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Investing in rural people

President's report

Proposed financing to the Republic of Armenia for the Infrastructure and Rural Finance Support Programme

Note to Executive Board representatives

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Abbreviations and acronyms

| | |
|-------|--|
| AWP/B | annual workplan and budget |
| FREDA | Fund for Rural Economic Development in Armenia |
| IRFSP | Infrastructure and Rural Finance Support Programme |
| KfW | KfW Development Bank |
| M&E | monitoring and evaluation |
| O&M | operation and maintenance |
| OFID | OPEC Fund for International Development |
| OPEC | Organization of the Petroleum Exporting Countries |
| PFI | participating financial institution |
| PIU | programme implementation unit |
| RAWI | rural areas water infrastructure |
| RFF | Rural Finance Facility |
| USAID | United States Agency for International Development |

Map of the programme area

Republic of Armenia

Infrastructure and Rural Finance Support Programme

Final Design Report



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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 | 24-04-2014

Republic of Armenia

Infrastructure and Rural Finance Support Programme

Financing summary

| | |
|--|---|
| Initiating institution: | IFAD |
| Borrower: | Republic of Armenia |
| Executing agency: | Office of the Prime Minister |
| Total programme cost: | US\$52.8 million |
| Amount of IFAD loan: | SDR 7,250,000 (equivalent to approximately US\$11.0 million) |
| Amount of IFAD grant: | SDR 231,000 (equivalent to approximately US\$0.35 million) |
| Terms of IFAD loan: | Blend terms, subject to interest at a fixed rate of 1.25 per cent in addition to a service charge of 0.75 per cent per annum on the principal amount outstanding with a maturity period of 25 years, including a grace period of 5 years, starting from the date of approval by the Executive Board |
| Cofinancier(s): | OPEC Fund for International Development (OFID) Bilateral donor(s) to be confirmed |
| Amount of cofinancing: | OFID: US\$25 million Bilateral donor(s): US\$2 million |
| Contribution of borrower: | US\$10.1 million |
| Contribution of beneficiaries: | US\$3.5 million |
| Contribution of national financial institutions | US\$0.9 million |
| Appraising institution: | IFAD |
| Cooperating institution: | Directly supervised by IFAD |

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed financing to the Republic of Armenia for the Infrastructure and Rural Finance Support Programme, as contained in paragraph 51.

Proposed loan and grant to the Republic of Armenia for the Infrastructure and Rural Finance Support Programme

I. Strategic context and rationale

A. Country and rural development and poverty context

1. Armenia overcame the economic difficulties that followed the collapse of the former Soviet Union and political conflicts in the early 1990s, and embarked on a steep development path. Over the past two decades, performance of the Armenian economy ranged from a real GDP contraction of 42 per cent following the collapse of the former Soviet Union, to sustained annual growth rates of over 10 per cent from 2001 to 2008. However, the advent of the global financial crisis in 2008, combined with a reduction in remittances, again led to a sharp contraction of the economy in 2009, when a contraction of 14 per cent was recorded. Since then, economic growth has gradually picked up again, from 2.2 per cent in 2010 to 4.7 per cent in 2011, and 7.2 per cent in 2012.
2. As of 2010, just over one third (36 per cent) of Armenia's 3.1 million people lived in rural areas, and one third in the capital city of Yerevan, with the balance of the population in numerous small towns. About a quarter of rural households are headed by women.
3. Agriculture accounted for some 20 per cent of GDP in 2012 and is the main source of livelihoods in rural communities. Of the total land area of Armenia, 70.7 per cent is agricultural land. The agriculture sector provides employment to more than 44 per cent of the country's economically active population, including 65 per cent in rural areas.
4. After the collapse of the Soviet Union, privatization of agriculture led to the deterioration and abandonment of a large part of the irrigation systems formerly used by state farms, because existing on-farm irrigation systems were not adapted to smallholder agriculture. The generally high altitude of the agricultural land, small average farm size and abundant labour in some areas favour labour-intensive agriculture sectors such as horticulture, viticulture and livestock production. Conversely, Armenia is at a comparative disadvantage in crops where strong economies of scale apply, such as grains.

B. Rationale and alignment with government priorities and RB-COSOP

5. Analysis of poverty data shows that the rural producers making the best progress in overcoming poverty in Armenia are those that increase their income by producing and selling cash crops. This is consistent with Armenia's comparative advantage in labour-intensive horticultural cash-cropping. The chief constraints on farmers who wish to move into cash crops include: lack of access to finance; inadequate access to irrigation water, caused by inexistent or dilapidated irrigation infrastructure; and limited awareness and know-how of appropriate technologies. To achieve sustained poverty reduction, it is thus important to link three elements: (i) irrigation infrastructure; (ii) access to financing; and (iii) technical advice and appropriate

training. The Infrastructure and Rural Finance Support Programme (IRFSP) combines these three elements.

6. The Government's Sustainable Development Strategy 2012-2030 emphasizes development of the agriculture sector as a priority area. Its Agricultural Development Strategy 2010-2025 emphasizes the need for intensification and for increasing the value added from agricultural and rural labour. The Government has indicated strong interest in including successful components of previous IFAD operations as part of the IRFSP through experienced existing units involved in rural finance: the Rural Finance Facility (RFF) and the Fund for Rural Economic Development in Armenia (FREDA), established under previous IFAD programmes.¹ The IRFSP is complementary to development programmes of the Asian Development Bank, World Bank, United States Agency for International Development (USAID) and KfW Development Bank.

II. Programme description

A. Programme area and target group

7. The main target group consists of poor farmers and rural households that cultivate crops in the command area of obsolete or inefficient ex-state-run irrigation schemes. The main coping strategies of this group include migration and a focus on subsistence agricultural activities. However these activities are constrained by lack of access to irrigation water, rural financial services, new technological packages and business skills. Targeting would give specific consideration to vulnerable woman-headed households and youth by mobilizing awareness and support activities for these groups to enable them to take advantage of programme opportunities. Households cultivate about 1.4 ha, typically involving a diversified production system based on crops and livestock. Average household size is estimated at 4.4 people. About a quarter of the households are headed by women as a result of the migration of men, leaving women with the double burden of rearing the family and taking responsibility for income-generating activities. Overall, the programme will reach approximately 66,000 beneficiaries.
8. The programme area for implementation of the infrastructure component is the seven *marzes* (regions) of Shirak, Lori, Tavoush, Gegharqunik, Vajots Dzor, Sjunik and Aragatsohn, which include the areas with the highest incidence of poverty in rural Armenia, but also have agricultural potential sufficient to lift programme beneficiaries out of poverty. The programme area for the rural finance component is countrywide.

B. Programme development objective

9. The overall objective is to improve the economic and social status of the population in selected rural areas where poverty is prevalent by generating income growth and sustainable employment opportunities through strengthening the agricultural production systems and the forward and backward linkages with value chains of cash crops.

C. Components/outcomes

10. The programme will alleviate rural poverty in selected regions of Armenia by: (i) increased efficiency of small-scale farming and post-production processes and the transition of participating smallholders to high-value cash crops; (ii) creation of linkages between agroprocessing facilities and poor rural smallholders to enhance their access to domestic and international markets and employment opportunities

¹ The RFF is a revolving fund providing refinancing capital to the private financial sector for onlending to the agriculture sector, established under the IFAD-financed Rural Areas Development Programme (2005-2009). The FREDA is an innovative equity fund for investment in industries processing agricultural goods and having strong forward and backward linkages to smallholders. It was established under the IFAD-financed Farmer Market Access Programme (2008-2013). Both units are operationally sustainable.

along the value chain; (iii) increased resilience of agricultural production systems to fluctuations in rainfall levels by providing improved on-farm irrigation; and (iv) upgrading of food safety systems, the quality of marketable products, and family health by improving household water supplies.

11. The programme has four components: rural finance; rural areas water infrastructure (RAWI); farmer awareness and support; and programme management.
12. **Component 1 – Rural finance.** Subcomponent 1.1 (RFF refinancing) will inject investment capital through the existing RFF of US\$3.5 million to participating financial institutions (PFIs). The RFF will provide this financing through PFIs to smallholders and small and medium-sized enterprises to improve and intensify their production and increase their incomes, in accordance with the RFF investment and operational guidelines approved by the Fund. Subcomponent 1.2 (FREDA investments) will provide investment capital to the existing FREDA of US\$5.2 million. The FREDA will invest such funds as equity, mezzanine financing and subordinated loans to investee companies with strong backward and forward linkages to rural producers, in accordance with FREDA investment and operational guidelines approved by the Fund. This will be complemented by grant-based funding for technical support (approximately US\$2 million) to FREDA's potential and actual investee companies to develop their operations – including local and export quality standards – and to increase their impact on rural suppliers and employees.
13. **Component 2 – RAWI.** Subcomponent 2.1 will invest in rural community water supplies in poor areas of the selected *marzes* based on demand. A total of approximately US\$14.8 million has been allocated to this subcomponent, pending receipt of satisfactory community requests for financing. Subcomponent 2.2 will invest in small-to-medium-scale irrigation distribution. A normative allocation of approximately US\$20.7 million has been allocated to this subcomponent, also pending receipt of satisfactory requests. The RAWI component will be implemented by the existing programme implementation unit (PIU), established in 2005 to manage the IFAD-financed Rural Areas Economic Development Programme, and which has since implemented all IFAD-financed programmes in Armenia.
14. **Component 3 – Farmer awareness and support.** Under this component, the programme will: (i) contribute to the infrastructure subproject selection process and improve farmer awareness of the programme; (ii) provide advisory services and training, including those in marketing, agroprocessing and improved agricultural practices; and (iii) provide training in business and financial planning. The advisory services and training provided under (ii) and (iii) above will be specifically targeted at beneficiaries of the infrastructure component, and at RFF clients for business and financial planning. This will develop their capacity to better use the opportunities offered by the improved infrastructure and by the financial services, and will thus link both components and leverage their synergies.
15. **Component 4 – Programme management.** Under this component, the PIU will be provided with the funding needed to manage and monitor the programme. As the RFF and FREDA are operationally sustainable, programme funds will only cover the salary and operating costs of the PIU.

III. Programme implementation

A. Approach

16. The six-year programme will adopt the successful implementation approaches and practices of ongoing and previous IFAD-funded projects in Armenia. Both the rural finance and RAWI components are demand-based. Moreover, the RAWI component, given the small size of proposed works and their dispersed locations, will adopt a programmatic approach for subproject selection. In all cases, investments will be

subject to selection criteria agreed by IFAD and the Government and as set out in the programme implementation manual.

B. Organizational framework

17. Overall responsibility for planning, management and implementation of the programme will rest with the existing PIU, which has been responsible for the successful management and implementation of all previous IFAD-financed programmes in Armenia. As with previous IFAD programmes, the PIU will operate under the authority of the Prime Minister's office through a programme steering committee. The PIU will implement the RAWI and farmer awareness and support components. For the latter, it will procure service providers to implement targeting and training activities.
18. The rural finance component will be implemented by the RFF and FREDA. The RFF is governed by a regulatory framework that delineates its independent status and management structure. It conducts its lending operations in accordance with the RFF investment guidelines approved by the Fund.
19. The FREDA's activities are governed by the laws and regulations applying to foundations in Armenia, and by its own statutes. FREDA statutes define its mandate as poverty reduction through economic development in rural Armenia. The FREDA is governed by a board of trustees and headed by a director. All its investment decisions are taken independently, in accordance with its approved statutes, investment procedures and guidelines approved by the Fund.

C. Planning, monitoring and evaluation, and learning and knowledge management

20. **Planning.** Detailed planning of IRFSP activities will be done through annual workplans and budgets (AWP/Bs) involving the PIU, FREDA and RFF. The PIU is responsible for preparing the AWP/B for components 2, 3 and 4, while the FREDA and RFF will prepare their respective AWP/Bs under component 1 and provide them to the PIU for consolidation.
21. **Monitoring and evaluation (M&E).** The M&E system will have a three-level structure consisting of: (i) output monitoring; (ii) outcome monitoring; and (iii) impact evaluation. Output monitoring will comprise the monitoring of physical and financial inputs, activities and outputs, both planned and actual. Outcome monitoring will assess the effectiveness of outputs (e.g. behavioural change). Impact evaluation will assess measured changes in the agreed success indicators. The main instruments of impact evaluation are the programme's baseline survey and programme completion report (PCR). The PCR will also make use of the results of output and outcome monitoring.
22. The PIU will have lead responsibility for coordination of all M&E activities of the programme and for consolidating relevant information from secondary sources – such as the M&E system of the World Bank-financed Irrigation Systems Enhancement Project on the financial and technical performance of water users' associations, and reports from the service providers contracted to implement component 3.
23. **Learning and knowledge management.** Activities will include: (i) impact studies comprising a baseline survey and completion report; (ii) thematic studies on the FREDA, RFF and infrastructure; (iii) dissemination campaigns for information about the programme; (iv) preparation of publications and video materials to disseminate best practices and lessons learned; (v) progress reports; and (vi) capacity-building activities for PIU, RFF and FREDA staff.

D. Financial management, procurement and governance

24. **Country context and risk rating.** The inherent risk is rated as medium. The Corruption Perception Index of Armenia, published by Transparency International,

has improved from 2.6 in 2011 to 3.4 in 2012 and to 3.6 in 2013. The Public Expenditure and Financial Accountability assessments undertaken (2008 and 2014) reveal well-performing public financial management systems that have been improving over time. From the financial management point of view, a strength of the IRFSP is that its arrangements will follow the standards already applied and proven as adequate in previous IFAD programmes. The initial programme risk rating has been assessed in accordance with IFAD guidelines as low, provided that the mitigation actions embedded in the programme design are implemented promptly.

25. **Financial management.** Responsibility for the programme's financial management will rest with the PIU, which will maintain a full set of accounts in accordance with IFAD's requirements and International Financial Reporting Standards. The PIU will prepare periodic interim financial reports and annual project financial statements in accordance with accounting standards acceptable to IFAD. All financial management arrangements will be detailed by the PIU in a financial procedures manual to be approved by the Fund. It is foreseen that the Government's Independent Internal Audit Department will serve as internal auditor of the programme.
26. **Accounts.** IFAD funds will be transferred from the IFAD loan and grant accounts to two designated accounts (for the loan and grant respectively) denominated in United States dollars at the Central Treasury of Armenia. The Ministry of Finance will open and maintain these accounts. Funds will flow from the designated accounts to programme accounts operated by the PIU, FREDa and RFF as required for programme implementation and as specified in the AWP/B. No funds shall be disbursed by IFAD to finance the rural finance component until the related implementation and financial management arrangements have been duly formalized, including opening of the necessary accounts and drafting of investment guidelines acceptable to the Fund.
27. **Start-up costs.** Withdrawals in respect of expenditures for start-up costs under the category "Consultancies", incurred before the satisfaction of the conditions precedent to withdrawal, shall not exceed an aggregate amount of SDR 35,000 (approximately US\$50,000).
28. **External audit arrangements.** The borrower, through the PIU, will appoint independent auditors acceptable to IFAD, under terms of reference cleared by IFAD, and in line with the IFAD Guidelines for Project Audits. An audited annual consolidated financial statement for the entire programme, together with a management letter on audit observations on internal controls, shall be submitted to the Fund within six months of the fiscal year end. Moreover, the borrower will ensure that the independent auditors are required to provide an assurance on implementing partners' (the RFF and FREDa) internal control procedures, adequacy of documentation in support of relevant fund transfers, operation of programme accounts and whether programme resources have been used in accordance with investment guidelines.
29. National procurement practices remain undeveloped, and there is a lack of functional procurement sample documentation. Thus the IFAD-financed activities will follow IFAD procurement guidelines, complemented by World Bank sample procurement documentation, amended as applicable. An exception will be the rural finance component, where expenditures will include equity, mezzanine investments, subordinated loans and lending to beneficiaries through PFIs, to be incurred by the FREDa and RFF in accordance with their investment guidelines as approved by the Fund. For activities financed by the OPEC Fund for International Development (OFID), the programme will follow OFID procurement guidelines.

E. Supervision

30. For IFAD and OFID, the main external financiers of the programme, the responsibility for supervision and loan administration will be divided as follows:

IFAD will be responsible for administration of its financing and for supervision of the activities under components 1, 3 and 4. OFID will be responsible for administration of its loan and for supervision of the activities under component 2. The Government will have overall responsibility for implementation of the programme through the PIU, acting under the programme steering committee.

IV. Programme costs, financing, benefits

A. Programme costs

31. The total investment and incremental recurrent programme costs, including physical and price contingencies, are estimated at US\$52.8 million. Physical and price contingencies are about 12 per cent of programme base costs. Funds allocated to programme management represent about 8 per cent of total programme costs.

B. Programme financing

32. IFAD financing will total US\$11.35 million, comprising a loan of US\$11.00 million (about 21 per cent of estimated total programme costs) and a grant of US\$350,000 (0.7 per cent). At this stage, it is envisaged that IFAD financing will total US\$11.35 million, comprising a loan of US\$11.00 million (about 21 per cent of estimated total programme costs) and a grant of US\$350,000 (0.7 per cent). A loan from OFID of US\$25 million (47 per cent) will be used mainly for the RAWI component. The Government will contribute US\$10.1 million (19 per cent), including US\$3.6 million from the budget (for infrastructure investments) and US\$6.5 million from taxes and duties foregone, primarily related to the RAWI component. About US\$2.0 million is being sought from other partners. US\$3.5 million (7 per cent) will be provided by beneficiaries as cash contributions to small-scale infrastructure investments linked to the RFF, and US\$0.9 million (2 per cent) from national PFIs.

Table 1

Programme costs by component and financier

(Thousands of United States dollars)

| Component | IFAD loan | | IFAD grant | | OFID | | Expected bilateral donor (grant) | | RFF clients | | Beneficiaries | | Borrower/ counterpart | | Borrower/ counterpart | | Total | |
|---|---------------|-------------|------------|------------|---------------|-------------|----------------------------------|------------|-------------|------------|---------------|------------|-----------------------|------------|-----------------------|-------------|---------------|--------------|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| 1. Rural finance | 8 700 | 75.2 | - | - | - | - | 2 001 | 17.3 | 875 | 7.6 | - | - | - | - | - | - | 11 576 | 21.9 |
| 2. Rural areas water infrastructure | - | - | - | - | 22 765 | 63.4 | - | - | - | - | 3 542 | 9.9 | 3 589 | 10.0 | 5 993 | 16.7 | 35 889 | 67.9 |
| 3. Farmer awareness and support component | 900 | 71.4 | 350 | 27.7 | - | - | - | - | - | - | - | - | - | - | 11 | 0.9 | 1 261 | 2.4 |
| 4. Programme management | 1 400 | 34.1 | - | - | 2 235 | 54.4 | - | - | - | - | - | - | - | - | 472 | 11.5 | 4 107 | 7.8 |
| Total | 11 000 | 20.8 | 350 | 0.7 | 25 000 | 47.3 | 2 001 | 3.8 | 875 | 1.7 | 3 542 | 6.7 | 3 589 | 6.8 | 6 477 | 12.3 | 52 833 | 100.0 |

Table 2

Programme costs by expenditure category and financier

(Thousands of United States dollars)

| Expenditure category | IFAD loan | | IFAD grant | | OFID | | Expected bilateral donor (grant) | | RFF clients | | Beneficiaries | | Borrower/ counterpart | | Borrower/ counterpart | | Total | |
|-------------------------|---------------|-------------|------------|------------|---------------|-------------|----------------------------------|------------|-------------|------------|---------------|------------|-----------------------|------------|-----------------------|-------------|---------------|--------------|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| 1. Civil works | - | - | - | - | 20 993 | 63.3 | - | - | - | - | 3 316 | 10.0 | 3 316 | 10.0 | 5 538 | 16.7 | 33 164 | 62.8 |
| 2. Goods & equipment | 23 | 83.3 | - | - | - | - | - | - | - | - | - | - | - | 5 | 16.7 | 27 | 0.1 | |
| 3. Vehicles | 47 | 83.3 | - | - | - | - | - | - | - | - | - | - | - | 9 | 16.7 | 56 | 0.1 | |
| 4. Technical assistance | 279 | 12.2 | - | - | - | - | 2 001 | 87.8 | - | - | - | - | - | - | - | 2 280 | 4.3 | |
| 5. Investment capital | 8 700 | 90.9 | - | - | - | - | - | - | 875 | 9.1 | - | - | - | - | - | 9 575 | 18.1 | |
| 6. Services | 843 | 21.5 | 350 | 8.9 | 1 772 | 45.2 | - | - | - | - | 226 | 5.8 | 273 | 7.0 | 455 | 11.6 | 3 918 | 7.4 |
| 7. Recurrent costs | 596 | 28.5 | - | - | 1 144 | 54.8 | - | - | - | - | - | - | - | 349 | 16.7 | 2 088 | 4.0 | |
| 8. Salaries | 513 | 29.8 | - | - | 1 091 | 63.2 | - | - | - | - | - | - | - | 121 | 7.0 | 1 725 | 3.3 | |
| Total | 11 000 | 20.8 | 350 | 0.7 | 25 000 | 47.3 | 2 001 | 3.8 | 875 | 1.7 | 3 542 | 6.7 | 3 589 | 6.8 | 6 477 | 12.3 | 52 833 | 100.0 |

C. Summary benefit and economic analysis

33. Programme benefits to direct beneficiaries and beneficiary communities include:
- (i) empowerment and training of the target population to enable them to improve their socio-economic situation and to offer a pathway out of poverty;
 - (ii) improvement of dilapidated and inefficiently used rural assets (mainly irrigation facilities);
 - (iii) support to improving the sustainability of key Armenian institutions benefiting rural areas, particularly the RFF and FREDA;
 - (iv) improvement of incomes and quality of life of the target population (which includes special targeting of women and youth); and
 - (v) economic benefits for Armenia through increased agricultural production, processing and exports.
34. The base-case economic internal rate of return (EIRR) of the productive components (rural finance and RAWI) was estimated at 14 per cent, based on 20-year discounting of economic costs and benefits and conservative assumptions. The base-case net present value of the programme's net benefit stream, discounted at 10 per cent, is approximately 1.2 billion Armenian drams (US\$3.1 million). The sensitivity analysis assessed the effect of variations in benefits and costs and for various lags in the realization of benefits, with satisfactory results. Sensitivity analysis shows that a 20 per cent cost overrun or decrease in benefits leads to an EIRR of 11 per cent.

D. Sustainability

35. The rural finance component operates through the RFF and FREDA, both of which are operationally sustainable units and thus generate enough revenue to cover their management costs. Scaling up of their activities through the programme will further buttress their sustainability, while enabling them to reach an even larger number of beneficiaries than covered before.
36. For the RAWI component, before a subproject can be supported by the programme, in each case, selection criteria for all interventions emphasize the need for a satisfactory agreement on arrangements for the operation and maintenance (O&M) of future facilities. For water supplies, it is expected that communities sign an agreement with regional water companies, which is currently the most successful management solution in Armenia. For irrigation schemes, regional water users' associations will play a similar role.
37. Farmer benefits will be supported by component 3 activities (farmer awareness and support), which are designed to help farmers learn about opportunities for: assistance from the extension services of national services and from other donor projects; credit options; and the extra farm management and extension training provided by the programme.

E. Risk identification and mitigation

38. The main risk is that the agreed criteria for allocation of credit or infrastructure funds are not adhered to for political or other reasons. This could result in programme benefits accruing to beneficiaries outside the IFAD target group, or to support for investments that do not have an adequate economic result. A second key risk is that inadequate arrangements are put in place for the O&M of programme investments on completion. To mitigate these two risks, the programme: (i) empowers targeted communities to participate in decision-making; (ii) requires that contractual relationships be put in place with competent water companies in the case of infrastructure; and (iii) sets adequate O&M arrangements as a precondition for financing. Finally, the programme will provide requisite training to PIU, RFF and FREDA staff.
39. A further risk is potential political interference in the operations of the RFF and FREDA. Their experience to date is that there has not been any political interference. Nevertheless, IFAD supervision missions will monitor this risk and, if undue influence is detected, investigate and recommend suitable measures. Finally,

the risk that beneficiaries have insufficient capacity to benefit from the opportunities offered by the rural finance and RAWI components is mitigated by the inclusion of component 3, farmer awareness and support through training and demonstration.

V. Corporate considerations

A. Compliance with IFAD policies

40. The design of the programme is guided by the IFAD policies and strategies on targeting, gender, environmental and natural resource management, and private-sector engagement.
41. The programme aims to increase the incomes of the poor rural population through measures ranging from production and processing of cash crops through innovative poverty reduction approaches that comprise improved access to rural finance, improved productive infrastructure and extension. Specifically, these measures have been designed in line with relevant IFAD policies: (i) targeting of women and youth; (ii) participatory approaches for programme planning; (iii) a strategy for scaling up positive programme results; and (iv) potential negative environmental impact has been analysed and mitigating measures designed accordingly. The environmental and social review note for the programme was prepared in accordance with IFAD's Environmental and Social Assessment Procedures. The programme is not expected to have any significant negative environmental impact and is classified as Category B.

B. Alignment and harmonization

42. The Government's Sustainable Development Strategy 2012-2030 (SDS) emphasizes development of the agriculture sector as a priority area. Its Agricultural Development Strategy 2010-2025 emphasizes the need for intensification of agriculture and increasing the value added from agricultural and rural labour. Improvements in rural water supplies were specifically called for in the SDS's second poverty reduction strategy paper.
43. Scaling-up approaches and activities supporting rural finance and infrastructure that have benefited the rural population under previous IFAD programmes are an effective way of contributing to poverty alleviation in Armenia. The Government accordingly indicated strong interest in including successful components of previous IFAD operations as part of the IRFSP through experienced existing units involved in rural finance: the RFF and FREDa, both established under previous IFAD programmes.
44. The IRFSP is complementary to development programmes by the Asian Development Bank, the World Bank, USAID and KfW, and formal linkages and forms of cooperation will be established during implementation to benefit from synergies. The design of the programme will, in particular, draw on the experience of other donors and investors and their ongoing programmes to support water users' associations (World Bank), and financial literacy training (USAID and KfW). To this end, the PIU will sign memorandums of understanding with selected complementary agencies, donor-financed projects and other relevant implementation partners to establish the basic principles of cooperation, such as the scope of cooperation, participating key staff and their functions, frequency of meetings, sharing of plans, reports, studies and other relevant documentation, and possible mutual support at the grass-roots level.

C. Innovations and scaling up

45. The interventions to be scaled up comprise support for the RFF and FREDa and rural infrastructure development concentrating on water infrastructure – building on the experience of two previous IFAD programmes in Armenia (the Rural Areas Economic Development Programme and Farmers Market Access Programme). Given

the sustainable, permanent nature of the RFF and FREDAs, and their qualified leadership, they are inherently endowed with the capacity to push forward and continue their activities. Both units are well-versed in the national implementation framework.

46. Central and local authorities, driven by potential beneficiaries, would be the main drivers working through the PIU, which has a proven track record in implementation of small-to-medium-scale rural infrastructure investments.

D. Policy engagement

47. The programme will foster dialogue with the Government on: rural lending policies and related best practices, appropriate policies in relation to small and medium-sized enterprises, and rural development in general. It will also engage with regional authorities (e.g. in relation to targeting of public infrastructure projects). While seeking opportunities to support strategic partnerships with the Government and other development organizations for networking and policy dialogue, the programme is expected to strengthen stakeholders' and partners' attitudes and commitment to poverty targeting, gender equality and women's empowerment, awareness-raising and capacity-building.

VI. Legal instruments and authority

48. A programme financing agreement between the Republic of Armenia and IFAD will constitute the legal instrument for extending the proposed financing to the borrower/recipient. A copy of the negotiated financing agreement is attached as an annex.
49. The Republic of Armenia is empowered under its laws to receive financing from IFAD.
50. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Policies and Criteria for IFAD Financing.

VII. Recommendation

51. I recommend that the Executive Board approve the proposed financing in terms of the following resolutions:

RESOLVED: that the Fund shall provide a loan on blend terms to the Republic of Armenia in an amount equivalent to seven million two hundred and fifty thousand special drawing rights (SDR 7,250,000), and 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 an amount equivalent to two hundred and thirty-one thousand special drawing rights (SDR 231,000), and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Kanayo F. Nwanze
President

Negotiated financing agreement: "Infrastructure and Rural Finance Support Programme"

(Negotiations concluded on 4 September 2014)

Loan Number:

Grant Number:

Programme Title: Infrastructure and Rural Finance Support Programme ("the Programme")

The Republic of the Armenia (the "Borrower")

and

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

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

WHEREAS:

(A) The Fund has agreed to provide financing to support the Infrastructure and Rural Finance Support Programme in the Republic of Armenia.

(B) The Borrower expects to obtain from the Organisation of the Petroleum Exporting Countries ("OPEC") Fund for International Development ("OFID") financial assistance approximately in the amount of twenty five million United States dollars (USD 25 000 000) to assist on financing the Programme.

(C) The Borrower has invited IFAD to mobilise grant funds from the Global Environment Facility ("GEF") and has provided the necessary endorsement documents therefor. Such grant funds, once available, are expected to be used for a project to be developed in 2015 and mainstreamed within the Programme upon mutual agreement between the Parties. The expected amount of such grant funds would be approximately four million three hundred thousand United States dollars (USD 4 300 000).

(D) The Borrower expects to obtain approximately two million United States dollars (USD 2 000 000) from other donors to assist in financing the Programme.

NOW THEREFORE, the Parties hereby agree as follows:

Section A

1. The following documents collectively form this Agreement: this document, the Programme Description and Implementation Arrangements (Schedule 1), the Allocation Table (Schedule 2), and Special Covenants (Schedule 3).

2. The Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, as may be amended 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.

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

Section B

1. A. The amount of the Loan is seven million two hundred and fifty thousand Special Drawing Rights (SDR 7 250 000).

B. The amount of the Grant is two hundred and thirty one thousand Special Drawing Rights (SDR 231 000).

2. The Loan is granted on blend terms, with a maturity period of 25 years with a grace period of 5 years, interest rate at 1.25% per annum and a service fee of 0.75% per annum.

3. The Loan Service Payment Currency shall be the USD currency of the United States of America.

4. The first day of the applicable Fiscal Year shall be 1 January.

5. Payments of principal and service charge (shall be payable on each 1st of February and 1st of August).

6. There shall be two accounts designated to receive funds in advance denominated in USD (Designated Accounts), one for the Loan proceeds (Loan Designated Account) and one for the Grant proceeds (Grant Designated Account), for the exclusive use of the Programme, at the Central Treasury of Armenia. Funds will flow from the Designated Accounts to the Programme Accounts described in paragraph 7 below, operated by the programme implementation unit (PIU), the Fund for Rural Economic Development (FREDA) and the Rural Finance Facility (RFF) as required by Programme implementation and as specified in the Annual Work Plans and Budgets.

7. The Borrower shall open two Programme Accounts in commercial banks acceptable to the Fund: one Programme Account for the Loan and one Programme Account for the Grant in Armenian Dram (AMD). The Borrower shall also open and thereafter maintain a Programme Account in AMD for Government counterpart contributions to the Programme (the "Government Counterpart Programme Account").

7.1 Moreover the Borrower shall cause FREDA and RFF to open and maintain the following accounts in banks acceptable to IFAD:

(a) FREDA: (i) one FREDA Incremental Investment Account in AMD to receive funds from the Loan Designated Account in order to make equity investments in local target companies; and (ii) one FREDA Investment Account in AMD for investment reflows (dividends and income), reinvestments, operating costs and loan service payment to the Borrower.

(b) RFF: (i) two RFF Incremental Credit Accounts, one in USD and one in AMD to receive funds from the Loan Designated Account for purposes of lending in the respective currencies; and (ii) two RFF Revolving Accounts, one in USD and one in AMD for reflows from the lending operations, relending, operating costs and loan service payment to the Borrower.

8. The Borrower shall provide counterpart financing for the Programme in the equivalent in AMD of USD 3 589 000 for the rural areas water infrastructure (RAWI) component, as well as duties and taxes.

Section C

1. The Lead Programme Agency (LPA) shall be the Republic of Armenia Government Staff Public Administration Institution.
2. The following are designated as additional Programme Parties:
 - (a) RFF as described in paragraph 8.1 of Schedule 1 hereto;
 - (b) FREDA as described in paragraph 8.2 of Schedule 1 hereto.
3. The Programme Completion Date shall be the sixth anniversary of the date of entry into force of this Agreement.

Section D

The Programme shall be supervised by IFAD except for the RAWI component described in paragraph 8 of Schedule 1, which shall be supervised by the Organisation of Petroleum Exporting Countries Fund for International Development (OFID). The IFAD Loan and Grant shall be administered by IFAD while the OFID loan will be administered by OFID.

Section E

1. The following are designated as additional grounds for suspension of this Agreement: (a) RFF or FREDA amend their investment guidelines or institutional set up, without having obtained IFAD's prior no objection; and (b) IFAD's and OFID's prior approval has not been received for the selection of any of the sub-projects under the RAWI component financed by OFID under the Programme.

2. (a) The following are designated as additional general conditions precedent to withdrawal:

- (i) the Governmental Decree, confirming the PIU as the implementation unit of the Programme, shall have been issued in accordance with paragraph 6 of Schedule 1;
- (ii) The Programme Implementation Manual (PIM) shall have been approved by IFAD; and
- (iii) A Programme Steering Committee (PSC), as described in paragraph 5 of Schedule 1, shall have been established.

(b) The following are designated as additional specific conditions precedent to withdrawal:

No funds will be disbursed under category Investment capital to finance the Rural Finance Component before:

- (i) the PIU has entered into a Framework Agreement with FREDA and the Framework Agreement has received IFAD's non objection;
- (ii) the Borrower has entered into a Memorandum of Understanding with RFF and such Memorandum of Understanding has received IFAD's non objection;

- (iii) the Borrower has entered into Subsidiary Agreement with FREDA and such Subsidiary Agreement has received IFAD's non objection;
- (iv) IFAD has provided no-objection to the investment guidelines of FREDA and RFF respectively as updated with respect to this Programme; and
- (v) IFAD has received documentation evidencing the opening of the FREDA Incremental Investment Account and the two RFF Incremental Credit Accounts as specified in section B paragraph 7.1 above and specifying the names of the persons/titles authorized to operate these accounts.

3. In the case of merger, dissolution or other significant changes to the institutional set up of the PIU, FREDA and RFF, their implementation responsibilities shall be assumed by their successors or other entities acquiring their legal rights and obligations for the purposes of this Agreement, subject to IFAD's prior no objection.

4. This Agreement shall become effective on the date in which the Fund is notified by the Borrower on the completion of the necessary internal procedures required for the entry into force in accordance with the legislation of the Borrower.

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
Ministry of Finance
1 Melik – Adamyan Str.
Yerevan 0010
Republic of Armenia

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 six (6) original copies, three (3) for the Fund and three (3) for the Borrower.

REPUBLIC OF ARMENIA

Authorized Representative

INTERNATIONAL FUND FOR
AGRICULTURAL DEVELOPMENT

Kanayo F. Nwanze
President

Schedule 1

Programme Description and Implementation Arrangements

I. Programme Description

1. *Target Population.* The Programme shall benefit poor farmers and rural households that cultivate crops in the command area of obsolete or inefficient irrigation schemes. The target group for the rural finance component will be poor farm families and actual and potential proprietors and employees of micro, small and medium-sized agricultural and rural enterprises, with particular attention being given to the economic development of poor rural women and youth. The geographic area for implementation of the infrastructure component will be the following seven administrative divisions of the Borrower's territory (marzes) of Shirak, Lori, Tavoush, Gegharqunik, Vajots Dzor, Sjunik and Aragatsotn, whereas the area of implementation of the rural finance component will be countrywide with special focus to the geographic area of the infrastructure component (the "Programme Area").

2. *Goal.* The goal of the Programme is to improve the economic and social status of the population in the Programme Area where poverty is prevalent by generating income growth and sustainable employment opportunities through strengthening the agricultural production systems and the forward and backward linkages of value chains promoted by the Programme.

3. *Objectives.* The objective of the Programme is supporting the Target Population by: (i) increased efficiency of small scale farming, post production processes and transition by participating smallholders to growing high value cash crops; (ii) creation of linkages between agroprocessing facilities and poor rural smallholders to enhance their improved access to domestic and international markets and employment opportunities; (iii) improved resilience of agricultural production systems to fluctuations in rainfall levels; and (iv) upgrading food safety and family health.

4. *Components.* The Programme shall consist of the following Components:

4.1 Rural Finance component. This component consists of:

- (i) RFF Refinancing. The Programme shall provide through the RFF funds to participating financial institutions, to be channeled as loans to smallholders and small medium enterprises for improvement and enhancement of their operations and for increasing their income.
- (ii) FREDA Investments. The Programme shall support through FREDA the provision of investments and subordinated loans as well as various types of management and technical support to private small and medium scale companies within agricultural value chains with strong links to poor rural producers.

4.2 Rural areas water infrastructure (RAWI) component. This component consists of:

- (i) Rural Community Water Supplies (CWS). The Programme shall provide on a demand based programmatic basis drinking water as well as water for livestock or for staple food production in small household plots.
- (ii) Small and Medium Scale Irrigation Distribution (SMSID). The Programme shall finance on a demand based programmatic basis the construction or rehabilitation of tertiary irrigation infrastructure to improve the efficiency of

water distribution with the aim of increasing the productivity of irrigated smallholder plots.

4.3 Farmer Awareness and Support component. This component shall (i) support the preparation of social and agronomic monographs to support RAWI sub-project selection; (ii) improve farmer awareness by empowerment; (iii) develop farmers' capacity through training to fully capitalise on the opportunities offered by the improved infrastructure being provided by the Programme including for women heads of households and Youth and (iv) provide training in business and financial planning.

4.4 Programme Management component. This component shall cover the salary and operating costs of the PIU over the Programme period including capacity building and PIU staff development activities, start-up workshop, annual review and planning workshops, outcome and impact monitoring, baseline survey and final impact surveys as well as studies relevant for Programme implementation.

II. Implementation Arrangements

A. General

5. *Programme Steering Committee (PSC)*. A Programme Steering Committee with a composition acceptable to the Fund shall be established. The PSC shall have the overall responsibility for management and implementation of the Programme and shall report to the LPA.

6. *Programme implementation unit (PIU)*. A Governmental Decree shall be issued to confirm that the current PIU of the Rural Assets Creation Programme (RACP), partially financed by the Fund through a Programme Financing Agreement dated 30 November 2010, shall have the overall responsibility for the administrative, financial and operational responsibilities of the Programme. The PIU will operate under the authority of the LPA and under the Programme Steering Committee.

7. *Programme Implementation Manual (PIM)*. The Programme will be implemented according to a Programme Implementation Manual, the terms of which will be subject to IFAD's no objection. The PIM shall include, among other things:

- (a) Financial management and reporting arrangements including financial reporting, internal controls, fixed asset management and audit arrangements; and
- (b) Procedures for selection and approval of RAWI sub-projects.

B. Component Management

8. *Rural Finance component*

8.1. RFF Refinancing Sub component. This subcomponent shall be implemented by the RFF which is a separate, independent unit within the structure of the PIU, and successor of the independent unit established by the Borrower under the Rural Areas Economic Development Programme financed by an IFAD loan. The RFF is governed by a regulatory framework that delineates the RFF's independent status and management structure, and which is subject to IFAD's approval. RFF conducts its lending operations in accordance with the RFF Investment Guidelines, which are subject to IFAD's approval.

- (a) Loan Committee. A Loan Committee with a composition acceptable to the Fund shall be established. The Loan Committee shall have the overall

responsibility for approval of loan applications pursuant to the regulations of the RFF Investment Guidelines.

- (b) Composition. RFF is headed by the RFF Director, with a complement of appropriate staff, nominated by the RFF Director for formal appointment in accordance with national legislation, subject to the prior approval by IFAD.
- (c) RFF Director. The RFF's Director shall have full and exclusive capacity and powers to manage the RFF's operations and resources in accordance with its regulatory framework and the RFF Investment Guidelines. Appointment and dismissal of the RFF Director is subject to the prior approval of IFAD.
- (d) Tripartite Agreement. The Borrower shall enter into a Tripartite Agreement with the RFF and each PFI, which shall set forth, among other things, the terms and conditions under which the proceeds of the Loan shall in part be transferred through the RFF to the Participating Financial Institutions as financing in pursuance of Programme objectives.
- (e) Memorandum of Understanding. The Borrower shall enter into a Memorandum of Understanding with the RFF to stipulate the conditions on which the proceeds of the Loan shall be made available to the RFF. The Borrower shall provide the proceeds of the Loan to RFF in USD. RFF shall pay 2% interest to the Borrower on the outstanding balance of such proceeds received from the Borrower.
- (f) The RFF Revolving Accounts. The RFF shall maintain Revolving Fund Accounts into which all net revenues from loans extended to Programme beneficiaries financed (directly or indirectly) by the Loan shall be deposited. Several Revolving Accounts may be established to keep the payments of amortizations and interest from loans in separate accounts. The RFF shall use the Revolving Fund Accounts to fund further credits to Programme beneficiaries in accordance with this Financing Agreement until all Loan service payments have been made unless otherwise determined by the Borrower and the Fund. For the purposes of this Paragraph "net revenues" means all repayments of principal and all payments of interest, less reasonable operating and other costs.

8.2. Sub component FREDA. This subcomponent shall be implemented by FREDA, which is a foundation established under the Farmer Market Access Programme financed by an IFAD loan. FREDA's activities are governed by the laws and regulations applying to foundations in Armenia, and by its own Statutes. FREDA's Statutes, subject to approval by the Fund, outline that its purpose is poverty reduction through economic development in rural Armenia and that it can make profits from individual investments in companies as long as it re-invests its surpluses into new investments in rural areas.

- (a) FREDA Board of Trustees. FREDA is governed by a Board of Trustees comprising: Government representation and highly professional private sector participants, including financial sector, legal, marketing, business and rural development experts. These private sector representatives will constitute the majority of the members of the Board of Trustees. The Board of Trustees will provide the overall policy and strategic guidance for FREDA. The Borrower nominates the members of the Board of Trustees with the prior approval of IFAD. While the Borrower nominates FREDA's Board members FREDA, under FREDA's Director, shall have complete independence to operate according to its approved Statutes.

- (b) **Composition.** FREDA is headed by the FRED A Director, with a complement of appropriate staff, recruited by the FRED A Director subject to the prior approval of the Fund. The FRED A Board of Trustees shall appoint the FRED A Director. Appointment and dismissal of the FRED A Director is subject to the prior approval of IFAD. The FRED A Director shall have qualifications and experience acceptable to IFAD. The responsibilities shall include the overall leadership, guidance and management for the implementation of FRED A, in accordance with the provisions of this Financing Agreement, FRED A Statutes and the FRED A Subsidiary Agreement. The Director of FRED A will act as secretary to the Board of Trustees.
- (c) **Investments.** All FRED A investment decisions shall be undertaken independently, in accordance with its approved Statutes and with the with FRED A's investment procedures and guidelines approved by IFAD. Investment decisions shall be made by a professional investment committee nominated by the Board of Trustees, and be approved by IFAD. The majority of the members of the investment committee shall be external experts. The FRED A investments will ultimately be used for goods, works and services as specified in FRED A's investment guidelines and procedures.
- (d) **The FRED A Subsidiary Agreement.** The Borrower and FRED A shall enter into a FRED A Subsidiary Agreement, which shall set forth, among other things, the terms and conditions under which the proceeds of the Loan shall in part be transferred by the Borrower to FRED A in pursuance of Programme objectives. The Borrower shall provide the proceeds of the Loan for implementation of the FRED A operations to FRED A in Armenian Dram. FRED A shall pay 3% interest to the Borrower on the outstanding balance of such proceeds received from the Borrower.
- (e) **The PIU shall enter into a Framework Agreement with FRED A setting forth the terms and conditions for cooperation between the PIU and FRED A in pursuance of Programme objectives, subject to prior approval by IFAD.**
- (f) **The FRED A Revolving Account.** The FRED A shall maintain a Revolving Fund Account into which all net revenues from FRED A's investments shall be deposited. FRED A shall use the FRED A Revolving Fund Account to fund further investments in accordance with this Financing Agreement until all Loan service payments have been made unless otherwise determined by the Borrower and the Fund. For the purposes of this Paragraph "net revenues" means all revenue from investments, less FRED A's reasonable operating and other costs.

8.3. Rural areas water infrastructure (RAWI) component. This component shall be implemented by the PIU. The PIU will ensure overall quality and promote the introduction of appropriate technologies in the implementation of the Project's infrastructure investments. A programmatic approach will be adopted where Programme works will not be pre identified before the start of the operation but will be selected on a periodic basis during implementation based on criteria agreed between the Fund and the Borrower and demand by participating communities. Said criteria are included in the PIM, and any amendment proposed in light of implementation experience to the procedures set in the PIM shall be subject to IFAD's no objection.

8.4. Farmer Awareness and Support component. The PIU shall select, in compliance with IFAD's procurement guidelines, an Extension Service Provider or Providers to (i) support the identification process for RAWI investments; (ii) improve farmer awareness by empowerment; (iii) provide advisory services and training; and as further set out in the

PIM. The PIU shall also select, in compliance with IFAD's procurement guidelines, a Financial Literacy Service Provider to conduct training in financial literacy.

The PIU shall establish local working groups at the marzes level as needed to bring together different parties involved in farmer outreach in different marzes to facilitate the exchange of views and provide a sounding board for the activities conducted by Service Providers.

Schedule 2

Allocation Table

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

| Category | Loan Amount Allocated (expressed in SDR) | Grant Amount Allocated (expressed in SDR) | Percentage net of tax, government and client contribution |
|---|---|--|---|
| I. Goods and Services including Equipment | 540 000 | 231 000 | 100% |
| II. Vehicles | 30 000 | | 100% |
| III. Consultancies | 175 000 | | 100% |
| IV. Investment Capital 1 (RFF) | 2 190 000 | | 100% |
| V. Investment Capital 2 (FREDA) | 3 255 000 | | |
| VI. Operating cost | 375 000 | | 32% |
| VII. Salaries and Allowances | 325 000 | | 32% |
| Unallocated | 360 000 | | |
| TOTAL | 7 250 000 | 231 000 | |

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

Category I "Goods and Services including Equipment" means Eligible Expenditures related to office equipment for the PIU under the Programme management component and eligible expenditures related to Farmer awareness training (including service provider fees) to be incurred by the procured service providers under the Farmer Awareness and Support component.

Category II "Vehicles" means Eligible Expenditures related to Vehicles for the PIU under the Programme Management component.

Category III "Consultancies" means Eligible Expenditures related to studies, technical assistance and other advisory services, to be incurred by the PIU under the Programme Management component.

Category IV and V "Investment Capital" means Eligible Expenditures related to i) investment capital for refinancing to be incurred by RFF in accordance with their credit guidelines as approved by the Fund and ii) equity, and mezzanine investments and subordinated loans to be incurred by FREDA in

accordance with their Investment guidelines as approved by the Fund under the Rural Finance component.

Category IV "Operating cost" means Eligible Expenditures related to recurrent costs under the Programme.

Category VII "Salaries and Allowances" means Eligible Expenditures related to salaries and allowances of the PIU staff.

2. Start-up Costs. Withdrawals in respect of expenditures for start-up costs under the Category "Consultancies" incurred before the satisfaction of the conditions precedent to withdrawal shall not exceed an aggregate amount of SDR 35 000 (approximately USD 50 000).

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 and the Grant 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 Programme:

1. *Fraud and corruption.* The Borrower shall promptly bring to the attention of the Fund 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.
2. *External Auditors.* The Borrower, through the PIU, will appoint independent auditors acceptable to IFAD, under the terms of reference cleared by IFAD, and in line with the IFAD Guidelines for Project Audits. An audited annual consolidated financial statement for the entire Programme, together with a management letter on audit observations on internal controls, shall be submitted to the Fund within six (6) months of the fiscal year end. Moreover, the Borrower shall ensure that the financial statements of RFF and FREDa are audited annually by independent auditors acceptable to IFAD in accordance with International Standards on Auditing (ISA) and that these audits are submitted to IFAD within six months after the end of the Borrower's fiscal year. In this regard, the Borrower shall also ensure the following: a) the independent auditors are required to provide an assurance on the internal control procedures employed by FREDa, the adequacy of the documentation in support of relevant fund transfers, operation of the investment accounts and whether Programme resources have been used in accordance with the FREDa investment guidelines as approved by the Fund and with this Agreement; and b) the independent auditors are required to provide an assurance on the internal control procedures employed by RFF, the adequacy of the documentation in support of relevant fund transfers, operation of the credit and revolving accounts and whether Programme resources have been used in accordance with the RFF investment guidelines as approved by the Fund and with this Agreement.
3. *Use of Programme Vehicles and Other Equipment.* The Borrower shall ensure that:
 - (a) all vehicles and other equipment procured under the Programme are allocated to the Programme Parties for Programme implementation;
 - (b) The types of vehicles and other equipment procured under the Programme are appropriate to the needs of the Programme; and
 - (c) All vehicles and other equipment transferred to or procured under the Programme are dedicated solely to Programme use.
4. *Insurance of Programme Personnel.* The PIU shall insure Programme personnel against health and accident risks to the extent consistent with its customary practice in respect of its national civil service.
5. The salaries of FREDa, RFF and PIU staff shall be set at levels that attract and retain competent personnel in line with the estimates of the Programme design.
6. *Tax Exemption.* IFAD loan and grant proceeds shall not be used for social security charges for Programme staff to the Social Security Fund.

7. The Borrower shall ensure that all investment capital for refinancing to be incurred by RFF and equity, and mezzanine investments and subordinate loans incurred by FREDA shall be disbursed from the FREDA Incremental Investment Account and RFF Incremental Credit Accounts and repaid to the FREDA Investment Account and RFF Revolving Accounts operated by FREDA and RFF respectively.

8. At all times during the Programme Implementation Period the Borrower shall ensure that all civil works, equipment and services procured for the purposes of the Programme financed from the IFAD loan and grant proceeds shall be exempted from any custom duties or taxes.

9. IFAD and OFID shall approve the selection of specific subprojects of the RAWI component according to the criteria described in the PIM during the Programme Implementation Period.

Logical framework

| | Indicators | Means of Verification | Assumptions |
|---|---|--|--|
| GOAL | | | |
| Improved living standards and economic prospects among the IFAD target group in the rural population in the Programme area. | <ul style="list-style-type: none"> • 15% increase in value of household assets for target population participating in Programme activities by end PY6 (RIMS 3rd level). • 5% reduction in the prevalence of malnutrition for children for target population by end PY 6 in the Programme Area (RIMS 3rd level). | <ul style="list-style-type: none"> • Government: national statistics, other public socio-economic surveys, including health sector surveys. • Programme M&E. • Programme completion report. | <ul style="list-style-type: none"> • Government maintains and pursues pro-poor policies. • No severe economic shocks. |
| DEVELOPMENT OBJECTIVE | | | |
| (i) Increased incomes and assets generated by small-scale producers, and small and medium-sized agricultural product processors providing impact on poverty groups. (ii) Improved quality of life of target population. | <ul style="list-style-type: none"> • 20% increase in income for target households participating in the Programme activities resulting from investments by end PY 6. • 1 500 ha of land under high value cash crops by end PY6. | <ul style="list-style-type: none"> • Baseline and follow up surveys. • Programme M&E. • FRED A investee company records. | <ul style="list-style-type: none"> • No deterioration in the macroeconomic situation. |
| OUTCOME 1: Rural Finance | | | |
| Investments by producers, small and medium-sized agricultural product processors and service providers into productive assets along the value chains increased including improved access to domestic and international markets created enables a move out of poverty. | <ul style="list-style-type: none"> • Improved access of the poor to financial services by end PY6 (RIMS 2nd level); proxy: 850 active borrowers of loans below US\$5,000 (tied to agricultural production price index 2013) by PY6. • 1 450 employment opportunities full time job equivalent provided by end PY6 (RIMS 2nd level). | <ul style="list-style-type: none"> • Baseline and follow up surveys. • Market studies. • FRED A investee company records. • RFF and participating financial institutions' records. • Farmer organization records. • Programme M&E. | <ul style="list-style-type: none"> • No deterioration/improvement in investment climate as a result of financial sector policy and regulatory framework. • Absence of political interference in operation of FRED A and the refinancing facility. • Financial institutions willing and able to address the needs of the intended target groups. |
| Output 1 | | | |
| RFF provided with additional financing capital and investing it through financially viable participating financial institutions in providing financial services having a direct and indirect impact on target group. | <ul style="list-style-type: none"> • Value of gross loan portfolio US\$3.5 million by end PY6 (RIMS 1st level). • Portfolio at risk kept at below 10%. • 1,700 active borrowers by PY 6 (RIMS 1st level). • 18 PFIs in the Programme by end of PY6 (RIMS 1st level). | <ul style="list-style-type: none"> • Programme M&E. • Records from participating financial institutions. • RFF records. | |
| Output 2 | | | |
| FRED A provided with additional investment capital leading to identification and strengthening of processors and service providers with strong backward and forward linkages to target group. | <ul style="list-style-type: none"> • 12 companies supported by FRED A by end PY4. • Increase of farmers selling produce to FRED A investee companies from 800 to 1,500 by end of PY6. | <ul style="list-style-type: none"> • Programme M&E. • FRED A investee company records. | |

| OUTCOME 2: Rural Areas Water Infrastructure (RAWI) | | | |
|--|---|--|---|
| Improved rural water infrastructure permits farmer families to have more effective and efficient irrigation infrastructure and better health from improved water supplies. | <ul style="list-style-type: none"> Effectiveness of productive infrastructure on 3,200 ha of farmland increased through improved irrigation efficiency by end PY6 (RIMS 2nd level); proxy: 20 per cent increase in volume of water saved (in m³) by end PY6. Likelihood of sustainability of social infrastructure (RIMS 2nd level); proxy: 100 per cent of water fees collected from all completed drinking water systems. 13,300 HH reached by end PY 6. | <ul style="list-style-type: none"> Programme M&E and impact assessments. WUAs. | <ul style="list-style-type: none"> Appropriate operation and maintenance of irrigation schemes. |
| Output 1 | | | |
| Modernized irrigation schemes permit target farmers to upgrade yields and value of crop production. | <ul style="list-style-type: none"> 3,200 ha farmland under irrigation schemes constructed and/or rehabilitated benefiting 4,500 HH by end PY6 (RIMS 1st level). 500 ha land under irrigation schemes for household plots constructed and/or rehabilitated benefiting 3,100 HH by end PY6 (RIMS 1st level). | <ul style="list-style-type: none"> Programme M&E Database. | |
| Output 2 | | | |
| Improved community water supplies to reduce family health problems and permit higher value added of production through using clean water. | <ul style="list-style-type: none"> Drinking water systems constructed/rehabilitated for human needs and livestock in 25 communities benefiting 5,700 HH (RIMS 1st level) by the end of PY6. 250 ha household plots under irrigation schemes constructed and/or rehabilitated benefiting 1,500 HH by end PY6 (RIMS 1st level). 32 small rural businesses using improved water supplies. | <ul style="list-style-type: none"> Water Company Records. Programme M&E Database. | |
| OUTCOME 3: Farmer Awareness and Support | | | |
| Farmer and producer capacity for modern production methods upgraded by training and support from IRFSP. | <ul style="list-style-type: none"> 5,000 HH adopting recommended technologies by end PY6 (RIMS 2nd level). 2,500 ha of land put under production with recommended technologies by end PY6 (RIMS 2nd level). | <ul style="list-style-type: none"> Service Provider records. M&E and impact assessments. | <ul style="list-style-type: none"> Willingness of target population to participate in collective action to improve production and marketing opportunities. |
| Output 1 | | | |
| Dissemination of information to potential beneficiaries about the opportunities offered by the Programme, and other accessible support opportunities. | <ul style="list-style-type: none"> 3,000 booklets and technical manuals distributed. 24 video materials produced. 13,300 HH reached with information dissemination campaigns. | <ul style="list-style-type: none"> Service Provider records. Programme M&E Database. | |
| Output 2 | | | |
| Training in modern farming methods, marketing, professional skills and entrepreneurship | <ul style="list-style-type: none"> 700 men and 300 women trained in financial services (RIMS 1st level). 1,400 women and 1,400 men trained in crop production and technologies (RIMS 1st level). 3,400 women and 3,400 men trained in crop production and technologies (in connection with demonstration plots) (RIMS 1st level). 3,100 women and 3,100 men trained in crop production and technologies (young farmers) (RIMS 1st level). 72 trainers trained. | <ul style="list-style-type: none"> Service Provider records. Programme M&E Database. | |