepare a resettlement action plan consistent with objectives and principles set forth in the Resettlement Action Plan, satisfactory to the Association, and furnish the same to the Association for its approval, and thereafter, carry, or cause to be carried out, such resettlement action plan in a manner satisfactory to the Association. Any proposed revision to the resettlement action plan referred to in this paragraph 11 shall be submitted to the Association for its prior approval.

12. In carrying out the Project, and without limitation to the provisions of paragraph 10 of this Schedule, the MUB shall, prior to commencing works on any Project activity in areas not covered in the Environmental Management Plan, prepare an environmental impact assessment and management plan, consistent with the objectives and principles set forth in the Environmental Management Plan, in a manner and substance satisfactory to the Association, and furnish the same to the Association, for its approval, and, thereafter, carry, or cause to be carried out such environmental management plan in a manner satisfactory to the Association. Any proposed revision to the environmental management plan referred to in this paragraph 12 shall be submitted to the Association for its prior approval.

**Monitoring and Reporting**

13. The MUB shall: (a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the indicators set forth in Schedule 4 to this Agreement, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Association, and furnish to the Association, on or about April 30 and October 31 of each year, commencing April 30, 2005, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and
(c) review with the Association, by June 30 and December 31 of each year, commencing June 30, 2005, or such date as the Association shall request, the report referred to in paragraph (b) of this Section, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Association’s views on the matter.

MUB Subsidiary Loan Agreement

14. The MUB shall establish by July 1, 2009, and thereafter maintain, a special and separate account in a commercial bank on terms and conditions satisfactory to the Association, including appropriate protection against set-off, seizure or attachment:

   (a) to be funded with the difference in amounts between; the principal paid by USAG to the MUB pursuant to the USAG Subsidiary Loan Agreement; and the principal paid by MUB to the Borrower pursuant to the MUB Subsidiary Loan Agreement; and

   (b) use the proceeds therein deposited exclusively for the financing of investments to improve services to the urban poor in the ger areas.
SCHEDULE 3

Principal Terms and Conditions of the USAG Subsidiary Loan Agreement

The principal terms and conditions set forth or referred to in this Schedule 3 shall apply for purposes of paragraph 8 of Schedule 2 to this Agreement.

A. Terms

1. The principal amount of the subsidiary loan repayable by USAG shall be the equivalent in Togrog (determined as of the date, or respective dates, of withdrawal) of amounts allocated to and withdrawn from Categories (1) through (4) set forth in paragraph 1 of Schedule 1 to the Development Credit Agreement.

2. Such principal amount shall be repaid by USAG in Togrog to the MUB in semi-annual installments over twenty years, including a grace period of five years.

3. Interest shall be charged on the outstanding balance of the said subsidiary loan at a rate equal to five percent (5%) per annum.

B. Conditions

The USAG Subsidiary Loan Agreement shall include the following principal conditions:

1. USAG shall undertake to enable the Association and the MUB to inspect the goods, sites and works financed out of the proceeds of the Credit, the operations thereof, and any relevant records and documents.

2. USAG shall undertake to take out and maintain with responsible insurers such insurance, against such risks and in such amounts, as shall be consistent with sound business practice, including, without limitation, such insurance to cover hazards incident to the operation and maintenance of goods financed out of the proceeds of the Credit, any indemnity thereunder to be made payable in a currency freely usable by USAG to operate, maintain, replace or repair such goods.
3. USAG shall undertake to maintain, its USAG Project Implementation Unit, which unit is responsible for the provision of support to the Project construction activities carried out by the MUB under the Project, under the direction of a qualified and experienced Manager, and provided with qualified staff in adequate numbers and with functions and responsibilities acceptable to the Association, and provided with adequate funds and resources as shall be necessary to enable said USAG Project Implementation Unit to provide such support to said Project construction activities, satisfactory to the Association.

4. USAG shall undertake to:

   (a) maintain records and accounts adequate to reflect in accordance with consistently maintained sound accounting practices its operations and financial condition;

   (b) have its financial statements (balance sheets, statements of income and expenses and related statements) for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association;

   (c) furnish to the MUB and to the Association, as soon as available, but in any case not later than six (6) months after the end of each such year:

      (i) certified copies of said financial statements and accounts for such year as so audited; and

      (ii) the report of such audit by said auditors in such scope and detail as the MUB and the Association shall have reasonably requested; and

   (d) prepare and furnish to the Association and the MUB all such other information concerning said records, accounts and financial statements, as well as the audit thereof, as the Association and/or the MUB shall reasonably request.

5. Immediately upon the first withdrawal of the proceeds in respect of payments made: (a) for expenditures under Categories (1) and (2) (a) of paragraph 1 of Schedule 1 to the Development Credit Agreement; and (b) in accordance with the provisions of paragraph 3(b) of said Schedule 1, USAG shall undertake to maintain thereafter its total annual operating revenues in an amount equivalent to the sum of its operating expenses and debt-servicing costs. The term “total operating revenues” mean revenues from all sources related to the operations of USAG, and the term “debt-servicing costs” means the
aggregate amount of repayments of, and interest and other charges on, the debts of USAG.

6. Immediately upon the first withdrawal of the proceeds in respect of payments made: (a) for expenditures under Category (2)(b) of paragraph 1 of Schedule 1 to the Development Credit Agreement; and (b) in accordance with the provisions of paragraph 3(c) of said Schedule 1, USAG shall undertake to maintain thereafter the tariff rates that are increased in Fiscal Year 2006 from the tariff rates in effect for its Fiscal Year 2005 by fifteen per cent (15%), except that the tariff rates for the kiosk water supply shall be exempt from such increase.

7. USAG shall, by December 31, 2008, undertake to generate sufficient operating revenues equivalent to the sum of its total operating expenses, depreciation charges, and interest costs. For purposes of this paragraph 7, the term “total operating expenses” means all expenses related to operations, including administration, maintenance, taxes and payments in lieu of taxes, and provision for depreciation on a straight-line basis at an annual rate to be agreed with the Association from time to time, or other basis acceptable to the Association.

8. USAG shall undertake to establish a Capital Expenditure Fund by January 1, 2009, in form and substance acceptable to the Association.

9. Immediately upon the commissioning of the assets provided and installed through the carrying out of Parts A, B, and C of the Project, satisfactory to the Association, the MUB shall undertake all necessary actions to facilitate and complete the lawful transfer to USAG the legal title of, and the physical and operational control over, the assets acquired by the MUB under such Parts of the Project out of the proceeds of the Credit, with said transfer to include the transfer to USAG from the MUB of any and all associated outstanding liabilities resulting from said acquisition.

10. (a) MUB shall have the right to suspend or terminate the right of USAG to the use of the proceeds of the subsidiary loan extended to it by the MUB under this Agreement upon failure by USAG to perform its obligations under the USAG Subsidiary Loan Agreement.

(b) MUB shall have the right to declare the principal of the subsidiary loan extended to it by the MUB under this Agreement then outstanding to be due and payable immediately together with the interest charges thereon and upon any such declaration such principal, together with such charges, shall become due and payable immediately, upon failure by USAG to perform its obligations under the USAG Subsidiary Loan Agreement.
## SCHEDULE 4

### Performance Indicators

<table>
<thead>
<tr>
<th>Outcome Indicators</th>
<th>Baseline 2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Frequency and Reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Number of persons per kiosk</td>
<td>1,492</td>
<td>1,524</td>
<td>1,496</td>
<td>1,419</td>
<td>1,271</td>
<td>1,139</td>
<td>1,124</td>
<td>Semi-annual PPR</td>
</tr>
<tr>
<td>• Percentage of kiosks on network</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>14%</td>
<td>51%</td>
<td>88%</td>
<td>88%</td>
<td>As above</td>
</tr>
<tr>
<td>• USAG net profit/loss (Tg billion)</td>
<td>(4.8)</td>
<td>(2.5)</td>
<td>(3.7)</td>
<td>(3.0)</td>
<td>0.7</td>
<td>2.0</td>
<td>1.1</td>
<td>As above</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Frequency and Reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Semi-annual PPR</td>
</tr>
<tr>
<td>As above</td>
</tr>
</tbody>
</table>

### Result Indicators for Each Component

#### Component One: (Part A)

Construction/repair of kiosks (cumulative Nos.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>0</td>
</tr>
<tr>
<td>2005</td>
<td>0</td>
</tr>
<tr>
<td>2006</td>
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<td>2007</td>
<td>40</td>
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<tr>
<td>2008</td>
<td>80</td>
</tr>
<tr>
<td>2009</td>
<td>140</td>
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<tr>
<td>2010</td>
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#### Component Two: (Part B)

Replacement of large-diameter pipeline (in cumulative km)

<table>
<thead>
<tr>
<th>Year</th>
<th>Length (km)</th>
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<tbody>
<tr>
<td>2004</td>
<td>0</td>
</tr>
<tr>
<td>2005</td>
<td>0</td>
</tr>
<tr>
<td>2006</td>
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<td>2007</td>
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<tr>
<td>2008</td>
<td>9</td>
</tr>
<tr>
<td>2009</td>
<td>12</td>
</tr>
<tr>
<td>2010</td>
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</table>

#### Component Three: (Part C)

Replacement of obsolete high energy-consumption electrical pumps and motors (in cumulative units)

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<tr>
<th>Year</th>
<th>Number</th>
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</thead>
<tbody>
<tr>
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<td>0</td>
</tr>
<tr>
<td>2005</td>
<td>0</td>
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#### Component Four: (Part D)

Project management (Cumulative awarded contracts)

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<tr>
<td>2006</td>
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<td>2007</td>
<td>30</td>
</tr>
<tr>
<td>2008</td>
<td>36</td>
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<tr>
<td>2009</td>
<td>40</td>
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USAG institutional development (Recommendations, Approvals, and implementation/operation)

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>2004</td>
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</tr>
<tr>
<td>2005</td>
<td>0</td>
</tr>
<tr>
<td>2006</td>
<td>8R</td>
</tr>
<tr>
<td>2007</td>
<td>8A</td>
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<tr>
<td>2008</td>
<td>8I/O</td>
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<tr>
<td>2009</td>
<td>8I/O</td>
</tr>
<tr>
<td>2010</td>
<td>8I/O</td>
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</table>

### Notes:

USAG = Ulaanbaatar Water and Sewerage Company
MIS = USAG management information system
PMU = Project Management Unit
PPR = Project Progress Reports
R = Recommendations from consultants in the eight principal areas of: metering policy; house connection policy; sanitation policy; private sector involvement in kiosks and water trucks; maintenance system improvements; communication (customer relations) strategy; internal audit procedures; and training plan.
A= Approval by USAG management
I/O = Implementation/Operation