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Investing in rural people

## **Report to the President**

### **Proposed loan**

### **Kingdom of Lesotho**

## **Smallholder Agriculture Development Project II**

Project ID: 2000002563

**Note to Executive Board representatives**  
**Approved on Wednesday 25 December 2019**

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### Project delivery team<sup>1</sup>

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<sup>1</sup> The team would like to acknowledge the strong collaboration with the World Bank design team, and thank the respective Task Team Leaders, Meeta Sehgal and Bobojon Yatimov.

## **Abbreviations and acronyms**

AWPB	Annual Work Plan and Budget
CSA	Climate Smart Agriculture
IDA	World Bank Group
JICA	Japan International Cooperation Agency
MG	Matching Grants
PIM	Project Implementation Manual
PMU	Project Management Unit
SADP	Smallholder Agriculture Development Project
SHEP	Smallholder Horticulture Empowerment Project
VC	value chain

## Map of the project area



The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

Map compiled by IFAD | 18-07-2019

## Financing summary

<b>Initiating institution:</b>	World Bank Group (IDA)
<b>Borrower:</b>	Government of the Kingdom of Lesotho, Ministry of Finance
<b>Executing agency:</b>	Ministry of Agriculture and Food Security
<b>Total programme cost:</b>	US\$62.0 million
<b>Amount of IFAD loan 1:</b>	EUR3.02 million (equivalent to approximately US\$3.35 million)
<b>Terms of IFAD loan 1:</b>	<p>The Loan granted on highly concessional terms shall be free of interest but shall bear a fixed service charge as determined by the Fund at the date of approval of the Loan by the Fund's Executive Board, payable semi-annually in the Loan Service Payment Currency. The Loan shall have a maturity period of forty, (40) years, including a grace period of ten (10) years starting from the date of approval of the Loan by the Fund's Executive Board.</p> <p>The principal of the Loan granted on highly concessional terms will be repaid at four and half per cent (4.5 per cent) of the total principal per annum for years eleven (11) to thirty (30), and one per cent (1 per cent) of the total principal per annum for years thirty-first (31) to forty (40).</p>
<b>Amount of IFAD loan 2:</b>	EUR1.49 million (equivalent to approximately US\$1.65 million)
<b>Terms of IFAD loan 2:</b>	<p>The Loan granted on blend terms shall be subject to interest on the principal amount outstanding and a service charge as determined by the Fund at the date of approval of the Loan by the Fund's Executive Board. The interest rate and service charge determined will be fixed for the life cycle of the loan and payable semi-annually in the Loan Service Payment Currency, and shall have a maturity period of twenty five (25) years, including a grace period of five (5) years starting from the date of approval of the Loan by the Fund's Executive Board</p>
<b>Cofinanciers:</b>	World Bank Group (IDA) Japanese International Cooperation Agency (JICA)
<b>Amount of cofinancing:</b>	IDA: US\$50.0 million JICA: US\$2.0 million
<b>Terms of cofinancing:</b>	IDA: credit JICA: grant
<b>Contribution of beneficiaries:</b>	US\$5.0 million
<b>Amount of IFAD climate finance:</b>	US\$2.5 million
<b>Cooperating institution:</b>	World Bank Group (IDA)

## Recommendation for approval

According to the delegation of authority procedure approved by the Executive Board at its 126<sup>th</sup> session and detailed in document EB 2019/126/R.48/Rev.2 the President is invited to approve the recommendation contained in paragraph 57.

### I. Context

#### A. National context and rationale for IFAD involvement

##### National context

1. Lesotho is a constitutional monarchy, governed by a parliamentary democracy, which has experienced periods of political instability, including three general elections between 2012 and 2017. Lesotho is a trade-driven economy, with textiles, water, and diamonds as its main exports. It is a member of the Southern African Customs Union, Southern African Development Community, and Common Monetary Area, creating strong opportunities for regional trade.
2. Rural poverty and unemployment are persistent challenges in Lesotho, exacerbated by the country having one of the world's highest HIV infection rates (23.6 per cent in 2018). Lesotho has a population of 2.1 million, 65.8 per cent of whom live in rural areas. It ranks 159 out of 189 countries on the Human Development Index<sup>2</sup> and an estimated 49.7 per cent of the population live below the national poverty line. Difficult agro-climatic conditions, and limited arable land and access to quality inputs have restricted agricultural growth. Agriculture's contribution to GDP declined from 20 per cent in the 1980s to around 6 per cent in 2017<sup>3</sup>.

##### Special aspects relating to IFAD's corporate mainstreaming priorities

3. In line with IFAD11 mainstreaming commitments, the project has been classified as:
  - Climate focused
  - Nutrition sensitive
  - Youth sensitive
4. **Gender inequality:** Restrictive gender norms are a challenge to advancing gender equality in Lesotho. According to the Global Gender Gap Index ranking, Lesotho dropped from 16<sup>th</sup> in 2013 to 81<sup>st</sup> in 2018, caused by a decrease in women's participation in the country's economic and political spheres. In rural areas, women still suffer from limited access to finance and land, insufficient infrastructure, limited skills, and poor health outcomes<sup>4</sup>.
5. **High youth unemployment:** The International Labor Organization estimates that 38.5 per cent of the total labor force, aged 15-24, was unemployed in 2017. Almost 80 per cent of employed youth work in the private sector, with 31 per cent in agriculture and 18 per cent in home-based income-generating activities<sup>5</sup>.
6. **Nutrition remains a concern:** 56 per cent of households are unable to afford a nutritious diet. Two main factors are associated with dietary vulnerability: lack of markets access and food seasonality. Food insecurity and the cost of a nutritious diet are higher in rural, mountainous and remote areas<sup>6</sup>.
7. **Climate change (CC) challenges the agricultural sector:** The Inter-Governmental Panel on CC categorizes Lesotho as highly vulnerable to the impacts of CC. The El Niño-Southern Oscillation and high intra-seasonal and inter-annual

<sup>2</sup> UNDP, *Human Development Indices and Indicators: 2018 in Statistical Update*. 2018.

<sup>3</sup> World Bank, *World Development Indicators Database - Lesotho*. 2019

<sup>4</sup> Government of Lesotho, *National Strategic Development Plan 2018/19-2022/23*, F. Draft. 2019; and UNDAF, *United Nations Development Assistance Framework for Lesotho 2019-2023*. 2018

<sup>5</sup> UNDP, *Lesotho Youth Empowerment Survey 2012*. 2014

<sup>6</sup> WFP/IFAD/UNICEF, *Fill the Nutrient Gap in Lesotho*. 2019.

rainfall variability, with frequent droughts, lead to delayed planting, crop failures, rangelands' deterioration and water scarcity.

### **Rationale for IFAD involvement**

8. The World Bank and IFAD have been implementing the Smallholder Agriculture Development Project (SADP) I for the last nine years, on a pari-passu basis. SADP I is a well performing project. It has brought climate smart and commercial practices of horticulture production under shed-nets and in greenhouses to scale and boosted piggery and poultry production. It also facilitated the development of a national masterplan for irrigation.
9. SADP II builds on SADP I's successes and broadens its approach by adding irrigation investments, working along commercial value chains (VCs) and increasing focus to nutrition, youth and climate resilience. SADP II will increase production and marketed surplus for selected high value commodities among semi-commercial and commercial farmers; and support VC development among agro-processors and agri-businesses, through the provision of technical assistance and investment support. IFAD funds will support SADP II's matching grant (MG) window on commercialization.

## **B. Lessons learned**

10. SADP II builds on a range of lessons learned:<sup>7</sup>
  - It is important to invest in all VC actors to unlock the potential of commercial horticulture.
  - Beneficiary profiles determine the sustainability of investments and potential trickle-down benefits to local communities.
  - There is need for continuous capacity building of extension staff for them to understand new technologies and promote their adoption, including climate smart agriculture (CSA) and modern agronomic practices.
  - Producer organizations, established under SADP I, were sustainable when sufficient benefits derived from group activities.
  - Targeting will consider economic potential of grant applicants and their production area to avoid investments in unsustainable enterprises.
  - Reliance on service providers has to be well managed and oversight on quality service delivery is important.
  - Social media proves as efficient tool to reach and encourage youth application.

## **II. Project description**

### **A. Project objectives, geographic area of intervention and target groups**

11. SADP II's development objective is to *promote commercialization, climate resilience and better nutritional outcomes in Lesotho's agriculture and food systems*. The project will cover all 10 districts, scaling-up from seven districts in SADP I. SADP II supports a paradigm shift, which puts climate resilience, productivity, commercialization and nutrition at the core of agriculture growth in Lesotho. The project will: (i) introduce transformational changes in agriculture by promoting solutions for agricultural productivity and resilience at farm and landscape levels; (ii) provide longer-term solutions at institutional level to ensure the sustainability of the outcomes achieved in the field; (iii) promote commercialization that contributes to improved livelihoods; and (iv) promote better nutritional outcomes. SADP II investments is expected to reduce farmers' climate vulnerability, enhance their resilience and ensure that smallholder farming remains a financially viable economic activity, by strengthening market linkages and horizontal linkages.

<sup>7</sup> See [COSOP Results Review](#) (1998-2018).

12. **Target groups:** SADP II's direct beneficiaries will include smallholder farmers (producers) and off-takers (traders/aggregators/agro-processors). The project will provide direct benefits to approximately 160,000 households. Most will be semi-commercial, emerging and semi-subsistence small producers, as rural people account for 87 per cent of all people living below the poverty line. Farm households will have access to training programmes. VC development beneficiaries will be progressive and emerging farmers in areas with higher potential, but within this group, smallholder farmers will be prioritised. At least 50 per cent of beneficiaries will be women and 35 per cent will be youth<sup>8</sup>.
13. The MG's upper ceiling will mitigate elite capture, as will the selectivity criteria. SADP II will also benefit agro-processors and agri-businesses, who will need to demonstrate how they work with small producers. An additional 10,000 households will be reached by IFAD's contribution. The youth applicants will benefit from incubation and mentorship, drawing on IFAD success with such approaches in other countries. Women participation will initially be supported through a set quota, and should this quota not be reached, targeted interventions will be implemented (e.g. calls for women only).

## B. Components/outcomes and activities

14. SADP II will have four components, and IFAD financing will exclusively support activities in component 2.2 and 2.3.
15. **Component 1: Promoting Climate Smart Agricultural (CSA) Practices and Advisory Services** aims to strengthen smallholder farmers' capacity to adapt their production systems to minimize impacts from climate variability. Component 1 focuses on: (i) scaling-up CSA technologies, by enhancing farm management practices, aimed at improving soil health, water-use efficiency, crop diversification, and farm productivity; (ii) promoting efficient use of surface water, accompanied with more sustainable use of groundwater, for improved availability and quality of water at farm level; and (iii) improving access to climate and market advisory services, thereby strengthening farmers' adaptation and resilience.
16. **Component 2: Improving Agricultural Commercialization and Nutrition** will provide financing, through MG, to enable cash-constrained farmers and agri-businesses to increase production, commercialisation and climate resilience. Activities under this component are expected to result in job creation; improved beneficiary incomes; better nutritional outcomes and increased economic opportunities for rural women and youth.
- (a) **Sub-component 2.1. Support for Horizontal Alliances** will finance the creation of new alliances for service and market-related activities and strengthen existing alliances among farmers. This will draw on the Smallholder Horticulture Empowerment Project (SHEP) approach, developed by the Japan International Cooperation Agency (JICA) and supports farmers to strengthen market linkages.
- (b) **Sub-component 2.2. Vertical Alliances and Commercialization** has two grant windows. Under the '*Matching Grants for Improving Smallholder Productivity*', smallholders will access MGs to finance investments for increasing on-farm productivity in high potential VCs. e.g. small farm equipment, climate adaptive technologies, improved varieties, agro-processing equipment, and storage. Maximum grant size will be US\$30,000 per applicant (individual or group) and require a 20 per cent equity contribution (in cash). Under the '*Matching Grants for Agri-Enterprises*' aggregators, processors and other business enterprises can access matching grants to facilitate investments in postharvest infrastructure and management. Grant size will range from US\$30,000 to US\$100,000, with an equity contribution of 40 per

<sup>8</sup> 40 per cent will be youth for the MG in component 2.2.



cent in cash. Business plans for grant support must show a clear commitment to building sustainable VCs with SADP II beneficiaries, as well as show the new employment their investment will generate.

- (c) **Sub-component 2.3, improved nutrition**, will aim to improve dietary habits and practices, and increased dietary awareness through improved knowledge of nutrition, increased household production and consumption of high-nutritious foods and food products, as well as small-scale processing in nutrition-sensitive VCs. Small grants, ranging between US\$2,000 and US\$20,000, will finance investments for production of nutritious foods at the household level.

17. Component 3 will be on project management and coordination, and a fourth component of for the IDA finance will have contingency emergency response.

### **C. Theory of change**

18. SADP II addresses key challenges in achieving food security, human capital development, improved nutrition, job creation and improved livelihoods. Project interventions use a combination of measures to build capacity, transfer technology, promote public and private investment and strengthen agricultural markets. A strong, broad-based emphasis on training will assist farmers to acquire skills required to create and manage viable producer organizations, understand and adopt improved agronomic practices and climate smart agricultural technologies as well as build effective market linkages with agri-business enterprises.
19. At farm-level, technology transfer will help to raise productivity. The rehabilitation of irrigation infrastructure will reduce dependence on rain-fed farming and increase farmers' capacity to address climatic risks of droughts and erratic rainfall patterns. With increased productivity, farmers will be capacitated to enter into productive alliances with agri-businesses, and, thereby be assured of markets and incomes. Investments in high value cash crops, such as fruits and vegetables, targeted under SADP II, will increase dietary diversity and consumption of fruits and vegetables, resulting in improved nutritional outcomes.

### **D. Alignment, ownership, and partnerships**

20. SADP II's goal is aligned with the United Nations Development Assistance Framework (UNDAF) as well as the Lesotho National Strategic Development Plan (NSDP)-II 2018-19/2022-23. NSDP-II prioritizes the development of the agricultural sector, and identifies three broad areas of strategic action: (i) sustainable commercialization and diversification of agriculture, (ii) a well-functioning agri-food system, and (iii) rehabilitation of rangelands and wet lands.
21. SADP II is also fully aligned with IFAD's 2016-2025 Strategic Framework and IFAD11 priorities. It also aligns to Lesotho's Country Strategic and Opportunities Programme 2020-2025, with its strategic objectives of inclusive commercialization and strengthening an enabling natural and business environment.
22. The project contributes to IFAD's cofinancing targets and to the strategic partnership with the World Bank and JICA.

### **E. Costs, benefits and financing**

23. IFAD will finance MG to the amount of US\$5 million (Component 2), of which US\$2.5 million accounts as IFAD climate finance.
24. **The total project costs** will be US\$62 million. This will comprise of US\$50 million IDA funding (SDR36.1 million), US\$5 million IFAD financing, US\$2 million JICA grant and US\$5 million beneficiary contribution. SADP II became effective in August 2019 and will close on 31 May 2026. IFAD financing is aligned to SADP II's financial closure date.

Table 1

**Project costs by subcomponent and financier**

(Thousands of United States dollars)

<i>Component/Subcomponent</i>	<i>IFAD loan 1</i>		<i>IFAD loan 2</i>		<i>IDA</i>		<i>Beneficiaries</i>		<i>JICA</i>		<i>Total</i>
	<i>Amount</i>	<i>%</i>	<i>Amount</i>	<i>%</i>	<i>Amount</i>	<i>%</i>	<i>Cash</i>	<i>%</i>	<i>Amount</i>	<i>%</i>	<i>Amount</i>
<b>1. Promoting Climate-Smart Agricultural Practices and Advisory Services</b>											
1.1. Capacity Building in CSA Practices	-	-	-	-	2 000	100	-	-	-	-	2 000
1.2. Rehabilitation and Modernization of Irrigation Infrastructure	-	-	-	-	15 000	100	-	-	-	-	15 000
1.3. Support for Investments in Soil Fertility Management	-	-	-	-	5 000	100	-	-	-	-	5 000
1.4. Integrated Climate, Weather and Market Advisory Services	-	-	-	-	4 000	100	-	-	-	-	4 000
<b>Subtotal</b>	-	-	-	-	<b>26 000</b>	<b>100</b>	-	-	-	-	<b>26 000</b>
<b>2: Improving Agricultural Commercialization and Nutrition</b>											
2.1. Support for Horizontal Alliances	-	-	-	-	1 500	100	-	-	-	-	1 500
2.2. Support for Vertical Alliances and Commercialization	2 847	12	1 402	6	14 500	61	5 000	21	-	-	23 750
2.3. Improved Nutrition	503	13	248	7	1 000	27	-	-	2 000	53	3 750
<b>Subtotal</b>	<b>3 350</b>	<b>12</b>	<b>1 650</b>	<b>6</b>	<b>17 000</b>	<b>59</b>	<b>5 000</b>	<b>17</b>	<b>2 000</b>	<b>7</b>	<b>29 000</b>
<b>3: Project Management, Coordination, Monitoring and Evaluation</b>	-	-	-	-	<b>7 000</b>	<b>100</b>	-	-	-	-	<b>7 000</b>
<b>4: Contingency Emergency Response Component (CERC)</b>	-	-	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>3 350</b>	<b>5</b>	<b>1 650</b>	<b>3</b>	<b>50 000</b>	<b>81</b>	<b>5 000</b>	<b>8</b>	<b>2 000</b>	<b>3</b>	<b>62 000</b>

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Table 2

**Project costs by expenditure category and financier***(Thousands of United States dollars)*

Category	IDA		IFAD loan 1		IFAD loan 2		JICA		Beneficiaries		Total
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount
(1) Goods, works, non-consulting services, consulting services, Training Costs and Incremental Operating Costs of the Project (except for Parts 1.2(a), 2.2(a), 2.2(b) and 3(c)(i) of the Project)	25 460	95	-	-	-	-	1 300	5	-	-	26 760
(2) Goods, works, non-consulting services, consulting services, Training Costs and Incremental Operating Costs under Part 1.2(b) of the Project	9 040	100	-	-	-	-	-	-	-	-	9 040
(3) Matching Grants and Grants	15 500	59	3 350	13	1 650	6	700	3	5 000	19	26 200
(4) Emergency Expenditures under Part 4 of the Project	-	-	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>50 000</b>	<b>81</b>	<b>3 350</b>	<b>5</b>	<b>1 650</b>	<b>3</b>	<b>2 000</b>	<b>3</b>	<b>5 000</b>	<b>8</b>	<b>62 000</b>

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Table 3

**Project costs by component and project year***(Thousands of United States dollars)*

Component	2020		2021		2022		2023		2024		2025		2026		Total
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount
1. Promoting Climate-Smart Agricultural Practices and Advisory Services	1 024	4	2 246	9	3 344	13	4 836	19	5 310	20	5 070	20	4 170	16	26 000
2. Improving Agricultural Commercialization and Nutrition	1 450	5	4 350	15	11 050	38	8 700	30	1 450	0	1 000	10	1 000	3	29 000
3. Project Management, Coordination, Monitoring and Evaluation	1 000	14	1 000	14	1 000	14	1 000	14	1 000	14	1 000	14	1 000	14	7 000
4. Contingency Emergency Response Component (CERC)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>3 474</b>	<b>6</b>	<b>7 596</b>	<b>12</b>	<b>15 394</b>	<b>25</b>	<b>14 536</b>	<b>23</b>	<b>7 760</b>	<b>13</b>	<b>7 070</b>	<b>11</b>	<b>6 170</b>	<b>10</b>	<b>62 000</b>

## Project financing and cofinancing strategy and plan

### Disbursement

25. Project's disbursements follow the World Bank's disbursement handbook. SADP II will open a segregated Designated Account, denominated in United States Dollars at the Central Bank of Lesotho to receive funds from the World Bank. Due to accountability issues, which emerged from project funds not being used for intended purposes by some grant beneficiaries under SADP I, SADP II will continue to disburse against Statement of Expenditures, until the internal control environment improves. The Direct Payment option is also available under SADP II. Details for various disbursement methods are stipulated in the World Bank's disbursement handbook. For the IFAD loans, SADP II will open one designated account in USD currency.<sup>9</sup>
26. Table 3 shows the projected disbursement of IDA and IFAD over the project period. IFAD funding is expected to be disbursed from PY2 to PY5, with PY6 and PY7, dedicated to ensure sustainability of the MG projects.

### Summary of benefits and economic analysis

27. The economic and financial analysis (EFA) highlights additional financing from IFAD with US\$5 million on MG, which generates an extra US\$13.2 million on the economic net present value (ENPV). A series of crop and farm budgets were developed for with and without-project scenarios. The social discount rate is assumed at 6.14 per cent. An investment horizon of 15 years is applied. Incremental benefits mainly result from horticultural crops VC development.
28. SADP II's economic rate of return is estimated at 28.0 per cent, with a corresponding ENPV of US\$82.2 million. An analysis also estimates the social value of carbon. On the basis of a net balance of -56,152 tCO<sub>2</sub>-eq per year and a social value of carbon starting at US\$40 (low value) and US\$80 (high value) in 2020, The project's ENPV, including carbon reduction benefits, is estimated at US\$101.6 million (at low value of carbon) and US\$121.1 million (at high value of carbon). SADP II's return on investment remains above the social discount rate. A sensitivity analysis demonstrates the results' robustness. The ENPV is positive for all proposed changes. Table 4 includes an up-date to the World Bank EFA, disclosed for the IFAD additional finance.<sup>10</sup>

Table 4  
Changes to project EFA with IFAD additional finance

	<i>With IFAD financing</i>	<i>Without IFAD financing</i>
Outreach	160,000 rural producers * 75,000 targeted farmers adopting CSA technologies*	150,000 rural producers 70,000 targeted farmers adopting CSA technologies
EIRR	28.0%	25.1%
ENPV	US\$82.2 million	US\$69.0 million

\* The calculation is based on proportional scaling. Original project investment accounts for US\$57 million, while additional financing (from IFAD) is US\$5 million. Thus, targeted farmers/MG recipients and crop areas are assumed to increase by 8.8 per cent. Values were rounded from 163,200 and 76,140 respectively.

### Exit strategy and sustainability

29. **Exit strategy:** The Project Implementation Manual (PIM) presents the project's overall exit strategy, including for the MG. The financing is frontloaded, and each MG will not run for more than two years per agribusiness/farmer/producer group, allowing for complete disbursement in year 4 or 5, thus leaving time for closure and exit. The service provider(s), hired under SADP II, will support grant recipients to transition out of project support.

<sup>9</sup> See appendix 1. The GoL requested the account to be in USD, though the loan is denominated in EUR.

<sup>10</sup> See complete documentation on [WB approved project](#).

30. **Sustainability:** SADP II will build ownership and institutional capacity to ensure the sustainability of project investments. Training farmers to think and act independently is the foundation of the SHEP approach that will be used to support individual farmers; and support for farmer groups will emphasize training in group dynamics, group management and conflict resolution as the basis for sustainable group activity. Support for investment will be based on a rigorous screening of grant applications ensuring business soundness. The required 20-40 per cent equity contribution further ensures ownership and co-investment.
31. **Environmental sustainability.** Activities under the proposed project will be screened against an Environmental and Social Management Framework to ensure that interventions are environmentally sustainable. The strong focus on dissemination and adoption of climate smart agriculture practices will also contribute positively to environmental sustainability, especially with regard to addressing threats from climate change.

### III. Risks

#### A. Project risks and mitigation measures

32. IFAD will adopt the risk-rating and risk-mitigation measures of the World Bank. Major risks and mitigation measures are listed in Table 5.

Table 5  
Risks and mitigation measures

<i>Risks</i>	<i>Risk rating</i>	<i>Mitigation measures</i>
<b>Political/governance</b>	High	The Project Management Committee (PMC), consisting of multiple ministries, ensures alignment and buy-in. The MG manual delineates responsibilities, selection criteria, awarding procedures, etc. To ensure transparency and address the risk of elite capture, details of all grants awarded will be published on the project website. The complaint handling mechanism under SADP I will be strengthened under SADP II to ensure timely and effective response to stakeholder concerns.
<b>Macroeconomic</b>	High	SADP II will help to offset projected slower economic growth and rising public debt, to some extent, by boosting agriculture sector growth, raising rural incomes and creating employment, as well as tax revenue from enterprises supported.
<b>Sector strategies and policies</b>	Medium	The World Bank and IFAD will work with Ministry of Agriculture and Food Security (MAFS) on strengthening sector strategies, their budgeting and monitoring.
<b>Institutional capacity</b>	High	Continuous training and capacity building of participating government entities. Retention of SADP I Project Management Unit (PMU) with additional technical and administrative staff and regular training to upgrade skills and knowledge Retaining PMU within MAFS to continue strengthening the skills of senior government officers support the capacity. Inclusion of performance-based contracts, agreements and memoranda of understanding to address non-performance. International service provider and qualified national service providers will support SADP II start-up.
<b>Portfolio</b>	Medium	Close communication with the WB on implementation challenges and joint supervision at least once per year.
<b>Fiduciary</b> Financial Management	High	Additional staffing for the PMU will address capacity weaknesses, and the external audit by the Office of the Auditor General of Lesotho will ensure appropriate monitoring.
<b>Fiduciary</b> Procurement	Medium	SADP II will implement procurement in accordance with the 'Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD and IDA and Grants', dated July 1 2016 (the Anticorruption Guidelines). Procurement will be covered by the procurement officer in the SADP I PMU, who has experience on World Bank procurement processes.

<i>Risks</i>	<i>Risk rating</i>	<i>Mitigation measures</i>
		World Bank staff will also provide hands-on implementation support and training.
<b>Stakeholders</b>	Medium	Engagement of project stakeholders through regular missions and appropriate project steering committee structures.
<b>Environment and social</b>	Medium	SADP II PMU's capacity will be enhanced with the hiring of a full-time safeguard specialist. An experienced Environmental and Social Consulting firm will ensure compliance with safeguards policies applicable to SADP II, during implementation. Training will ensure up-to-date knowledge of the World Bank's safeguard policies and requirements.
<b>Overall</b>	<b>Medium</b>	

## **B. Environment and social category**

33. **SECAP Compliance.** IFAD will adopt the World Bank environmental and social policies. Environmental classification (Category B) is confirmed. The environmental and social impacts are moderate and manageable.

## **C. Climate risk classification**

34. The project's climate risk classification is high. Extreme weather events (e.g. floods, droughts and hailstorms) are likely to continue over the life of the project.

## **D. Debt sustainability**

35. Lesotho's risk of external debt distress has been revised from "low" to "moderate," with some space to absorb shocks.<sup>11</sup> External and public debt as well as debt service indicators for the baseline remain below their respective thresholds, but shocks to contingent liabilities, exports and other flows lead to breaches. Debt Sustainability Analysis results highlight the importance of addressing the financing gap at the pension fund and continuing with a cautious debt management strategy focused on financing projects with high economic returns through concessional sources.
36. Total public debt increased to 38.8 per cent of GDP in FY 2017/18 from 37.6 per cent in 2016/17. The increase was observed in domestic and external borrowing. It was partially offset by growth in nominal GDP and appreciation of the Rand. External debt continues to account for most of total debt (79.1 per cent) and is largely owed to multilaterals. Domestic debt grew from 4.5 to 8.2 per cent of GDP in FY 2017/18 as authorities issued new bonds of M400 million and accumulated arrears of M700 million.

# **IV. Implementation**

## **A. Organizational framework**

### **Project management and coordination**

37. **Project oversight.** SADP II will be implemented under Principal Secretary, Ministry of Agriculture and Food Security (MAFS) direct oversight. The PMC, established under SADP I, will be maintained. It will include representatives from several ministries (e.g. Ministry of Finance, Ministry of Development Planning, MAFS, Ministry of Forestry and Land Reclamation, Ministry of Trade and Industry, Cooperatives and Marketing, Ministry of Environment and Tourism and Ministry of Local Government and Chieftainship). The PMC will review all project reports and Annual Work Plans and Budgets (AWPBs). It will meet quarterly, with the Project Manager acting as its Secretary.
38. **Project Implementation.** SADP I's PMU will undertake implementation of SADP II until closure of the former, after which the positions will be filled on a competitive

<sup>11</sup> Joint Bank-Fund Debt Sustainability analysis 2018, published June 11 2019

basis. Key personal will be transferred from phase I to phase II for quick start-up and additional positions will be recruited for the larger 2<sup>nd</sup> phase.

39. The PMU will be responsible for project implementation including fiduciary aspects; knowledge management/ communication; grievance redress mechanism; citizen engagement; and monitoring the implementation of safeguard related measures. Additional periodic surveys will be supported to improve project implementation, for example to assess and improve women and youth participation.
40. **Project Implementation Manual (PIM).** SADP I's PIM has been updated to guide SADP II's implementation. The grant manual describes the procedures and selection criteria, and specifies appropriate fiduciary, environmental and social safeguards. The PMU will be responsible for administering the MG program.

#### **Financial management, procurement and governance**

41. The PMU will be accountable for the project financial management arrangements, (including budgeting, accounting, payments, internal controls, transaction processing, quarterly and annual financial reporting).
42. Budgets will be prepared based on approved AWPB and procurements plans. SADP II will have to submit to the World Bank unaudited Interim Financial Reports no later than 45 days after the end of each financial quarter.
43. The project will be audited by the Office of the auditor General as is currently the case with SADP I, in accordance with the World Bank's project auditing guidelines.
44. The annual project financial statements, including the auditor's opinion and a management letter, will be submitted to the World Bank and IFAD no later than six (6) months after the end of the fiscal year.
45. **Procurement:** All procurement to be financed under SADP II will be done in accordance with the World Bank's Procurement Regulations for Investment Project Financing Borrowers and the provisions contained in the IFAD Financing Agreement. Procurement methods and prior review requirements will be identified in annual procurement plans, together with the AWPBs.
46. The procurement risk rating is 'Moderate'. Preliminary risk mitigation measures include: (a) hiring an additional procurement officer; (b) establishing a contract management plan for major contracts and (c) training PMU staff on the World Bank's procurement regulations and contract management.
47. **Fiduciary oversight by the World Bank.** The World Bank will review contracts according to the prior review thresholds set in the Project Procurement Strategy for Development/Procurement Plan. All other contracts will be subject to post review. IFAD entrusts the World Bank with the procurement reviews as per Appointment Letter.

### **B. Planning, monitoring and evaluation, learning, knowledge management and communications**

48. The monitoring and evaluation (M&E) system will include a Management Information System and beneficiary assessments to gather accurate data. The updated PIM details the organizational and technical setup, which will govern SADP II's M&E procedures. A mid-term evaluation will be conducted and an implementation completion report will be prepared after project closure.

#### **Innovation and scaling up**

49. SADP II promotes innovations in agriculture production system in Lesotho and lays the foundation for scaling up. Innovative approaches include climate-resilient agriculture, SHEP, vertical alliances and investments in irrigation management.

### **C. Implementation plans**

#### **Implementation readiness and start-up plans**

50. SADP II became effective in August 2019. The PMU from SADP is mobilising officials and districts. Staff currently financed under the GEF-financed Lesotho Agriculture Smallholder Adaptation Project, which ends in March 2021, will build a bridge between phases 1 and 2 of SADP and support start-up.

#### **Supervision, midterm review and completion plans**

51. IDA will be appointed as the cooperating institution and be formally responsible for project supervision. For the implementation period a costing of administrative work in the range of four per cent was agreed.<sup>12</sup> IFAD will field supervision missions jointly with the World Bank. There will also be joint no objections on AWPB and PIM revisions from World Bank and IFAD, while World Bank is responsible for every-day administration.
52. SADP II will ensure IFAD's visibility and adherence to corporate priorities during implementation, in particular those relating to pro-poor targeting and mainstreaming themes. To this end, the implementing arrangements will be formalized in the Appointment Letter and IFAD will ensure its staff presence in supervision missions.

### **V. Legal instruments and authority**

53. A project financing agreement between the Kingdom of Lesotho and IFAD will constitute the legal instrument for extending the proposed financing to the borrower. A copy of the negotiated financing agreement is attached as Appendix I.
54. The Kingdom of Lesotho is empowered under its laws to receive financing from IFAD.
55. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Policies and Criteria for IFAD Financing.

### **VI. Recommendation**

56. According to the delegation of authority procedure approved by the Executive Board at its 126<sup>th</sup> session and detailed in document EB 2019/126/R.48/Rev.2, the President is invited to approve the proposed financing in terms of the following resolution:

RESOLVED: that the Fund shall provide a loan on highly concessional terms to the Kingdom of Lesotho in an amount of three million, twenty two thousand euros (EUR 3,022,000) upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

RESOLVED FURTHER: that the Fund shall provide a loan on blend terms to the Kingdom of Lesotho in an amount of one million four hundred eight thousand euros (EUR 1,488,000) upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Donal Brown  
Associate Vice-President, Programme Management Department

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<sup>12</sup> Details are formalise in the appointment letter.



## **Negotiated financing agreement: "Smallholder Agriculture Development Project II (SADP II)"**

(Negotiations concluded on 4 November 2019)

Loan No:

Loan No:

Project name: Smallholder Agriculture Development Project II (SADP II)

The KINGDOM OF LESOTHO (the "Borrower")

and

The INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT (the "Fund" or "IFAD")

(each a "Party" and both of them collectively the "Parties")

**WHEREAS** the Borrower has requested financing from the Fund for the purpose of co-financing the SADP II;

**WHEREAS**, the Project shall be co-financed by the International Development Association (IDA);

**WHEREAS**, the International Development Association (herein referred to as "IDA") has agreed to extend financing (the "IDA Financing") to the Borrower in the amount of Fifty million United States dollars (USD 50 million) to assist in co-financing the Project on terms and conditions to be set forth in an Agreement (the "IDA Financing Agreement") between the Borrower and IDA;

**WHEREAS**, the Fund has agreed to co-finance the Project and provide a loan for the activities mentioned in Schedule 1 to this Agreement;

**NOW THEREFORE**, the Parties hereby agree as follows:

### **Section A**

1. The following documents collectively form this Agreement: this document, the Project Description and Implementation Arrangements (Schedule 1), the Allocation Table (Schedule 2), the Special Covenants (Schedule 3) and the General Conditions. In the event of a conflict between this document and any of the Schedules, the provisions of this document shall take precedence.

2. All provisions of the Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, amended as of December 2018, and as may be amended hereafter from time to time (the "General Conditions") shall apply to this Agreement except for the provisions identified in Section E paragraph 3 below. For the purposes of this Agreement the terms defined in the General Conditions shall have the meanings set forth therein, unless the Parties otherwise agree in this Agreement.

3. The Fund shall provide a Loan (the "Financing") to the Borrower which the Borrower shall use to implement the Project in accordance with the terms and conditions of this Agreement.

4. For the purpose of this Agreement:

"PIM" means the Project Implementation Manual prepared under the IDA Agreement;

"IDA Procurement Regulations" means the World Bank Procurement Regulations for IPF Borrowers, defined in the IDA Agreement;

"Grant Manual" means the Manual prepared under the IDA Agreement for the provision of Matching grants;

"Matching Grants" for the purpose of this Agreement, means the grants to be provided under component 2 to agri-enterprises and/or producers out of the IFAD Financing".

## **Section B**

The Loan is composed of:

A. The amount of the Loan eligible to highly concessional terms is EUR 3 022 000 (three million twenty two thousand Euro).

1. The Loan granted on highly concessional terms shall be free of interest but shall bear a fixed service charge as determined by the Fund at the date of approval of the Loan by the Fund's Executive Board, payable semi-annually in the Loan Service Payment Currency. The Loan shall have a maturity period of forty (40) years, including a grace period of ten (10) years starting from the date of approval of the Loan by the Fund's Executive Board.

2. The principal of the Loan granted on highly concessional terms will be repaid at four and half per cent (4.5%) of the total principal per annum for years eleven (11) to thirty (30), and one per cent (1%) of the total principal per annum for years thirty-first (31) to forty (40).

B. The amount of the Loan eligible to blend terms is EUR 1 488 000 (one million four hundred eighty eight thousand Euro).

3. The Loan granted on blend terms shall be subject to interest on the principal amount outstanding and a service charge as determined by the Fund at the date of approval of the Loan by the Fund's Executive Board. The interest rate and service charge determined will be fixed for the life cycle of the loan and payable semi-annually in the Loan Service Payment Currency, and shall have a maturity period of twenty five (25) years, including a grace period of five (5) years starting from the date of approval of the Loan by the Fund's Executive Board.

4. The Loan Service Payment Currency shall be the EUR.

5. The first day of the applicable Fiscal Year shall be 1 April.

6. Payments of principal and service charge shall be payable on each 15 February and 15 August.

7. The arrangements for the Designated Account denominated in USD (the "Designated Accounts") opened by the Borrower through which the proceeds of the IFAD Financing shall be channelled and the operational bank accounts shall be detailed in the IDA Disbursement and Financial Information Letter.

**Section C**

1. The Lead Project Agency shall be The Ministry of Agriculture and Food Security (MAFS) of the Borrower.
2. Additional Project Parties include those parties responsible for the implementation of any part of the project and any other parties deemed necessary by the Lead Project Agency.
3. A Mid-Term Review will be conducted by IFAD and IDA as specified in Section 8.03 (b) and (c) of the General Conditions; however, the Parties may agree on a different date for the Mid-Term Review of the implementation of the Project.
4. The Project Completion Date shall be the same as agreed with IDA, currently set at May 31, 2026; or such other date as the Fund may designate by notice to the Borrower, and the Financing Closing Date will be established as specified in the General Conditions.
5. Procurement of goods, works and services financed by the Financing shall be carried out in accordance with the IDA Procurement Regulations.
6. Financial Management arrangements shall be organized in accordance with those of IDA.

**Section D**

The Financing shall be administered by the IDA as the Cooperating Institution. The Project shall be supervised jointly by IDA and the Fund.

**Section E**

1. The following are designated as additional grounds for suspension of the right of the Borrower to request disbursements under the Financing:
  - a) The PIM has been waived or amended without the prior agreement of IFAD and/or IDA.
  - b) The right of the Borrower to withdraw the proceeds under the IDA Agreement has been suspended, cancelled or terminated, in whole or in part, or the IDA Loan has become due and payable prior to the agreed maturity thereof.
2. The following is designated as an additional ground for cancellation of this Agreement: the IDA Financing Agreement shall have been cancelled.
3. The following are designated as additional general conditions precedent to withdrawal:
  - a) The Additional Effectiveness Condition under the IDA Agreement Article IV 4.01 have been met by the Borrower.
  - b) Withdrawal condition under IDA Agreement Schedule 2 Section III B. 1 c) have been met by the Borrower.
  - c) The entry into force of a Letter of Appointment between the IDA and IFAD.

4. Sections 7.05 (Procurement) and Section 7.01 (b) (ii) and Article 8 (Implementation Reporting and Information) of the General Conditions shall not apply to this Agreement and instead the following will apply:

- (a) all goods, works and services required for the Project and to be financed out of the proceeds of the financing shall be procured in accordance with the IDA Procurement Regulations.
- (b) the Borrower, shall monitor and evaluate the progress of the Project and prepare Reports, as well as Annual Workplans and Budgets (AWPBs), in accordance with the IDA Financing Agreement.

5. The following are the designated representatives and addresses to be used for any communication related to this Agreement:

For the Borrower:

Minister of Finance  
P.O. Box 395  
Maseru 100  
The Kingdom of Lesotho

For the Fund:

President  
International Fund for Agricultural Development  
Via Paolo di Dono 44  
00142 Rome, Italy

This Agreement, dated \_\_\_\_\_, has been prepared in the English language in two (2) original copies, one (1) for the Fund and one (1) for the Borrower and shall enter into force as provided for in the General Conditions.

KINGDOM OF LESOTHO

\_\_\_\_\_  
(Authorized Representative)  
[insert his title]

Date: \_\_\_\_\_

INTERNATIONAL FUND FOR  
AGRICULTURAL DEVELOPMENT

\_\_\_\_\_  
Gilbert F. Hougbo  
President

Date: \_\_\_\_\_

## **Schedule 1**

### *Project Description and Implementation Arrangements*

#### **I. Project Description**

1. Part 2 "Improving Agricultural Commercialization and Nutrition" of Schedule 1 "Project Description" of the IDA Financing Agreement applies to this Agreement. The IFAD loan will be directed towards financing the matching grants mechanism.

#### **II. Implementation Arrangements**

1. Schedule 2 Section I "Implementation Arrangements" of the IDA Financing Agreement apply to this Agreement, with the exception of Part G "Contingent Emergency Response Component" under Part 4 of the Project.

#### **2. Project Implementation Manual**

The Borrower shall carry out the Project in accordance with a Project Implementation Manual, satisfactory to the Fund and IDA. The Borrower will finalize the development of the Project Implementation Manual (PIM) for the Fund's consideration and approval. The PIM will include, inter alia the targeting strategy of the project, as well as the matching grant manual as an appendix to the PIM.

Any revisions to the PIM shall have to be previously approved by the Fund and IDA.

## Schedule 2

### Allocation Table

1. *Allocation of Loan Proceeds.* (a) The Table below sets forth the Categories of Eligible Expenditures to be financed by the Loan and the allocation of the amounts to each category of the Financing and the percentages of expenditures for items to be financed in each Category:

Category	Loan (HC) Amount Allocated (expressed in EUR)	Loan (BT) Amount Allocated (expressed in EUR)	Percentage Net of Tax
I. Grants & subsidies	3 022 000	1 488 000	100%
<b>Total</b>	<b>3 022 000</b>	<b>1 488 000</b>	<b>100%</b>

(b) The terms used in the Table above are defined as follows:

- (i) Both Loans are provided net of taxes;
- (ii) All withdrawal applications shall be charged against the applicable category or categories and shall be apportioned by IDA as Cooperating Institution between IDA and the Fund in the ratio of 75:25 (IDA:IFAD);
- (iii) The Funds share of each withdrawal application shall be apportioned by IDA as Cooperating Institution in the ratio of 67% to 33% between the two loans;
- (iv) Grants & Subsidies - covers the Matching grants to be provided under component 2 to agri-enterprises and/or producers.

**Schedule 3***Special Covenants*

1. *Gender and youth.* The Borrower shall ensure that the concerns of women and youth are given due consideration in implementing the Project and that the quotas for women and youth participation established in the PIM are met.
2. *Compliance with Safeguards.* The Borrower shall ensure that the Project will be implemented in compliance with the safeguards provisions specified in the IDA Financing Agreement and as outlined in the PIM.



## Appendix II: Logical framework

Results Hierarchy	Indicators				Means of Verification		
	Name	Baseline	Mid-Term	End Target	Source	Frequency	Responsibility
<b>Outreach</b>	<b>1.b Estimated corresponding total number of households members</b>						
	Household members - Number of people			800000			
	<b>1.a Corresponding number of households reached</b>						
	Households - Number			160000			
	<b>1 Persons receiving services promoted or supported by the project</b>						
	Young - Percentage (%)			35			
Female - Percentage (%)			50				
<b>Project Goal</b>							
<b>Development Objective</b> To support increased adoption of climate smart agricultural technologies in Lesotho's agriculture, enhanced commercialization and improved dietary diversity among targeted beneficiaries	<b>Land area under sustainable landscape management practices</b>				Progress reports and secondary data	Annual	PMU, Lesotho Bureau of Statistics
	Hectares of land - Area (ha)	0		45000			
	<b>Increased sales in project supported enterprises &amp; farms</b>				Project surveys	Annual	PMU
	Increased sales - Percentage (%)	0		100			
	<b>Household consumption of diversified food and food products</b>				Qualitative Surveys	Annual	PMU
	Household consumption - Percentage (%)	0		80			
	<b>Farmers adopting climate smart agricultural technologies</b>				PMU Progress Reports	Bi-annual	PMU
	Farmers - Number	0		75000			
Females - Number	0		37500				
<b>Outcome 1. Climate Smart agriculture Practices &amp; Advisory Services</b>	<b>Community-based irrigation water management entities operational</b>				PMU Progress Reports	Annual	PMU
	Entities - Number	0		30			
	<b>Users receiving integrated agro-weather information and market information services</b>				Surveys	Bi-Annual	PMU
	Users - Number	0		305000			
<b>Output 1.1</b> Client days of training provided on improved agricultural practices	<b>Client days of training provided on improved agricultural practices</b>				PMU Progress Reports	Bi-annual	PMU
	Client days of training - Number	0		187500			
<b>Output 1.2</b> Area of land bought under climate-resilient management	<b>3.1.4 Land brought under climate-resilient practices</b>				MIS/M&E	Annual	PMU
	Hectares of land - Area (ha)	0		10000			
<b>Output 1.3</b> Number of groups supported to sustainably manage natural resources and climate related risks	<b>3.1.1 Groups supported to sustainably manage natural resources and climate-related risks</b>				MIS/M&E	Bi-annual	PMU
	Groups supported - Number	0		50			
<b>Output 1.4</b> Area provided with new/improved irrigation or drainage services	<b>Area provided with new/improved irrigation or drainage services</b>				MIS/M&E	Annual	PMU
	Hectares of land - Area (ha)	0		2860			
<b>Output 1.5</b> Area provided with new irrigation or drainage services	<b>Area provided with new irrigation or drainage services</b>				MIS/M&E	Annual	PMU
	Hectares of land - Area (ha)	0		260			
<b>Output 1.6</b> Area provided with improved irrigation or drainage services	<b>Area provided with improved irrigation or drainage services</b>				MIS/M&E	Annual	PMU
	Hectares of land - Area (ha)	0		2600			

Results Hierarchy	Indicators				Means of Verification		
	Name	Baseline	Mid-Term	End Target	Source	Frequency	Responsibility
<b>Output</b> 1.7 State-of-the-art soil laboratory	<b>State-of-the-art soil laboratory</b>				Site visits	Annual	PMU
	Laboratory - Number	0		1			
<b>Output</b> 1.8 Fertilizer blending facility established	<b>Fertilizer blending facility established</b>				Site visits	Annual	PMU
	Facility - Number	0		1			
<b>Outcome</b> Outcome 2. Agricultural commercialisation and nutrition improved	<b>2.2.2 Supported rural enterprises reporting an increase in profit</b>				Surveys/site visits	Annual	PMU
	Number of enterprises - Number	0		35000			
	<b>Number of beneficiaries reporting increased commercial activity in response to project action</b>				Surveys/site visits	Annual	PMU
	Beneficiaries - Number	0		50000			
	Females - Percentage (%)	0		50			
	Young - Percentage (%)	0		40			
	<b>2.2.1 New jobs created</b>				Surveys	Annual	PMU
	New jobs - Number	0		15000			
	<b>Number of beneficiaries reporting the use of improved household nutrition practices</b>				Surveys/Site visits	Annual	PMU
	Beneficiaries - Number	0		20000			
	<b>1.2.8 Women reporting improved quality of their diets</b>				Surveys/Site visits	Annual	PMU
	Percentage - Percentage (%)	0		70			
	<b>Rural producers engaged in partnerships / agreements, contracts with public or private entities</b>				MIS/M&E, Surveys	Bi-annual	PMU
	Rural producers - Number	0		50000			
	Females - Percentage (%)	0		50			
	Young - Percentage (%)	0		35			
<b>Number of trained beneficiaries reporting improved access to markets</b>				Surveys	Bi-annual	PMU	
Trained beneficiaries - Number	0		50000				
Females - Percentage (%)	0		50				
Young - Percentage (%)	0		35				
<b>Output</b> 2.1 Number of client days of training for horizontal alliances received by project beneficiaries	<b>Number of client days of training for horizontal alliances received by project beneficiaries</b>				MIS/Progress reports	Bi-annual	PMU
	Client days - Number	0		75000			
<b>Output</b> 2.2 Number of sub-projects completed in line with agreed contractual obligation	<b>Number of sub-projects completed in line with agreed contractual obligation</b>				Surveys/site visits	Annual	PMU
	Sub-project - Number	0		3000			
	Young - Percentage (%)	0		40			
<b>Output</b> 2.3 Number of National Public Awareness Campaigns Implemented	<b>Number of National Public Awareness Campaigns Implemented</b>				MIS/M&E	Annual	PMU
	Campaigns - Number	0		10			
<b>Output</b> 2.4 Households participating in Nutrition clubs	<b>Households participating in Nutrition clubs</b>				Surveys/site visits	Annual	PMU
	Households - Number	0		30000			
<b>Output</b> 2.5 Industry guidelines for sugar, salt, fat, fortification developed	<b>Industry guidelines for sugar, salt, fat, fortification developed</b>				Consultant report		PMU
	Industry guidelines - Number	0		1			