President’s report

Proposed loan and grant to the Republic of Armenia for the Farmer Market Access Programme
Note to Executive Board Directors

This document is submitted for approval by the Executive Board.

To make the best use of time available at Executive Board sessions, Directors are invited to contact the following focal point with any technical questions about this document before the session:

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### Abbreviations and acronyms

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<tr>
<td>FREDA</td>
<td>Fund for Rural Economic Development in Armenia</td>
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<td>OFID</td>
<td>OPEC Fund for International Development</td>
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<td>RFF</td>
<td>Rural Finance Facility</td>
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Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed loan and grant to the Republic of Armenia for the Farmer Market Access Programme, as contained in paragraph 35.
Map of the programme area

Source: IFAD
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.
Republic of Armenia

Farmer Market Access Programme

Financing summary

Initiating institution: IFAD

Borrower: Republic of Armenia

Executing agency: Ministry of Agriculture

Total programme cost: US$32.3 million

Amount of IFAD loan: SDR 7.90 million (equivalent to approximately US$11.9 million)

Amount of IFAD grant: SDR 0.33 million (equivalent to approximately US$0.5 million)

Terms of IFAD loan: 40 years, including a grace period of 10 years, with a service charge of three fourths of one per cent (0.75 per cent) per annum

Cofinancier: OPEC Fund for International Development (OFID) Other cofinancier (to be determined)

Amount of cofinancing: OFID: US$10.0 million Other cofinancier: US$2.0 million

Terms of cofinancing: OFID: Standard terms

Contribution of borrower: US$5.0 million

Contribution of participating financial institutions: US$0.9 million

Contribution of beneficiaries: US$2.0 million

Appraising institution: IFAD

Cooperating institution: United Nations Office for Project Services
Proposed loan and grant to the Republic of Armenia for the Farmer Market Access Programme

I. The programme

A. Main development opportunity addressed by the programme
1. The programme will provide innovative financing for rural enterprises that have the potential for rapid growth but are constrained by the lack of financial resources beyond those provided by conventional bank loans. Enabling their growth will increase the number of sustainable markets for farm produce and raise demand for rural labour and microenterprise services in the commodity value chains concerned. The programme’s main financing instrument will be a venture capital fund – the Fund for Rural Economic Development in Armenia (FREDA) – which represents an innovation for both rural Armenia and IFAD. Programme support to enterprises will be conditional on their ability to foster sustainable income growth among the programme’s target groups. The programme will link its rural financing with support for improving beneficiaries’ access to the knowledge, technology and infrastructure needed to enable them to participate profitably in domestic and export markets.

B. Proposed financing

Terms and conditions
2. It is proposed that IFAD provide to the Republic of Armenia a loan in the amount of SDR 7.90 million (equivalent to approximately US$11.9 million) on highly concessional terms, and a grant in the amount of SDR 0.33 million (equivalent to approximately US$0.5 million) to help finance the Farmer Market Access Programme. The loan will have a term of 40 years, including a grace period of 10 years, with a service charge of three fourths of one per cent (0.75 per cent) per annum. The grant will finance technical assistance and start-up activities for FREDA.

Relationship to the IFAD performance-based allocation system (PBAS)

Country debt burden and absorptive capacity of the State
4. Armenia is at low risk of debt distress with all indicators well below the relevant country-specific debt burden threshold. The external debt ratio declined from 33 per cent of GDP in 2004 to 22 per cent in 2005. Macroeconomic management is sound and annual real GDP growth is above five per cent. The implementation record for the IFAD-financed programmes in Armenia is excellent: all loans have been fully disbursed and most closed ahead of schedule.

Flow of funds
5. The proceeds of the IFAD loan and grant will be channelled through a standard financing agreement between IFAD and the Government. A special account will be opened by the Ministry of Finance and Economy for financing the IFAD share of programme expenditures, rural finance activities, civil works and operating costs.

Supervision arrangements
6. The cooperating institution will be the United Nations Office for Project Services, with IFAD providing frequent implementation support. This arrangement may be revised over time in line with IFAD’s development of its own supervisory capacity.

Exceptions to IFAD General Conditions for Agricultural Development Financing and operational policies
7. No exceptions are foreseen.
Governance
8. The following planned measures are intended to enhance the governance aspects of the IFAD financing: (i) annual audit of programme accounts and financial statements in accordance with international standards; (ii) frequent supervision and implementation support; (iii) emphasis on high-quality management information systems; and (iv) provision of high-calibre international and national technical assistance for institutional development and support.

C. Target group and participation

Target group
9. The programme will benefit rural people who are or could potentially become economically active. Its main target groups will be: (i) subsistence and semi-subistence farmers, in particular those willing to move to more commercial farming; (ii) the rural unemployed, underemployed and self-employed, including those in peri-urban areas, who are currently among the poorest rural groups; (iii) the landless; and (iv) poor rural women seeking employment.

Targeting approach
10. The geographic distribution of programme investments will reflect the poverty ranking of rural districts. In addition, targeting procedures are designed for the various programme subcomponents. For FREDA investments, a value chain multiplier index will be used to estimate the benefits accruing to the average individual within the target groups as a direct result of equity fund investments. For financing under the Rural Finance Facility (RFF), comprehensive business plans will document the implications for income generation. Applicants for FREDA support who engage women as suppliers and employees will be given preference. The programme will also support the introduction of personal guarantees as a collateral option for RFF-financed farm loans. This will be particularly important for women, who currently find it difficult to raise collateral.

Participation
11. The rural finance component is based on a market-driven approach that encourages people to access finance, employment and technical assistance. Socially-driven opportunities in terms of improved access to roads, small-scale irrigation and village gas supplies are also part of the programme. Beneficiaries will contribute a minimum of 10 per cent in cash or in kind to overall infrastructure costs, and participate in infrastructure design, supervision, operation and maintenance.

D. Development objectives

Key programme objectives
12. The goal of the programme is to improve the economic and social status of poor rural people in Armenia. Its specific objectives are to: (i) stimulate the growth of rural enterprises with a comparative advantage for and strong linkages to poor primary producers and rural people seeking improved employment opportunities; (ii) provide an investment instrument and associated funding that will respond to the need for rural equity finance; and (iii) develop greater financial-sector capacity.

Policy and institutional objectives
13. IFAD’s policy dialogue in Armenia seeks to assure focus on opportunities for pro-poor growth and rural mountain area development. Within this framework, improving the enabling environment for private-sector development, especially financial services, is a prime focus of the programme and of ongoing discussions with the Government and other partners.

IFAD policy and strategy alignment
14. The programme conforms to key thrusts in IFAD’s 2003 country strategic opportunities paper for Armenia: (i) increasing access of the poor to financial services and markets, and (ii) strengthening the capacity of the rural poor and their
organizations. Furthermore, it is aligned with various objectives in the IFAD Strategic Framework 2007–2010, namely enhancing poor rural people’s (i) access to natural resources, (ii) access to improved agricultural technologies, (iii) access to a broad range of financial services, and (iv) opportunities for taking advantage of rural, off-farm employment and enterprise development.

E. Harmonization and alignment

Alignment with national priorities

15. The programme will operationalize important parts of Armenia’s 2004 poverty reduction strategy paper, which singles out private-sector development and subsequent employment generation as the most important tool for poverty reduction. It will also align itself with the Government’s 2004 Agricultural Sustainable Development Strategy in terms of: (i) increasing gross agricultural production and profitability; (ii) using land, water, labour, research and technical resources more efficiently; (iii) improving food safety; (iv) strengthening agricultural infrastructure; (v) ensuring a greater share of profits for producers; and (vi) emphasizing integration with international agricultural processes.

Harmonization with development partners

16. The programme has been designed within close partnerships (both financial and strategic) with the United Nations Development Programme, the United States Agency for International Development, the World Bank, the Millennium Challenge Corporation and the OPEC Fund for International Development (OFID). Programme organization and management is harmonized with government systems and with the procedures used by other relevant donor-supported development initiatives.

F. Components and expenditure categories

Main components

17. The programme has three components: (i) rural finance, comprising support for establishing a venture capital fund (FREDA) and a smaller loans window through the existing IFAD-sponsored RFF; (ii) rural infrastructure investment; and (iii) programme implementation.

Expenditure categories

18. The main expenditure categories are: (i) civil works (46 per cent of base costs); (ii) investment/refinancing capital (41 per cent); and (iii) recurrent costs, including salaries, operation and maintenance and other operating costs (10 per cent). Three other categories together account for 3 per cent of base costs: (i) equipment, goods and vehicles; (ii) technical assistance; and (iii) training and specialist services.

G. Management, implementation responsibilities and partnerships

Key implementing partners

19. The Ministry of Agriculture will be the lead institution for the programme as a whole, with the Ministry of Finance and Economy overseeing the activities of the RFF. FREDA’s activities will be subject to the laws and regulations applying to foundations and to its own statutes. Under the overall responsibility of the Ministry of Agriculture, a programme coordination committee will ensure compliance with programme policies and criteria as negotiated and agreed with IFAD.

Implementation responsibilities

20. A programme administration unit will have overall day-to-day responsibility for planning, management, coordination, and monitoring and evaluation of programme outputs and effectiveness, and for administrative and financial reporting. It will also have administrative and financial autonomy to enter into contracts with third parties for programme implementation requirements. FREDA will be managed by a small cadre of professional staff recruited on terms and conditions acceptable to IFAD, and will be governed by a board of trustees comprising Government representatives and highly professional private-sector members, with the latter forming the majority.
The Government will nominate trustees acceptable to IFAD and, through its representation on the FREDA board of trustees influence the overall policy framework of FREDA. However, FREDA will enjoy full independence in taking investment decisions, which will be the responsibility of a professional investment committee. Other investors in FREDA, expected at a later stage, may claim a seat in FREDA’s board of trustees as appropriate.

Role of technical assistance

21. IFAD financing includes US$0.62 million for national and international technical assistance. As rural equity financing is new to Armenia, the establishment and initial operations of FREDA will be supported by internationally recruited experts, paid initially by a grant from IFAD. Local experts will support other elements of FREDA establishment.

Status of key implementation agreements

22. The legal basis for FREDA will be an independent foundation established under Armenian law with statutes reflecting its development objectives and acceptable to IFAD. As currently practised, implementation arrangements between the Ministry of Finance and Economy and the RFF are acceptable to IFAD.

Key financing partners and amounts committed

23. The total programme cost will be US$32.3 million over a five-year implementation period. IFAD will contribute US$12.4 million, including a US$0.5 million grant (39 per cent of total cost). OFID’s contribution, still to be confirmed, is expected to be US$10.0 million (31 per cent). Participating financial institutions will contribute US$0.9 million (3 per cent), the Government about US$5.0 million (15 per cent) and beneficiaries US$2.0 million (6 per cent). Additionally, cofinancing of US$2.0 million (6 per cent) is expected for the rural finance component.

H. Benefits and economic and financial justification

Main categories of benefits generated

24. Benefits include: (i) greater access to larger, more reliable and more lucrative markets for poor primary producers; (ii) greater opportunities for farmers to invest in developing their own capacity for profitable and commercially oriented production; and (iii) increased on-farm and off-farm employment opportunities. The programme's institutional and operational benefits in the financial sector will include: (i) provision of equity financing of agricultural and rural development through FREDA; (ii) greater orientation of commercial banks towards serving rural enterprises and farmers; and (iii) further development of appropriate financing instruments capable of reaching the rural poor.

Economic and financial viability

25. Since programme activities will be mostly demand-driven, an overall economic and financial analysis is unfeasible. Enterprise and farm models show satisfactory returns. A comprehensive financial model prepared for FREDA operations shows that, even with high-risk provisions, FREDA will make a surplus during its fourth year of operation. The RFF is already financially sustainable under the ongoing Rural Areas Economic Development Programme.

I. Knowledge management, innovation and scaling up

Knowledge management arrangements

26. The introduction of equity funding for agricultural and rural development is a new instrument for IFAD. Consequently, FREDA’s experience will be closely documented and results widely disseminated. In addition to a management information system, IFAD will finance annual review and technical support missions and related workshops to follow up and guide progress. FREDA will maintain a website and issue newsletters, while results achieved and lessons learned will be considered for wider publication.
Development innovations that the programme will promote
27. The establishment of a venture capital fund as a tool for poverty reduction, employment generation and improved market access is a major innovation for Armenia and for IFAD.

Scaling-up approach
28. FREDA will be a test case for the Fund. As noted, the intention is to thoroughly document the experience for possible replication in other member countries, as in the case of refinancing funds, which have now been scaled up to four countries in the region.

J. Main risks
Main risks and mitigation measures
29. As a major innovation, FREDA carries the principal programme-associated risk. The planned mitigation measures include: (i) recruitment of highly qualified and experienced professional staff; (ii) sustained support by highly qualified and experienced internationally recruited technical experts; (iii) statutory independence; (iv) careful selection, acceptable to IFAD, of FREDA trustees who should be sensitive to and knowledgeable about the programme’s concern for combining commercial viability with rural poverty reduction; (v) preparation at FREDA of a comprehensive five-year business plan that will, inter alia, provide a long-term exit strategy for Government withdrawal from FREDA ownership; (vi) graduated capitalization of FREDA conditional upon its financial performance; (vii) requirement that IFAD endorse FREDA’s first three investments on a “no objection” basis; (viii) close monitoring of FREDA operations and performance by the programme administration unit, the cooperating institution and IFAD; (ix) annual review and technical support missions by IFAD; and (x) annual review workshops.

Environmental classification
30. Pursuant to IFAD’s environmental assessment procedures, the programme has been classified as a Category B operation in that it is not likely to have any significant negative environmental impact.

K. Sustainability
31. The sustainability of programme investments are assured by: (i) the FREDA financial model; (ii) the proven sustainability of the RFF and the strong demand for the services it provides; (iii) the requirement of firm agreements on operation and maintenance as a precondition to programme investments in infrastructure; and (iv) an exit strategy for Government investments in FREDA.

II. Legal instruments and authority
32. A programme financing agreement between the Republic of Armenia and IFAD will constitute the legal instrument for extending the proposed financing to the borrower. Important assurances included in the negotiated agreement are attached as an annex.

33. The Republic of Armenia is empowered under its laws to borrow from IFAD.

34. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD.
III. Recommendation

35. I recommend that the Executive Board approve the proposed financing in terms of the following resolution:

RESOLVED: that the Fund shall make a loan to the Republic of Armenia in various currencies in an amount equivalent to seven million nine hundred thousand special drawing rights (SDR 7,900,000) to mature on or prior to 1 February 2047 and to bear a service charge of three fourths of one per cent (0.75 per cent) per annum, and to be 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 grant to the Republic of Armenia in various currencies in an amount equivalent to three hundred and thirty thousand special drawing rights (SDR 330,000) and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Lennart Båge
President
Important assurances included in the negotiated programme financing agreement

(Negotiations concluded on 24 July 2007)

**Gender**
1. The Government of Armenia (the Government) will ensure that gender concerns are integrated into all the "Farmer Market Access Programme (the Programme) activities during its implementation.

**Use of programme vehicles and other equipment**
2. The Government will ensure that:
   (a) all vehicles and other equipment procured under the programme are allocated to the programme parties and are solely dedicated to programme use; and
   (b) the types of vehicles and other equipment procured under the programme are appropriate to the needs of the programme.

**Insurance of programme personnel**
3. The programme administration unit (PAU/PAAU) will insure programme personnel against health and accident risks to the extent consistent with its customary practice in respect of its national civil service.

**Fraud and corruption**
4. The Government will promptly bring to the attention of IFAD any allegations or concerns of fraud and/or corruption in relation to the implementation of the programme of which it has knowledge or become aware.

**Tax exemption**
5. (a) The Government will exempt the IFAD loan and grant proceeds from all import duties, excise taxes and value added taxes on expenditures, including, but not limited to, vehicles, motorcycles, computers, printers and software, office equipment, laboratory equipment and supplies, video sets and any other goods. For taxes, the Government will use funds from its own resources.
   (b) IFAD loan and grant proceeds will not be used to social security charges for programme staff to the social security fund. For all such charges, the Government will use funds from its own resources. Income taxes will be paid by the contracted staff and individual service providers directly and will not be retained by the PAU/PAAU, the FREDA, the RFF or other implementing agencies.
   (c) The Government will ensure that it makes budgetary provisions for duties and taxes covering all programme needs in accordance with AWPBs. The Government will ensure that invoices in relation to the expenditures clearly show the amount to be paid from the loan and grant.

**Suspension**
6. IFAD may suspend, in whole or in part, the right of the Government to request withdrawals from the loan and grant accounts, upon the occurrence of any of the events set forth below provided, however, that if the audit has not been satisfactorily concluded within 12 months of the financial reporting period date, IFAD will suspend the right of the Government to request withdrawals from the loan account, or if:
   (a) the agreements regulating the OFID financial assistance have not been signed within twelve (12) months of the effective date of the programme financing agreement, and substitute funds are not available to the Government on terms and conditions acceptable to IFAD;
(b) FREDA statutes and/or RFF credit-by laws, or any provision thereof, have been waived, suspended, terminated, amended or otherwise modified, without the prior consent of IFAD, and IFAD has determined that such waiver, suspension, termination, amendment or modification has had, or is likely to have a material adverse effect on the programme components;

(c) any competent authority has taken any action for the dissolution of FREDA and/or RFF or the suspension of their operations, or any action or proceeding has been commenced for the distribution of any assets of FREDA and/or RFF among their creditors;

(d) IFAD has given notice to the Government that credible allegations of corrupt or fraudulent practices in connection with the programme have come to the attention of IFAD, and the Government has failed to take timely and appropriate action to address the matters to the satisfaction of IFAD; and

(e) procurement has not been or is not being carried out in accordance with the provisions set out in the programme financing agreement.

**Conditions precedent to withdrawals**

7. (a) No withdrawal will be made in respect of expenditures under the grant until the AWPB for the first programme year will has been submitted to and approved by IFAD.

(b) No withdrawal will be made in respect of expenditures under the rural venture capital fund development subcomponent until the AWPB for the first programme year has been submitted to and approved by IFAD and until:
   (i) FREDA has been established and registered;
   (ii) the FREDA board of trustees, FREDA director and other key FREDA staff have been duly appointed;
   (iii) the Ministry of Finance and Economy and the Ministry of Agriculture have entered into subsidiary agreements with FREDA; and
   (iv) the FREDA accounts have been opened.

(c) No withdrawal will be made in respect of expenditures under the investment loan to small and medium enterprises and the farm development loans subcomponents until the AWPB for the first programme year has been submitted to and approved by IFAD until:
   (i) the RFF/FMAP account and revolving fund have been opened; and
   (ii) the Government has entered into subsidiary agreements with RFF.

(d) No withdrawal will be made in respect of expenditures under the investment derived infrastructure subcomponent until the AWPB for the first programme year has been submitted to and approved by IFAD and until:
   (i) the programme civil works account in Armenian drams (AMD) has been duly opened; and
   (ii) the conditions mentioned in paragraph 7(b), above, have been satisfied.

**Conditions precedent to effectiveness**

8. The programme financing agreement will become effective subject to the fulfilment of the following conditions precedent:

(a) the programme coordination committee, with a composition acceptable to IFAD, has been duly established;

(b) the governmental decree, confirming PAU/PAAU, has been issued;
(c) the Government has duly opened the special account in United States dollars and in a commercial bank acceptable to IFAD;

(d) the Government has duly opened a grant bank account in United States dollars and in a commercial bank acceptable to IFAD;

(e) the Government has ensured that the PAU/PAAU have duly opened the programme operating account in AMD, in a commercial bank acceptable to IFAD and the Government has deposited the counterpart funds into such programme operating account or made budgetary allocation of counterpart funds;

(f) the Government has made the deposit of 50 per cent of counterpart funds in an amount of US$1,250,000 equivalent into the programme operating account;

(g) the programme financing agreement has been duly signed, and the signature and performance thereof by the Government has been duly authorised and ratified by all necessary administrative and governmental action; and

(h) the Government has delivered to IFAD a legal opinion issued by an authorized representative by the Government to issue such opinion in form and substance acceptable to IFAD.
Key reference documents

Country reference documents

IFAD reference documents
Administrative Procedures on Environmental Assessment
IFAD Strategic Framework 2007-2010
Learning Notes
Private-Sector Partnerships and Development Strategy

Other miscellaneous reference documents
Gorton, M., and White, J./2004/Vertical Coordination in Transition Countries: A comparative study of agri-food chains in Moldova, Armenia, Georgia, Russia, Ukraine
Statistical Yearbook of Armenia, 2006
USAID /June 2004/Armenia Competitiveness Assessment
World Bank/2005/Environmentally and Socially Sustainable Development Department for Europe and Central Asia
World Bank/2005/Armenia’s Rural Economy – From Transition to Development.
# Logical framework

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| To improve the economic and social status of poor rural people in the Programme area. | • Sustained per capita income growth.  
• Increase in household asset ownership.  
• Reduction in prevalence of malnutrition among children below five years of age. | • Household surveys.  
• UNICEF’s Armenian Demographic and Health Survey (DHS).  
• Impact assessment surveys.  
• National statistical data (Income Expenditures and Food Consumption in Armenia and Social Snapshot and Poverty in Armenia).  
• Programme M&E database. | • National security remains adequate.  
• Absence of external economic shocks. |
| **Purpose/Objectives:** |                       |                       |                   |
| To stimulate rapid growth of rural enterprises with a comparative economic advantage and strong linkages to poor primary producers and rural people seeking improved employment opportunities. | • Value of gross loan portfolio (loans outstanding – loans written off).  
• Value and volume of marketed rural produce.  
• No. of new full time equivalent jobs created.  
• Incremental assets of the smallholders.  
• Incremental value and volume of production of smallholders.  
• No. of farmers reporting improved farm profitability. | • Programme M&E database.  
• National and marz level statistics.  
• Export/import statistics.  
• RFF database (PFI’s record).  
• FREDA’s Investment Memorandum for each Company.  
• Farmer Market Access Facilitators’ Annual Report on the value chains for each Company. | • Liberal economic policies continue.  
• No deterioration in external trade routes.  
• Continued reforms in financial sector (policy and regulatory framework). |
| To provide an investment instrument and associated funding which would respond to the need for rural equity finance. |                       |                       |                   |
| To further develop the capacity of the financial sector in Armenia to respond to needs for small and medium credit products. |                       |                       |                   |
| **Outputs:**      |                       |                       |                   |
| Diversified and increased income and rural employment. New, appropriate and flexible financial services. Improved business and marketing environment. Increased compliance with food health and safety standards. Additional and improved rural infrastructure investments. | • No. of applications received/accepted by PFIs.  
• No. type and volume of loans and equity provision.  
• No. and value of loan repayment rate.  
• Revenue growth of enterprises.  
• No., type and quality of business and marketing services provided.  
• No. and type of food health and safety standards met.  
• Value invested in infrastructure.  
• No. and type of infrastructure built.  
• No. of households served by the infrastructure.  
• No. of infrastructures operational after three years. | • Programme M&E database.  
• RFF database (PFI’s record).  
• FREDA’s Investment Memorandum for each Company (containing business plans).  
• National and marz level statistics  
• Public sales records and enterprise records.  
• Export/import statistics  
• RESCAD Competitive Grant records.  
• Supervising Engineers’ Annual Infrastructure Investment Summary Report. | • Political situation conducive to private investment.  
• Availability of potential investors to take entrepreneurial risks.  
• Financial institutions willing and able to address the intended target groups.  
• GOA and IFAD able to identify and agree on the establishment and operations of a Venture Capital Fund.  
• Demand for medium, long-term loans from small, medium entrepreneurs. |