Loan Agreement

(Pernambuco Integrated Development: Education Quality Improvement Project)

between

STATE OF PERNAMBUCO

and

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

Dated June 27, 2005
AGREEMENT, dated June 27, 2005, between the STATE OF PERNAMBUCO (the Borrower) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) the Federative Republic of Brazil (the Guarantor) and the Borrower, having been satisfied as to the feasibility and priority of the project described in Schedule 2 to this Agreement (the Project) have requested the Bank to assist in the financing of the Project;

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

(C) the Bank has received a letter from the Borrower, dated July 15, 2003, describing a program designed to achieve an integrated development of the Borrower’s economic and social sectors (the Integrated Development Program) and declaring the Borrower’s commitment to the execution of such program;

WHEREAS the Bank has agreed, on the basis, *inter alia*, of the foregoing, to extend the Loan to the Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The “General Conditions Applicable to Loan and Guarantee Agreements for Single Currency Loans” of the Bank, dated May 30, 1995 (as amended through October 6, 1999) with the following modification (the General Conditions) constitute an integral part of this Agreement: The text in Section 5.01 which reads: “(a) on account of expenditures in the territories of any country which is not a member of the Bank or for goods produced in, or services supplied from, such territories: or (b)” is deleted in its entirety.
Section 1.02. Unless the context otherwise requires, the several terms defined in the Preamble to this Agreement and in the General Conditions have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “Basic Education” means the education provided through the Fundamental Education and Secondary Education;

(b) “Eligible Categories” means Categories (1) through (5) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

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

(d) “Eligible Municipal School” means a Municipal School which meets the criteria set forth in the Operational Manual to participate in Part B.2 of the Project;

(e) “Eligible State School” means a State School which meets the criteria set forth in the Operational Manual to participate in Part A.1 (c) of the Project;

(f) “Financial Monitoring Report” or “FMR” means each report prepared in accordance with Section 4.02 of this Agreement;

(g) “Fiscal Year” means the Borrower’s fiscal year which commences January 1;

(h) “FUNAI” means Fundação Nacional do Índio, the National Indian Foundation established by the Guarantor’s Decree (Decreto) No. 564, dated June 8, 1992 pursuant to the Guarantor’s Law No. 5371, of December 5, 1967;

(i) “Fundamental Education” means the education provided in Brazil from grades 1 through 8 (ensino fundamental), as described in Articles 21 and 32 of the Guarantor’s Law No. 9394, dated December 20, 1996;

(j) “Grant” means the amount of non-reimbursable financing provided by the Borrower, to a School Subproject Implementation Entity, for implementation of a PME School Subproject;

(k) “Indigenous Peoples” means the indigenous peoples recognized as such by FUNAI as eligible to benefit from the constitutional and other legal protection as
indigenous peoples and including the Atikum, Fulni-ô, Kambiwá, Kapinawá, Pankararu, Pipipan, Tuxá, Pankará, Truká and Xukuru;

(l) “Indigenous Peoples and Quilombolas Action Plan” means the plan set forth in the letter from the Borrower to the Bank dated July 20, 2004;

(m) “Indigenous School” means a school serving exclusively Indigenous Peoples’ students;

(n) “Minimum Operational Standards” means the essential inputs needed for schools to function adequately and offer children the opportunity to learn, all as set forth in the Operational Manual;

(o) “Model Municipality Cooperation Agreement” means the model(s) of Municipality Cooperation Agreement set forth in the Operational Manual;

(p) “Model PME School Subproject Implementation Agreement” means the model(s) of School Subproject Implementation Agreement set forth in the Operational Manual;

(q) “Municipal School” means a Fundamental Education school operated by a municipality in the Borrower’s territory;

(r) “Municipality Cooperation Agreement” means any of the Agreements referred to in section 3.01 (d) of this Agreement;

(s) “Operational Manual” means the manual referred to in Section 3.03 of this Agreement;

(t) “PCU” or “Project Coordination Unit” means the unit referred to in Section 3.01 (b) of this Agreement and established on December 29, 2003;

(u) “PDE” means Plano de Desenvolvimento Escolar, any of the plans for the improvement of a Fundamental Education school or a Secondary Education school, as the case may be, prepared by a School Subproject Implementation Entity;

(v) “PDE Guidelines” means the guidelines for the implementation of PDEs in State Schools and Municipal Schools, issued by SEDUC on August 20, 2004, as such guidelines may be amended from time to time with the agreement of the Bank;
(w) “PDRE” means *Plano Director da Reforma do Estado*, the Borrower State Reform (Master) Plan presented to the Borrower’s legislature in January 2003;

(x) “Performance Indicators” means the indicators set forth in a letter from the Borrower to the Bank dated July 15, 2003 as amended on September 10, 2004;

(y) “PME Guidelines” means the guidelines for the implementation of PME School Subprojects in State Schools and Municipal Schools, issued by SEDUC on August 20, 2004, as such guidelines may be amended from time to time with the agreement of the Bank;

(z) “PME School Subproject” means *Projeto de Melhoria da Escola*, any subproject for pedagogical and management improvement of a Fundamental Education school or a Secondary Education school to be carried out by a School Subproject Implementation Entity and consisting of, *inter alia*, the provision of goods, and in-service training and technical assistance to a school, which Subproject is eligible for financing in respect of goods, services and training in accordance with the provisions of this Agreement and the terms of the respective Subproject Implementation Agreement;

(aa) “Procurement Plan” means the Borrower’s procurement plan, dated September 9, 2004 covering the initial 12 month period (or longer) of Project implementation, as the same shall be updated from time to time in accordance with the provisions of Section 3.02 to this Agreement, to cover succeeding 18 month periods (or longer) of Project implementation;

(bb) “Quilombolas” means the communities of African descendants referred to in Transitory Article 68 of the Guarantor’s Constitution;

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

(dd) “SAEPE” means *Sistema de Avaliação da Educação do Estado de Pernambuco*, the Borrower’s education evaluation system;

(ee) “SARE” means *Secretaria de Administração e Reforma do Estado*, the Borrower’s State Reform and Management Secretariat;

(ff) “School Subproject Implementation Entity” means any state or municipal school with legal and financial autonomy which carries out a PME School Subproject;
ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Loan Agreement, an amount equal to thirty-one million five hundred thousand Dollars ($31,500,000).

Section 2.02. The amount of the Loan may be withdrawn from the Loan Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Bank shall so agree, to be made) in respect of the reasonable cost of goods, works, scholarships and services required for the Project and to be financed out of the proceeds of the Loan and in respect of the fee referred to in Section 2.04 of this Agreement.

Section 2.03. The Closing Date shall be December 31, 2009 or such later date as the Bank shall establish after having received evidence that the Guarantor had authorized
such extension of the Closing Date. The Bank shall promptly notify the Borrower and the Guarantor of such later date.

Section 2.04. The Borrower shall pay to the Bank a front-end fee in an amount equal to one percent (1%) of the amount of the Loan subject to any waiver of a portion of such fee as may be determined by the Bank from time to time. On or promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of such fee.

Section 2.05. The Borrower shall pay to the Bank a commitment charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Loan not withdrawn from time to time.

Section 2.06. (a) The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, at a rate for each Interest Period equal to LIBOR Base Rate plus LIBOR Total Spread.

(b) For the purposes of this Section:

(i) “Interest Period” means the initial period from and including the date of this Agreement to, but excluding, the first Interest Payment Date occurring thereafter, and after the initial period, each period from and including an Interest Payment Date to, but excluding the next following Interest Payment Date.

(ii) “Interest Payment Date” means any date specified in Section 2.07 of this Agreement.

(iii) “LIBOR Base Rate” means, for each Interest Period, the London interbank offered rate for six-month deposits in Dollars for value the first day of such Interest Period (or, in the case of the initial Interest Period, for value the Interest Payment Date occurring on or next preceding the first day of such Interest Period), as reasonably determined by the Bank and expressed as a percentage per annum.

(iv) “LIBOR Total Spread” means, for each Interest Period: (A) three-fourths of one percent (3/4 of 1%); (B) minus (or plus) the weighted average margin, for such Interest Period, below (or above) the London interbank offered rates, or other reference rates, for six-month deposits, in respect of the Bank’s outstanding borrowings or portions thereof allocated by the Bank
to fund single currency loans or portions thereof made by it that include the Loan; as reasonably determined by the Bank and expressed as a percentage per annum.

(c) The Bank shall notify the Borrower and the Guarantor of LIBOR Base Rate and LIBOR Total Spread for each Interest Period, promptly upon the determination thereof.

(d) Whenever, in light of changes in market practice affecting the determination of the interest rates referred to in this Section 2.06, the Bank determines that it is in the interest of its borrowers as a whole and of the Bank to apply a basis for determining the interest rates applicable to the Loan other than as provided in said Section, the Bank may modify the basis for determining the interest rates applicable to the Loan upon not less than six (6) months’ notice to the Borrower and the Guarantor of the new basis. The new basis shall become effective on the expiry of the notice period unless the Borrower or the Guarantor notifies the Bank during said period of its objection thereto, in which case said modification shall not apply to the Loan.

Section 2.07. Interest and other charges shall be payable semiannually in arrears on May 15 and November 15 in each year.

Section 2.08. The Borrower shall repay the principal amount of the Loan in accordance with the amortization schedule set forth in Schedule 3 to this Agreement.

Section 2.09. The Secretary of Education and Culture of the Borrower and any person or persons whom he or she shall designate in writing is designated as representative of the Borrower for the purposes of taking any action required or permitted to be taken under the provisions of Section 2.02 of this Agreement and Article V of the General Conditions.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project and, to this end, shall carry out:

(i) Parts A, B, C.2 and D of the Project through SEDUC; and

(ii) Part C.1 of the Project through SARE and SEPLAN,
all with due diligence and efficiency and in conformity with appropriate educational, economic, technical, administrative, financial, environmental and social practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) The Borrower shall maintain, during the implementation of the Project, the Project Coordination Unit and a Special Bidding Committee with functions and responsibilities satisfactory to the Bank, at all times headed by a Project coordinator and assisted by staff in adequate numbers, all with qualifications and experience acceptable to the Bank.

(c) The Borrower shall, through SEDUC, prior to submitting the Loan withdrawal application for the respective PME School Subproject, enter into an agreement with each School Subproject Implementation Entity, under terms and conditions satisfactory to the Bank, substantially in accordance with the terms of the Model PME School Subproject Implementation Agreement, setting forth, *inter alia*: (i) the terms and conditions for the financing of the PME School Subprojects; and (ii) the obligation of the School Subproject Implementation Entity to carry out the PME School Subproject in accordance with the provisions of the Operational Manual, the PDE Guidelines and PME Guidelines.

(d) The Borrower shall, through SEDUC, prior to submitting the Loan withdrawal application for related expenditures under Part B.2 of the Project, enter into an agreement with each municipality with jurisdiction over the schools participating in Part B.2 of the Project and those serving *Quilombola* students, under terms and conditions satisfactory to the Bank, substantially in accordance with the terms of the Model Municipality Cooperation Agreement, setting forth, *inter alia*, the municipality’s obligation: (i) to propose the Municipal Schools that could participate in the Project; and (ii) to cooperate in the execution of the activities included therein in accordance with the provisions of the Operational Manual.

(e) The Borrower shall: (i) not later than twenty-four months from the Effective Date, start the construction of Indigenous Schools, mentioned in the Indigenous Peoples and *Quilombolas* Action Plan, in accordance with the environmental guidelines applicable to school construction in rural areas set forth in the Guarantor’s document, issued by its Minister of Education and Culture, and entitled “*Subsidios para a Elaboração de Projetos e Adequação de Edificações Escolares, MEC/Fundescola 2002*”; and (ii) ensure that the contractors hired to construct such schools abide by the environmental requirements of such guidelines, and that all works are finalized not later than forty-two months after the Effective Date.

(f) The Borrower shall exercise its rights and carry out its obligations under each of the Subproject Implementation Agreements and Municipality Cooperation Agreement.
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, suspend, waive, terminate or fail to enforce any Subproject Implementation Agreement or Municipality Cooperation Agreement.

(g) Without limitation upon the provisions of paragraph (a) above, the Borrower shall carry out the Project in accordance with: (i) the Performance Indicators; and (ii) the Indigenous Peoples and *Quilombolas* Action Plan.

(h) The Borrower shall, through SEDUC, enter into agreements or make other institutional arrangements with the Guarantor’s agencies concerned with Indigenous Peoples and *Quilombolas* as needed for the implementation of the Indigenous Peoples and *Quilombolas* Action Plan.

Section 3.02. Except as the Bank 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 Loan shall be governed by the provisions of Schedule 4 to this Agreement, as said provisions may be further elaborated in the Procurement Plan. The Borrower shall update the Procurement Plan in accordance with guidelines acceptable to the Bank, and furnish such update to the Bank not later than 12 months after the date of the preceding Procurement Plan, for the Bank’s approval.

Section 3.03. The Borrower shall carry out the Project in accordance with an operational manual, satisfactory to the Bank, said manual to include, *inter alia*:

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

(b) the criteria for the approval, implementation and monitoring of PME School Subprojects and for the financing of the related Grants; and

(c) a model agreement: (i) for implementation of PME School Subprojects; and (ii) for municipal cooperation in the PME School Subprojects carried out in Municipal Schools.

In case of any conflict between the terms of the Operational Manual and those of this Agreement, the terms of this Agreement shall prevail.

Section 3.04. The Borrower shall:
(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the Performance Indicators, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, not later than twelve months after the Effective Date and yearly thereafter during the period of Project implementation, a report integrating the results of the evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of such report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and

(c) (i) review with the Bank, within no more than two months after each such reports’ preparation, the reports referred to in paragraph (b) of this Section and progress in the implementation of the Integrated Development Program; and

(ii) thereafter take all measures, as needed, to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said reports and the Bank's and the Borrower’s views on the matter.

Section 3.05. For the purposes of Section 9.07 of the General Conditions and without limitation thereto, the Borrower shall:

(a) prepare, on the basis of guidelines acceptable to the Bank, and furnish to the Bank not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Bank, a plan for the future operation of the Project; and

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

ARTICLE IV

Financial Covenants

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

(i) commencing with the fiscal year in which the Effective Date falls, to and including the fiscal year in which the last withdrawal from the Loan Account is made, have the financial statements referred to in paragraph (a) of this Section for each fiscal year, or other period agreed to by the Bank, audited, in accordance with consistently applied auditing standards acceptable to the Bank, by independent auditors acceptable to the Bank;

(ii) furnish to the Bank as soon as available, but in any case not later than six months after the end of each such year or such other period agreed to by the Bank: (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 Bank, as so audited; and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Bank; and

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

(c) For all expenditures with respect to which withdrawals from the Loan Account were made on the basis of reports referred to in Part A.5 of Schedule 1 to this Agreement (Report-based Disbursements) or on the basis of statements of expenditure, the Borrower shall:

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

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

(iii) ensure that such reports and statements of expenditures are included in the audit for each fiscal year, or other period agreed to by the Bank, referred to in paragraph (b) of this Section.

Section 4.02. (a) Without limitation upon the Borrower’s progress reporting obligations set out in Section 3.04 of this Agreement, the Borrower shall prepare and
furnish to the Bank a financial monitoring report, in form and substance satisfactory to the Bank, 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 Loan and explains variances between the actual and planned uses of such funds;

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

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

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

ARTICLE V

Effective Date; Termination

Section 5.01. The following events are specified as additional conditions to the effectiveness of the Loan Agreement within the meaning of Section 12.01 (c) of the General Conditions:

(a) that the Borrower has adopted the Operational Manual; and

(b) that SEDUC’s financial management system has been established in a manner satisfactory to the Bank and is able to generate financial, monitoring and procurement reports.

Section 5.02. The following is specified as an additional matter, within the meaning of Section 12.02 (c) of the General Conditions, to be included in the opinion or opinions to be furnished to the Bank, namely that the Loan has been duly registered by the Borrower’s Central Bank.
Section 5.03. The date September 26, 2005 is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

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

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

For the Borrower:

Secretaria da Fazenda do Estado de Pernambuco
Rua do Imperador, S/N
Santo Antonio/Recife/PE
CEP 50 010 – 020
Brazil

Facsimile: (81) 2126 6705

With copy to:

Secretaria da Educação e Cultura do Estado de Pernambuco
Rua Siqueira Campos, 304
50010-010 Recife- Pernambuco
Brazil

Facsimile: 55-81-2122 6393  2122 6348

SARE
Rua Dona Maria Cesar, 68
50030-140 Recife – PE

Facsimile 55-81-3424-2795
Secretaria do Planejamento do Estado de Pernambuco
Rua da Moeda, 46
50030-040 Recife-PE
Brazil
Facsimile: 55-81-3224-7061

SEAIN - Secretaria de Assuntos Internacionais do Ministério do Planejamento, Orçamento e Gestão
Esplanada dos Ministérios - Bloco “K” - 5º Andar
70040-906 Brasília, DF
Brazil
Facsimile: 55 61 225-4022

For the Bank:

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

Cable address: INTBAFRAD
Telex: 248423 (MCI) or 64145 (MCI)
Facsimile: (202) 477-6391
IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

STATE OF PERNAMBUCO

By /s/ Jarbas de Andrade Vasconcelos
Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Pamela Cox
Authorized Representative
**A. General**

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Loan, the allocation of the amounts of the Loan to each Category and the percentage of expenditures for items so to be financed in each Category:

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount of the Loan Allocated (Expressed in Dollars)</th>
<th>% of Expenditures to be Financed</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Works (other than for PME School Subprojects and construction of Indigenous Schools)</td>
<td>7,600,000</td>
<td>60%</td>
</tr>
<tr>
<td>(2) Goods (other than for PME School Subprojects)</td>
<td>5,800,000</td>
<td>60%</td>
</tr>
<tr>
<td>(3) Consultants’ services (including audits) (other than for PME School Subprojects)</td>
<td>2,400,000</td>
<td>60%</td>
</tr>
<tr>
<td>(4) Training and scholarships (other than for PME School Subprojects)</td>
<td>10,200,000</td>
<td>60%</td>
</tr>
<tr>
<td>(5) PME School Subprojects</td>
<td>4,500,000</td>
<td>65% of the cost of goods, and services (including training) financed by a Grant</td>
</tr>
<tr>
<td>(6) Front-End Fee</td>
<td>157,500</td>
<td>Amount due under Section 2.04 of this Agreement</td>
</tr>
<tr>
<td>(7) Unallocated</td>
<td>842,500</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>31,500,000</strong></td>
<td></td>
</tr>
</tbody>
</table>
2. For the purposes of this Schedule the term “training and scholarships” means expenditures incurred in connection with the provision of training and/or scholarships, as the case may be, under Parts A, B, and C of the Project, including the reasonable travel cost and per-diem of the trainees.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding $6,000,000, may be made on account of payments made for expenditures incurred within twelve months before that date.

4. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditure for expenditures for goods, works, scholarships and services, all under such terms and conditions as the Bank shall specify by notice to the Borrower.

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

B. Special Account

1. The Borrower may open and maintain in Dollars a special deposit account in a commercial bank acceptable to the Bank, on terms and conditions satisfactory to the Bank, including appropriate protection against set-off, seizure and attachment.

2. After the Bank has received evidence satisfactory to it that the Special Account has been opened, withdrawals from the Loan Account of amounts to be deposited into the Special Account shall be made as follows:

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

   (b) if the Borrower is making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex B to this Schedule 1.
3. Payments out of the Special Account shall be made exclusively for Eligible Expenditures. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Bank shall reasonably request, furnish to the Bank such documents and other evidence showing that such payment was made exclusively for Eligible Expenditures.

4. Notwithstanding the provisions of Part B.2 of this Schedule, the Bank shall not be required to make further deposits into the Special Account:

   (a) if the Bank, at any time, is not satisfied that the reports referred to in Part A.5 of this Schedule 1 adequately provide the information required for Report-based Disbursements;

   (b) if the Bank determines at any time that all further withdrawals for payment of Eligible Expenditures should be made by the Borrower directly from the Loan Account; or

   (c) if the Borrower shall have failed to furnish to the Bank, within the period of time specified in Section 4.01 (b) (ii) of this Agreement, any of the audit reports required to be furnished to the Bank pursuant to said Section in respect of the audit of: (A) the records and accounts for the Special Account; or (B) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based Disbursements or were made on the basis of statements of expenditure, as the case may be.

5. The Bank shall not be required to make further deposits into the Special Account in accordance with the provisions of Part B.2 of this Schedule if, at any time, the Bank shall have notified the Borrower and the Guarantor of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Loan Account pursuant to Section 6.02 of the General Conditions. Upon such notification, the Bank shall determine, in its sole discretion, whether further deposits into the Special Account may be made and what procedures should be followed for making such deposits, and shall notify the Borrower and the Guarantor of its determination.

6. (a) If the Bank determines at any time that any payment out of the Special Account was made for an expenditure which is not an Eligible Expenditure, or was not justified by the evidence furnished to the Bank, the Borrower shall, promptly upon notice from the Bank, provide such additional evidence as the Bank may request, or deposit into the Special Account (or, if the Bank shall so request, refund to the Bank) an amount equal to the amount of such payment. Unless the Bank shall otherwise agree, no further deposit by the Bank into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.
(b) If the Bank determines at any time that any amount outstanding in the Special Account will not be required to cover payments for Eligible Expenditures during the six-month period following such determination, the Borrower shall, promptly upon notice from the Bank, refund to the Bank such outstanding amount.

(c) The Borrower may, upon notice to the Bank, refund to the Bank all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Bank made pursuant to subparagraph (a), (b) or (c) of this paragraph 6 shall be credited to the Loan Account for subsequent withdrawal or for cancellation in accordance with the provisions of the Loan Agreement.
Annex A
to
SCHEDULE 1

Operation of Special Account
When Withdrawals Are Not
Report-based Disbursements

1. For the purposes of this Annex, the term “Authorized Allocation” means the amount of $3,000,000 to be withdrawn from the Loan Account and deposited into the Special Account pursuant to paragraph 2 of this Annex provided, however, that unless the Bank shall otherwise agree, the Authorized Allocation shall be limited to the amount of $1,000,000 until the aggregate amount of withdrawals from the Loan Account plus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General Conditions shall be equal to or exceed the equivalent of $2,000,000.

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

   (b) For replenishment of the Special Account, the Borrower shall furnish to the Bank requests for deposit into the Special Account at such intervals as the Bank shall specify. Prior to or at the time of each such request, the Borrower shall furnish to the Bank the documents and other evidence required pursuant to Part B.3 of Schedule 1 to this Agreement for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for Eligible Expenditures. Each such deposit into the Special Account shall be withdrawn by the Bank from the Loan Account under one or more of the Eligible Categories.

3. The Bank shall not be required to make further deposits into the Special Account, once the total unwithdrawn amount of the Loan minus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General
Conditions shall equal the equivalent of twice the amount of the Authorized Allocation. Thereafter, withdrawal from the Loan Account of the remaining unwithdrawn amount of the Loan shall follow such procedures as the Bank shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Bank shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for Eligible Expenditures.
Annex B

to

SCHEDULE 1

Operation of Special Account
When Withdrawals Are
Report-based Disbursements

1. Withdrawals from the Loan Account shall be deposited by the Bank into the Special Account in accordance with the provisions of Schedule 1 to this Agreement. Each such deposit into the Special Account shall be withdrawn by the Bank from the Loan Account under one or more of the Eligible Categories.

2. Upon receipt of each application for withdrawal of an amount of the Loan, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account an amount equal to the lesser of: (a) the amount so requested; and (b) the amount which the Bank has determined, based on the reports referred to in Part A.5 of this Schedule 1 applicable to such withdrawal application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such reports.
SCHEDULE 2

Description of the Project

The objectives of the Project are to: (a) improve the quality, efficiency and inclusiveness of the Borrower’s education system; (b) modernize and strengthen the managerial, financial and administrative capacity of SEDUC to set policies and guidelines for the education sector and deliver public education efficiently; and (c) support the Borrower’s education sector modernization effort.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Bank may agree upon from time to time to achieve such objectives:

Part A: Improvement of the Quality and Efficiency of the Borrower’s Basic Education Schools

1. School Autonomy

   (a) Provision of management training to directors and other administrative staff of State Schools;

   (b) provision of technical assistance and training for preparation of PDEs in State Schools; and

   (c) Carrying out of PME School Subprojects in Eligible State Schools.

2. Minimum Operational Standards

   Provision of equipment, educational materials and minor school reconstruction for Basic Education schools and Indigenous Schools, and in selected cases, computer laboratories, all as needed by such schools to meet the Minimum Operational Standards.

3. Teachers’ Qualifications

   Carrying out of a program of pre-service training of teachers (including scholarships) on the Borrower’s revised curricula, as needed to address the shortage of teachers in grades 5 through 8 of Fundamental Education and in Secondary Education.
Part B: Improvement of the Efficiency, Effectiveness and Inclusiveness of the Education System in the Borrower’s Territory

1. Educational Policies and Performances

(a) Carrying out of studies designed to improve the formulation and implementation of the Borrower’s education policies including, *inter alia*, studies to define:

(i) curricula and education materials, including educational software;

(ii) school certification and standards; and

(iii) strategies to strengthen teacher training colleges in municipalities and provision of scholarships related thereto.

(b) Consolidation of SAEPE and dissemination to schools and stakeholders of the evaluation results.

(c) Improvement of the Borrower’s information systems covering education statistics, school enrollment, school census, and other education management tools.

2. Strengthening of the Quality and Inclusiveness of the Education Programs carried out in the Borrower’s Territory

Carrying out of a program to improve the quality of education, reduce age-grade distortions, and diminish youth idleness and involvement in anti-social activities in Eligible Municipal Schools, such program to include, *inter alia*:

(a) strengthening and expansion of accelerated classes for overage students attending grades 1 to 8 of Fundamental Education;

(b) in-service training to all teachers of grades 1 and 2 in all State Schools and selected Municipal Schools;

(c) job-skills and other educational training for youth at risk; and

(d) preparation and implementation of PDEs and PME School Subprojects in selected Municipal Schools, and in all schools with *Quilombola* students.
Part C: State Reform

1. Implementation of the PDRE, including, *inter alia*:

   (a) carrying out of a management modernization program in SEDUC;

   (b) the creation of a customer relations office at SEDUC (*Ouvidoria*) serving education stakeholders;

   (c) e-government development and implementation;

   (d) strengthening of SEDUC’s capacity in education management through training;

   (e) development of a human resource policy for SEDUC’s employees; and

   (f) collection and processing of social indicators data, and development and implementation of models for monitoring and evaluation of public policies and expenditures, in particular as related to education.

2. Modernization of Education Management

   (a) Carrying out of selected measures (including training and scholarships) proposed as a result of the activities carried out under Part C.1 of the Project in the following areas:

   (i) human resources;

   (ii) financial management;

   (iii) planning;

   (iv) technology; and

   (v) supervision, monitoring and evaluation of the education sector activities.
(b) Provision of technical (including legal) assistance for the reorganization of SEDUC to ensure more efficient service delivery and foster other management improvements.

Part D: Project Management

Establishment and operation of the PCU.

* * *

The Project is expected to be completed by June 30, 2009.
### SCHEDULE 3

**Amortization Schedule**

<table>
<thead>
<tr>
<th>Date Payment Due</th>
<th>Payment of Principal (Expressed in Dollars)*</th>
</tr>
</thead>
<tbody>
<tr>
<td>On each May 15 and November 15</td>
<td></td>
</tr>
<tr>
<td>beginning May 15, 2010</td>
<td>1,315,000</td>
</tr>
<tr>
<td>through May 15, 2021</td>
<td>1,315,000</td>
</tr>
<tr>
<td>on November 15, 2021</td>
<td>1,255,000</td>
</tr>
</tbody>
</table>

* The figures in this column represent the amount in Dollars to be repaid, except as provided in Section 4.04 (d) of the General Conditions.
SCHEDULE 4

Procurement

Section I. General

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

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

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

Section II. Particular Methods of Procurement of Goods, Works and Services (other than Consultants’ Services)

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

B. Other Procurement Procedures

1. National Competitive Bidding. Goods estimated to cost less than $ 350,000 and works estimated to cost less than $ 5,000,000 equivalent per contract, may be procured under contracts awarded on the basis of National Competitive Bidding and the following additional provisions:

   (a) contracts shall be awarded to the bidder whose bid has been determined to be the lowest evaluated bid, such evaluation to be based on price, and whenever appropriate, to also take into account factors similar to those referred to in paragraph 2.51 of the Guidelines, provided, however, that the bid evaluation shall always be based on
factors that can be quantified objectively, and the procedure for such quantification shall be disclosed in the invitation to bid;

(b) whenever required by the Bank during revisions of the Procurement Plan, the invitation to bid shall be advertised for at least three consecutive days in a newspaper of wide circulation in Brazil;

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

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

(e) there shall not be, without the Bank’s prior approval, issuance of any change order under a contract which would increase or decrease by more than 15% the quantity of works or goods (and related services), as the case may be, without any change in the unit prices or other terms and conditions of such contract.

2. **Shopping.** Goods estimated to cost less than $100,000 equivalent per contract and works estimated to cost less than $350,000 equivalent per contract, may be procured under contracts awarded on the basis of Shopping, including as a form of such shopping in respect of goods, the electronic bidding (pregão eletrônico) procurement system set forth in the Guarantor’s Law No. 10,520 of July 17, 2002.

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

4. **Community Participation.**

(a) Goods and services required for PME school subprojects may be procured on the basis of community participation in accordance with the procedures set forth in the Operational Manual.

(b) The Borrower shall, through SEDUC, carry out or cause to be carried out yearly procurement reviews of the goods and services procured by School Subproject Implementation Entities.
Section III. Particular Methods of Procurement of Consultants’ Services

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

B. Other Procedures

1. Selection Based on Consultants’ Qualifications. Services 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, 3.7 and 3.8 of the Consultant Guidelines.

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

Section IV. Review by the Bank of Procurement Decisions

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