Loan Agreement

(Second Rural and Small Towns Water Supply and Sanitation Project)

between

REPUBLIC OF ECUADOR

and

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

Dated December 1, 2006
LOAN AGREEMENT

Agreement dated December 1, 2006, between the REPUBLIC OF ECUADOR ("Borrower") and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT ("Bank"). The Borrower and the Bank hereby agree as follows:

ARTICLE I—GENERAL CONDITIONS; DEFINITIONS

1.01. The General Conditions (as defined in the Appendix to this Agreement) constitute an integral part of this Agreement.

1.02. Unless the context requires otherwise, the capitalized terms used in the Loan Agreement have the meanings ascribed to them in the General Conditions or in the Appendix to this Agreement.

ARTICLE II—LOAN

2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, the amount of forty-eight million Dollars ($48,000,000), 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 ("Loan"), to assist in financing the project described in Schedule 1 to this Agreement ("Project").

2.02. The Borrower may withdraw the proceeds of the Loan in accordance with Section IV of Schedule 2 to this Agreement.

2.03. The Commitment Charge payable by the Borrower shall be equal to three-fourths of one per cent (3/4 of 1%) per annum on the Unwithdrawn Loan Balance, subject to any waiver of a portion of such charge as may be determined by the Bank from time to time.

2.04. The Front-end Fee payable by the Borrower shall be equal to one percent (1.0%) of the Loan amount, subject to any waiver of a portion of such fee as may be determined by the Bank from time to time. The Borrower shall pay the Front-end Fee not later than 60 days after the Effective Date.

2.05. The interest payable by the Borrower for each Interest Period shall be at a rate equal to LIBOR for the Loan Currency plus the Fixed Spread, subject to any waiver of a portion of such interest as may be determined by the Bank from time to time; provided, that upon a Conversion of all or any portion of the principal amount of the Loan, the interest payable by the Borrower during the Conversion Period on such amount shall be determined in accordance with the relevant provisions of Article IV of the General Conditions.

2.06. The Payment Dates are March 15 and September 15 in each year.
2.07. The principal amount of the Loan shall be repaid in accordance with the amortization schedule set forth in Schedule 3 to this Agreement.

2.08. (a) The Borrower may at any time 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 the 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 General Conditions, and shall be effected in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.

ARTICLE III—PROJECT

3.01. The Borrower declares its commitment to the objective of the Project and the Program. To this end, the Borrower shall: (a) carry out the Project through MIDUVI; and (b) cause Eligible Municipalities to cooperate in the carrying out of Parts 2 (a), 2 (b), 3 (a), 3 (b) and 3 (c) of the Project, all in accordance with the provisions of Article V of the General Conditions.

3.02. Without limitation upon the provisions of Section 3.01 of this Agreement, and except as the Borrower and the Bank shall otherwise agree, the Borrower shall ensure that the Project is carried out in accordance with the provisions of Schedule 2 to this Agreement.

ARTICLE IV—REMEDIES OF THE BANK

4.01. (a) The Additional Events of Suspension consist of the following:

   (i) The Municipality Law has been amended, suspended, abrogated, repealed or waived so as to affect, in the opinion of the Bank, materially and adversely the ability of the Municipalities to perform any of their obligations under any of the Grant Agreements or Technical Assistance Agreements.

   (ii) Any Eligible Municipality shall have failed to perform any of its obligations under any of the Grant Agreements and/or Technical Assistance Agreements.

(b) Notwithstanding the rights contained in Section 7.02 of the General Conditions, it is understood that if any of the events specified in paragraph (a) (ii) of this Section shall have occurred, the Bank may, by notice to the Borrower, choose to suspend in whole or in part the
right of the Borrower to make withdrawals from the Loan Account for expenditures solely in respect of the concerned Municipality.

4.02. The Additional Events of Acceleration consist of the following:

(a) The event specified in paragraph (a) (ii) of Section 4.01 of this Agreement occurs and is continuing for a period of 60 days after notice of the event has been given by the Bank to the Borrower.

(b) The event specified in paragraph (a) (i) of Section 4.01 of this Agreement occurs.

ARTICLE V—EFFECTIVENESS

5.01. The Additional Conditions of Effectiveness consist of the following:

(a) that the PMU has been staffed for the Project with: (i) a general coordinator; (ii) technical, social and planning directors; (iii) area coordinators for: (A) procurement; (B) financial management; (C) hand washing; (D) strategic communications; (E) promotion and capacity building; (F) rural water and sanitation sector investments; (G) water and sanitation sector delegation; (H) solid waste management; and (I) information systems; (iv) an accountant; and (v) a treasurer; all acceptable to the Bank.

(b) that revised bidding documents and standard formats for bid evaluation, acceptable to the Bank, for the procurement of goods, works and services financed with the proceeds of the Loan, have been submitted to the Bank.

5.02. Without prejudice to the provisions of the General Conditions, the Effectiveness Deadline 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 January 25, 2008.

ARTICLE VI — REPRESENTATIVE; ADDRESSES

6.01. The Borrower’s Representative is its Minister of Economy and Finance.

6.02. The Borrower’s Address is:
Ministry of Economy and Finance
Avenida 10 de Agosto y Jorge Washington
Quito, Ecuador
Facsimile: (5932) 2503-111
2558-232

6.03. The Bank’s Address is:
International Bank for Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address: Telex: Facsimile:
INTBAFRAD 248423(MCI) or 1-202-477-6391
Washington, D.C. 64145(MCI)
AGREED at the District of Columbia, United States of America, as of the day and year first above written.

REPUBLIC OF ECUADOR

By /s/ Héctor Vélez Andrade

Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Marcelo Giugale

Authorized Representative
SCHEDULE 1

Project Description

The objective of the Project is to increase the coverage and effective use of sustainable water, sanitation and solid waste services with a focus on the poorer populations in rural communities and small towns.

The Project constitutes the second phase of the Program, and consists of the following parts:

1. **Water and Sanitation Sector Reform and Institutional Strengthening**
   
   (a) Support, through the provision of technical assistance and studies, to strengthen the Borrower’s institutional capacity to: (i) effectively apply the ICE assignment formula for water supply and sanitation sector investments; and (ii) develop coherent policies for the use of public funds in the water supply and sanitation sector.

   (b) Support to the Borrower’s water sector reform and the strengthening of SAPSyRS, through: (i) the provision of training and technical assistance to SAPSyRS working groups; (ii) the provision of technical assistance for sectoral planning and policy development; (iii) the provision of expert consultant support for the development of regulations for the water supply and sanitation sector; (iv) the upgrading of the physical working environment of the SAPSyRS; and (v) the carrying out of workshops, study tours and other training activities for key sector actors in line with the water supply and sanitation sector development objectives.

   (c) Support to strengthen the Borrower’s environmental management framework for the water supply, sanitation and solid waste sector through: (i) the creation, accreditation and strengthening of an environmental management unit within SAPSyRS; (ii) the provision of technical assistance to develop reforms to environmental norms, appropriate discharge standards for sewerage, and environmental guidelines for water supply, sanitation and solid waste investments; and (iii) the strengthening of the environmental management capacity of Municipalities.

2. **Rural Water and Sanitation**

   (a) Provision of technical assistance to Eligible Municipalities for the carrying out of Promotion and Pre-investment Subprojects consisting of activities including engineering designs, community development (including training and hygiene education) and the supervision of works to enable Eligible Municipalities and Rural Communities to prepare Rural Water and Sanitation Subprojects.

   (b) Provision of financing, in the form of grants, to Eligible Municipalities for the carrying out of Rural Water and Sanitation Subprojects consisting of the construction and/or rehabilitation of water supply systems, on-site sanitation systems and rural sewerage systems where soil conditions and population density make on-site systems unviable.

   (c) Provision of technical assistance, equipment, supplies, training, and operational management services to associations of Water User Boards to enable them to provide technical
assistance and support services to existing Water User Boards (including, but not limited to, the Water User Boards created under the first phase of the Program) to improve operation of their systems.

(d) Support to the Borrower’s implementation of a national hand washing initiative through: (i) the establishment of a steering committee consisting of key public and private sector partners; (ii) the execution of a hand washing behavioral study and baseline; and (iii) the design, implementation and evaluation of a hand washing communication program consisting of: (A) mass media communication activities; (B) direct hand washing marketing at district and community level; and (C) integration of hand washing promotion into existing training and capacity-building activities at the community level.

3. Promotion of New Management Models for Water, Sanitation and Solid Waste

(a) Provision of technical assistance to Eligible Municipalities for the carrying out of Institutional Reform Technical Assistance Subprojects consisting of: (i) the identification of an appropriate model for the delegation to autonomous operators of the water and sanitation services provided by an Eligible Municipality and the preparation of the legal, financial, technical and social documents required to implement such delegation; and/or (ii) the improvement of solid waste management in Eligible Municipalities.

(b) Provision of financing, in the form of grants, to Eligible Municipalities that have successfully delegated their water and/or sanitation services to autonomous operators under Part 3 (a) of the Project, for the carrying out of Institutional Reform Water and Sanitation Investment Subprojects, consisting of expansion and/or rehabilitation of water supply and sanitation systems.

(c) Provision of financing, in the form of grants, to Eligible Municipalities for the carrying out of Institutional Reform Solid Waste Investment Subprojects, consisting of solid waste investments including equipment (e.g., office equipment, collection vehicles, landfill management equipment, etc.) and civil works (e.g., landfills, composting facilities, transfer stations, etc.).

4. Project Administration

(a) Operation of the PMU including provision of, inter alia: (i) cost of salary, travel and general operating costs of the PMU; (ii) incremental operating costs for the SAPSyRS’s central office and provincial technical teams; and (iii) equipment and software.

(b) Development and implementation of a strategic communication program for the Project.

(c) Updating of the Project’s monitoring and evaluation systems.

(d) Preparation of the Project’s audits required under Section II.B.3 of Schedule 2 to this Agreement.

(e) Other Project management activities acceptable to the Bank.
SCHEDULE 2

Project Execution

Section I. Subsidiary Financing; Institutional and Other Arrangements

A. Subsidiary Financing: Grant Agreements

1. The Borrower, through MIDUVI:

   (a) before commencing the implementation of any Promotion and Pre-investment Subproject, shall: (i) evaluate, according to the indicators and methodology set out in the Operational Manual, the management and debt payment capacity of Municipalities interested in participating in Part 2 of the Project; and (ii) enter into an agreement (a Promotion and Pre-investment Technical Assistance Agreement) with the respective Eligible Municipality, under terms and conditions substantially similar to those of the respective model forms contained in the Operational Manual, to provide for:

   (A) the provision to such Eligible Municipality, by the Borrower, of the technical assistance required to carry out the respective Promotion and Pre-investment Subproject;

   (B) the obligation of such Eligible Municipality to: (1) co-finance at least 20 percent in cash and to cause Rural Communities to co-finance at least 30 percent in cash or in kind (provided that at least 10% shall be in cash) of the Rural Water and Sanitation Subprojects that will be prepared under the Promotion and Pre-investment Subproject; (2) adopt rural tariffs that cover the cost of operation and maintenance and equipment replacement of investments under Rural Water and Sanitation Subprojects; and (3) follow a demand-driven approach for Rural Water and Sanitation Subprojects;

   (C) the obligation of each Eligible Municipality to: (1) carry out its respective Promotion and Pre-investment Subproject with due diligence and efficiency and in conformity with appropriate administrative, engineering, social, financial and environmental practices and in accordance with the provisions of this Agreement and the Operational Manual; and (2) maintain adequate reporting in accordance with the standards specified in the Operational Manual;

   (D) the right of the Borrower to inspect, by itself or jointly with the Bank, if the Bank shall so request, the goods, works and services financed by the Loan under the respective Promotion and Pre-investment Subproject, the operations thereof, and any relevant records and documents;

   (E) the right of the Borrower to obtain all information as the Borrower or the Bank shall reasonably request regarding the administration, operations and financial conditions of the activities and results financed by the Loan; and
(F) the right of the Borrower to suspend and terminate the right of an Eligible Municipality to receive technical assistance services under the Loan;

(b) before commencing the implementation of any Rural Water and Sanitation Subproject, shall enter into an agreement (a Rural Water and Sanitation Grant Agreement) with the respective Eligible Municipality, under terms and conditions substantially similar to those of the respective model forms contained in the Operational Manual, to provide for:

(i) the provision to such Eligible Municipality, by the Borrower, of the funds, facilities, services and other resources required to carry out the respective Rural Water and Sanitation Subproject, including the transfer of the proceeds of the Loan required for such Rural Water and Sanitation Subproject on a grant basis;

(ii) the obligation of such Eligible Municipality to: (A) co-finance at least 20 percent in cash and to cause Rural Communities to co-finance at least 30 percent in cash or in kind (provided that at least 10% shall be in cash) of the respective Rural Water and Sanitation Subprojects; (B) adopt rural tariffs that cover the cost of operation and maintenance and equipment replacement of investments under Rural Water and Sanitation Subprojects; and (C) follow a demand-driven approach for Rural Water and Sanitation Subprojects;

(iii) the obligation of each Eligible Municipality to: (A) carry out its respective Rural Water and Sanitation Subproject with due diligence and efficiency and in conformity with appropriate administrative, engineering, social, financial and environmental practices and in accordance with the provisions of this Agreement and the Operational Manual; (B) maintain adequate records to reflect, in accordance with sound accounting practices defined in the Operational Manual, the operations, the resources and expenditures in respect of its respective Water and Sanitation Subproject; and (C) maintain adequate reporting in accordance with the standards specified in the Operational Manual;

(iv) the requirement that the goods, works and services needed for their respective Rural Water and Sanitation Subproject and to be financed from the proceeds of the Loan shall be procured in accordance with the procedures set forth in Section III of this Schedule and the Operational Manual;

(v) the right of the Borrower to inspect, by itself or jointly with the Bank, if the Bank shall so request, the goods, works and services financed by the Loan under the respective Rural Water and Sanitation Subproject, the operations thereof, and any relevant records and documents;

(vi) the right of the Borrower to obtain all information as the Borrower or the Bank shall reasonably request regarding the administration, operations and financial conditions of the activities and results financed by the Loan; and
(vii) (A) the right of the Borrower to suspend and terminate the right of an Eligible Municipality to use the proceeds of the Loan; and (B) the obligation of each Eligible Municipality to refund any portion of the Loan proceeds to the Borrower, whenever the Borrower or the Bank determines that such portion was used for items improperly procured in violation of Section III to this Schedule, or was not used for Eligible Expenditures;

(c) before commencing the implementation of any Institutional Reform Technical Assistance Subproject, shall enter into an agreement (an Institutional Reform Technical Assistance Agreement) with the respective Eligible Municipality, under terms and conditions substantially similar to those of the respective model forms contained in the Operational Manual, to provide for:

(i) the provision to such Eligible Municipality, by the Borrower, of the technical assistance required to carry out the respective Institutional Reform Technical Assistance Subproject;

(ii) the obligation of such Eligible Municipality to sign a withdrawal authorization (fideicomiso) that will allow the Borrower to withhold the cost of the technical assistance from budget transfer payments to such Eligible Municipality should the Eligible Municipality not delegate as referred to in paragraph (d) (ii) (A) below, or fail to maintain such delegation;

(iii) the obligation of each Eligible Municipality to: (A) carry out its respective Institutional Reform Technical Assistance Subproject with due diligence and efficiency and in conformity with appropriate administrative, engineering, social, financial and environmental practices and in accordance with the provisions of this Agreement and the Operational Manual; and (B) maintain adequate reporting in accordance with the standards specified in the Operational Manual;

(iv) the right of the Borrower to inspect, by itself or jointly with the Bank, if the Bank shall so request, the goods, works and services financed by the Loan under the respective Institutional Reform Technical Assistance Subproject, the operations thereof, and any relevant records and documents;

(v) the right of the Borrower to obtain all information as the Borrower or the Bank shall reasonably request regarding the administration, operations and financial conditions of the activities and results financed by the Loan; and

(vi) the right of the Borrower to suspend and terminate the right of an Eligible Municipality to receive technical assistance services under the Loan;

(d) before commencing the implementation of any Institutional Reform Water and Sanitation Investment Subproject, shall enter into an agreement (an Institutional Reform Water and Sanitation Investment Grant Agreement) with the respective Eligible Municipality and the operator selected under the respective Institutional
Reform Technical Assistance Agreement, under terms and conditions substantially similar to those of the respective model forms contained in the Operational Manual, to provide for:

(i) the provision to such Eligible Municipality, by the Borrower, of the funds, facilities, services and other resources required to carry out the respective Institutional Reform Water and Sanitation Investment Subproject, including the transfer of the proceeds of the Loan required for such Institutional Reform Water and Sanitation Investment Subproject on a grant basis;

(ii) the obligation of such Eligible Municipality to: (A) maintain the delegation of their water and/or sanitation services to autonomous operators under the respective Institutional Reform Water and Sanitation Investment Subproject; (B) sign a withdrawal authorization (fideicomiso) that will allow the Borrower to withhold the cost of the investments from budget transfer payments to such Eligible Municipality should the Eligible Municipality reverse such delegation within a period of two years or less from the date of the respective Institutional Reform Water and Sanitation Investment Grant Agreement; and (C) cause the water and sanitation operators to provide counterpart financing in the percentage set forth in the Operational Manual, for investments to be carried out under the respective Institutional Reform Water and Sanitation Investment Subproject;

(iii) the obligation of each Eligible Municipality to: (A) carry out its respective Institutional Reform Water and Sanitation Subproject with due diligence and efficiency and in conformity with appropriate administrative, engineering, social, financial and environmental practices and in accordance with the provisions of this Agreement and the Operational Manual; (B) maintain adequate records to reflect, in accordance with sound accounting practices defined in the Operational Manual, the operations, the resources and expenditures in respect of its respective Institutional Reform Water and Sanitation Subproject; and (C) maintain adequate reporting in accordance with the standards specified in the Operational Manual;

(iv) the requirement that the goods, works and services needed for the respective Institutional Reform Water and Sanitation Subproject and to be financed from the proceeds of the Loan shall be procured in accordance with the procedures set forth in Section III of this Schedule and the Operational Manual;

(v) the right of the Borrower to inspect, by itself or jointly with the Bank, if the Bank shall so request, the goods, works and services financed by the Loan under the respective Institutional Reform Water and Sanitation Subproject, the operations thereof, and any relevant records and documents;

(vi) the right of the Borrower to obtain all information as the Borrower or the Bank shall reasonably request regarding the administration, operations
and financial conditions of the activities and results financed by the Loan; and

(vii) (A) the right of the Borrower to suspend and terminate the right of an Eligible Municipality to use the proceeds of the Loan; and (B) the obligation of each Eligible Municipality to refund any portion of the Loan proceeds to the Borrower, whenever the Borrower or the Bank determines that such portion was used for items improperly procured in violation of Section III to this Schedule, or was not used for Eligible Expenditures;

(e) before commencing the implementation of any Institutional Reform Solid Waste Investment Subproject, shall enter into an agreement (an Institutional Reform Solid Waste Investment Grant Agreement) with the respective Eligible Municipality, under terms and conditions substantially similar to those of the respective model forms contained in the Operational Manual, to provide for:

(i) the provision to such Eligible Municipality, by the Borrower, of the funds, facilities, services and other resources required to carry out the respective Institutional Reform Solid Waste Investment Subproject, including the transfer of the proceeds of the Loan required for such Institutional Reform Solid Waste Investment Subproject on a grant basis;

(ii) the obligation of such Eligible Municipality to: (A) co-finance at least the percentage set forth in the Operational Manual of the cost of the respective Institutional Reform Solid Waste Investment Subproject; (B) maintain cost recovery and outsourcing measures (as defined in the Operational Manual) adopted under Part 3 (a) of the Project; and (C) sign a withdrawal authorization (fideicomiso) that will allow the Borrower to withhold the cost of the investments from budget transfer payments to such Eligible Municipality should the Eligible Municipality go back on its decision to maintain cost recovery and outsourcing measures (as defined in the Operational Manual); (D) enter into agreements with other Municipalities for sharing landfills, transfer stations or composting;

(iii) the obligation of each Eligible Municipality to: (A) carry out its respective Institutional Reform Solid Waste Investment Subproject with due diligence and efficiency and in conformity with appropriate administrative, engineering, social, financial and environmental practices and in accordance with the provisions of this Agreement and the Operational Manual; (B) maintain adequate records to reflect, in accordance with sound accounting practices defined in the Operational Manual, the operations, the resources and expenditures in respect of its respective Institutional Reform Solid Waste Investment Subproject; and (C) maintain adequate reporting in accordance with the standards specified in the Operational Manual;

(iv) the requirement that the goods, works and services needed for the respective Institutional Reform Solid Waste Investment Subproject and to be financed from the proceeds of the Loan shall be procured in accordance with the procedures set forth in Section III of this Schedule and the Operational Manual;
(v) the right of the Borrower to inspect, by itself or jointly with the Bank, if the Bank shall so request, the goods, works and services financed by the Loan under the respective Institutional Reform Solid Waste Subproject, the operations thereof, and any relevant records and documents;

(vi) the right of the Borrower to obtain all information as the Borrower or the Bank shall reasonably request regarding the administration, operations and financial conditions of the activities and results financed by the Loan; and

(vii) (A) the right of the Borrower to suspend and terminate the right of an Eligible Municipality to use the proceeds of the Loan; and (B) the obligation of each Eligible Municipality to refund any portion of the Loan proceeds to the Borrower, whenever the Borrower or the Bank determines that such portion was used for items improperly procured in violation of Section III to this Schedule, or was not used for Eligible Expenditures.

2. The Borrower shall exercise its rights under the Grant Agreements and the Technical Assistance Agreements 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 any Grant Agreement, any Technical Assistance Agreement, or any provision thereof.

B. Institutional and Other Arrangements

1. (a) The Borrower shall carry out the Project in accordance with an operational manual satisfactory to the Bank (the Operational Manual), such manual to include, inter alia:

   (i) the procedures for the carrying out, monitoring and evaluation of the Project (including the procurement, financial, social and environmental requirements thereof);

   (ii) the criteria for the eligibility of Municipalities to participate in the Project, according to the type of Subprojects;

   (iii) the criteria for the eligibility of each type of Subprojects, including without limitation: (A) the activities/investments eligible for financing under each type of Subproject; and (B) the procedures required for a participatory process during the preparation of Subprojects;

   (iv) the requirements and procedures for the approval, implementation, monitoring and evaluation of Subprojects, including: (A) standards, satisfactory to the Bank, for environmentally sound construction practices; (B) appropriate screening procedures for Subprojects; and (C) technical, social and economic criteria for the evaluation of such Subprojects (including the requirement that the rehabilitation and/or extension of existing systems be assessed);

   (v) model forms for the Grant Agreements and Technical Assistance Agreements;
(vi) the IPDP, the Sectoral Environmental Assessment, and the procedures to safeguard cultural property; and

(vii) the Performance Indicators.

(b) The Operational Manual may be amended by the Borrower from time to time with the prior approval of the Bank. In the case of any conflict between the terms of the Operational Manual and those of this Agreement, the terms of this Agreement shall prevail.

2. The Borrower shall maintain, during the execution of the Project, a project management unit (the PMU) with structure and functions satisfactory to the Bank, with qualified staff in adequate numbers as required to carry out its responsibilities.

3. Without limitation to the provisions of paragraph (a) of Section I.B.1 of this Schedule, the Borrower, through MIDUVI, shall:

(a) implement the IPDP in accordance with its terms;

(b) implement the actions required under the Sectoral Environmental Assessment in accordance with its terms, including without limitation the activities set forth in Part I (c) of the Project;

(c) ensure that no physical or involuntary resettlement (as interpreted in accordance with the Bank’s Operational Policy 4.12) shall take place as a consequence of the carrying out of the Project; and

(d) ensure that no significant loss or degradation of terrestrial or aquatic natural habitats shall take place as a consequence of the carrying out of the Project.

Section II. Project Monitoring, Reporting, Evaluation.

A. Project Reports.

1. (a) The Borrower shall monitor and evaluate the progress of the Project and prepare Project Reports in accordance with the provisions of Section 5.08 of the General Conditions and on the basis of the Performance Indicators. Each Project Report shall cover the period of one calendar semester, and shall be furnished to the Bank not later than forty-five days after the end of the period covered by such report.

(b) Each Project Report shall also include: (i) the financial reports referred to in Section II.B.2 below; (ii) a physical progress report; and (iii) procurement reports, all in accordance with the formats agreed with the Bank.

2. For purposes of Section 5.08 (c) of the General Conditions, the report on the execution of the Project and related plan required pursuant to that Section shall be furnished to the Bank not later than August 28, 2010.


1. The Borrower shall maintain or cause to be maintained a financial management system in accordance with the provisions of Section 5.09 of the General Conditions.
2. Without limitation on the provisions of Part A of this Section, the Borrower shall prepare and furnish to the Bank as part of the Project Report, interim un-audited financial reports for the Project covering the semester, in form and substance satisfactory to the Bank.

3. The Borrower shall have its Financial Statements audited in accordance with the provisions of Section 5.09 (b) of the General Conditions. Each audit of the Financial Statements shall cover the period of one fiscal year of the Borrower. The audited Financial Statements for each such period shall be furnished to the Bank not later than six months after the end of such period.

Section III. Procurement

A. General.

1. Goods, Works and Non-Consultants’ Services. All goods, works and non-consultants’ services required for the Project and to be financed out of the proceeds of the Loan shall be procured in accordance with the requirements set forth or referred to in Section I of the Procurement Guidelines, and with the provisions of this Schedule.

2. Consultants’ Services. All consultants’ services required for the Project and to be financed out of the proceeds of the Loan shall be procured in accordance with the requirements set forth or referred to in Sections I and IV of the Consultant Guidelines and with the provisions of this Schedule.

3. Definitions. The capitalized terms used below in this Section to describe particular procurement methods or methods of review by the Bank of particular contracts refer to the corresponding method described in the Procurement Guidelines, or Consultant Guidelines, as the case may be.

B. Particular Methods of Procurement of Goods, Works and Non-Consultants’ Services

1. International Competitive Bidding. Except as otherwise provided in paragraph 2 below, goods, works and non-consultants’ services shall be procured under contracts awarded on the basis of International Competitive Bidding procedures.

2. Other Methods of Procurement of Goods, Works and Non-Consultants’ Services. The following table specifies the methods of procurement, other than International Competitive Bidding, which may be used for goods, works and non-consultants’ services. The Procurement Plan shall specify the circumstances under which such methods may be used.

<table>
<thead>
<tr>
<th>Procurement Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) National Competitive Bidding</td>
</tr>
<tr>
<td>(b) Shopping</td>
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<tr>
<td>(c) Direct Contracting</td>
</tr>
</tbody>
</table>

The procurement of goods, works and non-consultants’ services following the above procurement methods will be made using standard bidding documents and procedures agreed with the Bank and subject to the provisions of paragraph E below.
C. **Particular Methods of Procurement of Consultants’ Services**

1. **Quality- and Cost-based Selection.** Except as otherwise provided in paragraph 2 below, consultants’ services shall be procured under contracts awarded on the basis of Quality and Cost-based Selection.

2. **Other Methods of Procurement of Consultants’ Services.** The following table specifies the methods of procurement, other than Quality and Cost-based Selection, which may be used for consultants’ services. The Procurement Plan shall specify the circumstances under which such methods may be used.

<table>
<thead>
<tr>
<th>Procurement Method</th>
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<tbody>
<tr>
<td>(a) Quality Based Selection</td>
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<tr>
<td>(b) Selection under a Fixed Budget</td>
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<tr>
<td>(c) Least Cost Selection</td>
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<tr>
<td>(d) Selection based on Consultants’ Qualifications</td>
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<tr>
<td>(e) Single-source Selection</td>
</tr>
<tr>
<td>(f) Procedures set forth in paragraphs 5.2 and 5.3 of the Consultant Guidelines for the Selection of Individual Consultants</td>
</tr>
<tr>
<td>(g) Sole Source Procedures for the Selection of Individual Consultants</td>
</tr>
</tbody>
</table>

The procurement of consultants’ services following the above procurement methods will be made subject to the provisions of paragraph E below.

D. **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.

E. **Special Provisions**

1. In addition and without limitation or restriction to any other provisions set forth in this Section or the Procurement Guidelines, the following provisions shall govern the procurement of goods, works and non-consultants’ services under this Section.

   (a) Each bid shall be evaluated and the corresponding contract awarded to the responsive bidder who meets appropriate technical and financial standards of capability and whose bid has been determined to be the lowest evaluated bid in a manner satisfactory to the Bank. Such determination shall be made exclusively on the basis of the specifications, conditions and evaluation criteria, stipulated in the bidding documents. Evaluation criteria other than price shall be expressed in monetary terms. For purposes of bid evaluation and comparison, the only bid amount or amounts to be used as a factor shall be the bid amount or amounts as quoted in the corresponding bid, including correction of arithmetic errors.

   (b) No reference value shall be required for publication in the bidding documents.
(c) There will be no prescribed minimum number of bids submitted for a contract to be subsequently awarded under International Competitive Bidding and National Competitive Bidding.

(d) Foreign bidders shall not be required to authenticate (legalizar) their bidding documents or any documentation related to such bidding documents with Ecuadorian authorities as a prerequisite of bidding.

(e) The Borrower shall use standard bidding documents and standard evaluation formats; all satisfactory to the Bank.

2. In addition and without limitation or restriction to any other provisions set forth in this Section or the Consultant Guidelines, the following provisions shall govern all employment of consultants:

(a) Foreign consultants shall not be required to be locally registered as a condition of participation in the selection process.

(b) Foreign consultants shall not be required to authenticate (legalizar) any documentation related to their participation in the selection process with Ecuadorian authorities as a condition of participation in said selection process.

(c) No reference value shall be required for publication in the proposal documents.

(d) Foreign consultants shall not be required, either directly or indirectly, to give any participation in or share of any consulting contracts to any local firm or person.

(e) Foreign consulting firms shall not be required, as a condition to provide services, to be registered in Ecuador with a minimum capital different from that required for Ecuadorian firms.

(f) Foreign consultants, either individuals or firms, shall not be required to pay fees to the Ecuadorian Consultants’ Association that are different from those required for Ecuadorian consultants.

(g) No consultant financed out of the proceeds of the Loan shall, at the time he or she is carrying out his or her contractual obligations as consultant, hold civil service office or any other position in any agency of the Borrower, nor shall such consultant have any right to re-entry into any such office or position upon the conclusion of his or her consulting services.

(h) The Borrower shall use standard requests for proposals and standard evaluation formats; all satisfactory to the Bank.
Section IV. Withdrawal of Loan Proceeds

A. General.

1. The Borrower may withdraw the proceeds of the Loan in accordance with the provisions of this Section and such additional instructions as the Bank shall specify by notice to the Borrower to finance Eligible Expenditures as set forth in the table in paragraph 2 below.

2. The following table specifies the categories of Eligible Expenditures that may be financed out of the proceeds of the Loan (“Category”), the allocation of the amounts of the Loan to each Category, and the percentage of expenditures to be financed for Eligible Expenditures in each Category.

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount of the Loan Allocated (expressed in USD)</th>
<th>Percentage of Expenditures to be Financed</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Goods under Parts 1, 2 (c) and 4 of the Project</td>
<td>1,000,000</td>
<td>100%</td>
</tr>
<tr>
<td>(2) Works under Parts 1 and 4 of the Project</td>
<td>500,000</td>
<td>100%</td>
</tr>
<tr>
<td>(3) Consultants’ services and Training under Parts 1 and 4 of the Project</td>
<td>6,000,000</td>
<td>100%</td>
</tr>
<tr>
<td>(4) Consultants’ services and Training under Parts 2 (a), 2 (c), 2 (d) and 3 (a) of the Project</td>
<td>7,500,000</td>
<td>100%</td>
</tr>
<tr>
<td>(5) Goods, works and Training for Rural Water and Sanitation Subprojects</td>
<td>19,000,000</td>
<td>100% of the amounts disbursed under each Water and Sanitation Grant Agreement, excluding the counterpart contribution cited in paragraph (b) of Section I.A.1 of Schedule 2 to this Agreement</td>
</tr>
<tr>
<td>Category</td>
<td>Amount of the Loan Allocated (expressed in USD)</td>
<td>Percentage of Expenditures to be financed</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
<td>-------------------------------------------------</td>
<td>------------------------------------------</td>
</tr>
<tr>
<td>(6) Goods, works and Training for Institutional Reform Water and Sanitation Investment Subprojects</td>
<td>10,000,000</td>
<td>100% of the amounts disbursed under each Institutional Reform Water and Sanitation Investment Grant Agreement, excluding the counterpart contribution cited in paragraph (d) of Section I.A.1 of Schedule 2 to this Agreement</td>
</tr>
<tr>
<td>(7) Goods, works and Training for Institutional Reform Solid Waste Investment Subprojects</td>
<td>4,000,000</td>
<td>100% of the amounts disbursed under each Institutional Reform Solid Waste Investment Grant Agreement, excluding the counterpart contribution cited in paragraph (e) of Section I.A.1 of Schedule 2 to this Agreement</td>
</tr>
<tr>
<td>TOTAL AMOUNT</td>
<td>48,000,000</td>
<td></td>
</tr>
</tbody>
</table>

For purposes of this table, the term “Training” means the reasonable cost of: (i) training materials and rental of training facilities and equipment; (ii) tuition fees, travel and per-diem of trainers and trainees; and (iii) any other non-consultant expenses related to training (including study tours and workshops) to be carried out under the Project.

B. Withdrawal Conditions; Withdrawal Period.

1. Notwithstanding the provisions of Part A of this Section no withdrawal shall be made from the Loan Account:
   
   (a) until the Bank has received payment in full of the Front-end Fee; or
   
   (b) for payments made prior to the date of this Agreement.

2. The Closing Date is February 28, 2011.

Section V. Other Undertakings

A. The Borrower shall cause each Eligible Municipality:

1. to carry out its operations and conduct its affairs in accordance with sound administrative, financial, engineering, social and environmental practices under the supervision of qualified and experienced management assisted by competent staff in adequate numbers; and

2. at all times to operate and to maintain all Project equipment and construction, and from time to time, promptly as needed, to make all necessary repairs and renewals thereof, all in accordance with sound engineering, financial, administrative, social, cultural and environmental practices.
B. Unless the Bank shall otherwise agree, the Borrower shall enforce its right to recover the cost of technical assistance and/or investment resources from Eligible Municipalities in the cases specified in the withdrawal authorization (*fideicomiso*) signed by the respective Eligible Municipality in connection with each Institutional Reform Technical Assistance Agreement, Institutional Reform Water and Sanitation Investment Grant Agreement and/or Institutional Reform Solid Waste Investment Grant Agreement, as the case may be.

C. Within one month after the Effective Date, the Borrower shall ensure that: (1) the accounting system for the Project is operating effectively; and (2) the terms of reference for the external audit referred to in Section II.B.3 of Schedule 2 to this Agreement have been submitted to the Bank for its review and no-objection.

D. Within three months after the Effective Date, the Borrower shall execute the contract, satisfactory to the Bank, for the provision of the external financial audit referred to in Section II.B.3 of Schedule 2 to this Agreement.

E. Not later than December 31, 2006, the Borrower, through MEF and MIDUVI, shall submit to the Borrower’s Presidency, a draft Executive Decree, satisfactory to the Bank, setting out policies for all public spending in the water and sanitation sector.

F. Without limitation to the provisions of Section 5.03 of the General Conditions, the Borrower, through MEF and MIDUVI, shall provide, as part of MIDUVI’s annual budget, such resources as are necessary to finance the Operating Expenditures required under Parts 1 and 4 of the Project.

G. Within one month after the Effective Date, the Borrower, through MIDUVI, shall adopt through a resolution, in form and substance satisfactory to the Bank, the Operational Manual.
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 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) Withdrawn Loan Balance as of the first Principal Payment Date; by (b) the Installment Share for each Principal Payment Date, such repayable 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>Principal Payment Date</th>
<th>Installment Share (Expressed as a Percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>On each March 15 and September 15</td>
<td></td>
</tr>
<tr>
<td>Beginning March 15, 2015 through September 15, 2019</td>
<td>10%</td>
</tr>
</tbody>
</table>

2. If the proceeds of the Loan have not 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 have been withdrawn as of the first Principal Payment Date, the Borrower shall repay the Withdrawn Loan Balance as of such date in accordance with paragraph 1 of this Schedule.

   (b) Any amount withdrawn 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 is the original Installment Share specified in paragraph 1 of this Schedule for said Principal Payment Date ("Original Installment Share") and the denominator of which is the sum of all remaining Original Installment Shares for Principal Payment Dates falling on or after such date, such amounts repayable 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) Amounts of the Loan withdrawn 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 sub-paragraph (a) of this paragraph, if at any time the Bank adopts a due date billing system under which invoices are issued on or after the respective Principal Payment Date, the provisions of such sub-
paragraph 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 Loan Balance to an Approved Currency, the amount so converted in the Approved Currency that is 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 the Conversion by either: (i) the exchange rate that reflects the amounts of principal in the Approved Currency payable by the Bank under the Currency Hedge Transaction relating to the 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 Withdrawn Loan Balance is 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.
APPENDIX

Section I. Definitions

1. “Category” means a category set forth in the table in Section IV of Schedule 2 to this Agreement.


3. “Eligible Municipality” means a Municipality which is located in the Borrower’s continental territory and is eligible to participate in the Project in accordance with the provisions set forth in the Operational Manual.


5. “Grant Agreements” means, collectively, Rural Water and Sanitation Grant Agreements, Institutional Reform Water and Sanitation Investment Grant Agreements, and Institutional Reform Solid Waste Investment Grant Agreements.

6. “ICE” means Impuesto Sobre Consumos Especiales, the Borrower’s special tax on telephone calls, earmarked for water and sanitation sector investments through the Borrower’s Decreto Ejecutivo No. 2562, published February 21, 2005.

7. “Institutional Reform Solid Waste Investment Grant Agreement” means the Agreement referred to in paragraph (e) of Section I.A.1 of Schedule 2 to this Agreement.

8. “Institutional Reform Solid Waste Investment Subproject” means a set of activities or investments covered by Part 3 (c) of the Project which is eligible for financing in accordance with the criteria set forth in the Operational Manual.

9. “Institutional Reform Technical Assistance Agreement” means the Agreement referred to in paragraph (c) of Section I.A.1 of Schedule 2 to this Agreement.

10. “Institutional Reform Technical Assistance Subproject” means a set of technical assistance activities covered by Part 3 (a) of the Project which is eligible for financing in accordance with the criteria set forth in the Operational Manual.

11. “Institutional Reform Water and Sanitation Investment Grant Agreement” means the Agreement referred to in paragraph (d) of Section I.A.1 of Schedule 2 to this Agreement.

12. “Institutional Reform Water and Sanitation Investment Subproject” means a set of activities or investments covered by Part 3 (b) of the Project which is eligible for financing in accordance with the criteria set forth in the Operational Manual.

13. “IPDP” means the Borrower’s indigenous peoples’ development plan for the Project dated March 30, 2006, as such may be amended from time to time with the prior approval of the Bank.

15. “MIDUVI” means Ministerio de Desarrollo Urbano y Vivienda, the Borrower’s Ministry of Urban Development and Housing.

16. “Municipality” means an autonomous entity established pursuant to the Municipality Law.

17. “Municipality Law” means the Borrower’s Ley del Régimen Municipal, Law No. 104, published in the Borrower’s Official Registry No. 315 of August 26, 1982, as said Law may have been amended to the date of this Agreement.

18. “Operating Expenditures” means the cost of travel and per diem of personnel of the PMU and the SAPSyRS, and office supplies, utilities, gasoline and vehicle maintenance for the PMU and the SAPSyRS, all included in annual plans acceptable to the Bank.

19. “Operational Manual” means the manual for the operation of the Project referred to in paragraph (a) of Section I.B.1 of Schedule 2 to this Agreement.

20. “Performance Indicators” means the indicators for Project monitoring and evaluation.


22. “Procurement Plan” means the Borrower’s procurement plan for the Project, dated June 1, 2006 and referred to in paragraph 1.16 of the Procurement Guidelines and paragraph 1.24 of the Consultant Guidelines, as the same shall be updated from time to time in accordance with the provisions of said paragraphs.

23. “Program” means the program designed to increase the coverage and sustainable use of water and sanitation services in the Borrower’s territory and to modernize the overall sector structure, referred to in the letter dated June 19, 2006 from the Borrower to the Bank.

24. “Project Management Unit” or “PMU” means the the unit referred to in Section I.B.2 of Schedule 2 to this Agreement.

25. “Promotion and Pre-investment Technical Assistance Agreement” means the Agreement referred to in paragraph (a) of Section I.A.1 of Schedule 2 to this Agreement.

26. “Promotion and Pre-investment Subproject” means a set of activities or investments covered by Part 2 (a) of the Project which is eligible for financing in accordance with the criteria set forth in the Operational Manual.

27. “Rural Community” means a legally established community or Water User Board.

28. “Rural Water and Sanitation Grant Agreement” means the Agreement referred to in paragraph (b) of Section I.A.1 of Schedule 2 to this Agreement.

29. “Rural Water and Sanitation Subproject” means a set of activities or investments covered by Part 2 (b) of the Project which is eligible for financing in accordance with the criteria set forth in the Operational Manual.
30. “SAPyRS” means Subsecretaría de Agua Potable, Saneamiento y Resíduos Sólidos, the Borrower’s Subsecretariat for Water Supply, Sanitation and Solid Waste within MIDUVI.

31. “Sectoral Environmental Assessment” means the Borrower’s assessment for the management of environmental aspects of the Project dated May 31, 2006, as such may be amended from time to time with the prior approval of the Bank.


34. “Water User Board” means a citizens’ committee constituted for the purpose of operating, maintaining and expanding a water supply and/or sanitation system within a given community.