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Investing in rural people

The Republic of the Armenia

Infrastructure and Rural Finance Support Programme

Negotiated financing agreement

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) FREDAs 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 FREDAs 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 FREDAs 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, Gegharunik, 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 FRED A. This subcomponent shall be implemented by FRED A, which is a foundation established under the Farmer Market Access Programme financed by an IFAD loan. FRED A's activities are governed by the laws and regulations applying to foundations in Armenia, and by its own Statutes. FRED A'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) **FRED A Board of Trustees.** FRED A 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 FRED A. The Borrower nominates the members of the Board of Trustees with the prior approval of IFAD. While the Borrower nominates FRED A's Board members FRED A, under FRED A's Director, shall have complete independence to operate according to its approved Statutes.

- (b) **Composition.** FREDA is headed by the FREDA Director, with a complement of appropriate staff, recruited by the FREDA Director subject to the prior approval of the Fund. The FREDA Board of Trustees shall appoint the FREDA Director. Appointment and dismissal of the FREDA Director is subject to the prior approval of IFAD. The FREDA Director shall have qualifications and experience acceptable to IFAD. The responsibilities shall include the overall leadership, guidance and management for the implementation of FREDA, in accordance with the provisions of this Financing Agreement, FREDA Statutes and the FREDA Subsidiary Agreement. The Director of FREDA will act as secretary to the Board of Trustees.
- (c) **Investments.** All FREDA investment decisions shall be undertaken independently, in accordance with its approved Statutes and with the with FREDA'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 FREDA investments will ultimately be used for goods, works and services as specified in FREDA's investment guidelines and procedures.
- (d) **The FREDA Subsidiary Agreement.** The Borrower and FREDA shall enter into a FREDA 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 FREDA in pursuance of Programme objectives. The Borrower shall provide the proceeds of the Loan for implementation of the FREDA operations to FREDA in Armenian Dram. FREDA 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 FREDA** setting forth the terms and conditions for cooperation between the PIU and FREDA in pursuance of Programme objectives, subject to prior approval by IFAD.
- (f) **The FREDA Revolving Account.** The FREDA shall maintain a Revolving Fund Account into which all net revenues from FREDA's investments shall be deposited. FREDA shall use the FREDA 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 FREDA'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 FRED A 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 FRED A, 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 FRED A 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 FRED A, 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.