CONFORMED COPY

CREDIT NUMBER 4233-ZA

Financing Agreement

(Water Sector Performance Improvement Project)

between

REPUBLIC OF ZAMBIA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated December 22, 2006
FINANCING AGREEMENT

AGREEMENT dated December 22, 2006, between REPUBLIC OF ZAMBIA ("Recipient") and INTERNATIONAL DEVELOPMENT ASSOCIATION ("Association"). The Recipient and the Association 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 Financing Agreement have the meanings ascribed to them in the General Conditions or in the Appendix to this Agreement.

ARTICLE II — FINANCING

2.01. The Association agrees to extend to the Recipient, on the terms and conditions set forth or referred to in this Agreement, a credit in an amount equivalent to fifteen million seven hundred Special Drawing Rights (SDR 15,700,000) ("Credit") to assist in financing the project described in Schedule 1 to this Agreement ("Project").

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

2.03. The Maximum Commitment Charge Rate payable by the Recipient on the Unwithdrawn Financing Balance shall be one-half of one percent (1/2 of 1%) per annum.

2.04 The Service Charge payable by the Recipient on the Withdrawn Credit Balance shall be equal to three-fourths of one percent (3/4 of 1%) per annum.

2.05. The Payment Dates are February 15 and August 15 in each year.

2.06. The principal amount of the Credit shall be repaid in accordance with repayment schedule set forth in Schedule 3 to this Agreement.
2.07. The Payment Currency is Dollars.

ARTICLE III — PROJECT

3.01. The Recipient declares its commitment to the objectives of the Project. To this end, the Recipient shall carry out Part B of the Project and cause Part A of the Project to be carried out by the Project Implementing Entity in accordance with the provisions of Article IV of the General Conditions.

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

ARTICLE IV — REMEDIES OF THE ASSOCIATION

4.01. The Additional Event of Suspension is that the Project Implementing Entity’s Articles of Association have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of the Project Implementing Entity to perform any of its obligations under the Project Agreement.

4.02. The Additional Event of Acceleration is that the event specified in 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 Association to the Recipient.

ARTICLE V — EFFECTIVENESS; TERMINATION

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

(a) The Subsidiary Agreement has been executed on behalf of the Recipient and the Project Implementing Entity;

(b) The Development Financing Agreement for Performance Enhancement has become effective; and

(c) The Project Implementing Entity has finalized the plan to streamline its procurement functions.
5.02. The Additional Legal Matter is that the Subsidiary Agreement has been duly authorized or ratified by the Recipient and the Project Implementing Entity and is legally binding upon the Recipient and the Project Implementing Entity in accordance with its terms.

5.03. The Effectiveness Deadline is the date 90 days after the date of this Agreement.

5.04. For purposes of Section 8.05 (b) of the General Conditions, the date on which the obligations of the Recipient under Articles IV and V of the General Conditions shall terminate is 20 years after the date of this Agreement.

ARTICLE VI — REPRESENTATIVE; ADDRESSES

6.01. The Recipient’s Representative is the Minister responsible for Finance.

6.02. The Recipient’s Address is:

Ministry of Finance and National Planning
P.O. Box 50062
Lusaka, Zambia.

Facsimile: 260-1-253494  Telephone: 260-1-251078

6.03. The Association’s Address is:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America.

Cable: INDEVAS  Telex: 248423 (MCI) or 1-202-477-6391
Facsimile: Washington, D.C. 64145 (MCI)
AGREED at Lusaka, Republic of Zambia, as of the day and year first above written.

REPUBLIC OF ZAMBIA

By: /s/ Ng’andu P. Magande

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By: /s/ Ohene O. Nyanin

Authorized Representative
SCHEDULE 1

Project Description

The objective of the Project is to support the Recipient’s efforts towards the: (i) improvement of access to, and sustainability of, the water supply and sanitation services for consumers in Lusaka; and (ii) development of a comprehensive institutional structure supporting a coordinated approach to water supply and sanitation investments.

The Project consists of the following parts:

Part A: Support to Lusaka Water and Sewerage Company

1. Support to the Project Implementing Entity consisting of consultancy services, goods, works and operating costs for the implementation of the Development Financing Agreement for Performance Enhancement.

2. The carrying out of rehabilitation works for bulk water production, repair of distribution systems and repairs to sewer networks and plants through the provision of consultancy services, goods and works.

3. The design and implementation of a human resources strategy through the provision of technical assistance and performance payments.

4. Provision of technical assistance for the preparation of designs, carrying out of feasibility studies, and completion of environmental impact assessment for a follow up Project.

Part B: Support to the MLGH for the Preparation of a Coordinating Mechanism for Water Supply and Sanitation Sector

1. Support to the restructuring of water and sanitation function within the MLGH through the provision of technical assistance.

2. Strengthening the strategic analytical function for water and sanitation within the MLGH through the provision of technical assistance, logistical support and equipment.
3. Provision of technical assistance for the implementation of the rural water supply and sanitation financing mechanism and its harmonization with other government mechanisms.
SCHEDULE 2

Project Execution

Section I. Subsidiary Financing; Institutional and Other Arrangements

A. Subsidiary Agreement

1. To facilitate the carrying out of the Project Implementing Entity’s Respective Part of the Project, the Recipient shall make part of the proceeds of the Financing available to the Project Implementing Entity under a subsidiary agreement between the Recipient and the Project Implementing Entity, under terms and conditions approved by the Association (the “Subsidiary Agreement”).

2. The Recipient shall exercise its rights under the Subsidiary Agreement in such manner as to protect the interests of the Recipient and the Association and to accomplish the purposes of the Financing. Except as the Association shall otherwise agree, the Recipient shall not assign, amend, abrogate or waive the Subsidiary Agreement of any of its provisions.

B. Institutional Arrangements

1. The Recipient shall maintain the Project Implementing Entity, as an on-going concern, with responsibility for the implementation of Part A of the Project and the MLGH with responsibility for the implementation of Part B of the Project.

2. The Recipient shall maintain the Development Financing Agreement for Performance Enhancement Review Committee with composition and terms of reference satisfactory to the Association, to be responsible for the administration, monitoring and assessment of the Development Financing Agreement for Performance Enhancement and carrying out the Performance Audit.

C. ESMF, EMP and RPF

The Recipient shall cause the Project Implementing Entity to implement the Project in accordance with the ESMF, EMP and RPF.
D. Development Financing Agreement for Performance Enhancement

The Recipient shall discharge all of its obligations under the Development Financing Agreement for Performance Enhancement with due diligence and in accordance with all time-tables and performance targets set forth therein.

Section II. Project Monitoring, Reporting and Evaluation

A. Project Reports

1. The Recipient shall monitor and evaluate, or cause to be monitored and evaluated, the progress of the Project and prepare Project Reports in accordance with the provisions of Section 4.08 of the General Conditions and on the basis of indicators set forth below in paragraph 2 of this Part A. Each Project Report shall cover the period of one calendar quarter, and shall be furnished to the Association not later than one month after the end of the period covered by such report.

2. The performance indicators referred to above in paragraph 1 of this Part A consist of the following:

<table>
<thead>
<tr>
<th>Performance Criteria</th>
<th>Unit</th>
<th>Performance by Close of Project</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Number of new Kiosks</td>
<td>Number</td>
<td>60</td>
</tr>
<tr>
<td>(b) Installation of new meters</td>
<td>Number</td>
<td>20,000</td>
</tr>
<tr>
<td>(c) Drinking water quality - biological samples failing</td>
<td>% failed</td>
<td>From 10% to 5%</td>
</tr>
<tr>
<td>(d) Energy reduction in KWh/m³ water produced</td>
<td>Reduction in KWh/m³</td>
<td>12%</td>
</tr>
<tr>
<td>(e) Energy reduction in KWh/m³ sewerage discharged</td>
<td>Reduction in KWh/m³</td>
<td>15%</td>
</tr>
<tr>
<td>(f) Leakage control reduction in unaccounted for water</td>
<td>%</td>
<td>55% to 45%</td>
</tr>
<tr>
<td>(g) Collection ratio (collect/billed current period per billing cycle)</td>
<td>%</td>
<td>From 70% to 80%</td>
</tr>
<tr>
<td>(h) Operating and maintenance cost coverage</td>
<td>%</td>
<td>100%</td>
</tr>
</tbody>
</table>
B. Financial Management, Financial Reports and Audits

1. The Recipient shall maintain or cause to be maintained a financial management system in accordance with the provisions of Section 4.09 of the General Conditions.

2. Without limitation on the provisions of Part A of this Section, the Recipient shall prepare and furnish to the Association as part of the Project Report not later than one month after the end of each calendar quarter, interim un-audited financial reports for the Project covering the quarter, in form and substance satisfactory to the Association.

3. The Recipient shall have its Financial Statements audited in accordance with the provisions of Section 4.09 (b) of the General Conditions. Each audit of the Financial Statements shall cover the period of one fiscal year of the Recipient, commencing with the fiscal year in which the first withdrawal under the Project Preparation Advance was made. The audited Financial Statements for each such period shall be furnished to the Association not later than six months after the end of such period.

Section III. Procurement

A. General

1. Goods and Works. All goods and works required for the Project and to be financed out of the proceeds of the Financing 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 Financing 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 Association 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 and Works

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

2. Other Methods of Procurement of Goods and Works. The following table specifies the methods of procurement, other than International Competitive Bidding, which may be used for goods and works. 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) Direct Contracting</td>
</tr>
<tr>
<td>(c) Shopping</td>
</tr>
<tr>
<td>(d) Force Account</td>
</tr>
</tbody>
</table>

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 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>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Least Cost Selection</td>
</tr>
<tr>
<td>(b) Selection Based on Consultants’ Qualifications</td>
</tr>
<tr>
<td>(c) Selection under a Fixed Budget</td>
</tr>
<tr>
<td>(d) Quality Based Selection</td>
</tr>
<tr>
<td>(e) Single Source Selection</td>
</tr>
<tr>
<td>(f) Individual Consultants</td>
</tr>
</tbody>
</table>

D. Review by the Bank of Procurement Decisions

The Procurement Plan shall set forth those contracts which shall be subject to the Association’s Prior Review. All other contracts shall be subject to Post Review by the Association.
Section IV. Withdrawal of the Proceeds of the Financing

A. General

1. The Recipient may withdraw the proceeds of the Financing in accordance with the provisions of this Section and such additional instructions as the Bank may specify by notice to the Recipient, 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 Financing (“Category”), the allocations of the amounts of the Credit 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 Credit Allocated (expressed in SDR)</th>
<th>Percentage of Expenditures to be Financed</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Goods, works, consultants’ services, training and Performance Payments for the Project</td>
<td>10,000,000</td>
<td>100%</td>
</tr>
<tr>
<td>(2) Operating Costs</td>
<td>2,400,000</td>
<td>100%</td>
</tr>
<tr>
<td>(3) Refund of Project Preparation Advance</td>
<td>450,000</td>
<td>Amount payable pursuant to Section 2.07 of the General Conditions</td>
</tr>
<tr>
<td>(4) Unallocated</td>
<td>2,850,000</td>
<td>100%</td>
</tr>
<tr>
<td><strong>TOTAL AMOUNT</strong></td>
<td><strong>15,700,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

B. Withdrawal Conditions; Withdrawal Period

1. Notwithstanding the provisions of Part A of this Section no withdrawal shall be made:
(i) for payments made prior to the date of this Agreement;

(ii) for payments in respect of Eligible Expenditures under Category (2) in any year during implementation of the Project, unless the Recipient has furnished to the Association an approved annual budget forecast for the Operating Costs of the Project Implementing Entity for the year concerned, acceptable to the Association.

2. For purposes of this Section, the term:

(i) “Operating Costs” means the expenses incurred by the Project Implementing Entity on account of implementation, management, and monitoring, including utilities, office supplies and equipment, bank charges, communications, vehicle operation, maintenance, insurance cost, building and equipment maintenance, travel, supervision and advertising.

(ii) “Performance Payments” means the payments to be made to the Project Implementing Entity as incentive for achieving the performance targets set out in the Development Financing Agreement for Performance Enhancement.

3. The Closing Date is June 30, 2010.

Section V. Other Undertaking

The Recipient shall ensure that payments to the Project Implementing Entity for water and sewerage services provided to its ministries and departments are made within 60 days of the claim.
**SCHEDULE 3**

**Repayment Schedule**

<table>
<thead>
<tr>
<th>Date Payment Due</th>
<th>Principal Amount of the Credit repayable (expressed as a percentage)*</th>
</tr>
</thead>
<tbody>
<tr>
<td>On each February, 15 and August 15:</td>
<td></td>
</tr>
<tr>
<td>commencing February 15, 2017 to and including August 15, 2026</td>
<td>1%</td>
</tr>
<tr>
<td>commencing February 15, 2027 to and including August 15, 2046</td>
<td>2%</td>
</tr>
</tbody>
</table>

*The percentages represent the percentage of the principal amount of the Credit to be repaid, except as the Association may otherwise specify pursuant to Section 3.03 (b) of the General Conditions.*
APPENDIX

Definitions

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


3. “Development Financing Agreement for Performance Enhancement” means an agreement between the Recipient and the Project Implementing Entity aimed at improving the technical and financial efficiency of the Project Implementing Entity and consisting of the strategic plan, human resources plan, monitoring and assessment and other matters relating to the Project;

4. “Development Financing Agreement for Performance Enhancement Review Committee” means the committee referred to in Section I.B.2 of Schedule 2 to this Agreement;

5. “Displaced Person” means a person who, on account of the execution of the Project, has experienced or would experience direct economic and social impacts caused by: (i) the involuntary taking of land, resulting in: (A) relocation or loss of shelter, (B) loss of assets or access to assets, or (C) loss of income sources or means of livelihood, whether or not such person must move to another location; or (ii) the involuntary restriction to access to legally designated parks and protected areas, resulting in adverse impacts on the livelihood of such persons and “Displaced Persons” means more that one Displaced Person;

6. “EMP” or Environmental Management Plan means the set of mitigation, enhancement, monitoring, and institutional measures to be taken during implementation of the Project to mitigate adverse environmental and social impacts, offset them, or reduce them to acceptable levels, or to enhance positive impacts;

7. “ESMF” means the Recipient’s Environmental and Social Management Framework document dated April, 2006 referred to in paragraph C of Section I of Schedule 2 to this Agreement, setting forth, inter alia, guidelines, procedures, timetable and other specifications designed to offset adverse environmental and social impacts related to Project activities, or to reduce them to acceptable levels, or to enhance positive impacts;
8. “General Conditions” means the “International Development Association General Conditions for Credits and Grants”, dated July 1, 2005;

9. “MLGH” means the Recipient’s Ministry of Local Government and Housing;

10. “Performance Audit” means the annual technical and financial management audit referred to in Section 10 of the Development Financing Agreement for Performance Enhancement and in Section I. B.2 of Schedule 2 to this Agreement;

11. “Procurement Guidelines” means the “Guidelines for Procurement under IBRD Loans and IDA Credits” published by the Bank in May 2004;

12. “Procurement Plan” means the Recipient’s procurement plan for the Project, dated April 19, 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;

13. “Project Implementing Entity” means the Lusaka Water and Sewerage Company, incorporated under the Companies Act, Chapter 388 of the Laws of Zambia;

14. “Project Implementing Entity’s Articles of Association” mean the articles governing the existence and operations of the Project Implementing Entity and referred to in section 4.01 of this Agreement;

15. “Project Preparation Advance” means the advance referred to in Section 2.07 of the General Conditions, granted by the Association to the Recipient pursuant to the letter agreement signed on behalf of the Association on November 17, 2004 and on behalf of the Recipient on November 25, 2004;

16. “RPF” means the Resettlement Policy Framework of the Recipient dated April, 2006 setting forth, inter alia, guidelines, procedures, timetable and other specifications of the resettlement / compensation to be made under the Project to Affected Persons and referred to in paragraph C of Section I of Schedule 2 to this Agreement; and

17. “Subsidiary Agreement” means the agreement referred to in Section I.A of Schedule 2 to this Agreement pursuant to which the Recipient shall make the proceeds of the Financing available to the Project Implementing Entity.