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IFAD
Investing in rural people

# Republic of Kenya

# Rural Kenya Financial Inclusion Facility (RK FINFA)

# Negotiated financing agreement

Executive Board — 134th Session
Rome, 13-16 December 2021

For: **Information**

# Negotiated financing agreement: "Rural Kenya Financial Inclusion Facility (RK FINFA)"

(Negotiations concluded on 25 November 2021)

Loan No: _____
Loan No: _____

Project name: Rural Kenya Financial Inclusion Facility ("RK FINFA"/ the "Project")

The Republic of Kenya (the "Borrower")

and

The International Fund for Agricultural Development (the "Fund" or "IFAD")

(hereinafter referred to each as a "Party" and collectively as the "Parties")

**WHEREAS** the Borrower has requested a loan from the Fund for the purpose of financing the Project described in Schedule 1 to this Agreement;

**WHEREAS**, the Fund has agreed to provide financing for the Project;

**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) and the Special Covenants (Schedule 3).

2. The Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, amended as of December 2020, and as may be amended hereafter from time to time (the "General Conditions") are annexed to this Agreement, and all provisions thereof shall apply to this Agreement. For the purposes of this Agreement the terms defined in the General Conditions shall have the meanings set forth therein, unless the Parties shall otherwise agree in this Agreement.

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

## Section B

1. A. The amount of the Loan on highly concessional terms (Loan 1) is six million two hundred and forty thousand Euro (EUR 6 240 000).

   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. 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).

B. The amount of the Loan on blend terms (Loan 2) is twelve million six hundred and sixty thousand Euro (EUR 12 660 000).

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. The Loan 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. The principal of the Loan granted on Blend terms will be repaid in equal instalments.

2. The Loan Service Payment Currency shall be in Euro (EUR).

3. The first day of the applicable Fiscal Year shall be 1st July.

4. Payments of principal, interest and service charge shall be payable on each 15 June and 15 December.

5. A Designated Account for the exclusive use of the Project shall be held by the National Treasury at the Central Bank of Kenya to receive funds from IFAD. The Borrower shall inform the Fund of the officials authorized to operate the Designated Account.

6. A dedicated project operational account in Kenya Shillings (KES) will be managed by the PMU.

7. The Borrower shall provide counterpart financing for the Project in an amount equivalent to approximately USD 24 million, of which taxes and duties account for USD 44,000, (0.2 per cent), cash for USD 23 million (99.5 per cent) and in-kind contributions for USD 72,000 (0.3 per cent). Government co-financing will mostly be provided through support to the Rural Credit Guarantee Scheme (R-CGS) and the Green Finance Facility. Government will also allocate counterpart funds to capacity building of the PFIs and project coordination.

**Section C**

1. The Lead Implementing Agency of RK-FINFA will be the Directorate of Budget, Fiscal and Economic Affairs in the National Treasury and Planning (NT&P).

2. A Mid-Term Review will be conducted 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.

3. The Project Completion Date shall be the sixth anniversary of the date of entry into force of this Agreement and the Financing Closing Date shall be 6 months later, or such other date as the Fund may designate by notice to the Borrower.

4. Procurement of goods, works and services financed by the Financing shall be carried out in accordance with the provisions of the Borrower's procurement laws, namely, Public

Procurement and Asset Disposal Act, 2015 and the Regulations made thereunder as may be amended from time to time, to the extent such are consistent with the IFAD Procurement Guidelines. For procurement activities to be carried out by co-investing/implementing partners, the applicable procurement framework will be determined by a due diligence exercise carried out according to IFAD's Project Procurement Framework and will be included in the related agreements subject to IFAD's No-Objection.

**Section D**

1. The Fund will administer the Loans and supervise the Project.

**Section E**

1. The following are designated as additional grounds for suspension of this Agreement.

   (a) The Project Implementation Manual (PIM) and/or any provision thereof, has been waived, suspended, terminated, amended or modified without the prior agreement of the Fund and the Fund, after consultation with the Borrower, has determined that it has had, or is likely to have, a material adverse effect on the Project.

   (b) The Project Coordinator and the Financial Controller have been appointed, transferred or moved from the PMU without the non-objection of the Fund;

2. The following are designated as additional specific conditions precedent to withdrawal:

   (a) The first Annual Work Plan and Budget (AWPB) shall have received IFAD's non-objection;

   (b) The Designated Account shall have been opened by the Borrower;

   (c) The Project Coordinator, the Financial Controller and the Project Procurement Specialist within PMU shall have been appointed with terms of reference and qualification acceptable to the Fund;

   (d) The PIM as described in Section II of Schedule 1, shall have been finalised in form and substance satisfactory to the Fund; and

   (e) The Project Steering Committee (PSC) shall have been established.

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

For the Borrower:

Cabinet Secretary
The National Treasury and Planning
P.O. Box 30007-00100
Nairobi
Kenya

For the Fund:

The 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.

REPUBLIC OF KENYA

_____
Ukur Yatani E.G.H
Cabinet Secretary
National Treasury and Planning

Date: _____

INTERNATIONAL FUND FOR
AGRICULTURAL DEVELOPMENT

_____
Gilbert F. Houngbo
President

Date: _____

# Schedule 1

*Project Description and Implementation Arrangements*

## I. Project Description

1. *Target Population*. The Project will benefit 190,000 rural Kenyan households, including both direct and indirect clients. This includes direct financial and technical services to 68,000 households/micro-small-and-medium enterprises (MSMEs), covering: (i) an estimated 66,000 economically active smallholder households; and (ii) 2,000 rural MSMEs engaged in smallholder-inclusive value chains (VCs). Indirect outreach of the project includes: (i) estimated 32,000 persons, through employment in the RK-FINFA supported agribusinesses and farms; and (ii) 90,000 smallholder households, through participation in the VCs, strengthened by the supported agribusinesses. The targeting focus is on low-income, economically active rural households, with overall Project targets on 50 per cent of women and 30 per cent of youth participation.

2. *Project area.* The geographic coverage of RK-FINFA, once fully operational, will be nationwide *(the "Project Area")*. For an effective project start-up, the entry point for the RK-FINFA outreach will be the 14 counties in which at least two IFAD-supported projects operate with agricultural value chains. With this approach, RK-FINFA and its Participating Financial Institutions (PFIs) will benefit from synergies with ongoing IFAD-supported agriculture and agribusiness development activities on diversified value chains. After the RK-FINFA capacity building and initial financing cycle of two years, or another time agreed between the Parties, the PFIs can expand their targeted area of investments with RK-FINFA resources to any rural county in Kenya. The PFIs will identify these expansion areas based on their market opportunities and capabilities while continuing to apply the agreed targeting principles of the project.

3. *Goal.* RK-FINFA's project goal is: "*poverty reduction, climate change resilience and improved livelihoods in rural areas*".

4. *Objectives.* The objective of the Project is increased rural financial inclusion and green investments by agriculture value chain stakeholders, leading to equitable employment opportunities, innovative and resilient production systems, and increased incomes for smallholders, poor and marginalised rural households, women and youth.

5. *Components*. The Project will have the following components: (i) Component 1: Technical Support and Innovation Services (TSIS); (ii) Component 2: Rural Investment Instruments; and (iii) Component 3: Enabling Rural Finance Environment and Project Coordination

5.1 **Component 1**: *Technical Support and Innovation Services (TSIS).* Through two fully inter-linked sub-components, Component 1 will: (i) strengthen PFI capacities for innovation, rural outreach and green finance services in Kenya; and (ii) build MSME and smallholder sustainable investment capacities and financial literacy skills particularly tailored to reach women, youth and marginalized groups. Both aspects of the TSIS, supply and demand side, will be embedded into the rural growth strategies of PFIs to foster sustainability and effective use of the resources provided through the project investment instruments. A co-financing partner organization/organizations will be engaged to coordinate the TSIS component

5.1.1 *Sub-Component 1.1: PFI Capacity Building for Rural Outreach and Innovation* will build the capacity of participating commercial banks, MFBs and DT-SACCOs to provide rural and agriculture financial services, to implement green investment portfolios, and for effective ESM systems.

5.1.2 *Sub-component 1.2*: *Business Development Services for Agribusinesses and Smallholders* will build MSME and smallholder sustainable investment capacities and financial literacy skills particularly tailored to reach women, youth and marginalized groups. Both aspects of TSIS, supply and demand, will be embedded into the rural growth strategies of PFIs to foster sustainability and effective use of the resources provided through the project investment instruments.

5.2 **Component 2:** *Rural Investment Instruments*. The RK-FINFA will operate with two Rural Investment Instruments: (i) a Rural Credit Guarantee Scheme (R-CGS); and (ii) a Green Financing Facility (GFF). Both the R-CGS and the GFF will be designed as sustainable financing vehicles, which can utilize resources from the Government and from interested international financiers to unlock private investment into Kenya's agricultural and agribusiness sector at attractive market terms through Kenyan financial institutions.

5.2.1 *Sub-component 2.1*: *Rural Credit Guarantee Scheme (R-CGS)* provides risk sharing to promote rural outreach innovations and catalyze funding from Kenyan mainstream financial institutions into the rural and agriculture sector. Supported by the R-CGS guarantee amount of USD 20 million by IFAD and the Government of Kenya, the PFIs are expected to lend USD 80 million to rural MSMEs and smallholders in agriculture value chains. The RCGS will be established as part of an existing MSME credit guarantee scheme, hosted and managed by the National Treasury and the Central Bank of Kenya; the scheme has received technical assistance and seeks additional support from a coalition of international partners.

5.2.2 *Sub-component 2.2*: *Green Financing Facility (GFF)* will support the innovative and sustainable transformation of Kenya's rural economy. It is to be established with RK-FINFA's supported amount of USD 15 million by IFAD and the Government of Kenya. The GFF will contribute to the sustainable rural transformation, growth, and income generation through alleviating the liquidity constraints of non-bank financial institutions and Micro-Finance Banks that are the main financial service providers to smallholders and rural micro-enterprises, and by encouraging small-scale farmers and micro-firms to invest in climate-smart and environmentally friendly activities.

5.3 **Component 3**: *Enabling Rural Finance Environment and Project Coordination*, consisting of two sub-components. The aim of Sub-component 3.1. (Enabling Rural Finance Environment) is to promote policies and institutional arrangements that support the development of a more conducive operational environment for the R-CGS and the GFF, therefore, fostering their capacity to improve rural financial intermediation. Sub-component 3.2 (Project Coordination) covers the project implementation and coordination arrangements.

## II. Implementation Arrangements

6. *Lead Project Agency*. The Lead Implementing Agency of RK-FINFA will be the Directorate of Budget, Fiscal and Economic Affairs in the National Treasury and Planning (NT&P). The Directorate is headed by a Director General who is answerable to the Principal Secretary of the NT&P.

7. *Project Steering Committee*. A Project Steering Committee (PSC) will be established, with representatives from the ministries, public agencies and apex representative organizations of the relevant sector private sector stakeholders.

8. *Project Management Unit*. Under the PSC, a dedicated Project Management Unit (PMU) will be established at the NT&P and housed in the Financial and Sectoral Affairs Department. The key investment components and sub-components are planned to be implemented by intermediaries or investing partner institutions.

9. *Implementing partners*. RK-FINFA will build partnerships with Kenyan FIs serving the rural market and other institutions active in the sector. The GFF will be established as a permanent facility at a selected Host Financial Institution to provide wholesale capital to rural financial institutions for on-lending to the smallholder sub-sector. The GFF Host Institution will be selected against standard financial performance criteria and determined capacity requirements on wholesale lending and green rural finance. The R-CGS, instead, will be established as part of an existing MSME credit guarantee scheme, hosted and managed by the National Treasury and the Central Bank of Kenya, which has received technical assistance and seeks additional support from a coalition of international partners. Furthermore, technical implementation partnerships with organizations from non-government sector will be established to introduce international best practices to the project implementation. All partnering institutions that will receive funds from the PMU will keep sub-project accounts for segregating the funds received. The sub-project accounts will be denominated in local currency and will be opened in a financial institution acceptable to IFAD. The R-CGS funds, after required conditions are met, will be deposited and ring-fenced at the Central Bank of Kenya or at a reputable commercial bank. Any interest generated should be used for the purposes of the R-CGS. The guarantee reserve is accessible to PFIs only after possible losses materialise and have been reported and approved. The GFF funds will be transferred to the host financial institution after required conditions are met. There will be monthly financial reports to the PMU for monitoring operations of sub-accounts and consolidation.

10. *Monitoring and Evaluation*. During the pre-project period and immediately after project effectiveness, RK-FINFA will develop a robust M&E system in compliance with IFAD and the Government requirements. The M&E system implementation for the various project activities will be fully integrated with one another, to ensure aggregation of data to the reports covering all activities, as well as the provision of appropriate guidance to management.

11. *Knowledge Management*. The project's Knowledge Management (KM) activities are guided by a robust KM plan, to improve learning, KM and communication practices within the Project. A comprehensive draft RK-FINFA KM Plan is incorporated in the PIM. The wider adoption outside the project of RK-FINFA's documented lessons learnt, best practices and especially green financing methods will be an important measure of the project's success in KM.

12. *Project Implementation Manual.* A draft PIM has been prepared as a part of the RK-FINFA design process. In addition, a draft AWPB and a draft procurement plan (PP) have been prepared for the first 18 months of project implementation. These documents aim to ensure that implementation starts without unnecessary delays during the first year of the project. Furthermore, various pre-project activities, including the preparations for the documentation of the partnership agreements and for the tendering of the technical service providers, are planned to start immediately after the project approval by IFAD and the Government. The PIM should be finalised as part of start-up processes.

## 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 Loans 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 1 Amount Allocated (EUR)** | **Loan 2 Amount Allocated (EUR)** | **Percentage (net of tax)** |
|---|---|---|---|---|
| I. | Credit, guarantee funds | 4 220 000 | 8 560 000 | 100% |
| II. | Goods, services and inputs | 670 000 | 1 370 000 | 100% |
| III. | Training | 230 000 | 470 000 | 100% |
| IV. | Salaries and allowances | 490 000 | 990 000 | 100% |
| Unallocated | | 630 000 | 1 270 000 | |
| **TOTAL** | | **6 240 000** | **12 660 000** | |

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

(i) Goods, services and inputs includes equipment, materials and vehicles.

2. *Disbursement arrangements*

(a) *Start-up Advance*. Withdrawals in respect of expenditures for start-up costs incurred before the satisfaction of the general conditions precedent to withdrawal shall not exceed an aggregate amount of EUR 280,000 for expenditure in categories II and IV. Activities to be financed by start-up costs will require the no objection from IFAD to be considered eligible.

## Schedule 3

*Special Covenants*

In accordance with Section 12.01(a)(xxiii) of the General Conditions, the Fund may suspend, in whole or in part, the right of the Borrower to request withdrawals from the Loan Account if the Borrower has defaulted in the performance of any covenant set forth below, and the Fund has determined that such default has had, or is likely to have, a material adverse effect on the Project:

1. *Anticorruption*. The Borrower shall comply with IFAD Policy on Preventing Fraud and Corruption in its Activities and Operations. The Borrower ensures that the systems governing the expenditure from the project funds will be subject to its national and IFAD anti-corruption practices and in this regard, IFAD's anti-corruption policy shall be communicated as appropriate, including its concept of zero tolerance and the mechanisms for reporting suspected irregular practices.

2. *Anti-money Laundering and Countering the Financing of Terrorism (AML/CFT) Measures.* The Borrower ensures its commitment to combating money laundering and terrorism financing, consistent with IFAD's Anti-Money Laundering and Countering the Financing of Terrorism Policy in the Project Activities. The Borrower ensures that the systems governing the expenditure from the project funds will be subject to national laws and regulations as well as IFAD's Framework on this regard, which will be communicated to the Borrower. Further, the Borrower shall ensure that appropriate controls are included in the PIM and that the Participating Financial Institutions: (i) comply with applicable laws and regulations of the Borrower on AML-CFT and that the Financing proceeds are not used, directly or indirectly, in money laundering or financing of terrorism; (ii) formulate and implement internal control procedures, including due diligence procedures; and (iii) promptly inform the Borrower if there is any violation or potential violation of this paragraph. In the event that PFIs inform the Borrower of an alleged violations, PFIs shall cooperate in good faith with the Fund and its internal investigations.

3. *Compliance with the Social Environmental and Climate Assessment Procedures* (SECAP). The Borrower shall ensure that the Project will be implemented in compliance with IFAD's SECAP guidelines and Government of Kenya's Environmental Laws, and more specifically: in line with the Environment and Social Management Framework (ESMF), the Environmental and Social Management Plans, the basic climate risk analysis as included in the ESMF. The Borrower shall enhance positive environmental and social outcomes during project implementation and mitigate negative impacts. The Borrower will also ensure that the Free, Prior and Informed Consent Process will be followed to ensure active participation of indigenous in the project areas.

4. *Gender*. The Borrower shall ensure that a strategy for gender has been designed to contribute to the social and economic inclusion of youth, women and other vulnerable and marginalised groups and offer them an equal opportunity to participate and benefit from the project activities.

5. *Land tenure security.* The Borrower shall ensure that the land acquisition process has already been completed and that compensation processes were consistent with international best practice and free prior and informed consent principles.

6. *Marginalized Groups and Minorities*. The Borrower shall ensure that the concerns of Marginalized Groups and Minorities are given due consideration in implementing the Project and, to this end, shall ensure that:

a. The Project is carried out in accordance with the applicable provisions of the relevant national legislation on the protection of Marginalized Groups and Minorities;

b. Marginalized Groups and Minorities are adequately and fairly represented in all local planning for project activities;

c. Marginalized Groups and Minorities' rights are duly respected;

d. Marginalized Groups and Minorities participate in policy dialogue and local governance;

e. The Project will not involve encroachment on traditional territories used or occupied by Marginalized Groups and Minorities.

7. *Sexual Harassment, Sexual Exploitation and Abuse*. The Borrower and the Project Parties shall ensure that the Project is carried out in accordance with the provisions of the IFAD Policy on Preventing and Responding to Sexual Harassment, Sexual Exploitation and Abuse, as may be amended from time to time.

8. *Internal audit.* The NT&P, through the Directorate of Budget, Fiscal and Economic Affairs, shall identify internal auditors to audit the PMU and project counties once a year. Further these internal auditors shall review the internal audit processes performed by internal auditors at project counties. Internal audit reports may be requested by IFAD in a mutually acceptable manner.

9. *Audit Committee.* A NT&P Audit Committee shall be formed to review and ensure action is taken on internal and external audit findings and to review regular reports on budget execution.

10. *Final Audit.* Notwithstanding the timeline in which the Borrower prepares its year-end accounts for audit by the Office of the Auditor General of Kenya, the Borrower will ensure that the Project has a Final Audit by the Financial Closing Date of the Project. The Borrower will thus ensure that it will engage the Office of the Auditor General of Kenya to perform the Final Audit in order to comply with this term.

11. *Financial Reporting.* Within three months of entry into force of the Financing Agreement, the Borrower shall ensure that a financial reporting system meeting IFAD's requirements and International Accounting Standards is in place.

12. *Memoranda of Understanding.* Within six (6) months of entry into force of the Financing Agreement, the Project will enter into Memoranda of Understandings (MoU) with implementing partners that will structure the collaboration, define roles, responsibilities and duties with regards to implementation, financial management, auditing, accounting and reporting.

13. *Planning, Monitoring and Evaluation*. The Borrower shall ensure that a Planning, Monitoring and Evaluation (PM&E) system shall be established within twelve (12) months from the date of entry into force of this Agreement.

14. *Use of Project Vehicles and Other Equipment*. The Borrower shall ensure that:

a. The types of vehicles and other equipment procured under the Project are appropriate to the needs of the implementation of the Project; and

b. All vehicles and other equipment transferred to or procured under the Project are dedicated solely to project use.

15. *IFAD Client Portal (ICP) Contract Monitoring Tool.* The Borrower shall ensure that a request is sent to IFAD to access the Project Procurement Contract Monitoring Tool in the

IFAD Client Portal (ICP). The Borrower shall ensure that all contracts, memoranda of understanding, purchase orders and related payments are registered in the Project Procurement Contract Monitoring Tool in the IFAD Client Portal (ICP) in relation to the procurement of goods, works, services, consultancy, non-consulting services, community contracts, grants and financing contracts. The Borrower shall ensure that the contract data is updated on a quarterly basis during the implementation of the Project.

16. The Key Project Personnel will include: Project Coordinator, Financial Comptroller, Rural Finance Specialist, M&E Specialist, Knowledge Management Officer, Project Procurement Specialist, Social Inclusion and Gender Specialist, and Environment and Climate Assessment Specialist. In order to assist in the implementation of the Project, the NT&P, unless otherwise agreed with IFAD, shall employ or cause to be employed, as required, key staff for the PMU whose qualifications, experience and terms of reference are satisfactory to IFAD. The recruitment of Key Project Personnel is subject to IFAD's prior review as is the dismissal of Key Project Personnel. Key Project Personnel are subject to annual evaluation and the continuation of their contract is subject to satisfactory performance. Any contract signed for Key Project Personnel shall be compliant with the national labour regulations or the ILO International Labour Standards (whichever is more stringent) in order to satisfy the conditions of IFAD's updated SECAP. Repeated short-term contracts must be avoided, unless appropriately justified under the Project's circumstances.