
LOAN NUMBER 2201-SRI (SF)

LOAN AGREEMENT
(Special Operations)

(Local Government Infrastructure Improvement Project)

between

DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

and

ASIAN DEVELOPMENT BANK

DATED 19 January 2006

LAS: SRI 35201

LOAN AGREEMENT (Special Operations)

LOAN AGREEMENT dated 19 January 2006 between DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA ("the Borrower") and ASIAN DEVELOPMENT BANK ("ADB").

WHEREAS

(A) the Borrower has applied to ADB for a loan for the purposes of the Project described in Schedule 1 to this Loan Agreement;

(B) the Project will be carried out by the Borrower's Ministry of Provincial Councils and Local Governments (hereinafter called "MPCLG"), and for this purpose the Borrower will make available to MPCLG the proceeds of the Loan provided for herein upon terms and conditions satisfactory to ADB; and

(C) Component B of the Project will be carried out by the Local Loans and Development Fund (hereinafter called "LLDF"), and for this purpose the Borrower will enter into a Subsidiary Loan Agreement with LLDF upon terms and conditions satisfactory to ADB to make available to LLDF a portion of the proceeds of the Loan provided for herein pursuant to Section 3.01 (a) of this Loan Agreement; and

(D) ADB has, on the basis inter alia of the foregoing, agreed to make a Loan to the Borrower from ADB's Special Funds resources upon the terms and conditions set forth herein and in the Project Agreement of even date herewith between ADB and LLDF, respectively;

NOW THEREFORE the parties agree as follows:

ARTICLE I

Loan Regulations; Definitions

Section 1.01. All the provisions of the Special Operations Loan Regulations of ADB, dated 1 May 2004 (the "Loan Regulations"), are hereby made applicable to this Loan Agreement with the same force and effect as if they were fully set forth herein.

Section 1.02. The definitions set forth in the Loan Regulations are applicable to this Loan Agreement unless the context requires otherwise. In addition, the following terms have the following meanings:

(a) "CLG" means Commissioner of Local Government;

(b) “Code of Conduct” means the Code to be prepared by LLDF as referred to in paragraph 3 of Schedule 1 to this Loan Agreement;

(c) “Components” means any of the components of the Project as more fully described in Schedule 1 to this Loan Agreement and as the context requires;

(d) “Executing Agency” or “EA” means, for the purposes for and within the meaning of the Loan Regulations, MPCLG, and any other successor thereto agreed to by ADB, which shall be responsible for the carrying out of the Project;

(e) “Fiscal Year” means the fiscal year of the Borrower commencing on 1 January and ending on 31 December of each calendar year;

(f) “FLIP” means the Financial and Local Improvement Plan as referred to in paragraph 2 (1) of Schedule 1 to this Loan Agreement;

(g) “Grant” means a grant made or proposed to be made by LLDF for a Subproject under Component B of the Project;

(h) “Guarantee Agreement” means the agreement between LLDF and the PCs as referred to in paragraph 14 of Schedule 6 to this Loan Agreement;

(i) “LLDF” means Local Loans and Development Fund established under the Local Loans and Development Ordinance No. 22 of 1916 as amended and the Local Loans and Development Commissioners as described in Section 2 Subsection 3 of the said Ordinance, responsible for carrying out Component B of the Project, and any successor thereto;

(j) “Local Authorities” or “LAs” means Municipal Councils, Urban Councils and Pradeshiyas Sabhas;

(k) “MOFP” means Ministry of Finance and Planning of the Borrower, and any successor thereto;

(l) “MPCLG” means Ministry of Provincial Councils and Local Government of the Borrower, and any successor thereto;

(m) “Municipal Council” or “MC” means the local government authority or body of the Borrower created under the Municipal Councils Ordinance (MCO), No. 29 of 1947 of the Borrower;

(n) “NSC” means the National Steering Committee established in accordance with paragraph 6 of Schedule 6 to this Loan Agreement;

(o) “NWSDB” means the National Water Supply and Drainage Board of the Borrower established under Law No. 2 of 1974;

(p) “O&M” means operation and maintenance;

(q) “Operations Manual” means the manual referred to in paragraph 16 of Schedule 6 to this Loan Agreement;

(r) “Ordinance” means the Ordinance No. 22 of 1916 establishing the Local Loans and Development Fund as amended from time to time;

(s) “PAU” means the Project Appraisal Unit as referred to in paragraph 8 of Schedule 6 to this Loan Agreement;

(t) “PCs” means the eight Provincial Councils in Sri Lanka established under the Thirteenth Amendment of the Constitution and “PC” refers to any one of the PCs;

(u) “PCU” means Project Coordination Unit as referred to in paragraph 3 of Schedule 6 to this Loan Agreement;

(v) “Project Development Assistance” or “PDA” means assisting LAs to identify, prioritize and compile proposals within their respective areas as referred to in paragraph 2 (2) b of Schedule 1 to this Loan Agreement;

(w) “Performance Agreement” means the agreement for the grant made or proposed to be made under Component B of the Project, as referred to in paragraph 14 of Schedule 6 to this Loan Agreement;

(x) “Pradeshiya Sabha(s)” or “PS” means the local government authority or body of the Borrower created under the Pradeshiya Sabha Act No. 15 of 1987 of the Borrower;

(y) “Project Area” means the territory of the Borrower except the district of Colombo;

(z) “Project Director” means the full-time head of PCU appointed by the Borrower, responsible for all activities in relation to the implementation of the Project and as more specifically provided for in paragraph 3 of Schedule 6 to this Loan Agreement;

(aa) “Project Implementing Agency” or “PIA” means the agency directly responsible for Component B;

(bb) “Province” means any of the nine Provinces within the territory of the Borrower, namely Central, Eastern, North Central, Northern, North Western, Sabaragamuwa, Southern, Uva and Western;

(cc) “Resettlement Plan” means the resettlement plan to be prepared in accordance with paragraph 18 of Schedule 6 to this Loan Agreement;

(dd) “RRP” means the Report and Recommendation of the President to the Board of Directors of ADB for the Project;

(ee) “Rupees” or “SLRs” means the currency of the Borrower;

(ff) “SPCU” means the Subproject Coordination Unit as described in paragraph 5 of Schedule 6 to this Loan Agreement;

(gg) “Subborrower” means a recipient LA of a Subloan;

(hh) "Subloan" means a loan made or proposed to be made by LLDF for a Subproject under Component B of the Project;

(ii) "Subloan Agreement" means the agreement to be entered into by LLDF and participating LAs for financing of Subprojects (defined below) under Component B of the Project, as referred to in paragraph 14 of Schedule 6 to this Loan Agreement;

(jj) "Subprojects" means a Subproject to be included under Component B of the Project to be financed in accordance with the procedures and criteria set forth in paragraph 10 of Schedule 6 to this Loan Agreement and "Subproject" means any one of them;

(kk) "Subrecipient" means the recipient LA of a grant;

(ll) "Subsidiary Loan Agreement" means the agreement to be entered into between the Borrower and LLDF for the purposes of onlending a portion of the proceeds of the Loan for the carrying out of Component B of the Project as referred to in Section 3.01(a) of this Loan Agreement;

(mm) "UDA" means the Borrower's Urban Development Authority established under Law No. 41 of 1978 and any successor thereto; and

(nn) "Urban Council" means the local government authority or body of the Borrower created under the Urban Councils Ordinance (UCO), No. 61 of 1939 of the Borrower.

ARTICLE II

The Loan

Section 2.01. ADB agrees to lend to the Borrower from ADB's Special Funds resources an amount in various currencies equivalent to thirty four million four hundred and ninety six thousand Special Drawing Rights (SDR 34,496,000).

Section 2.02. (a) The Borrower shall pay to ADB an interest charge at the rate of one percent (1%) per annum during the grace period, and one and one-half percent (1.5%) per annum thereafter, on the amount of the Loan withdrawn from the Loan Account and outstanding from time to time.

(b) The term "grace period" as used in paragraph (a) of this Section means the period prior to payment of the first principal amount of the Loan on the payment date in accordance with the amortization schedule set forth in Schedule 2 to this Loan Agreement.

Section 2.03. The interest charge and any other charge on the Loan shall be payable semiannually on 15 May and 15 November in each year.

Section 2.04. The Borrower shall repay the principal amount of the Loan withdrawn from the Loan Account in accordance with the amortization schedule set forth in Schedule 2 to this Loan Agreement.

ARTICLE III

Use of Proceeds of the Loan

Section 3.01. (a) The Borrower shall relend an amount equivalent to twenty four million six hundred and sixty seven thousand Special Drawing Rights (SDR 24,667,000) to LLDF under a Subsidiary Loan Agreement for Component B of the Project upon terms and conditions satisfactory to ADB. Except as ADB shall otherwise agree, the terms for relending parts of the proceeds of the Loan shall include a relending interest rate at the same rate as that applicable to the Loan and a repayment period of thirty two years including a grace period of eight years. The Borrower shall bear the foreign exchange risk of the Loan.

(b) The Borrower shall cause MPCLG and LLDF to apply the proceeds of the Loan to the financing of expenditures on the Project in accordance with the provisions of this Loan Agreement, the Project Agreement and the Subsidiary Loan Agreement.

(c) The Borrower shall make available through budgetary allocations an amount equivalent to at least six million four hundred and eighty two thousand Special Drawing Rights (SDR 6,482,000) to MPCLG for the purpose of carrying out Component A and Component C of the Project.

Section 3.02. The goods and services and other items of expenditure to be financed out of the proceeds of the Loan and the allocation of amounts of the Loan among different categories of such goods and services and other items of expenditure shall be in accordance with the provisions of Schedule 3 to this Loan Agreement, as such Schedule may be amended from time to time by agreement between the Borrower and ADB.

Section 3.03. Withdrawals from the Loan Account in respect of goods and services shall be made only on account of expenditures relating to

- (a) goods which are produced in and supplied from and services which are supplied from such member countries of ADB as shall have been specified by ADB from time to time as eligible sources for procurement, and
- (b) goods and services which meet such other eligibility requirements as shall have been specified by ADB from time to time.

Section 3.04. Except as ADB may otherwise agree, all goods and services to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 4 and Schedule 5 to this Loan Agreement.

Section 3.05. The Loan Closing Date for the purposes of Section 8.02 of the Loan Regulations shall be 30 April 2012 or such other date as may from time to time be agreed between the Borrower and ADB.

ARTICLE IV

Particular Covenants

Section 4.01. In the carrying out of the Project and operation of the Project facilities, the Borrower shall perform, or cause MPCLG and LLDF to perform, all obligations set forth in Schedule 6 to this Loan Agreement.

Section 4.02. (a) The Borrower shall (i) maintain, and cause the MPCLG, LLDF and each of the PCs and SPCUs to maintain, separate records and accounts for the Project; (ii) have, and cause MPCLG, LLDF and each of the PCs and SPCUs to have, such accounts and related financial statements audited annually, in accordance with the appropriate auditing standards consistently applied, by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB; (iii) furnish to ADB, as soon as available but in any event not later than 6 months after the end of each related fiscal year, certified copies of such audited accounts and financial statements and the report of the auditors relating thereto (including the auditors opinion on the use of the Loan proceeds and compliance with the financial covenants of this Loan Agreement and the use of the procedures for imprest account and statement of expenditures issued under the Project), all in the English language; and (iv) furnish to ADB such other information concerning such accounts and financial statements and the audit thereof as ADB shall from time to time reasonably request.

(b) The Borrower shall enable ADB, upon ADB's request, to discuss each of MPCLG, LLDF, the PC's and SPCU's financial statements for the Project and its financial affairs related to the Project from time to time with the Borrower's auditors, and shall authorize and require any representative of such auditors to participate in any such discussions requested by ADB, provided that any such discussion shall be conducted only in the presence of an authorized officer of the Borrower unless the Borrower shall otherwise agree.

Section 4.03. Without limiting the generality of Section 6.05 (a) of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB quarterly reports on the carrying out of the Project.

Section 4.04. The Borrower shall enable ADB's representatives to inspect the Project, the goods financed out of the proceeds of the Loan, and any relevant records and documents.

Section 4.05. The Borrower shall take all action which shall be necessary on its part to enable MPCLG and LLDF to perform its obligations under the Project Agreement, and shall not take or permit any action which would interfere with the performance of such obligations.

Section 4.06. (a) The Borrower shall exercise its rights under the Subsidiary Loan Agreement in such a manner as to protect the interests of the Borrower and ADB and to accomplish the purposes of the Loan.

(b) No rights or obligations under the Subsidiary Loan Agreement shall be assigned, amended, or waived without the prior concurrence of ADB.

ARTICLE V

Suspension; Cancellation; Acceleration of Maturity

Section 5.01. The following are specified as additional events for suspension of the right of the Borrower to make withdrawals from the Loan Account for the purposes of Section 8.01(m) of the Loan Regulations:

(a) The LLDF Ordinance or any provision thereof shall have been repealed, suspended or amended in a manner which in the reasonable opinion of ADB will or may adversely affect the carrying out of the Project or the operation of the Project.

(b) LLDF shall have failed to substantially perform any of its obligations under the Subsidiary Loan Agreement or the Project Agreement.

Section 5.02. The following are specified as additional events for acceleration of maturity for the purposes of Section 8.07(d) of the Loan Regulations: any of the events specified in Section 5.01 to this Loan Agreement shall have occurred.

ARTICLE VI

Effectiveness

Section 6.01. The following are specified as additional conditions to the effectiveness of this Loan Agreement for the purposes of Section 9.01(f) of the Loan Regulations:

(a) The Borrower shall have constituted a National Steering Committee as provided in paragraph 6 of Schedule 6 to this Loan Agreement;

(b) The Borrower shall have set up a Project Coordination Unit under the authority of MPCLG as provided in paragraph 7 of Schedule 6 to this Loan Agreement;

(c) The Borrower shall have selected the staff of each of the Subproject Coordination Units in the PCs under each of the eight CLGs as provided in paragraph 5 of Schedule 6 to this Loan Agreement; and

(d) A Subsidiary Loan Agreement acceptable to ADB shall have been duly executed and delivered on behalf of the parties thereto, and shall have become fully

effective and binding on the parties thereto in accordance with its terms, subject only to the effectiveness of this Loan Agreement.

Section 6.02. The following is specified as an additional matter, for the purposes of Section 9.02(d) of the Loan Regulations, to be included in the opinion to be furnished to the Bank: the Subsidiary Loan Agreement has been duly authorized or ratified by, and executed and delivered on behalf of the parties thereto and is legally binding upon the parties thereto in accordance with its terms, subject only to the effectiveness of this Loan Agreement.

Section 6.03. A date ninety (90) days after the date of this Loan Agreement is specified for the effectiveness of the Loan Agreement for the purposes of Section 9.04 of the Loan Regulations.

ARTICLE VII

Designation of Authority

Section 7.01. The Borrower hereby designates MPCLG and LLDF (solely with respect to Component B) its agents for the purposes of taking any action or entering into any agreement required or permitted under Sections 3.02 and 3.04 of this Loan Agreement and under Sections 5.01, 5.02, 5.03 and 5.04 of the Loan Regulations.

Section 7.02. Any action taken or any agreement entered into by MPCLG pursuant to the authority conferred under Section 7.01 of this Loan Agreement shall be fully binding on the Borrower and shall have the same force and effect as if taken by the Borrower.

Section 7.03. The authority conferred on MPCLG under Section 7.01 of this Loan Agreement may be revoked or modified by agreement between the Borrower and ADB.

ARTICLE VIII

Miscellaneous

Section 8.01. The MOFP of the Borrower is designated as representative of the Borrower for the purposes of Section 11.02 of the Loan Regulations.

Section 8.02. The following addresses are specified for the purposes of Section 11.01 of the Loan Regulations:

For the Borrower

The Secretary
Ministry of Finance and Planning
Secretariat
Colombo 1, Sri Lanka

Copy: Deputy Secretary to the Treasury
Director General, Department of External Resources

Cable Address:

SECMINFIN
COLOMBO

Telex Number:

21232 FORAID COLOMBO
21409 FINMIN COLOMBO

Facsimile Number:

(94-11) 244-9823
(94-11) 244 7633

For ADB

Asian Development Bank
P.O. Box 789
0980 Manila, Philippines

Cable Address:

ASIANBANK
MANILA

Telex Numbers:

29066 ADB PH (RCA)
42205 ADB PM (ITT)
63587 ADB PN (ETPI)

Facsimile Numbers:

(632) 636-2444
(632) 636-2391

IN WITNESS WHEREOF the parties hereto, acting through their representatives thereunto duly authorized, have caused this Loan Agreement to be signed in their respective names and to be delivered at the principal office of ADB, as of the day and year first above written.

DEMOCRATIC SOCIALIST REPUBLIC
OF SRI LANKA

By _____
PUNCHI BANDARA JAYASUNDERA
Authorized Representative

ASIAN DEVELOPMENT BANK

By _____
ALESSANDRO A. PIO
Country Director
Sri Lanka Resident Mission

SCHEDULE 1

Description of the Project

1. The principal objective of the Project is to increase the growth potential of and to reduce poverty in the selected LAs in the Project Area. The purpose of the Project is to improve the urban environment, economy and the living conditions for the population of the LAs in the Project Area through (i) improving and expanding the urban infrastructure and services; (ii) enhancing urban livelihoods; and (iii) improving urban management, planning, and financing capacity of the LAs.

2. The Project consist of the following components:

Component A: Provincial/Municipal/Urban Management Improvement

1. Local Authority Capacity Building.

Develop a Financial and Local Improvement Plan (FLIP) through the provision of consulting services for developing an (i) action plan; and (ii) milestones for revenue enhancement, financial management and improved governance.

2. Provincial Council Capacity Building.

(a) Assist in the capacity building of the PCs through the provision of consulting services for (i) assessing the LAs project implementation performance and (ii) developing a model citizen's grievance redress system on infrastructure deficiency, and O&M; and

(b) Provide support to PCs for Project Development Assistance (PDA) through the provision of consulting services for (i) policy, financial management and overall day-to-day Project development and (ii) preparing an Operations Manual comprising the eligibility criteria, borrowing capacity conditions, flow of funds specifications, details for the Subloans, Performance Agreements and procurement guidelines for Subprojects.

3. LLDF Strengthening.

(a) Provide financial resources to LAs for small and medium infrastructure projects, equipment and provision of consulting services;

(b) Analyze LAs capacity to plan, implement and manage basic infrastructure investments, and to integrate the associated expenditures and revenues into their budget; and

(c) Strengthen LLDF as a primary financial intermediary through the provision of consulting services for preparing documents, including the Operations Manual, the five-year Business Plan, the Code of Conduct and the financial projection.

Component B: Basic Local Government Infrastructure and Services Delivery

- (a) Provide community water supply through financing Subprojects in (i) groundwater wells with hand pumps; (ii) rainwater harvesting; (iii) piped system with overhead tank; and (iv) gravity pipe systems.
- (b) Finance the rehabilitation of Class D, E and other unclassified roads of LAs;
- (c) Rehabilitate LAs drainage and communal sewerage by financing Subprojects for (i) elimination of blockages and obstructions encroachments on existing paths; (ii) construction of new drains to serve previously unserved areas; and (iii) construction of missing links;
- (d) Improve collection of household wastes and other wastes within the LAs area and ensure improved arrangements for waste disposal; and
- (e) Provide financing for development of basic clinics, public libraries small recreational parks and LAs institutional infrastructure.

Component C: Project Coordination and Administration Support

- (a) Facilitate Project coordination; and
- (b) Assist MPCLG, PCs and LAs in Project administration through the provision of consulting services for (i) supporting PCU in the Project implementation management, including the development and implementation of the Project performance management system; (ii) assisting SPCUs in supporting the local authorities for Project awareness building; (iii) supporting the strengthening of NSC; and (iv) supporting community development strategies, including Subproject prioritization and infrastructure maintenance.

5. The Project is expected to be completed by 31 October 2011.

SCHEDULE 2**Amortization Schedule****(Local Government Infrastructure Improvement Project)**

<u>Date Payment Due</u>		<u>Payment of Principal</u> (expressed in SDR)*
15 May	2014	718,666
15 November	2014	718,666
15 May	2015	718,666
15 November	2015	718,666
15 May	2016	718,666
15 November	2016	718,666
15 May	2017	718,666
15 November	2017	718,666
15 May	2018	718,666
15 November	2018	718,666
15 May	2019	718,666
15 November	2019	718,666
15 May	2020	718,666
15 November	2020	718,666
15 May	2021	718,666
15 November	2021	718,666
15 May	2022	718,666
15 November	2022	718,666
15 May	2023	718,666
15 November	2023	718,666
15 May	2024	718,666
15 November	2024	718,666
15 May	2025	718,666
15 November	2025	718,666
15 May	2026	718,666
15 November	2026	718,666
15 May	2027	718,666
15 November	2027	718,666
15 May	2028	718,666
15 November	2028	718,666
15 May	2029	718,666
15 November	2029	718,666

* The figures in this column represent SDR equivalents determined as of the respective dates of withdrawal. The arrangements for payment of each maturity are subject to the relevant provisions of the Special Operations Loan Regulations.

Schedule 2

<u>Date Payment Due</u>		<u>Payment of Principal</u> <u>(expressed in SDR)*</u>
15 May	2030	718,666
15 November	2030	718,666
15 May	2031	718,666
15 November	2031	718,666
15 May	2032	718,666
15 November	2032	718,666
15 May	2033	718,666
15 November	2033	718,666
15 May	2034	718,666
15 November	2034	718,666
15 May	2035	718,666
15 November	2035	718,666
15 May	2036	718,666
15 November	2036	718,666
15 May	2037	718,666
15 November	2037	718,698
TOTAL		34,496,000

* The figures in this column represent SDR equivalents determined as of the respective dates of withdrawal. The arrangements for payment of each maturity are subject to the relevant provisions of the Special Operations Loan Regulations.

SCHEDULE 3**Allocation and Withdrawal of Loan Proceeds**General

1. The table attached to this Schedule sets forth the Categories of goods, services and other items to be financed out of the proceeds of the Loan and the allocation of amounts of the Loan to each such Category (hereinafter called the Table). (Reference to "Category" or "Categories" in this Schedule is to a Category or Categories of the Table).

Taxes

2. No withdrawal from the Loan Account shall be made in respect of any local taxes.

Percentages of ADB Financing

3. Except as ADB may otherwise agree, the items of the Categories listed in the Table shall be financed out of the proceeds of the Loan on the basis of the percentages set forth in the Table.

Interest Charge

4. The amount allocated to Category 8 is for financing the interest charge on the Loan during the implementation period of the Project.

Reallocation

5. Notwithstanding the allocation of Loan proceeds and the withdrawal percentages set forth in the Table:

(a) if the amount of the Loan allocated to any Category appears to be insufficient to finance all agreed expenditures in that Category, ADB may, by notice to the Borrower, (i) reallocate to such Category, to the extent required to meet the estimated shortfall, amounts of the Loan which have been allocated to another Category but, in the opinion of ADB, are not needed to meet other expenditures, and (ii) if such reallocation cannot fully meet the estimated shortfall, reduce the withdrawal percentage applicable to such expenditures in order that further withdrawals under such Category may continue until all expenditures thereunder shall have been made; and

(b) if the amount of the Loan then allocated to any Category appears to exceed all agreed expenditures in that Category, ADB may, by notice to the Borrower, reallocate such excess amount to any other Category.

Imprest Account; Statement of Expenditures

6. (a) Except as ADB may otherwise agree, the Borrower shall establish immediately after the Effective Date, an imprest account at Central Bank of Sri Lanka for MPCLG. The imprest account shall be established, managed, replenished and liquidated in accordance with ADB's "Loan Disbursement Handbook" dated January 2001, as amended from time to time, and detailed arrangements agreed upon between the Borrower and ADB. The initial amount to be deposited into the imprest account shall not exceed the equivalent of 10 percent of the Loan or six months Project expenditure, whichever is less. A second generation imprest account shall be established for LLDF. The initial amount to be deposited into the second generation imprest account shall not exceed the first six months of estimated expenditure or the equivalent of \$1 million, whichever is less.

(b) The statement of expenditures (SOE) procedure may be used for reimbursement of eligible expenditures for the Project and to liquidate advances provided into the imprest account, in accordance with ADB's "Loan Disbursement Handbook" dated January 2001, as amended from time to time, and detailed arrangements agreed upon between the Borrower and ADB. Any individual payment to be reimbursed or liquidated under the SOE procedure shall not exceed the equivalent of \$ 50,000.

Condition for withdrawal

7. Notwithstanding any other provision of this Loan Agreement, no withdrawals shall be made from the Loan Account for Categories 5 and 6 in the Table until each of the eight PCs has issued a letter of commitment to ADB (i) agreeing to implement the Project in its respective Province, and to implement the relevant terms and conditions of this Loan Agreement; and (ii) agreeing to enter, promptly as required, into a Guarantee Agreement with LLDF for the guarantee of the Subloans to be provided to the LAs under its jurisdiction.

8. Notwithstanding any other provision of this Loan Agreement, no withdrawals shall be made from the Loan Account for Category 1 in the Table until the LLDF has prepared (i) a model Subloan Agreement for LLDF Subloans; (ii) a model Guarantee Agreement; (iii) a model Performance Agreement for LLDF grants; (iv) a Code of Conduct; (v) an Operations Manual; and (vi) a five-year Business Plan, in form and substance acceptable to ADB.

TABLE

ALLOCATION AND WITHDRAWAL OF LOAN PROCEEDS (Local Government Infrastructure Improvement Project)			
CATEGORY			ADB FINANCING
Number	Item	Amount Allocated [SDR] Category	Percentage and Basis for Withdrawal from the Loan Account
1	Civil Works	20,833,000	70 percent of total expenditure
2	Equipment	3,835,000	80 percent of total expenditure
3	Furniture and Vehicles	99,000	100 percent of total expenditure*
4	Studies and Workshops	587,000	100 percent of total expenditure*
5	Staff Development	1,487,000	100 percent of total expenditure*
6	Consulting Services	3,265,000	100 percent of total expenditure*
7	Project Management Expenditure	1,043,000	61 percent of total expenditure
8	Interest Charge	893,000	100 percent of amount due
9	Unallocated	2,454,000	
	Total	34,496,000	

* Exclusive of taxes and duties

SCHEDULE 4

Procurement

1. Except as ADB may otherwise agree, the procedures referred to in the following paragraphs of this Schedule shall apply in the procurement of goods and services to be financed out of the proceeds of the Loan. In this Schedule and the Attachment hereto, the term "goods" includes equipment and materials; the term "services" does not include consulting services.

2. Procurement of goods and services shall be subject to the provisions of the "Guidelines for Procurement under Asian Development Bank Loans" dated November 2004 (hereinafter called the Guidelines for Procurement), as amended from time to time, which have been furnished to the Borrower, MPCLG and LLDF.

3. Procurement of goods and services shall be made without any restriction against, or preference for, any particular supplier or contractor or any particular class of suppliers or contractors, except as otherwise provided in paragraph 6 below.

International Competitive Bidding

4. (a) Each supply contract for equipment or materials estimated to cost the equivalent of more than \$500,000 shall be awarded on the basis of international competitive bidding as described in Chapter II of the Guidelines for Procurement.

(b) For contracts to be awarded on the basis of international competitive bidding, there shall be submitted to ADB, as soon as possible, and in any event not later than 90 days before the issuance of either the first prequalification invitation or the first invitation to bid for the Project, a General Procurement Notice (which ADB will arrange to publish separately) in such form and detail and containing such information as ADB shall reasonably request. ADB shall be provided the necessary information to update such General Procurement Notice annually as long as any goods and works remain to be procured on the basis of international competitive bidding.

(c) For contracts to be awarded on the basis of international competitive bidding, procurement actions shall be subject to review by ADB in accordance with the procedures set forth in Chapter IV of the Guidelines for Procurement. Each draft prequalification invitation and each draft invitation to bid, to be submitted to ADB for approval under such procedures, shall reach ADB at least 21 days before it is issued and shall contain such information, as ADB shall reasonably request to enable ADB to arrange for the separate publication of such invitation.

International Shopping

5. (a) Each supply contract for equipment or materials estimated to cost the equivalent of \$500,000 but not less than \$300,000 shall be awarded on the basis of international shopping as described in Chapter III of the Guidelines for Procurement.

(b) Each draft invitation to bid and related bid document shall be submitted to ADB for approval before they are issued.

Schedule 4

(c) Notwithstanding paragraph 3.03 (b) of the Guidelines for Procurement, any award of contract shall be subject to prior ADB approval.

6. In comparing bids under international competitive bidding, a margin of preference may be provided, at the option of the Borrower and in accordance with the provisions of the Attachment to this Schedule, for (a) goods manufactured in the territory of the Borrower, provided that the bidder offering such goods shall have established to the satisfaction of the Borrower and ADB that the domestic value added equals at least 20 percent of the ex-factory bid price of such goods and (b) civil works to be carried out by eligible domestic contractors, as defined by ADB.

Local Competitive Bidding

7. Civil works contracts estimated to cost the equivalent of \$500,000 may be awarded on the basis of local competitive bidding among contractors in accordance with the standard procurement procedures of the Borrower and acceptable to ADB. Prequalification, selection and engagement of contractors shall be subject to the approval of ADB. As soon as the bids received have been evaluated, the proposal for award of contract shall be submitted to ADB for approval. For this purpose, ADB shall be furnished with three copies of (i) an account of the public opening of bids; (ii) a summary and evaluation of the bids; (iii) the proposal for award; and (iv) a draft contract or a draft letter of acceptance. Promptly after each contract is awarded, ADB shall be furnished with three copies of the contract as executed. For the subsequent contracts, bid evaluation and award of contracts shall be subject to post review by ADB.

Local procurement

8. Each supply contract for equipment or materials estimated to cost the equivalent of \$300,000 but not less than \$100,000 may be awarded on the basis of local competitive bidding among contractors in accordance with the standard procurement procedures of the Borrower and acceptable to ADB. For the first contract to be awarded on the basis of local competitive bidding, selection and engagement of contractors shall be subject to the approval of ADB. As soon as the bids received have been evaluated, the proposal for award of contract shall be submitted to ADB for approval. For this purpose, ADB shall be furnished with three copies of (i) an account of the public opening of bids; (ii) a summary and evaluation of the bids; (iii) the proposal for award; and (iv) a draft contract or a draft letter of acceptance. Promptly after each contract is awarded, ADB shall be furnished with three copies of the contract as executed.

Direct purchase

9. Minor items, estimated to cost, in the aggregate, the equivalent of \$100,000 or less, may be procured through direct purchase in accordance with procedures acceptable to ADB. After award, three copies of each contract for such items shall be furnished to ADB.

Industrial or Intellectual Property Rights

10. (a) The Borrower shall ensure that all ADB-financed goods and services procured (including without limitation all computer hardware, software and systems, whether separately procured or incorporated within other goods and services procured) do not violate or infringe any industrial property or intellectual property right or claim of any third party.

(b) The Borrower shall ensure that all ADB-financed contracts for the procurement of goods and services contain appropriate representations, warranties and, if appropriate, indemnities from the contractor or supplier with respect to the matters referred to in subparagraph (a) of this paragraph.

Preference for Domestically Manufactured Goods

1. In the procurement of goods through international competitive bidding, goods manufactured in the territory of the Borrower may be granted a margin of preference in accordance with the following provisions, provided that the bidder shall have established to the satisfaction of the Borrower and ADB that the domestic value added equals at least 20 percent of the ex-factory bid price of such goods. The 20 percent domestic value added applies to the total ex-factory bid price of the goods and not only to one item in a list.

- (a) For application of domestic preference, all responsive bids shall first be classified into the following three categories:

Category I -- bids offering goods manufactured in the territory of the Borrower which meet the minimum domestic value added requirement;

Category II -- bids offering other goods manufactured in the territory of the Borrower; and

Category III -- bids offering imported goods.

- (b) The lowest evaluated bid of each category shall then be determined by comparing all evaluated bids in each category among themselves, without taking into account customs duties and other import taxes levied in connection with the importation, and sales and similar taxes levied in connection with the sale or delivery, pursuant to the bids, of the goods.
- (c) Such lowest evaluated bids shall next be compared with each other and if, as a result of this comparison, a bid from Category I or Category II is found to be the lowest, it shall be selected for the award of contract.
- (d) If, however, as a result of the comparison under subparagraph (c) above, the lowest bid is found to be from Category III, it shall be further compared with the lowest evaluated bid from Category I. For the purpose of this further comparison only, an upward adjustment shall be made to the lowest evaluated bid price of Category III by adding either
- (i) the amount of customs duties and other import taxes which a nonexempt importer would have to pay for the importation of the goods offered in such Category III bid; or
 - (ii) 15 percent of the CIF bid price of such goods if the customs duties and import taxes referred to above exceed 15 percent of the CIF bid price.

If, after such further comparison, the Category I bid is determined to be the lowest, it shall be selected for the award of contract; if not, the lowest evaluated bid from Category III shall be selected for the award.

2. (a) Bidders applying for the preference shall provide evidence necessary to establish the eligibility of a bid for the preference, including the minimum domestic value added.

(b) The bidding documents shall clearly indicate the preference to be granted, the information required to establish the eligibility of a bid for the preference claimed, and the procedures to be followed in the comparison of bids, all as set forth above.

SCHEDULE 5

Consultants

1. The services of international consultants and domestic consultants (hereinafter referred to as consultants) shall be utilized in the carrying out of the Project, particularly with regard to Component A and Component C. The terms of reference of the consultants shall be as determined by agreement between the Borrower and ADB.

2. The selection, engagement and services of the consultants shall be subject to the provisions of this Schedule and the provisions of the "Guidelines on the Use of Consultants by Asian Development Bank and Its Borrowers" dated January 2005 (hereinafter called the Guidelines on the Use of Consultants), as amended from time to time, which have been furnished to the Borrower, MPCLG and LLDF.

3. The consultants for Components A-2, A-3 and C shall be selected and engaged as a firm by MPCLG using the quality-and-cost-based selection (QCBS) method in accordance with the following procedures:

(a) Invitation for technical and financial proposals. The invitation to submit technical and financial proposals (hereinafter called the Request for Proposals or RFP) and all related documents shall be approved by ADB before they are issued. For this purpose, three copies of the draft RFP, the names of consultants to be short-listed, the proposed criteria for evaluation of both proposals, a draft consultancy contract, and other related documents shall be submitted to ADB. A period of at least 45 days shall be allowed for submission of both proposals. A copy of the final RFP as issued, together with all related documents, shall be furnished to ADB for information promptly after issuance. The validity period for the technical and financial proposals as provided in the RFP shall usually not exceed three months from the date specified for submission of the technical and financial proposals. The approval of ADB shall be obtained for any request to extend such validity period. Except as ADB may otherwise agree, the validity period, including any extensions, shall not exceed a maximum total period of six months. If the contract is not signed within the validity period in accordance with the Guidelines on the Use of Consultants, the selection shall be invalid and the selection and engagement process as provided in this paragraph shall be followed again.

(b) Evaluation and scoring of technical proposals. Immediately after the technical proposals have been evaluated and scored, approval of ADB shall be obtained to the evaluation and scoring of the technical proposals. For this purpose, ADB shall be furnished with three copies of the technical proposals.

(c) Public opening of financial proposals. The financial proposals of the firms whose technical proposals meet the minimum qualifying technical score shall be opened publicly after adequate notice is given to such firms or their representatives to attend the opening of the financial proposals.

(d) Evaluation and scoring of financial proposals and ranking of technical and financial proposals. After the financial proposals have been evaluated and scored, the ranking of the technical and financial proposals shall be made. Before negotiations are started with the first-ranked consultants, approval of ADB shall be obtained to the evaluation

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and scoring of the financial proposals and the ranking of the technical and financial proposals. For this purpose, ADB shall be provided with three copies of (i) the evaluation and scoring of the financial proposals and (ii) the ranking of the technical and financial proposals.

(e) Execution of contract. After the conclusion of negotiations but before the signing of the contract, ADB shall be furnished with the contract as negotiated for approval. Promptly after the contract is signed, ADB shall be furnished with three copies of the signed contract. If any substantial amendment of the contract is proposed after its execution, the proposed changes shall be submitted to ADB for prior approval.

4. The international individual consultants, as required, shall be selected and engaged by MPCLG in accordance with the following procedures.

(a) A list of the candidates together with their qualifications and their ranking and a draft contract shall be furnished to ADB for approval before the selection of consultants.

(b) Promptly after the contract is signed, ADB shall be furnished with the evaluation of the candidates and a brief justification for the selection, together with three copies of the signed contract.

(c) If any substantial amendment of the contract is proposed after its execution, the proposed changes shall be submitted to ADB for prior approval.

5. The domestic consultants shall be selected and engaged in accordance with procedures acceptable to ADB, and the selection and engagement of the consultants shall be subject to the approval of ADB with regard to their competence and experience for carrying out the assignment. As soon as the proposals received have been evaluated but before negotiations are started with the consultants selected for negotiations, ADB shall be furnished with three copies of (i) a list of consultants invited; (ii) an evaluation of the proposals (together with one set of the first-ranked proposal); and (iii) justification for the selection. After the conclusion of negotiations, but before signing of the contract, the contract as negotiated shall be furnished to ADB for approval. Promptly after the contract is signed, ADB shall be furnished with three copies of the signed contract. If any substantial amendment of the contract is proposed after its execution, the proposed changes shall be submitted to ADB for prior approval.

6. The Borrower shall ensure that all ADB-financed contracts with consultants contain appropriate representations, warranties and, if appropriate, indemnities from the consultants to ensure that the consulting services provided do not violate or infringe any industrial property or intellectual property right or claim of any third party.

SCHEDULE 6

Project Management and Project Implementation

Executing Agency and Project Implementing Agency

1. MPCLG shall be the Executing Agency (EA) responsible for overall Project coordination and for carrying out Components A and C of the Project.
2. LLDF shall be the Project Implementing Agency (PIA) for Component B of the Project.

Project Coordination Unit and Subproject Coordination Unit

3. MPCLG shall establish a Project Coordination Unit (PCU) to be headed by a full time Project Director experienced in handling externally funded projects and local government issues. The Project Director will be exclusively charged with the execution of the Project. The Project Director will be directly responsible for coordination of the activities under the Project, overall Project quality, monitoring, supervision and reporting. The Project Director shall report to the Secretary of MPCLG for routine matters of operation, management and administration of the Project. The Project Director will be supported by full time compliance officers responsible for legal, procurement, documentation, environment and social compliance; a senior accountant; administrative staff and supplemented by consultants as required.
4. The PCU shall (i) consolidate the overall Project implementation plan and annual work plan; (ii) assist the PCs and the LAs in implementing the capacity building program; (iii) monitor and supervise the Project administration and coordination activities; (iv) lead monitoring and evaluation exercises; and (v) prepare quarterly Project reports and the Project completion report.
5. In each of the PCs, at the office of the Commissioner for Local Government (CLG), a Subproject Coordination Unit (SPCU) shall be established. The SPCU will be headed by the CLG. A full time accountant, a full time civil engineer, an assistant engineer and support staff will support the CLG. A part time financial management specialist, compliance officer and consultants with expertise in social development and environment would be made available as required. The SPCU shall be responsible for (i) preparation of an annual development program for the respective Province; (ii) accounting for expenditures; (iii) implementation of resettlement plans and of environmental mitigation measures when required; (iv) initial evaluation of Subprojects proposals from LAs; (v) management of the PDA; (vi) maintenance and management of the funds for the support to LAs for the development of Business Plan and the implementation of FLIP; (vii) assistance to LAs with weak capacity in implementing civil works; (viii) ensuring Project quality assurance, performance, monitoring and evaluation; and (ix) evaluation of tenders and issues related to final award of civil works contracts. Each SPCU shall have an accounting section, directly under the CLG which will be responsible for the recording of the financial transactions and preparation of the liquidation statements and replenishments requests to LLDF.

National Steering Committee and Provincial Steering Committee

6. The Borrower shall establish an inter-ministerial National Steering Committee (NSC) chaired by the secretary, MPCLG. The members of the NSC shall comprise the representatives from the Borrower's MOFP; External Resources Department; National Planning Department; Finance Commission; Department of National Budget; Foreign Aid Utilization and Budget Monitoring Department; Ministry of Urban Development and Water Supply; UDA; NWSDB; Central Environment Authority; National Physical Planning Department; LLDF; Provincial chief secretaries; chairpersons of the Association of the MCs, UCs and PSs; Project Director; and civil society representatives. The NSC shall oversee the Project. The NSC shall hold its first meeting within three months of the Effective Date and shall meet at least once every six months thereafter.

7. A Provincial Steering Committee (PSC) shall be established at each of the eight PCs to provide overall strategic guidance and coordination support. The chief Secretary of the Province will chair the PSC and shall include the CLG, the Secretary of the Provincial Local Government Ministry, District secretaries, regional representatives of the Central Environment Authority, NWSDB, UDA and the chairpersons of selected LAs.

Component B of the Project

8. A Project Appraisal Unit (PAU) within the LLDF shall be established for the implementation of Component B of the Project. The PAU shall comprise a fund manager with economic or financial background, a civil engineer, an environment or special development specialist and accountants. The PAU shall be responsible for (i) assisting the PCs to meet the requirement for funding activities; (ii) reviewing the eligibility of LAs Subloans and grant activities; (iii) compiling annual data on the technical and financial performance of the LAs; and (iv) managing disbursements of funds to the LAs. The PAU shall operate under the supervision of the Chief Executive Officer of LLDF and shall liaise with the Project Director on a regular basis, at least quarterly.

9. The existing Board of Commissioners of the LLDF shall include one member representing the civil society. It will approve the Operations Manual, the Business Plan and other documents and the financial reports to be prepared and compiled by LLDF under Component A. It shall be responsible for reviewing annually the performance of LLDF and of the participating LAs.

10. The Borrower shall ensure that all the Subprojects shall be selected by LLDF on the basis of selection criteria agreed with ADB and as set forth in Appendix 4 to the RRP as agreed with the Borrower.

11. The Borrower shall cause the LLDF to ensure that the LAs prepare the Subproject proposals in format agreed between the Borrower and ADB. The Subproject proposals shall be prepared by the LAs and submitted to the SPCU, under CLG which will assess the Subproject proposals based on the selection criteria as described in Appendix 4 to the RRP as agreed with the Borrower. Each CLG will present the Subproject proposals to LLDF for approval. ADB will assess the first two Subprojects from each of the five Subsectors. Subsequently, ADB will review all Subprojects over \$500,000.

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12. LLDF shall ensure that the funding of each Subproject shall be disbursed to the LAs partly as grants and partly as loan on the following basis:

MC: 40% grant and 60% loan;
 UC: 50% grant and 50% loan; and
 PS: 60% grant and 40% loan.

13. The Borrower and LLDF shall ensure that the interest rate for the Subloans shall be at least equivalent to Sri Lanka Inter-Bank Offer Rate (SLIBOR) (12-month) per annum. The Borrower and LLDF shall revise the interest rate every six months.

14. For each Subproject from LLDF to an LA, LLDF shall enter into:

(a) a Subloan Agreement for the loan component in form and substance acceptable to ADB, setting out the terms and conditions for onlending by LLDF to each participating LA, including detailed operating instructions;

(b) a Performance Agreement with each LA for the grant component in form and substance acceptable to ADB; and

(c) a Guarantee Agreement with the respective PC in form and substance acceptable to ADB.

15. The Borrower agrees that LLDF shall channel part of the proceeds of the Loan to the LAs for carrying out Component B of this Project. In providing the funds to the LAs, LLDF shall observe the following operational principles, unless modified by agreement with the Borrower and ADB:

(a) maintain a regional balance for infrastructure funding through a predefined transparent allocation process;

(b) ensure that Subprojects comply with pre-defined appraisal criteria for each sector and must be limited to identified services;

(c) ensure that Subprojects selected are included in the functions devolved to LAs;

(d) maintain an overall balance within each Province for the various categories of LAs;

(e) limit the maximum cumulative borrowing for an LA to twice its own revenues;

(f) ensure that for each Subproject, an LA contributes a minimum of 7 % of the overall cost of the Subproject;

(g) ensure that the investment in a sub-sector does not exceed 30% of the total infrastructure funding in each Province and the minimum investment in each sub-sector is at least 5% of the overall funding;

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- (h) ensure representation of all Provinces in the Project Area; and
- (i) ensure that there is no reduction in the incremental funds of LAs by a decrease in the block grants or other funds due by PCs to LAs.

16. In the event the Subproject proposal from any LA does not meet the selection criteria on technical grounds, SPCU shall assist the LA in identifying a technical expert from the roster of consultants located at the PC level. Following the improvement of the Subproject proposal, SPCU shall submit the completed application for Subproject to LLDF. LLDF shall appraise the Subproject in accordance with (i) the criteria in LLDF's Operations Manual; (ii) the regional balance; and (iii) the past performance of the LA, before sending it to ADB for final approval. PCU shall be responsible for establishing the necessary management information systems to track Subprojects through their preparation, submission, approval, implementation, and evaluation stages.

Sustainability

17. The Borrower shall ensure that by the end of the Project, LAs, with the assistance of consulting services, shall have come up with long term operation and maintenance procedures and sustainable funds which represent at least 5% of the Subproject costs to operate and maintain the assets upgraded or constructed under the Project.

Resettlement

18. The Borrower shall ensure, and cause the EA to ensure, that all lands and rights-of-way required for the Project are made available in a timely manner, adequate compensations are provided prior to the commencement of civil works, and any resettlement activity is carried out in accordance with the resettlement framework agreed upon between the Borrower and ADB, the Borrower's *National Involuntary Resettlement Policy* and ADB's *Policy on Involuntary Resettlement* (1995). The Borrower shall ensure that a Resettlement Plan in accordance with the Borrower's *National Involuntary Resettlement Policy* and ADB's *Policy on Involuntary Resettlement* is prepared and submitted to ADB for approval for the first Subproject involving land acquisition or resettlement activities. This will serve as a model for preparing Resettlement Plan for any subsequent Subproject involving land acquisition or resettlement activities. All Subprojects involving a Resettlement Plans will be submitted to ADB for review and approval of such Plan. The Borrower shall ensure that any Resettlement Plan for the Project shall be placed in the relevant CLG's office and made available as a reference to affected persons.

Environment

19. The Borrower shall ensure, and cause the EA to ensure, that the design, construction, operation and implementation of all Subproject facilities is carried out in accordance with the environmental assessment framework agreed upon between the Borrower and ADB, and complies with the Borrower's environmental laws and regulations and ADB's Environmental Policy. Any adverse environmental impacts arising from the construction, operation and implementation of the Subproject facilities will be minimized by implementing the environmental mitigation and management measures, and other recommendations specified in environmental assessment reports (e.g. IEEs).

Indigenous people

20. The Borrower shall ensure that Subprojects will not affect vulnerable population groups, such as indigenous peoples. In the event of their involvement in any of the Subprojects, the Borrower shall ensure that the Subprojects are carried out in accordance with the indigenous people development framework agreed upon between the Borrower and ADB and comply with *ADB's Policy on Indigenous Peoples (1998)*.

Construction

21. The Borrower shall ensure that civil works contractors comply with all applicable labor laws. Bidding documents will include a clause prohibiting child labor for construction and maintenance activities, and a clause regarding equal pay for men and women for work of equal value. Compliance with these provisions will be strictly monitored during Project implementation.

Block grants from the Borrower

22. The Borrower shall ensure that the annual block grant allocation currently provided by the Borrower to LAs continues to be provided and does not decrease, irrespective of this Project and whether the total revenue level of each LA increases. The Borrower shall ensure to disburse the funds to the LAs on a timely manner.

Good governance and transparency

23. Consistent with ADB's and with the Borrower's commitment to good governance, accountability and transparency, the Borrower shall ensure that the Project funds are utilized effectively and efficiently to implement the Project and to achieve the Project objectives. ADB shall have the right to conduct spot audits at any time during the Project implementation to determine the degree to which Project funds have been effectively and efficiently utilized to implement the Project and achieve its objectives, outputs and performance indicators. ADB shall also have the right to investigate any possible financial or management impropriety in conducting the Project. The Borrower shall cooperate with any such audit and investigation and extend necessary assistance, including access to all relevant books and records, as well as engagement of independent auditors and experts that may be needed for satisfactory completion of such audits and investigations. All external costs related to the audits and investigations shall be funded from the Loan.

SPCU Staff

24. Before the completion of the Project, the Borrower shall ensure that at least 50% of the technical staff of the SPCU engaged during this Project is retained and mainstreamed by the PCs.

General and Counterpart Funds

25. The Borrower and ADB agree that the Project implementation arrangements reflect the present administrative structure of the Borrower in the Project Area and that this may be changed during the implementation of the Project. If the Borrower proposes to change the administrative structure in the Project Area, the Borrower shall immediately notify ADB of such change and shall take all steps necessary to ensure that the Project arrangements are revised in consultation with ADB to reflect the new administrative structure and the viability of the Project.

26. The Borrower shall ensure that throughout the implementation of the Project, adequate allocations of the required counterpart funds are made, approved and released in a timely manner in order to ensure proper implementation of the Project. The Borrower shall also allocate sufficient counterpart funds for MPCLG to cover the incremental recurrent costs of staff of SPCU for at least 10 years following the Closing Date.

27. The Borrower shall provide adequate office space for the Project, and will ensure that the facilities provided under the Project are operated and maintained appropriately.

Peace building and community reconciliation

28. The Borrower, MPCLG and LLDF shall ensure that all Project interventions contribute to, or do not detract from ongoing peace building and community reconciliation. In the event that during Project implementation any intervention has or is thought to have negative impact on such peace building or community reconciliation efforts, the Borrower and ADB will mutually determine whether the intervention should be continued, redesigned, suspended or cancelled.

Project Performance Management System

29. Within one year of the Effective Date, the Borrower shall cause PCU to develop a Project Performance Monitoring System including (i) baseline data and output target set up during the FLIP and Subproject implementation manual preparation within Component A; (ii) comprehensive implementation-related performance data collected and recorded by LLDF and SPCUs, periodically audited by PCU; and (iii) post-completion performance and impact data collected by PCU. Data to be compiled and analyzed for the purpose of performance monitoring and evaluation shall be in a format acceptable to ADB.

Project Reviews

30. The Borrower and ADB shall carry out semiannual reviews of the Project during Project implementation. The semiannual reviews shall include an examination of budgetary allocations for the Project, operation and maintenance costs, staffing and other incremental recurrent costs, implementation arrangements and achievements under the Project. The review shall include assessing progress for each Project component, identifying difficulties and constraints, and determining ways to overcome them. Before disbursement under Component B of the Project, ADB shall carry out a review of the readiness of the LLDF to carry out the Project in accordance with ADB's requirements in *Operations Manual D6/OP* of 15 December 2003, as amended from time to time.

31. MPCLG, PCU, SPCU and ADB shall jointly carry out a mid term review of the Project during the third year of Project implementation or at any other time as may be agreed upon by the Borrower and ADB. The mid term review will (i) review the scope, design, and implementation arrangements of the Project; (ii) identify changes needed since the time of Project appraisal; (iii) assess implementation performance against Project indicators; (iv) review and establish compliance with loan covenants; and (v) identify problems and constraints. The Borrower and ADB shall discuss the results of the midterm review and if required, appropriate corrective measures shall be formulated to ensure successful Project implementation and achievement of Project objectives.